Understanding of Contractual Matters by First Time Car Buyers Using Balloon Finance in Pretoria

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ABSTRACT

This study assessed the alignment of balloon payments offered to customers within the provisions of the National Credit Act, 2005 (Act No 34 of 2005) of South Africa, by exploring whether car buyers had been made aware of and understood the nature of their contractual obligations when they signed a balloon payment agreement. Based on the simple random sampling approach, a structured questionnaire was used to collect primary data from the sample of 71 respondents who had purchased motor vehicles using the balloon payment financing method. The results indicated that consumers who purchased cars using the balloon payment method did not understand the National Credit Act regarding entering into a balloon payment contract. Moreover, the respondents revealed that the methods used when educating them with regard to the purchase of vehicles using balloon payments were not effective, and they revealed that the provisions contained in the balloon car loan plan were not aligned with the provisions of the National Credit Act. The chi-square results indicated no evidence of statistically significant relationships between understanding the National Credit Act, and age and gender. The result of this study has significant impact for car finance industry in South Africa.

Keywords: balloon payment, National Credit Act, car buyers, balloon contract, South Africa

INTRODUCTION AND BACKGROUND

Consumer credit in South Africa had never received as much attention in the past as it has been given since the inception of the National Credit Act (NCA) in 2008. However, it has unfortunately been established that the emergence of trouble-free access to and utilisation of credit facilities resulted in consumers taking credit for granted. Whether it 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. This scenario points to one of the major causes for most financial institutions experiencing liquidity problems over the years as being lenient credit standards for borrowers and a lack of adequate knowledge about the legal conditions incorporated in the car purchase contracts under consideration.

Well-defined credit criteria are a necessary condition for approving credit in a safe and sound manner. In the 2009 financial year, the country's financial institutions managed to endure the global financial recession largely due to sound application of the NCA in the examination and approval of all credit applications easily accessible credit facilities coupled with reckless credit provision were the key motivations for the formation of the NCA in the first place (Pieterse 2009).

The previous Credit Agreements Act, 1980 (Act No 74 of 1980), made provision for compulsory payment of prescribed deposits and prescribed maximum periods for installment sale and lease agreements. These provisions were presumably aimed at averting over-indebtedness, as they prohibited consumers from binding themselves to an extended period, while the compulsory deposit requirement stipulated that only those consumers who could afford credit could receive it. However, to date it has been observed that these regulations did not achieve what they intended to achieve, namely to protect consumers against credit risk exposures (Vessio, 2008).

Notwithstanding the fundamental purpose of the NCA, namely 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, and, for the purpose of this study, more specifically motor vehicle finance. Under the new Act, a mandatory upfront deposit was no longer 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.

Conversely, the Act also imposes significantly more stringent conduct requirements and regulations on credit providers and requires them to strengthen their credit policies and lending criteria. As such, the NCA requires a credit provider to ensure that consumers can afford the credit that they apply for before actually approving the credit application.

Additionally, it has been alleged that such requirements have made it more difficult to obtain vehicle finance, as credit applicants have to prove that they earn sufficient income to provide for the new installment in addition to their other existing personal monthly expenses. This development seems to be contradictory to one of the major objectives of the NCA, which is to make credit more accessible to all income groups, as it means that the lower income group is largely driven altogether out of the credit market. Hence, sound regulations are vital to the continuing existence of the motor finance sector as a whole (De Klerk, 2008).

The coming into force of the National Credit Act in June 2007 has played an enormous part in the gradual decline of balloon payments (De Kock, 2011). However, about 65% of the consumers have either not been able to make their installments or their cars were confiscated by the bank due to defaulting on the balloon payment settlement (Wesbank, 2011).

Against the background of the problem cited above, the objectives of this study were to measure customer understanding of the NCA in relation to entering into a balloon payment contract as a method to finance a vehicle and the alignment of balloon payments offered to customers with the provisions of the NCA.

LITERATURE REVIEW

The motor vehicle sales (new and used) in South Africa have fluctuated between R 30 billion and R 40 billion during 2010 to 2013 (Statistics South Africa 2013). The figures indicate that total vehicle sales gradually increased from the first quarter of 2010 to the fourth quarter of 2013; thus signifying that the industry was recovering 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.

Motor finance in South Africa is a very competitive industry and is 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 NedCredit, a division of Nedbank. Apart from the four finance houses identified above, another market player who is very competitive under the current market conditions is the Motor Finance Corporation (MFC), a subsidiary of Nedbank. In that respect, the Econometrix (2008) indicated that South Africa's automotive industry contributed approximately 7.5% to the country's gross domestic product (GDP) in 2006, and 6.9% in 2007.

With roughly 50% of all vehicles bought in South Africa being financed, it is clear why the financial services industry makes such a pivotal contribution to the country's economy. If it were not for the corporate sector being responsible for nearly 85% of vehicles bought, this percentage would be much higher, as many large companies prefer to make cash purchases rather than to conclude motor finance transactions through financing options such as balloon payment. Under the NCA, consumers can choose between several finance options when purchasing a motor vehicle, namely installment sale agreements, lease and rental agreements (Campbell & Logan, 2008).

