

Causes of Late Payment of Commercial Debt and Challenges of Working Capital to Small and Medium Enterprises (SMES) in the Construction Industry of Zamfara State, Nigeria

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Abstract:- One of the most significant current discussions in the construction industry is the issue of late payment of commercial debt to the contractors. Late payment of debts has been a very serious problem in the construction industry of both developed and developing countries. This research investigated late payment of commercial debt and challenges of working capital to small and medium enterprises (SMEs) in the construction industry of Zamfara state (Nigeria). The research was carried out through the use of structured quantitative questionnaire survey administered within the stakeholders in the construction industry of the study area. The data obtained was analysed using SPSS software through the frequency, percentage, mean, standard deviation and ranking tools. It was discovered that there is an evidence of the existence of late payment of commercial debt to SMEs in the construction industry of Zamfara state, Nigeria, because clients don't pay contractors as at when due. Poor management and financial base of the clients has been identified as the leading factor causing late payment of commercial debt in the Nigerian construction industry. It was also discovered that lack of access to bank loans, overdraft and other facilities is the most severe challenge of working capital management with the small and medium enterprises (SMEs) in the construction industry of zamfara state. This research have recommended among others that contractors should study and understand the financial base and management of their clients before engaging into any contract with them to avert the likelihood of late payment of monies due to them. The three tiers of government should initiate a supporting scheme that will enable the SMEs to access low income loans so as to contribute maximally to the economic growth of Nigeria.

Keywords:- Commercial Debt, Construction Industry, Late Payment, Small and Medium Enterprises (SMEs), Working Capital.

I. INTRODUCTION

Late payment of commercial debts has been a very serious problem in the construction industry of both developed and developing countries. These problems affect the cash flow of many contractors thereby preventing them from meeting up with their financial obligations. Traditionally, construction works are paid after certifying

the progress of work, and the payment chain is from the client to the main contractor down to the sub-contractors and suppliers. It is not surprising then, when the client delays or withholds the payment to see the contractors, sub-contractors and suppliers suffering from cash crunch even after their works are found to be satisfactory.

Recently, researchers have shown an increased interest in the problems of late debt payment and its effects on the stakeholders in the construction industry (Ramachandra and Rotimi, 2011). However, De carvalho (2015) says delay of payment in commercial debt between companies is not a new phenomenon. The effects of such late payment have also been widely acknowledged. In a study carried out by Mohammed and Isah (2012) it was observed that late payment of completed works by the clients was rated high among the factors that influence delay in construction projects in Nigeria. A research carried out by Arumita (2012) revealed that the most crucial causes of delay in building projects in Nigeria in order of importance are delayed payment of interim certificates and late payment of certified and approved claims due to contractors by the clients.

Similarly, Shwarka and Anigbogu (2012) observed that Federal Government's delay in implementing budget has always been leading to delayed payment of completed works as at when due. Furthermore, in a study carried out by Fatoye (2012) it was discovered that, all the clients, contractors and consultants ranked delayed payment leading to cash flow problems highest as a factor causing delay in executing construction works in Nigeria. The most critical setback is delay between the time of issuance of interim certificates and the time such payments are made to the contractors (Tunde, 2008).

In a research conducted by Patience (2008) it was reported that financing and payment of work done is responsible for cost escalation of construction work in Nigeria. Generally, contractors are not paid in accordance with the contract conditions earlier agreed. There are cases where clients fail to honour Architect's certificate of payment for up to 6 months or more whereas the contract conditions, in most cases stipulates about 28 days.

This research investigated the issue of late payment of commercial debt and challenges of working capital to Small

and Medium Enterprises(SMEs) in the construction industry

of Zamfara state, Nigeria.

II. RESEARCH LOCATION

Zamfara State is in the North-western part of Nigeria, with Gusau as its capital. Zamfara state was founded on 1st October, 1996. It covers a total area of 39,762 square kilometre and ISO 3166 – 2: NG. It is on Latitude 12.1628, Longitude 6.6745, N 12 9'46", E 6 40'28" North and East hemisphere.



