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An Assessment of Car Buyers' Understanding of Balloon Payment Method in Relation to the National Credit Act in South Africa

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Abstract
The objectives of this study were to measure the extent to which first time car buyers understand the National Credit Act in relation to using balloon payment as a vehicle finance method, and explore the first time car buyers' perceived extent to which balloon payment vehicle finance method is aligned with the provisions of the National Credit Act (Act No 34 of 2005). The study was driven by the observed reported continued loss of cars by some consumers as a result of failure to meet all provisions of balloon car financing contract. Based on simple random sampling approach, a self-administered standardized questionnaire was used to collect primary data from 71 Pretoria based respondents who had purchased motor vehicles using balloon financing method. Data was processed and analyzed using SPSS version 21 statistical program for windows. Based on the Cronbach's alpha and Keiser-Meyer Olkin (KMO) measure of sampling adequacy (MSA) values, the research instrument's items met the internal consistency and sampling adequacy requirements. The results on the frequencies and descriptive statistics indicate that first time car buyers who purchased cars using the balloon payment finance method did not understand the National Credit Act with respect to entering into a balloon payment contracts. Moreover, the respective car buyers perceived that the provisions contained in the balloon car loan plan were not aligned with the provisions of the National Credit Act.
Keywords: balloon payment, National Credit Act, first time car buyers, balloon contract

1. INTRODUCTION

The purchase of new motor vehicles by customers in South Africa using the balloon finance has caused problems for many buyers due to lack of adequate knowledge of contractual matters (NAAMSA, 2009). Consumer credit in the country had never received as much attention in the past as it has been given since the inception of the National Credit Act in 2008. Notwithstanding the fundamental purpose of the National Credit Act; which is to achieve integrity in the credit market, the Act also intended to remove unfair credit lending practices to ensure coverage of creditworthy consumers. Certain provisions of the Act were designed to enhance the chances of those in lower income groups to obtain credit, which include motor vehicle finance. Under the Act, a mandatory upfront deposit no longer stands as a requirement and the finance period was increased from the traditional 54 months, as prescribed by the Credit Agreements Act, to 84 months. In order to further enhance the possibility of customers in lower income levels securing vehicle finance, total household income instead of personal income was considered necessary for integration in the evaluation process for granting credit under the new Act. Whether credit was for the purchase of a motor vehicle or any other asset prior to September 2008, the process of obtaining a credit facility was not considered as a serious financial obligation that could have detrimental repercussions, especially if the consumer entered into the contract without adequate knowledge of the legal conditions attached to it.

The coming into effect of the National Credit Act in June 2007 changed the motor finance sector landscape significantly. Following De Klerk (2008) from Absa Vehicle & Asset Finance, certain sections of the National Credit Act makes motor finance easier as it allows motor finance agreements to be concluded over longer terms, namely 72 months or even 82 months, instead of the maximum 54 months previously allowed by the Credit Agreements Act. However, De Klerk (2008) indicates that the Act does not necessarily do enough to educate the consumers on implications of stretching the motor finance agreement to its maximum term though. As less capital is settled with each installment, the longer the motor vehicle repayment period, the higher the cost of the vehicle it is ultimately going to be (De Klerk, 2008). Consumer education therefore remains to be a valuable strategy in relation to the marketing of complex services and in context of particular groups of consumers (Burton, 2002a).

Currently, there is lack of education and information for car buyers who use balloon payment contract as a motor vehicle financing method (Wesbank, 2009). According to De Kock (2008), head of sales and marketing at WesBank, the data indicates that the number of South Africans choosing balloon payments as part of their vehicle finance contract fell from 22% in July 2007 to 9.5% in June 2012 (WesBank, 2009). Standard Bank Vehicle and Asset Finance has reported a similar trend. Watson (2008), director of strategy and business support at Standard Bank, indicates that approximately 10% of vehicle buyers currently choose a balloon payment; the 2007 percentage was nearly twice (National Credit Regulator, 2007). Prior to implementation of the National Credit Act, finance contracts were largely restricted to 54 months, involving slightly higher installments. Provision is currently made for 72-month finance contracts (Robertson, 2009).

