

Centre on Regulation and Competition

WORKING PAPER SERIES

Paper No. 80

**REGULATION AND SMALL  
CONTRACTOR DEVELOPMENT  
A CASE OF GHANA**

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October 2004

ISBN: 1-904056-79-2

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# **Regulation and Small Contractor Development**

## **A Case of Ghana**

### **INTRODUCTION**

I am not proposing to eliminate all government regulation of business. I am urging balance and moderation, so that business can both help to achieve the nation's social goals and can still fulfill the basic economic function of more efficient production and distribution of better goods and services. To restore common sense to government is a major challenge to economic education of the public (Weidenbaum, 1976).

Contractor development, though not a generic term, has been used extensively in the literature to refer to the application of management and economic principles to remove the constraints affecting the development of small and medium scale construction firm (hereinafter small contractors) in developing countries. There is a consensus this group of firms need supporting to enhance their effective participation in the construction industry. However, the impact of programmes has been marginal (e.g. World Bank, 1984; Ofori, 1991; UNCHS, 1996). On the academic front, there are concerns about failure of research undertaken to advance the field of knowledge (Kirmani, 1988), failure to consider each country as a separate entity with perculia problems, resource endowments and operating conditions (Ofori, 1993); and outdatedness of existing studies (Fox et al., 1999). The United Nations Centre for Human Settlement (UNCHS, 1996) calls "for more research, more information and further development effort".

The impact that regulatory policies might have on the performance of small contractors has been accorded much less recognition in the literature of contractor development. The construction industry is one of the most highly regulated industries. Regulatory policies of the industry, however, tends to result in distortion and in inefficiencies: homeowners cannot be guaranteed their requirements, design and construction cost increase, profit margins are affected and the industry, in general, fails to perform adequately because competition is reduced. "There is a sense within the industry that many regulations are imposed without proper understanding of the construction process. Regulations are born that may give grief to the builder, increase cost, and yet not even achieve the purpose for which they were conceived" (the British Columbia Construction Association (BCCA), 2001,p. 24). It is within this nexus that contractor classification, with emphasis on Ghana, is examined.

The aim of this paper is to explore the link between classification of contractors and constraints and investment decisions. The objective is to demonstrate that while the purpose of classification exercise is not achieved, at least in Ghana, the system has the potential of threatening the development and survival of small contractors. The remainder of the paper contains: definition of small contractor; justification for supporting small contractors; review of regulation literature with emphasis on small businesses; regulation in the context of construction industry; appraisal of classification system in Ghana, formulation of hypotheses and testing; conclusion and questions for further investigation.

## **DEFINITION OF SMALL CONTRACTOR**

There is no single definition of what constitutes a small business (Storey, 1994). This stems from the fact that businesses vary in their level of capitalisation, sales and employment. Countries also differ in their level of economic development to justify the generalisation of a single definition. The Bolton committee (1971), in attempting to address the problem, based on what they called 'economic' and 'statistical' definitions, proposed various definitions for different sectors. The committee categorised construction firms with 25 employees as small businesses. Eyiah (2001) argued that this definition could have been realistic, but for the wide range of subcontracting in the construction sector. A firm may have 25 or fewer employees and be involved in relatively sophisticated and expensive projects subcontracting, to other contractors. That does not make it a small firm considering turnover, or equipment and plant holdings. Eyiah and Cook (2003) identified financial class 1 contractors in Ghana (made up mainly of foreign firms) as large contractors. They note that although classes 2, 3 and 4 contractors are different, based on financial capabilities, they possess similar characteristics in terms of managing their businesses hence they could all be categorised as small and medium scale enterprises. This definition is adopted for this paper.

## **JUSTIFICATION FOR SUPPORTING SMALL CONTRACTORS**

The link between the construction industry and the wider economy has been theoretically and empirically acknowledged (e.g. Turin, 1969; Drewer, 1980; Wells, 1986; Ofori, 1988). A developed construction industry is described as a powerful engine to growth (Kirmani, 1988). In general, demand for new construction products, and hence construction activities, tend to be highest at the early stages of economic development and level off after high level

of economic development has been attained (Edmonds and Miles, 1984; Wells, 1986). It has also been shown that:

“During periods of acceleration economic growth, construction output grows at a faster rate than the economy as a whole. Inadequate construction capacity could act as a constraint on capital investment programmes. Investment and the rate of growth will be slowed down – and may eventually grind to a halt” (Wells, 1986, p. 33).