III. STATEMENT OF THE PROBLEM

Late payment is one of the factors that lead to delay in completing construction projects in many countries where the construction industry is one of the important sectors that contributes to the economic growth. Vliet *al.* (2015) explained that any extension of payment terms induces a non-linear financial cost to the contractor beyond the opportunity cost of carrying additional work. Westphalet *al.*(2015) informed that because of some fiscally vulnerable economies like that of Spain and Italy, the European Commission had totake an initiative at the EU level in order to reduce debt payment delays, Such as the 2011 Directive on combating late debt payment in commercial businesses, which covers transactions between the private companies and the Government. This type of initiative does not exist in the Nigerian construction market.

As a result of the present day worldwide economic downturn, the EU have discovered that SMEs are important areas for job creation and they are particularly vulnerable to delayed payment by their client for two major reasons, firstly, the SMEs are more likely to accept unjustifiable delayed payment because of their low bargaining power during negotiations (Cara,2013). Secondly, as a result of their limited liquidity they are more likely to be affected by the consequences of delayed payment compered to their larger counterparts.

To this effect, research questions were developed with a view to evaluating these problems and finding solutions. For this research, the questions are:

- What are the causes of late payment of commercial debt in the Small and Medium Enterprises (SMEs) sector of the construction Industry of Zamfara State, Nigeria?
- What are the challenges of working capital to Small and Medium Enterprises (SMEs) in the construction Industry of Zamfara State, Nigeria?

It is the intension of this research to investigate the issue of late payment of commercial debt in the Nigerian construction industry with particular emphasis to the Small and Medium Enterprises (SMEs) in Zamfara State, with a view to find the causes and challenges of the working capital.

IV. LITERATURE REVIEW

A. *An Overview of Small and Medium Enterprises (SMEs) In Nigeria.*

In Nigeria, the construction industry is one of the driving forces that sustain the economic growth of the country. On the average it contributes 5% of the country's annual GDP and 1/3 of the cumulative fixed assets investment (Chukwudi and Tobechukwu, 2014). Companies, organizations or firms that are engaged in construction projects are referred to as 'Contractors'. They make use of their skills and offer services in exchange for financial gains.

The Nigeria's Small and Medium Enterprises (SMEs) were formally recognised with the introduction of the

Nigeria Enterprises promotion decree of February 1972. Since then SMEs has been a key player in the Nigerian construction industry. The SME contractor in Nigeria is considered as an individual or private organization established under the Nigeria Enterprises promotion decree of 1972 based only in Nigeria with its capital base and ownership entirely Nigerian (Owoh, 1993 in Chukwudi and Tobechukwu, 2014). The companies are of different sizes ranging from self-employed craftsmen called jobbers undertaking mainly repairs and maintenance of buildings to medium size companies that carryout medium sized construction contracts.

Unfortunately, Oyedele (2013) stressed that Nigeria construction industry is still neither organized nor controlled because there is no demarcation between the contractors and some others in the business just to make money irrespective of the type of work. This is why anybody can erect any structure without Government notice or specifications (Oyedele, 2013) and this practice has led to frequent collapse of buildings with casualties in Nigeria. Shittu, 1997 in Chukwudi and Tobechukwu, (2014) argues that small and medium size construction companies constitutes 90% of the total contractors registered in Nigeria. These SMEs are characterized by insufficient capital base, underutilization, understaffing and lack of managerial skills.

B. Late Payment of Commercial Debt in the Construction Industry.

Late payment of commercial debt has been an issue of discussion within the construction industry between the client and the contractor, but still the problem is persisting with no body coming up with a solution (Baird, 2013). Delayed payment of commercial debt has a great impact on the cash flows of all sizes of enterprises, but mostly credit management strategies are being emphasized, although some businesses are exploiting other avenues to protect themselves against the menace. Different people have different perspective as to who is to carry the blame of late payment, while some said the Government is to be blamed for not introducing penalty for late payment; others are saying the cure should come from within the businesses themselves.