1.1 Problem Statement
Following De Kock (2011), the coming into effect of the National Credit Act in June 2007 played an enormous part in the gradual decline of balloon payments. Approximately 65% of the customers have either not been able to make payment or their cars were confiscated by banks due high levels of defaulting on balloon payment settlements (Wesbank, 2011).

1.2 Research Objectives
The objectives of this study were to:

- To measure the extent to which first time car buyers understand the National Credit Act in relation to entering into a balloon payment contract as a method to finance a vehicle
- To explore the first time car buyers' perceived extent to which balloon payment vehicle finance method is aligned with the provisions of the National Credit Act

1.3 Research Questions
- To what extent do first time car buyers understand the National Credit Act in relation to entering into a balloon payment contract as a method to finance a vehicle?
- What is the first time car buyers' perceived extent to balloon payment vehicle finance method is aligned with the provision of the National Credit Act?

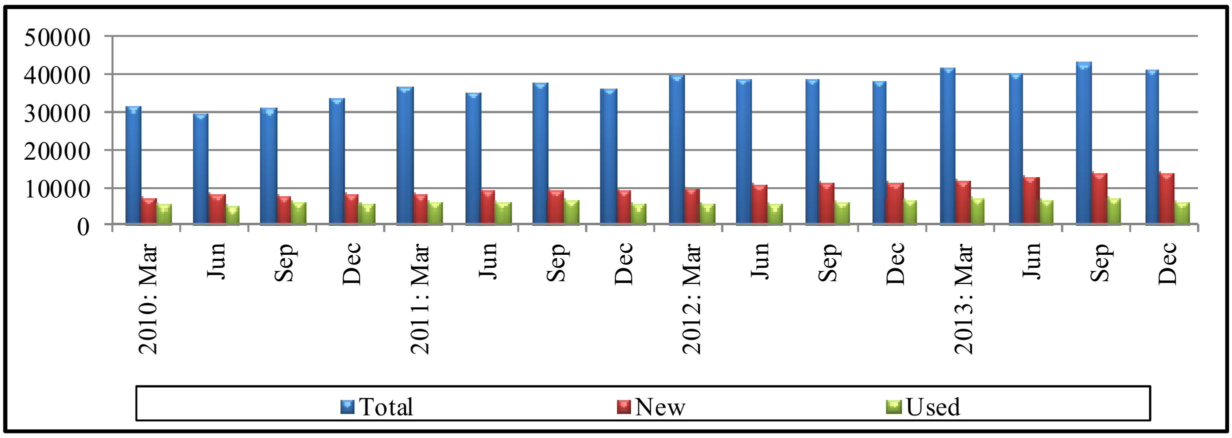
1.4 Research Hypotheses
- First time car buyers to a small extent understand the National Credit Act in relation to entering into a balloon payment contract as a method to finance a vehicle
- First time car buyers perceive that balloon payment contracts are to a small extent aligned with the provision of the National Credit Act

1.5 Significance of the Study
In light of the background that not much theoretical and empirical research has been conducted in this thematic field, the findings of this study will contribute significantly to the existing body of knowledge on the purchase of motor vehicles using balloon financing in relation to the provisions of the National Credit Act in South Africa. Further, the findings will generate policy insights into the level of customers' level of understanding of all the contractual obligations integrated with the financing of motor vehicle purchase using balloon payment method.

2. LITERATURE REVIEW
This reviews literature on South African motor vehicle industry and motor vehicle retail prices, and the UK and USA credit regulation systems. The purpose of the National Credit Act (Act No 34 of 2005); coupled with motor vehicle finance methods in South Africa were also discussed.