The importance of the industry is more felt in developing countries where infrastructure facilities required for improved living conditions is relatively undersupplied. Ghana's case typifies the current infrastructure position in many developing countries. The housing situation could be described as national crisis. A study conducted by the Ghana Real Estate Developers Association (GRADA) in 1999 estimated the annual housing requirement to be about 120,000 units per annum, but production at that period was only about 30,000 units per annum (UK Trade Partners, 2003). The road network condition survey conducted in 1999/2000 under the Road Sub-sector Plan for 2000-2005 established that the overall network was 29.2% good, 27.1% fair, and 43.7% poor; the rate of rehabilitation and maintenance equalled the rate of deterioration. It was concluded “If the road sub-sector is to achieve its set objective...by the year 2005, it implies that over the next six years, a total of 2,822km of the trunk road network will have to be improved to good conditions through reconstruction, rehabilitation and upgrading” (MRT, 1999, p. 63). The need for urgent response to address the situation cannot be an underestimation.

Meanwhile, because of the inadequacies of local contractors in many developing countries (most of whom are small firms), foreign construction firms are usually engaged to undertake most large projects (Ofori, 1991; Adams, 1993; Aniekwa, 1999). These firms prefer to employ expatriates even where qualified local professional manpower is available (Osborne, 1984), and to import other resources required for their operations. Writers of contractor development argue that most developing countries can no longer afford dependence solely on imported resources to execute their construction works or to maintain existing ones to meet these demands because of the direct bearing on the value-added, explained as:

“For a given work, the value-added in construction depends on many factors, such as design, construction technology, use of equipment and labour, equipment

performance, price and wage levels, temporal works and processing of materials during construction. A contractor who carries out a highly mechanised construction operation using expatriate personnel and imported equipment and materials may be able to achieve high quality and complete the job on time, but the value added in construction as well as the value added by local industries supplying construction input will be low" (Kirmani, 1988, p. 29).

The engagement of foreign contractors is not being disputed, for reasons given earlier, but many are of the view that to enhance efficiency in implementation of the construction required to stimulate growth, development of local contractors must be given due consideration. Their effective participation, Adams (1993) notes, would increase competition among themselves; they would in turn make increased use of local materials and resources and also create job opportunity for local professionals. Consequently, value-added by the industries supplying various inputs to construction. In support, the UNCHS (1996) suggests that the quality of work of small contractors needs to be upgraded to enable them to give greater value for client money; with improved expertise small contractors can help reduce the reliance of imported inputs. It is also acknowledged that improvement in the activities of small contractors would optimise job creation opportunities in construction infrastructure and housing; encourage the creation and sustainability of small-scale enterprises; strive towards fulfilling the country's projected construction needs; and enhance the benefit accruing to the community through their involvement in construction (Ofori, 1991).

It becomes imperative to develop small contractors, particularly, in situations where foreign contractors feel reluctant to engage themselves in projects in the rural areas (where infrastructure are most needed) because of their financial unattractiveness (Kirmani, 1988). Miles and Ward (1991), in their study in Ghana, sponsored by the ILO, justified their focus on small contractors on the grounds that:

- they are powerful generators of income and employment
- without a network of efficient small contractors rural health centres, villages water suppliers, low-cost roads and similar projects are often difficult or expensive to provide
- the more soundly based the small-scale sector can be made the better will be the prospect for the development of medium and large-scale national firms.

## **GOVERNMENT REGULATION: LITERATURE REVIEW**

Government regulations may be considered as any government measure or intervention that seeks to change the behaviour of individuals or groups. It is generally accepted that without government intervention the market will allow the overexploitation of common property resources and/or the under-provision of public goods. Regulation is defined to include not only formal rules but also “the general legal system relating to contracts, employment and intellectual property rights (patent and copyright law) within which firms operate” (Smith, 2000). The OECD (2000) categorises regulation under three areas: (i) employment regulation covering issues including hiring and firing, health and safety, provision of facilities, social security and pension rights and employee related benefits: maternity, sick leave; (ii) environmental regulation covering issues including licensing, permits, planning hazardous substances and materials, product quality standards, environmental reporting and testing, record keeping and administration requirements related to environment, environmental levies and taxes; and (iii) Tax regulation covering issues such as business taxes, sales taxes.