Different countries and continents are taking measures to reduce the effects of late payment in their construction industries. For example, El-adaway *et al.* (2016) puts that in the US, the prompt payment Act is enforced for public sector works in 49 states and for private sector works in 31 states. Similarly, prompt payment legislation is applicable to both private and public construction works in the UK, Australia, New Zealand and Ireland. The European Union (EU) in its own wisdom came up with a popular 'Directive 2011/7' on February, 16, 2011, that is meant to reduce late payment in commercial businesses (Cara, 2013). Among the objectives of this directive is to encourage Government and Enterprises to pay their bills on time. Even with these efforts made late payment of commercial debt still persists in both developed and developing countries. It is even worst and severe in countries where these legislations and Acts does not exist or not enforced.

C. Causes of late payment of commercial debt in the construction industry

The underlying issues that lead to late payments of commercial debt in the construction industry are numerous, Abdul-rahman *et al.* (2009) identify some of them to include; Poor management and financial base of the client, Late raising of valuation and certificates of interim payment by the consultant, Client's unnecessarily withholding payment, Too many parties participating in the process of payment, Misunderstanding of client's variation order by the contractor, Inadequate information for valuation, Wrong valuation of work done and Invalid contractor's claim.

De Carvalho (2015) says that private and public enterprises operating on short time debt would not be able to pay their contractors on time, there by delaying the contractor's payment to a latertime. Persistent pressure on the cash flow of both large and small enterprises will not only bring about late payment to their creditors, but it is also an issue that is difficult to handle (Bair, 2013). Sara (2010) also puts that forum of private business revealed that small enterprises are finding it difficult in terms of business orders and turn over as a result of cash flow crunch due to late payment of debt. Mensah (2012) submits that delay in payment could results due to poor bargaining power of the SMEs, because the larger enterprises can use threat to make SMEs accept late debt payment. Those exposed to a higher risk are the Small and Medium Enterprises (SMEs) by virtue of their size making it difficult to control the working capital (Peel and Wilson, 1996; Kargar and Blumenthal, 1994, in Salima and Rebecca, 2011).

Delayed payment of commercial debt is usually linked up with the relationship of the business enterprises and their clients, if the client is having an advantage over the contractor or there is market competition or changes in the technology of payment then the enterprise is prone to high risk of delinquency and defaults (Paul and Wilson, 2006, in Salima and Rebecca, 2011). Salima and Rebecca (2011) further stressed that in economic hard periods SMEs are the most hit by the credit squeeze and there is a relationship between late debt payment and the rate of insolvency and bankruptcy. El-adaway *et al.*, (2016) concur with Abdul-rahman *et al.*, (2009) but added that using the 'pay when paid' clause with subcontractors, suppliers and manufacturers and non-adherence to the contractual clauses in requesting payment by the contractors are additional causes of delayed payment in the construction industry. Obviously, it is clear that most of the stated reasons are not within the control of the contractors, subcontractors or the suppliers.

D. Sources of Working Capital

Different sources of working capital exist in the construction industry, but Nwude (2001) and Wolfe (2014) in Chukwudi and Tobechukwu (2014) grouped these sources in to short term (up to one year), such as mobilization payment, retention fee; medium term (one to five years), that include hire purchase, leasing and long term (over five years), such as mortgage, capital grant, debenture etc. Mobilization/advance payment and retention are key sources of working capital of the contractor. They also form part of

the payment system in the Nigerian construction industry (Godwin, 2013, pp.61-64). Any delay in the payment of such monies will affect the cash flow of the contractor.

E. Challenges of Working Capital Management in the Nigerian construction industry.

Harris *et al.* (2013) described working capital as the liquid and near-liquid assets that are required to run the day-to-day business transactions of the company. It is usually the excess of current assets over the current liabilities that is locked up in an uninterrupted cycle. Working capital could also be defined as the amount of money required to pay for the difference between the operating cost and the receipt of income, which is usually the short term (30-60 days) cash flow cycle of the business (Yescombe, 2014, pp. 352).