2.1 The South African Motor Vehicle Industry
The South African economy has a number of motor vehicle manufacturers; which include BMW, Ford, Volkswagen, Daimler-Chrysler and Toyota, who all have assembly plants in various parts in the country. Vehicles are assembled for both the local and international market (Tera, 2003). The country has a vibrant automotive component manufacturing industry that supplies these original equipment manufacturers (Trade & Investment South Africa, 2003). Based on Figure 2.1 below, despite the country's automotive industry having been once adversely affected by the global economic recession and credit crunch in 2009, total vehicle sales gradually increased from the first quarter of 2010 to the fourth quarter of 2013 (NAAMSA, 2009).

Figure 2.1: Vehicle Sales: All Categories – Total, New and Used (R million)



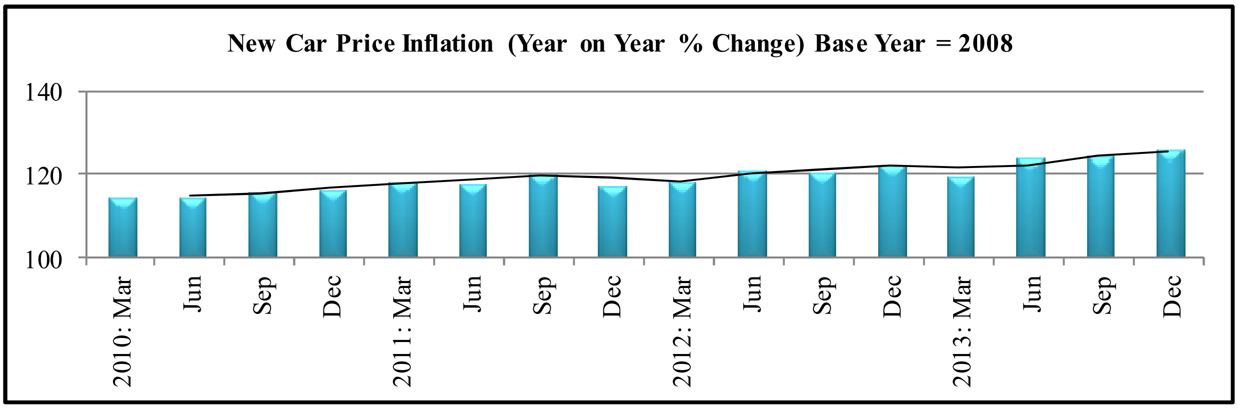
Source: Statistics South Africa (2013)

The gradual increase total vehicle sales from the first quarter of 2010 to the fourth quarter of 2013 signifies recovery by the industry in terms of both domestic and global competitiveness. The sales of new vehicles were remarkably higher throughout the entire period under review as compared to the sales of used vehicles.

2.2 Motor Vehicle Retail Prices

According to Robertson (2009), car prices had been forecast to rise by as much as 20% to 25% by the end of 2009. This was based on the vehicle pricing index (VPI) developed by TransUnion Auto South Africa, which measures how the price level of new or used motor vehicles purchased by consumers change over time. The VPI enables the country's motor industry to observe the impact of changes in interest rate, changes in demand and supply of motor vehicles and other variables affecting motor vehicle retail prices. The figure below depicts the trend of new car inflation based on the VPI from the first quarter of 2010 to the fourth quarter of 2013.

Figure 2.2: New Vehicle Price Inflation – Vehicle Pricing Index



Source: TransUnion Media Release (2013): Vehicle Pricing Index, Edition 18)

Based on Figure 2.2 above, new car price inflation showed a rising trend from the first quarter of 2010 to the third quarter of 2011. The prices of new vehicles dropped in the fourth quarter of 2011 and then rose until the fourth quarter of 2012. In the first quarter of 2013, prices were relatively lower but they surged up to the fourth quarter of 2013. The main contributing factors to the growth of new car price inflation include the weakness of the South African currency and rising domestic production costs due to a dramatic increase in the prices of commodities such as the steel and platinum group metals (Cokayne, 2009). Despite the decrease in demand for new cars, manufacturers have been, in most instances, left with no choice other than to increase prices in order to regain some of the losses suffered from depreciation of the local currency.