It has been argued that regulation is driven by the needs of businesses and are acquired, designed and operated primarily for the benefit of business to increase profit and protect against competition (Stigler, 1971). Contrasting theories, however, suggest that regulation is in response to broad social movement or crises situation and act to protect the public (Wilson, 1994). Consistent to these, the Better Regulation Task Force (BRTF, 2000a) identifies the policies use to justify regulation as:

- to protect and enhance the rights and liberty of citizens
- to promote a safe and peaceful society
- to collect taxes and ensure that they are spent in accordance with policy objectives
- to safeguard health and safety or protect citizens from harming themselves
- to protect consumers, employees and vulnerable groups from abuse
- to promote the efficient working of markets
- to protect the environment and promote sustainable development

There is growing concern that regulation, while bringing certain benefits, carries significant costs: higher prices of products, loss of productivity and jobs, a slower rate of introduction of new and better products, less capital available for new undertakings and the administrative cost of enforcers. For SMEs, the burden includes the expensive and time-

consuming process of submitting reports, making applications, filing out questionnaires, replying to orders and directives and court appeals resulting from regulatory rulings (Weidenbaum, 1976; BRTF, 2000a; ADB, 2001). The burden on SMEs is compounded when the level of expertise required to address regulatory issues is taken into consideration.

More jurisdictions have come to the realisation that regulatory reforms are necessary in order to have an active competitive business environment. The argument made is: regulations are presumed to prevent, control or cope with problems that the free markets do not manage so well; they should not be enacted to satisfy the political pressures of any particular group hoping to in some way restrict competition. The BRTF (2000b) considers that if entrepreneurs are to focus on driving forward their business, the time and therefore opportunity cost of regulatory compliance must be minimised. It is of the view that helping SMEs cope with regulations is in governments' own interests, as it will improve the effectiveness of both regulations and the economy. Higher compliance can be expected if regulations are geared to make it easier for SMEs to comply. It considers, among others, exemptions; compensations; compliance mechanisms, incentives to comply and simplify procedures as alternative approaches to reducing the burden of regulation on SMEs. The Asian Development Bank (ADB, 2001), on the other hand, identifies two areas: governments should ensure that the overall regulatory framework is as limited or streamlined as possible without compromising public objectives; governments need to ensure that implementation and enforcement is efficient and transparent and that regulatory mechanisms are accessible and convenient for business.

## **REGULATION AND CONSTRUCTION INDUSTRY**

The construction industry is one of the most highly regulated industries. Contractors find themselves interfacing with national, regional and district bureaucracies at all levels of a project: to obtain building permits, to have work inspected; and to have the completed project certified good for possession. Where the client is the government, particularly in developing countries, contractors deal with additional bodies in the layers of the bureaucracy to have their work monitored and valued and to follow-up payment certificates. A construction process is arguably the most competitive of all industrial process. In the general sense, it cannot adequately perform without a healthy competitive environment. A single project brings together diverse disciplines, such as architects; engineers, quantity surveyors, material suppliers, general contractors and subcontractors, for whom competition

forms the basis of their activities. Excessive regulation might result not only in distortion, but also in inefficiencies.

It has been argued that reducing regulation within the construction industry will harm the health and safety of the nation as a whole: individuals and organisations need the quality and efficient building, roads and other infrastructure facilities to carry out everyday activities; and construction operatives need protection from an industry which is prone to accidents. The EU policy report on the European construction industry argues that "...market forces in construction do not always operate in the public interest, there are many external effects, and long-term benefits can be pre-empted by short-term decision making..." (Atkins, 1994). The report argues that, for construction, the free market mechanism is inefficient and unfair, so that "...regulation is required to protect the interest of consumers and future generations. This means efficient land use planning and construction control, and clear regime of liability legislation..."

Proponents of lesser regulation in the industry are of the view that prescriptive regulation and legislation about who can do what work could hinder the type of flexibility, competition and innovation that the industry needs (Creusen, 1999; WTO, 2001; BCCA, 2001). They argue on the basis of the uniqueness of the industry. The effects of any given location is acute, each project's site presents unique conditions and environmental constraints, projects are primarily of short duration and weather conditions can be adverse. Whereas as a manufacturer, for example, can differentiate his product and absorb higher cost by delivering greater perceived value, contractors generally bid on a job whose specifications are determined ultimately by the buyer (client). Several participants (including developers, contractors, trades, architects, engineers and suppliers) need to come together from inception to completion of any one project. There are contracts at every level of a project with every member of the construction team. Many of the contracts will be lengthy and extremely complicated requiring careful deliberation in order to ascertain what is expected of each party. Balancing these rights and obligations is vital for mutual co-operation and productivity. The existence of an entire series of Construction Law Reports available to legal practitioners and published on a regular basis evidences the fact that such a balance is not always achieved. Because of these unique characteristics, unnecessary regulation could frustrate contractors' ability to maintain adequate profit margin and, to innovate and remain competitive.