The result of a research conducted by Chukwudi and Tobechukwu (2014) revealed that SMEs in particular are faced with some challenges in managing working capital including but not limited to: Insufficient information on the need for managing working capital, Mostly individual business with little or no technical skills and inadequate personnel, underfinanced, Cash flow challenges, High cost in project financing, SMEs are prone to reckless spending and diversion of project funds and Inadequate project planning and control.

These challenges could further be compounded by ineffective payment system or poor payment practices. For example, a contractor who sourced capital at high interest rate is bound to become insolvent if payment is delayed, the contractor may not be able to repay the loan because of cash flow challenges.

V. RESEARCH METHODOLOGY

Traditionally, research questions are crafted based on the study problem or questions leading to the research methodology to be employed. Research methodology has been described as a systematic way of getting answers to the questions raised (Kumar, 2014). It is also considered to be the approach through which a research work could be undertaken to achieve the set aim and objectives. The techniques involved in this research include the conduct, collection of data, analysis and presentation of the result in order to make the information meaningful.

As this research is investigating causes of late payment of commercial debt and challenges of working capital to SMEs in the construction industry of Zamfara state, Nigeria, the major source of data are the stakeholders in the construction industry. These include the clients/clients representatives, contractors, subcontractors and consultants. Although there will be difficulty in collecting data from these stakeholders because of the limited time for the research, a sample size between 100 – 140 participants is selected using random sampling method, so that every member of the population will have equal opportunity of being selected (Creswell, 2013). This randomly selected sample shall be used to generalise to the population within Zamfara state in Nigeria.

The primary data was collected from the randomly selected stakeholders in the SMEs construction industry of Zamfara state, Nigeria using a structured questionnaire. The questionnaire method of obtaining information was adopted because it is flexible and a structured questionnaire can be administered to a large group of participants within a short period of time in a given geographical area. With few exceptions the questionnaire was constructed using the five-fold Likert scale, where 5 is strongly agreed, 4 agreed, 3 undecided, 2 disagreed and 1 strongly disagreed.

For the purpose of this research, the data was presented in tabular form and analysed using SPSS computer software through descriptive frequency, percentage, mean, standard deviation and ranking tools. The study was concluded by summarising the results in writing to enable drawing of the conclusions based on the research questions and other limitations.

VI. RESULTS AND DISCUSSIONS

This section encompasses the presentation and analysis of the data obtained from the field questionnaire survey and discussion of the results. A total of 100 structured questionnaires were distributed to the stakeholders including clients/representatives, contractors, consultants and subcontractors within the survey area. However, 82 of them were returned as valid responses. This indicated a response rate of 82%, and this is above average signifying a reliable and confident number of samples that can be used to generalise.

How often do you receive progress/interim payment in accordance with the contract agreement?	Frequency	Percent	Valid Percent	Cumulative Percent
Always	15	18.3	18.3	18.3
Often	31	37.8	37.8	56.1
Sometimes	26	31.7	31.7	87.8
Rarely	8	9.8	9.8	97.6
Never	2	2.4	2.4	100.0
Total No. of Respondents	82	100.0	100.0	

Table 1 Frequency of respondent’s receiving progress/interim payment in accordance with the contract agreement.

Source: Field survey (2018)

This section requires the respondents to indicate how often they receive progress/interim payment in accordance

with the contract agreement. From the result in table 6.1 it could be seen that respondents that often receive

progress/interim payment have the highest frequency of 31 (37.8%). The cumulative percentage of respondents that receive sometimes, rarely and never (43.9%) is alarming leading to an indication of the existence of late payment of the progress/interim payment. This result is similar to the

position of(Hughes *et al.* 2008) who says in the UK; contractors are entitled to interim payments at agreed intervals during the construction processes, provided the contractor applies.