2.3 International Credit Regulation

The past six to ten years have produced numerous sections of credit regulatory legislation introduced across the globe. Some examples are the Consumer Credit Act of 2006 in the UK, the Credit Contracts and Consumer Finance Act of 2003 in New Zealand and the National Credit Act of 2005 in South Africa. Since the deregulation of the USA credit industry in late 1980s, there has been no single regulatory body controlling the industry in that country. Instead, a series of Acts covering various aspects of the industry was entrusted with regulating consumer credit in the USA (Card, 2005; and Richards, Palmer & Bogdanova, 2007).

2.3.1 Credit Regulation in the United Kingdom

The Consumer Credit Act of 2006; fully implemented in 2008, replaced the Consumer Credit Act of 1974, and was the first Act to cover all forms of instalment credit in the UK. Card (2005) indicates that the new credit Act strengthened the regulator's arm and addressed certain weaknesses of the previous Act, for instance, the extortionate credit bargaining rules. The 2006 Act's major objectives were to establish an independent ombudsman service allowing consumers to challenge agreements without having the added burden of going through a court battle, make it easier to challenge unfair lending practices and loan agreements, require lenders to provide better information regarding their credit accounts, and introduce a more targeted licensing system, limiting the burden on reputable businesses and freeing the OFT for more investigations into unscrupulous organisations. The major shortcoming of the 2006 Act was identified as its failure to require the lender to disclose certain information, such as the main contributing factors that could lead to a credit application being declined. By not divulging this information, consumers would be unable to rectify the problem and improve their credit standing (Card, 2005).

2.3.2 Credit Regulation in the United States of America

The USA does not hold a piece of legislation similar to that of the UK. The deregulation of the USA credit industry in the late 1980s was promulgated by the need to respond to multiple bodies and pieces of legislation that were controlling the credit sector. A series of Acts covering various aspects of the industry was entrusted with regulating consumer credit in the country. However, until recently, this did not apply equally to all the states in that country, as some states had their own sub-pieces of consumer credit legislation (Card, 2005). As most of the regulatory Acts applied in the USA were mainly focused on disclosure, anti-terrorism, anti-money laundering, fraud prevention, anti-usury lending, and credit accessibility to lower income groups, consumers were not adequately protected against the exploits of unscrupulous credit providers (Card, 2005).

2.3.3: Consumer Protection and Credit Regulation

According to the World Bank (2014), the levels of consumer protection and credit regulation in a country can be assessed based on the ease of access to loans indicator and the credit depth of information index. The ease of access to loans indicator measures how easy it is to obtain bank loans on a scale of one to seven, with higher values suggesting easiest access and low values indicating hardest access. Congruently, the credit depth of information index measures rules affecting the scope, accessibility and quality of credit information available through public or private credit registries. The credit depth information index ranges from 0 to 6, with higher values indicating availability of more credit information. Table 2.1 below comparatively provides information on these indicators between South Africa vis-à-vis the UK and USA.

Table 2.1: Selected Countries' Consumer Protection Legislation, Ease of Access to Loans and Credit Depth of Information Index (2013)

Country	**Consumer credit legislation**	**Ease of access to credit** (0 = hardest to 7 = easiest)	**Credit Depth of Information Index** (0 = low to 6 = high)
United Kingdom	Consumer Credit Act (2006)	4.8	6
United States of America	Consumer Credit Protection Act (1969)	4.8	6
South Africa	Consumer Protection Act (2008)	4.2	6

Source: World Bank (2014)

As shown in Table 2.1 above, South Africa, in relative terms, has the moderate access to credit. In the upper band, United Kingdom and United States of America demonstrate equal levels (score = 4.8) of access to credit. Regarding the credit depth of information, all countries demonstrate high availability of credit information in their economies.