On the international level, regulatory policies relating to control of land use, technical requirement, building permits and inspections, registration of contractors and professionals, wages and remunerations, classification of contractors, foreign equity limitation, transfer of funds between projects and lack of recognition of professional qualification have all impacted on the competitiveness and performance of contractors operating abroad (GATS, 2001). Nationally, politicians have voiced their concerns regarding regulation of the industry and the economy in general. In a UK parliamentary debate, a case was cited of a small construction firm who had to turn down major contracts because it could not secure insurance cover for accidents, which were extremely costly. This had resulted in loss of employment for the workforce (House of Commons, 2003). In Japan, high cost of housing was blamed on unnecessary regulatory policies, prompting a review relating to importation of foreign construction materials, labour and plant, and the overall building regulation system (Ministry of Foreign Affairs of Japan, 1996).

Empirical studies reveal the extent of regulation on the performance of contractors and efficiency of the industry as a whole. In the Dutch housing industry, overlapping quality and safety requirements had resulted in high administrative costs for contractors and entry barriers to new firms: information disparity between regulators and construction participants resulted in inefficiencies in the supply chain (Creusen, 1999). In the USA, design costs of contractors engaged in government projects were found to be 6 per cent higher than they were on private-sector contractors and construction costs were 9 per cent higher. Respondents attributed half of the increase in design costs to the need to comply with cost control and accountability clauses and, two-thirds of increase in construction costs on labour statute clauses, and restrictive technical and material specifications (The American Consulting Engineers Council (ACEC, 2000). In some cases, bureaucratic and complicated building permit procedures had resulted in delays with construction cost implications, which were ultimately passed on to consumers (BCCA, 2001).

The burden on small contractors in developing countries, where public official exploit the situation for their personal interests, tends to be exacerbated. In Ethiopia, contractors were held responsible and made to pay fines and damages even where custom authority interferences had caused project delays. They were required to carry out work permitted within their licenses, which have restricted them from diversifying their projects and forced them to purchase expensive equipment to keep on hand, as required by the licensing provision. They were unable to expand their businesses because regulation prohibits them

from borrowing from foreign banks. Excessively long periods taken for custom clearances for the importation of construction machinery and equipment and spare parts had affected productivity on sites. They were required to pay huge taxes on wages of technical expertise employed to manage their machines (Building blocks of Ethiopian construction). In Tanzania, a survey to establish why contractors were operating informally revealed that 47 per cent felt requirements were difficult to meet and the costs involved were high (Mlinga and Lema, 1999).

In many developing countries, after obtaining licence and registering to operate as a construction business, contractors who wish to engage themselves on government sponsored projects are further required to register with appropriate government department and then be categorised into financial groups. In Tanzania, contractors are categorised into five groups, and within each group contractors are categorised in seven financial classes (Mlinga and Lema, 1999). In Malawi building contractors are categorised under six financial classes, while civil engineering and Electrical contractors are categorised into five financial classes (Ebohon and Rwelamila, 1999). In Ghana, contractors are classified under four financial classes (details of the classification system is discussed later). The classification system is justified on the basis that construction product is a social good, so effort should be made to select the most efficient contractor; and that the client (this case the government) needs protection from unscrupulous contractors.

The author's view is that the processes and procedures involved in undertaking a construction project should be sufficient in addressing these concerns. For example, the tendering process ensures that the contractor chosen for the project has experience of undertaking similar projects, expertise, plant and equipment, financial standing and has indicated the period for completion suitable to the client. Contractors are required to provide bid bonds to ensure they do not retreat from ones they have committed themselves to the contract. Performance bond, on the other hand, is to compensate the client if the contractor fails to perform satisfactorily. Interim payments are only made if the client's representative are satisfied that the work done is up to the standard stated in the contract specification. Also, each interim payment is subjected to retention (an agreed percentage of the amount deducted) and released to the contractor after the defect liability period – no defects are detected when handing over is made.

Construction clients all over the world, including private clients in developing countries, have employed these well-researched procedures in judging the competence of contractors. Furthermore, professionals such as architects, engineers and quantity surveyors take responsibility (letter of assurance) and bear the liability for their action in each process. The question is why a classification system which could damage the very small contractors whom efforts are being made to develop.

## **CONTRACTOR CLASSIFICATION IN GHANA**

Governments regulate business formation and operation in the form of licences, registration and permits. Complying with such statutory requirements to start and run a business is a process that all businesses need to go through to acquire legal form. ADB (2001) identifies business licenses under two categories: general business license, government permission needed for all business activities prior to engagement in the market; and specific business license, regulation of business activities in fields where government claims a specific public interest requiring safeguards concerns arising from specific sectoral, process or product-related activities. The purpose of registration is to create a basic information structure, which helps provide up-to-date information on the business population for public policy-making and administrative purposes. Permits are related to activities which are in general forbidden, but where the government allows exemptions to conduct such activities under certain conditions.