How often do clients/representatives issue payment certificates on time?	Frequency	Percent	Valid Percent	Cumulative Percent
Always	11	13.4	13.4	13.4
Often	34	41.5	41.5	54.9
Sometimes	23	28.0	28.0	82.9
Rarely	12	14.6	14.6	97.6
Never	2	2.4	2.4	100.0
Total No. of Respondents	82	100.0	100.0	

Table 2 Frequency of clients/representatives issuing payment certificates on time.

Source: Field survey (2018)

Table 2 above sought to find out how frequent clients/representatives issue payment certificates on time. The result from the analysis shows that 41.5% of the respondents often receive their payments certificates on time. But the cumulative percent of those who sometimes, rarely and never receive (45.1%) call for concern because it is an indication that clients/representatives delay or doesn't issue payment certificates on time. Depending on the standard form of contract being used, different contracts

have different provisions as per issuance of payment certificate. For example, the yellow book of FIDIC being an international standard form of contract recommends that within 28 days of receipt of the contractor's statement, the Engineer should issue the contractor payment certificate informing the contractor of the amount due to him. This is after giving due consideration to all previous payments made to the contractor as stated by Hughes *et al.* (2008).

Causes of late payment in the Nigerian construction industry	N	Minimum	Maximum	Mean	Std. Deviation	Ranking
Poor management and financial base of the client.	82	2.00	5.00	4.4634	.77292	1
Clients unnecessarily withholding payment.	82	2.00	5.00	4.2073	.99055	2
Too many parties participating in the process of payment.	82	1.00	5.00	3.9878	1.09425	3
Late raising of valuation by the consultants.	82	1.00	5.00	3.8049	1.22161	4
Implementing 'pay when paid' and 'pay if paid' clauses.	82	1.00	5.00	3.7439	1.01606	5
Concern about the cash flow difficulties of the contractor.	82	1.00	5.00	3.7073	1.07138	6
Wrong valuation of work done.	82	1.00	5.00	3.6585	1.18862	7
Invalid contractor's claim.	82	1.00	5.00	3.6220	1.01398	8
Poor SMEs bargaining power.	82	1.00	5.00	3.5488	1.07901	9
Inadequate information for valuation.	82	1.00	5.00	3.5122	1.18888	10
Late raising of certificates of interim payment by the consultants.	82	1.00	5.00	3.5122	1.22971	11
Contractor's poor relationship with the clients.	82	1.00	5.00	3.5122	1.23971	12
Contractor's non-adherence to relevant clauses in requesting payments.	82	1.00	5.00	3.4756	1.07984	13
Total No. of Respondents	82					

Table 3: Causes of late payment in the Nigerian construction industry

Source: Field survey (2018)

Table 3 of the questionnaire deals with the causes of late payment of commercial debt in the Nigerian SMEs construction industry. The respondents were asked to state their level of agreement or disagreement with the causes and rank on a scale of 5 to 1, 5 being strongly agree down to 1 strongly disagree.

It could be seen that the respondents rated poor management and financial base of the clients high and strongly agree that it is a leading factor causing late payment of commercial debt in the Nigerian construction industry with a mean score of 4.46 and therefore ranked 1. The average mean score of these causes of late payment of

commercial debt in construction industry is 3.75 and this indicates that the respondents have accepted them to be the causes of late payment of commercial debt in the Nigerian SMEs construction industry as ranked in the table. The

result is similar to the findings of Abdul-rahman *et al.* (2009), El-adaway *et al.* (2016), Bair (2013), Sara (2010) and Salima and Rebecca (2011) as to the existence of these causes in the UK construction industry.