2.3.4 Motor Vehicle Finance

The motor vehicle finance in South Africa is a very competitive industry dominated by four leading finance houses, namely Wesbank (a division of First Rand Bank), ABSA Vehicle and Asset Finance Division (a division of ABSA Bank), Stanbic (a division of Standard Bank), and Ned Credit; a division of Nedbank (Campbell & Logan, 2008).

Among others, the common methods of motor vehicle finance include balloon payment, fixed interest rate, and instalment sale agreement. The balloon payment option allows for reduced monthly instalments for the duration of the credit agreement with the final instalment being inflated compensating for the capital amount not settled. This option gives the consumer a certain amount of breathing space with regard to the monthly cash flow required to service the instalment (Burton, 2002b). The fixed interest is a credit agreement linked to the prime interest rate. Any movements in the prime interest rate; whether up or down, will similarly affect a consumer's monthly repayments. Lastly, an instalment sale agreement; the most frequently used motor finance option, is a credit agreement that allows consumers to spread the capital amount plus interest over a set period. The NCA has made it possible for an instalment sale agreement to be concluded over a period of 72 months or longer, up from 54 months, as prescribed by the Credit Agreements Act. Ownership of vehicle passes to the consumer once the final instalment has been paid (Campbell & Logan, 2008).

Provided in Table 2.2 below is a comparison of balloon payment, fixed interest and installment sale agreement car finance methods based on scheduled monthly installments, interest rates, required minimum deposits, car purchase deal closure amounts and total repayments.

Table 2.2: Comparison of car finance options

Balloon payment						
Retail price	**Interest rate**	**Deposit**	**Term**	**Balloon**	**Monthly instalment**	**Total repayment**
R363 990	8.28%	17% R61 878	60 Months	R127 397	R3 999	R429 215
Fixed Interest						
Retail price	Interest rate	Deposit	Term	Final payment	Monthly instalment	Total repayment
R363 990	8.28%	17% R61 878	60 Months	R108 960	R3 942.36	R407 380
Instalment sale agreement						
Retail price	Interest rate	Deposit	Term	Final payment	Monthly instalment	Total repayment
R363 990	8.28%	17% R61 878	60 Months	R0.00	R5 828	R411 558

Source: GM South Africa Financial Services, 2014 [https://www.gmsa.co.za/finance]

Based on the Table above, the motor vehicles' purchase prices, interest rates, deposits and terms of contract are the same for all purchase options, namely balloon payment, fixed interest and instalment sale agreement. At the end of the contract, the balloon payment option requires a higher final settlement amount comparative to the final settlement amount for the fixed-interest rate option. In terms of the monthly instalment, the instalment sale agreement attracts the highest instalment due to nil final settlement payment required at the end of the contract. Balloon payment requires a relatively higher monthly instalment compared to the fixed-interest rate option. Regarding total repayment, the balloon payment is the most expensive method compared to the other finance options. Moreover, consumers should bear in mind that the balloon payment also requires refinancing of the car after settlement of the balloon amount (Temkin, 2006).

3. METHODOLOGY

3.1ntroduction

This section describes the research design used, sample and sampling procedure, data collection, validity and reliability of the instrument; overview of data and the analytical techniques applied.

3.2 Research Design

The research was conducted based on descriptive survey design. The survey design was chosen to ensure use of information, which accurately describes the nature of existing conditions.

3.2 Sample and Sampling Approach

The sample of 78 Pretoria based first time car buyers was used in the study, out of which 71 of the participants provided fully completed responses. Simple random sampling approach was employed in gathering data from the respective participants.

3.3 Research Instrument

Primary data collected through use of a self-administered standardized questionnaire anchored on 5-point Likert scale: No Extent (NE = 1), Small Extent (SM = 2), Moderate Extent (ME = 3), Large Extent (LE = 4), and Very Large Extent (VLE = 5). The data collected was initially tested for scale reliability and sampling adequacy prior undertaking statistical analysis using SPSS statistical program version 21 for windows.