Contractor classification can thus be identified as combination of general and specific business licences and registration. Contractors, like all companies operating in Ghana, after obtaining a general business license are required by law (companies Act of 1963) to register with the register general. In addition, contractors who wish to undertake public projects are to purchase application forms and complete them for consideration by the Contractor Classification Committee. The Ministry of Roads and Transport (MRT) guidelines for the classification of contractors indicates that the exercise “aim at the proper grading of contractors into respective categories and financial classes... A contractor who wishes to apply for classification under these guidelines should first satisfy himself that he can fulfil the basic requirement in this document” (MRT, 2001, p.2). Depending on the type and nature of project contractors want to undertake the MRT categorises contractors in to categories A, B, C, and S. The Ministry of Works and Housing (MOWH), on the other hand, categorises contractors into categories D and K. Based on the contractors' technical and managerial expertise, financial standing, previous experience, and equipment and plant

holding both MOWH and MRT further categories contractors into financial classes 1, 2, 3 and 4. Contractors can register with any of the ministries, and then be grouped into one or more of the categories, and their respective classes. A contractor could thus, be identified as A2, B2, C1 and D2, K3.

The classification system is highly controversial, cumbersome and could hinder the development and survival of small contractors. Although not compulsory, with the narrow base of the private sector, only well established contractors could afford not to consider it for government sponsored projects.

The procedure involves six steps in which the Chief Director, technical sub-committee, classification committee and the Minister of the respective ministry are involved. Applications must be supported by 14 documents, including purchase receipt for equipment, DVLA registration form for road vehicles, current vehicle examination certificates, lease and site plan for landed property and audited account for the past two years, which many small contractors just entering the industry would struggle to obtain.

Much emphasis is placed on plant and equipment holdings, For example, for classification into financial class A1, a minimum of 66 pieces of equipment and plant (15 must be 5 cubic meter tipper trucks) are required. The large capital needed to afford these resources, and the need to fulfil other requirements automatically rules out the entire local contractors in this category, where projects are most lucrative. However, with the wide range use of subcontracting within the construction industry, one would not necessarily require all these to be able to undertake large projects, but rather an efficient contract administration. Within their managerial and technical acumen, it could be argued that a consortium made up of enterprising professionals: engineers; quantity surveyors, architects could obtain such projects and sublet to smaller contractors. They could then provide support relating to planning and programming, scheduling, valuation and coordinating the activities of all parties. They could depend on equipment and plant hiring organisations, which are now abundant in Ghana (Trade Partners UK, 2003), for supplies as to when they are required on site.

In a bid to gain qualification into higher financial class some contractors acquire equipment in excess of the minimum requirement (DMJM and GHANAXIM, 1994), but fail to satisfy the classification committee for upgrade. Meanwhile, with the seasonality of work within the

industry, which is more pronounced in developing country such as Ghana, because of the overt reliance on government work, and the narrow base of the private sectors, many of these items are left idle on sites under-utilised, with cost implications.

The system allows contractors in the higher financial categories to tender for projects which otherwise are meant for contractors categorised in the lower classes, but the reverse is not allowed. In effect, during the boom seasons, contractors in the higher grades could take on several projects beyond their capabilities, with the lower classes left to concentrate on the relatively unattractive small projects. During recession, they are at a competitive disadvantage with respect to tendering for projects within their class. The irony is, at a given point in time, an enterprising financial class 3 or 4 contractor could be identified being engaged in several projects scattered all over the country, whose combined value could exceed the value of projects within financial class 1 range. If contractors could manage these diverse projects they should not be prevented from competing for more profitable projects if the opportunity exists. After all, such projects would not be awarded to them on a silver platter; they would have to go through the tendering process, provide bid and performance bond and be bound by the conditions of contract.

The argument that the exercise would facilitate easy access to the numbers of contractors within each financial class and the number of work they undertake to influence government policy does not hold true in Ghana. Investigation revealed that both the MRT and the MOWH do not have an up-to-date list of contractors operating within their sectors. Many contractors could be identified on the register list, but have ceased to operate for several years (Eyiah and Cook, 2003). The inadequacy of the classification system is further highlighted in the following statement:

I have no reliable data on the number of contractors in each works and financial categories used by the various contractor registration agencies. I dare say that given the current inflationary state of the economy, the financial categories are meaningless as a guide on the financial standing of contractors. Nor does the evaluation process lend any credence to the results of the classification (GIS, 2000, p.7).