Challenges of working capital management	N	Minimum	Maximum	Mean	Std. Deviation	Ranking
Access to overdrafts and other facilities.	82	1.00	5.00	4.0610	1.21053	1
Availability of reserves/savings.	82	1.00	5.00	3.8049	1.19090	2
Failure to implement working capital management strategies.	82	1.00	5.00	3.6707	1.01902	3
High interest rate on borrowed capital.	82	1.00	5.00	3.6341	1.21220	4
Late payment from the client.	82	1.00	5.00	3.6220	1.08457	5
Access to credit facilities from suppliers.	82	1.00	5.00	3.5732	1.18666	6
Non-payment by the client.	82	1.00	5.00	3.4024	1.17442	7
Reckless spending by the contractor.	82	1.00	5.00	3.3415	1.23947	8
Inadequate planning and control.	82	1.00	5.00	3.3049	1.10765	9
Limited/no financial management capability (Staffing).	82	1.00	5.00	3.0610	1.17953	10
Total No. of Respondents	82					

Table 4: Challenges of working capital management in the Nigerian SMEs construction industry.

Source: Field survey (2018)

This section of the questionnaire deals with the challenges of working capital management in the Nigerian SMEs construction industry. The respondents were asked to rate the challenges in order of their severity on a scale of 5 to 1, 5 being the most severe down to 1 undecided.

This result indicates that the respondents rated Access to overdraft and other facilities high as the most severe challenge of working capital management with a mean score of 4.06 and therefore ranked 1. The average mean score of these challenges is 3.55 and this means that the respondents have accepted these as challenges militating against working capital management by the Nigerian SMEs construction industry. This result has further confirmed the assertion of Chukwudi and Tobeckwu (2014) who posits that Nigerian SMEs in particular are faced with some challenges in managing working capital including but not limited to: Insufficient information on the need for managing working capital, individual business with little or no technical skills and inadequate personnel, cash flow challenges, high cost in project financing, reckless spending and diversion of project funds and inadequate project planning and control. Access to overdraft being the most severe challenge in working capital management has confirmed the opinion of Halpin and Senior (2012) who puts that Money being the basic resource is the cascading component that is required at every stage of the project activity. The contractor must have money to finance the work in progress as payment from the client is being awaited.

VII. CONCLUSION

Late payment of commercial debts has been a very serious challenge in the construction industry of both developed and developing countries like Nigeria. These

problems affect the cash flow of many contractors thereby preventing them from meeting up with their financial obligations. It is in the tradition of construction industry that payments are made based on the certified progress of work. The payment will be made from the client to the main contractor down to the sub- contractors and suppliers. It is therefore not surprising when higher party in the payment chain delays or withhold the payment the lower parties will suffer from cash crunch even though their work is satisfactory.

Numerous factors give rise to late payment of commercial debt as discovered in the research, but the respondents rated poor management and financial base of the clients as the leading factor causing late payment of commercial debt in the Nigerian construction industry. The SMEs in the Nigerian construction industry have been discovered to be faced with numerous challenges of working capital. The study revealed that lack of access to overdraft and other facilities is the most challenging factor that militates against the SMEs working capital management in the industry. The research shows that 43.9% of the contractors, never, rarely or receive progress/interim payment, which is alarming and an indication of the existence of late payment of the progress/interim payment. Majority (52.4%) of the contractors depend on the client's certificate that doesn't come on time and therefore leading to delay in the processing and subsequent payment.

VIII. RECOMMENDATIONS

Based on the findings of this research, the following recommendations are made:

- The three tiers (Federal, state and local) of government should initiate a supporting scheme that will enable the

SMEs to access low interest loans so as to contribute maximally to the economic growth of Zamfara State and Nigeria in general.

- Clients should endeavour to pay their contractors all progress/interim payments as the work progresses and retention funds at the end of the contract on time. This will improve the contractors' cash flows and hence early completion of the contract and better financial stability.
- All the stakeholders in the Nigerian construction industry should acquaint themselves with the provisions of the standard form of contract in use and the Nigeria procurement act, 2007 to enable them understand and utilize the provisions therein for improved relationship and development of the industry.
- Contractors should study and understand the financial base and management of their clients before engaging into any contract with them to avert the likelihood of late payment of monies due to them.

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