3.5 Scale Reliability and Validity of Items

In order to measure both the internal consistency and sampling adequacy of the research instrument's items, the Cronbach's Alpha criterion and Keiser-Meyer Olkin (KMO) test were applied; respectively. The Cronbach's Alpha coefficient was applied to assess the consistency of a set of measurements. Statistically, the minimum acceptable value of the Cronbach's alpha coefficient is 0.7; thus a higher value implies higher reliability of items. Correspondingly, the KMO test was employed as a measure of sampling adequacy (MSA); for which the minimum acceptable KMO value is 0.6; hence a higher value indicates higher sampling adequacy.

3.6 Data Analysis

Descriptive statistics were used as standard technique for analyzing and reporting results of the research study. Based on the Likert scale, the descriptive statistics were applied to generalise the average participants' responses regarding their understanding of the National Credit Act in relation to using balloon payment as a vehicle finance method, and explore the first time car buyers' perceived extent to which balloon payment vehicle finance method is aligned with the provisions of the National Credit Act.

4. RESULTS AND ANALYSIS

4.1 Demographic Profiles

With regards to gender, 34% were males and 66% were females. The composition of the gender variable reflects that female respondents constituted more than 50% of the sample. From these respondents, the modal age group comprised 49% respondents aged between 30 and 34 years, followed by 20% aged between 40 and 44 years; while 17% were aged between 35 and 39 years and the smallest age group comprised 6% respondents aged between 25 and 29 years. Regarding educational qualifications, 75% of the respondents had diplomas, followed 17% with bachelor's degrees, 6% with honours degrees; and 3% with matric certificates. To that effect, 41% of the participants were employed on a permanent basis, followed by approximately 23% who were employed on fixed-term contracts. The remaining 37% of the respondents comprised 17% who were temporarily employed and 20% were self-employed.

4.2 Internal Consistency

The internal consistency of the instrument items was examined based on Cronbach's alpha. Technically, the scale reliability test was undertaken to determine the degree to which the chosen set of items measured a single one-dimensional latent construct.

Table 4.1: Scale Reliability

Cronbach's alpha	Cronbach's alpha based on standardised items	N of items
.709	.784	23

The value of Cronbach's alpha ($\alpha = 0.709$) indicates that the survey instrument's items were statistically reliable; thus the items measured a single unidimensional latent construct.

4.3 Statistical Validity

The structural validity or sampling adequacy of the measurement tool was examined based on the Keiser-Meyer-Olkin (KMO) criterion; with results provided in Table 4.2 below.

Table 4.2: KMO and Barlett's Test

Kaiser-Meyer-Olkin measure of sampling adequacy		.655
Bartlett's test of sphericity	Approx. Chi-Square	680.238
	df	253
	Sig.	.000

The KMO value (= 0.655) indicates that the variables satisfy the criteria for appropriateness of factor analysis. The Bartlett's test of sphericity of the research items of 680.238 ($p < 0.01$) confirm that factor analysis could be performed on the data.

4.4 Descriptive Statistics

The results in this section provide arithmetic mean statistics for individual constructs regarding the participants' responses on their understanding of the National Credit Act in relation to using balloon payment as a vehicle finance method, and explore the first time car buyers' perceived extent to which balloon payment vehicle finance method is aligned with the provisions of the National Credit Act.

Table 4.3: Understanding of the National Credit Act in relation to the provisions of the balloon car loan contract

	Mean		Std. Dev
	Statistic	Std. Error	Statistic
National Credit Act provisions on balloon car payment loan are easily understandable	1.44	.069	.579
Car balloon payment issues are adequately dealt with in the National Credit Act	1.30	.058	.490
Formal terms on car balloon payment in the National Credit Act are easily understandable	1.62	.079	.663
National Credit Act provisions on consumer credit are easily understandable	1.42	.062	.525
Different consumer credit plans contained in the National Credit Act are clearly explained	1.46	.077	.651
Knowledge that National Credit Act provides for up to 84-month contracts; up from 54 months	1.24	.058	.492
Bank is the official owner of the leased car during the balloon contract	3.76	.149	1.259
Upon lease expiry, either cash for the remaining balance or new finance is required	1.15	.055	.467
Bad credit rating upon lease expiry might cause the bank not to refinance the car	1.41	.079	.667
Failure to meet obligations of balloon payment leads the bank to repossess the car	2.92	.160	1.350