While the classification system is failing to achieve its objectives, the implication for contractors developing and the economy in general could be substantial. If after registering

their businesses contractors cannot be guaranteed government projects, and have to go through stringent and costly procedures for further licensing then the incentive to formal legal status would be reduced. The affected firms are thus encouraged to operate without licence in the informal sector, which provide the opportunity for foreign firms to dominate the industry. Lack of legal status makes it difficult for such firms to get access to formal services including established financial institutions. For contractors in the lower grades, economic growth is reduced, as business decision-making are distorted and long-term planning and investments are discouraged. For example, why invest in equipment and plant, expertise and premises when it takes several years to be upgraded to a higher financial class to be able to take up more profitable projects to justify the investment. Emerging entrepreneurs who have graduated from the universities, with the necessary managerial and technical know-how, that could have helped nurture local small contractors are discouraged from joining the industry. Although contractors need not be classified before they could bid for privately sponsored projects, it is expected that the decision of client representatives would be influenced if they knew the financial status of contractors, in which case they would favour contractors in a higher financial class.

The complex, opaque and costly nature of the classification procedures increases opportunities for corruption. Evidence by the fact that many contractors have no valid certificates and feel no need to renew their registration if they could obtain projects; contractors with poor performance records continued to obtain renewal certificates and have been offered major contracts (DMJM and GHANAXIM, 1994). It is not uncommon to identify persons such as musicians and actresses, who have never been involved in construction, being awarded government contracts with value in the range financial class 1. Some applicants have stated equipment on the application form which they do not own (UNCHS, 1996). Contractors identified within the higher financial classes have better influence with officials, as a result are less likely to have their payments delayed (Eyiah, et al, 1998). It would not be an understatement to suggest that this would be the trend with mobilisation payment (advantage payment to contractors before projects have started).

Generally, contractors in developing countries have a poor reputation (Edmond and Miles, 1984; Miles and Ward, 1991). In Ghana, perceptions on credibility favours contractors identified within the higher financial class. It is expected that this would filter through to stakeholders including material suppliers, plant hire organisations, financial institutions,

trade creditors and client organisations. In this regard, contractors in the lower financial classes would be disadvantaged in attempting to deal with these stakeholders.

## **DERIVATION OF HYPOTHESES**

Drawing on the information presented in the previous sections, this section formulates hypotheses to test whether there are significant differences between the financial class into which contractors are categorised and constraints and, investment decisions.

### **Constraints**

*Hypothesis (H) 1:* Contractors in the lower financial class categories are more likely to face problems relating to access to work. Contractors in the higher financial class categories are at an advantage regarding continuity of work, as they can decide to compete for jobs meant for contractors in the lower grades. Although contractors need not be classified before they bid for privately sponsored projects, it is expected that the decision of client representatives would be influenced if they knew the financial status of contractors, in which case they would favour contractors in a higher financial class.

*Hypothesis (H) 2:* Contractors in the lower financial class categories are more likely to face problems in obtaining credit. It takes relatively longer periods for contractors in the lower grades to receive payment for work done. There is the likelihood that this would affect their ability to repay loans and damage their reputation with creditors, which would affect their chances of obtaining subsequent loans.

*Hypothesis (H) 3:* Contractors in higher financial class categories are less likely to face constraints in obtaining mobilisation payments. With the relatively better reputation they have with banks and other established financial institution, it is expected that contractors in the higher financial classes would be able to secure guarantees required before mobilisation is offered.

*Hypothesis (H) 4:* Contractors in the lower financial class categories are more likely to experience low profits on construction projects. Contractors in the lower classes face lengthy delays in receiving payments for completed work. They would have to rely on other sources to finance their activities with cost implications, which dwindles profit margin.

*Hypothesis (H) 5:* Contractors in the lower financial class categories, for a given period, are more likely to experience constraint to growth. With limited access to work, lack of finance and delays in receiving payments contractors within the lower financial class categories would be more affected with respect to growth.

### **Investment Decisions**

*Hypothesis (H) 6:* Contractors in the lower financial class category are less likely to engage professionals to assist in business development. This is partly because contractors in the lower financial categories are involved in relatively small, unattractive projects, which attracts little profits. They would be unable to engage professionals because of the high cost involved. They are the most disadvantaged regarding access to jobs during recession, and hence might consider it cost ineffective to engage such expertise.

*Hypothesis (H) 7:* Contractors within the higher financial class category are more likely to invest in equipment and plant. Because the classification system places much emphasis on equipment and plant holding contractors within the higher financial categories, who have comparatively good track record with financial institution, would continue to invest in them in order to sustain their status and also attract more jobs.

*Hypothesis (H) 8:* Contractors in the lower financial category are less likely to expand and upgrade their business premises. Uncertainties in the availability of work and lack of access to finance would reduce the incentive to invest in premises.

*Hypothesis (H) 9:* Contractors in the lower class financial category are more likely to invest their funds and energies into other business ventures. This is in part caused by the likelihood of being out jobs during recession where firms in the higher financial class categories decide to compete with them for the same projects. They would venture into any business that might generate extra income to pay employees permanently contracted and also to satisfy their own personal needs.

### **RESEARCH METHODOLOGY**

The evidence presented in this paper is derived from a wider questionnaire survey of small and medium scale contractors in Ghana.<sup>1</sup> 300 questionnaires were administered for

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<sup>1</sup> For a full discussion of the methodology see Eyiah and Cook, 2003.



contractors for completion. A questionnaire was built around four areas of interest. Background characteristics, financing practices, constraints, and support needs. The following variable, which serves the purpose of this paper can be identified under a combination of these areas: lack of access to work; lack of access to bank loans, lack of access to credit from material suppliers, lack of access to credit from material suppliers, lack of access to credit from plant hire organisation and lack of access mobilisation payments, low profits on projects and growth referred to as constraints; engagement of professions, purchase of equipment; and expansion in office premises.

SPSS version 10.1 for windows was used for the analysis. The analytical procedures employed were aimed at establishing the perceptions of contractors. The chi square test was used to determine whether significant differences exist between the characteristics of contractors and constraints and financing needs. The survey observed 14 different combinations of classification. For simplicity, therefore, a contractor identified under different categories and financial class was taken to be in the higher class. That is, for example, a contractor categorised as class A2 and class K3 was considered as a financial class 2 contractor.

## **RESULTS**

### **Contractor Constraints**

Table 1.1 shows that there is a statistically significant difference between financial class and lack of access to work. However, in contrast to hypothesis (H1), contractors in the lower financial class seemed to be less constrained than did contractors in the higher classes. The reasons be that in the absence on government-sponsored projects contractors in the lower classes had engaged themselves informally constructing private residential housing. It might also be that they had engaged themselves in minor subcontracting projects.

Supporting H2, tables 1.2 and 1.3 show that there exists statistically significant differences between the class of a contractors and problems in obtaining bank loans, credit from material suppliers. That is contractors in the lower financial categories were more likely than contractors in the higher classes to face problems in obtaining bank loans. Also, contractors in the lower financial categories were more likely than contractors in the higher financial classes to face problems in being offered credit from material suppliers. However, the hypothesis that a financial class is associated with problems in being offered credit by plant hire organisations cannot be confirmed. Supporting H3, table 1.4 shows that significantly

more contractors within the higher financial class were less likely to face problems with obtaining mobilisation payments. Hypotheses 4 and 5 cannot be confirmed.

## INVESTMENT DECISIONS AND BUSINESS GROWTH

While H6 seems to be supported by the relationships between class 2 and class 3 contractors it is contrasted by the relationship between class 3 and class 4, and between class 2 and class 4 contractors. H7 is supported. A significantly larger portion of class 4 contractors had invested in equipment and plant than did class 3 firms. On the other hand, a significantly larger portion of class 3 contractors had invested in equipment and plant than did class 4 contractors. Hypotheses 8 and 9 cannot be confirmed.

T 1.1

		<b>Lack of access to work* Financial class</b>		
		Class 2	Class 3	Class 4
		%	%	%
Access to work	No problem	10.8	30.4	30.6
	Problem	89.2	69.6	69.4
	Total	N = 37	N = 69	N = 72

NB:  $\chi^2 = 5.58$  S  $P < 0.05$

T 1.2

		<b>Access of access to bank loans* Financial class</b>		
		Class 2	Class 3	Class 4
		%	%	%
Bank Loans	No problem	65.7	62.5	42.3
	Problem	34.3	37.5	57.7
	Total	N = 35	N = 64	N = 71

NB:  $\chi^2 = 7.72$  S  $P < 0.05$

T 1.3

		<b>Lack of access to trade credit* Financial class</b>		
		Class 2	Class 3	Class 4
		%	%	%
Material suppliers	No problem	85.7	82.4	30.6
	Problem	14.3	17.6	69.4
	Total	N = 35	N = 68	N = 69

NB:  $\chi^2 = 21.34$  S  $P < 0.01$

## T 1.4

		<b>Lack of access to trade credit* Financial class</b>		
		Class 2	Class 3	Class 4
		%	%	%
Plant/equipment hire	No problem	61.8	70.0	72.5
	Problem	38.2	30.0	27.5
	Total	N = 34	N = 60	N = 69