The computed mean statistics for the dimensions revealed that the respondents surveyed in the study generally to no extent understood the National Credit Act in relation to the provisions of the balloon car loan. The respondents only understood to a moderate extent that failure to meet the obligations of balloon payment leads the bank to repossess the leased car. To a large extent, consumers understood that the bank remains the official owner of the leased car during the balloon contract. Overall, the results indicated that first time car buyers did not understand the National Credit Act in relation to the provisions of the balloon car loan method. The results conform to the report by Wesbank (2009) that there is lack of education and information for car buyers who use balloon payment contract as a motor vehicle financing method in the country. This findings also support De Kock (2011) who indicated that since the introduction of the National Credit Act in June 2007, nearly 65% of the car buyers have either failed to make final instalments for their cars or have had their cars confiscated by banks.

Table 4.4: Balloon car loan provisions are aligned with the provisions of the National Credit Act

	Mean		Std. Dev.
	Statistic	Std. Error	Statistic
Tenure of balloon car loan contract can be negotiable	1.27	.072	.608
Deposit paid determines monthly instalment to be made or amount of the balance	2.93	.126	1.060
During the loan term, huge payment goes towards interest rather than principal debt	1.08	.033	.280
Car loans are structured to reduce monthly payments and shift huge portion to one final payment	1.31	.079	.667

The results reveal that first time car buyers to no extent understood that the tenure of balloon car loan can be negotiable. Moreover, car buyers also to no extent understood that during the loan term, huge payment goes towards interest rather than the principal debt; and that car loans loan s are structured to reduce monthly payments and shift huge portion to one final instalment. On the contrary, the first time car buyers surveyed indicate that they understood to a moderate extent that the deposit paid determines monthly instalment to be made or the amount of the balance.

5. CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusion

The majority of participants surveyed in the study showed that they did not understand the National Credit Act in relation to the provisions of the balloon car loan plan. The results are indeed consistent with De Klerk (2009) who indicated that the NCA did not necessarily do enough to educate the consumer about the implications of stretching the motor finance agreement to its maximum term. In that respect, it can be inferred that car buyers generally have low levels of understanding the application of the National Credit Act in relation to the purchase of motor vehicles using a balloon payment financing method. With respect to the extent to which each of the provisions contained in the balloon car loan are aligned with the provisions of the NCA, the respondents indicated that they were to no extent aware that the tenure of the balloon car loan contract could be negotiable. In general terms, this reveals that more provisions of the car balloon payment plan are not clearly aligned with the provisions of the National Credit Act.

5.2 Recommendations for further research

When a bank provides consumers with finance for motor vehicle purchases, the bank itself bears the largest portion of the risk, should the consumer default or ultimately fail to pay back the amount provided. Therefore, before providing finance to customers for motor vehicle purchases, banks should assess the consumer's credit history through relevant authorities and credit bodies. Similarly, car buyers need to be aware of the amount of financial resources they would require currently and in future in order service their monthly instalments without default. Government agencies responsible for credit regulation such as the National Credit Regulator (NCR) and Financial Services Board (FSB) should execute financial literacy education programs to educate consumers and empower them to make financially responsible decisions. It is therefore in this regard that future research of this similar study should explore consumers' perceived levels of disclosure of all information relating to balloon contracts. The sample size should also be increased to enhance unbiased generalisation of results from the study. Furthermore, future studies on analysis of consumer understanding of balloon payment should also consider assessing consumer vulnerabilities based on their education and income levels.

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