NB:  $\chi^2 = 1.25$  NS  $P < 0.05$

## T 1.5

		<b>Lack of access to mobilisation* Financial class</b>		
		Class 2	Class 3	Class 4
		%	%	%
Mobilisation	No problem	20.0	9.2	4.1
	Problem	80.0	90.8	95.9
	Total	N = 35	N = 65	N = 71

NB:  $\chi^2 = 6.89$  S  $P < 0.05$

## T 1.6

		<b>Profit margin* Financial class</b>		
		Class 2	Class 3	Class 4
		%	%	%
Profit margin	High profit	5.6	19.7	12.5
	Low profit	94.4	80.3	87.5
	Total	N = 36	N = 66	N = 72

NB:  $\chi^2 = 4.09$  NS  $P < 0.05$

## T 1.7

		<b>Business growth* Financial class</b>		
		Class 2	Class 3	Class 4
		%	%	%
Business growth	No	72.7	61.2	74.6
	Yes	27.3	38.8	25.4
	Total	N = 33	N = 67	N = 71

NB:  $\chi^2 = 3.13$  NS  $P < 0.05$

### T 2.1

<b>Engage professionals* Financial class</b>		Class 2	Class 3	Class 4
		%	%	%
Professionals	No	29.7	31.9	9.5
	Yes	70.3	68.1	90.5
	Total	N = 37	N = 69	N = 74

NB:  $\chi^2 = 48.1$  S  $P < 0.01$

### T 2.2

<b>Purchase equipment/plant* Financial class</b>		Class 2	Class 3	Class 4
		%	%	%
Purchase equipment	No	25.8	39.7	65.6
	Yes	74.2	60.3	34.4
	Total	N = 31	N = 58	N = 61

NB:  $\chi^2 = 15.28$  S  $P < 0.01$

### T 2.3

<b>Expand premises * Financial class</b>		Class 2	Class 3	Class 4
		%	%	%
Mobilisation	No	65.6	75.4	85.2
	Yes	34.4	24.6	14.8
	Total	N = 32	N = 57	N = 61

NB:  $\chi^2 = 4.79$  NS  $P < 0.05$

### T 2.4

<b>Enter in other business ventures* Financial class</b>		Class 2	Class 3	Class 4
		%	%	%
Mobilisation	No problem	20.0	9.2	4.1
	Problem	80.0	90.8	95.8
	Total	N = 33	N = 55	N = 62

NB:  $\chi^2 = 1.64$  NS  $P < 0.05$

## CONCLUSION

The importance of the construction industry to socio-economic development of every country cannot be underemphasized. While it is necessary to regulate the industry to

protect the interest of consumers and the general public, excessive and unnecessary regulation might result not only in distortion, but also inefficiencies. Contractor's ability to maintain adequate profit and, to innovate and remain competitive could be affected. Regulations of the industry have resulted in high administrative costs for contractors; increase in design and construction cost; delays in construction; and reduction in competition within the industry.

While the classification system in Ghana is not achieving its purpose, there are several unintended consequences. The system is breeding corruption; unqualified persons are being offered lucrative construction projects at the expense of enterprising individuals who could have helped in building the capacity of the construction. The categorisation creates the impression that contractors in the higher classes could perform better and could be trustworthy, which puts contractors at the lower end at a competitive disadvantage. The survey revealed that contractors in the lower classes are less likely to receive credit facilities from banks and materials suppliers and mobilisation payment. They are also less likely to invest in their business.

Why a classification system, which has the potential of constraining the development of contractors whom efforts are being made to develop, if clients all over the world are basing their selection of contractors on tendering and the associated procedures. At least, there is no indication that contractors classified perform better than unclassified contractors. The author is urging balance and moderation, so that small contractors can both help to achieve the nation's social goals and can still fulfill the basic economic function of more efficient construction projects. Based on the evidence provided in this paper, the classification system should be subjected to a necessity test; a broader investigation into regulation relating to the industry is now eminent. Questions for investigation could include:

- What is the full scope of regulation that small contractors face in Ghana?
- To what extent do regulatory policies impact upon the development of contractors?
- Do regulatory policies affect contractor's attitude with regard to project cost, completion and quality?
- What is the broad purpose of the classification system?
- Is contractor classification the most efficient in achieving this purpose?
- Do contractors engaged in government-sponsored projects perform better than contractors engaged in private-sponsored projects?

- Does a contractor's class influence stakeholder's decisions?
- Does the classification system impinge upon contractors' investment decisions?
- What are the current benefits of contractor classification and what would be the implication if it were abolished?
- Can the classification system be designed to improve upon the competitiveness of small contractors?
- What contract arrangements and procedures would improve upon the effective participation of contractors in the construction industry?

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