Balloon payment

The balloon payment option allows for reduced monthly installments for the duration of the credit agreement with the final installment being inflated to compensate 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 installment. The balloon payment is calculated by taking the following into consideration (Campbell & Logan, 2008):

- The estimated future value of the motor vehicle as at the expiry date of the credit agreement. The most important consideration here is to establish whether the vehicle will be worth more than the amount of the balloon payment, were the consumer to default on the balloon payment and the vehicle have to be repossessed or sold as a result.
- The market sentiment towards the vehicle that is financed in terms of the credit agreement. The amount of effort it would take to sell the motor vehicle in order to recover the outstanding balloon payment is an important consideration when the balloon payment is calculated. Some vehicles are less popular than others and would consequently require a more involved resale procedure, which means more costs.

Temkin (2006) mentions that, once a credit agreement reaches the balloon payment stage, the consumer has the following options:

- The consumer may apply to have the balloon payment refinanced for an additional period.
- The vehicle can be traded in or sold; hence a third party will settle the balloon payment.
- The consumer may settle the balloon payment that is due to obtain car ownership.

When a consumer does not budget properly for the balloon payment that is due at the end of the term, this option come back to haunt him/her as paying the balloon payment may necessitate the sale of the motor vehicle in order to raise the needed funds. This could result in the consumer never obtaining ownership of the said vehicle. The consumer would be forced to enter into another credit agreement, which means that he will almost never be released from the debt trap.

Residual packages

Residual values are very commonly included in lease agreements. While a balloon payment places the responsibility of paying the final balloon payment on the consumer, a residual value on a lease agreement places the responsibility for the residual value on the finance agent. At the end of the lease agreement term, the consumer has the option to either return the vehicle to the finance agent or tender payment of the residual amount to obtain ownership. Campbell and Logan (2008:167) state that consumers tend to refinance the residual value at the end of the lease term.

Fixed interest rate

A linked-rate credit agreement is 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. In order to protect the consumer from increases in the prime interest rate, the option is available to fix the credit agreement at a set interest rate. This rate would normally be higher than that of a linked-rate agreement, but shields consumers from installment increases due to rate changes.

Installment sale agreements

The most frequently used motor finance option is the installment sale agreement. This type of credit agreement allows consumers to spread the capital amount plus interest over a set period. The NCA has made it possible for an installment sale agreement to be concluded over a period of 72 months or longer, instead of 54 months, as prescribed by the Credit Agreements Act. Ownership of the vehicle will pass to the consumer once the final installment has been paid, thus if ownership of the vehicle at the end of the agreement is required by the consumer, this type of agreement will be the preferred choice (Campbell & Logan, 2008). This type of agreement could also include a balloon payment, which means that the final installment is much larger than the preceding installments. Ownership of the vehicle will pass to the consumer once the balloon payment and all preceding installments have been paid in terms of the agreement.

Lease agreements

Consumers who favour a hire arrangement over an ownership arrangement would most likely lean towards the conclusion of a lease agreement. In terms of the lease agreement, the consumer (the lessee) would pay monthly installments to the finance house or bank (lessor) of a motor vehicle for a period of time agreed upon by the respective parties involved. Payment of the lease installments gives the lessee full and exclusive use of the motor vehicle for the lease period, subject to an upper limit regarding mileage travelled and the return of the vehicle in a good state, with the exclusion of reasonable wear and tear of the motor vehicle.

Rental agreements

The main issue with a rental agreement is that ownership of the motor vehicle never passes to the consumer. In essence, the consumer pays for the use of the motor vehicle for the term agreed on in the rental agreement and he/she must return it to the owner on the expiry date. The amount of mileage travelled would normally be limited and any mileage over and above the set limit would be subject to an excess mileage cost or penalty at the end of the rental agreement. The benefits of this sort of agreement for a consumer are that the monthly rental payable could be structured to suit the consumer's needs and the monthly rental installments are tax-deductible. Rental agreements are excluded from the domain of the NCA, and do not require any further elaboration for the purposes of this research project.

In addition to the different motor finance options discussed above, various finance products exist that a consumer may encounter when applying for the financing of a motor vehicle. The aim of these products is predominantly to protect the consumer against possible negative effects of changes in their personal circumstances as well as unforeseen changes in economic factors such as prime interest rate fluctuations, which could result in consumers becoming unable to service their obligations to a bank or financial institution.

Financial shock absorber

A financial shock absorber option basically refers to an interest rate linked to the prime rate (the variable interest rate at which a bank borrows from another bank) combined with a fixed or capped monthly installment. The impact of any prime rate variation is postponed until the very last installment becomes due at the end of the agreement.

Where the prime rate is to be increased, the consumers' monthly installments will remain unchanged but the final installment will be inflated in order to compensate for the rate change. Conversely, where the prime rate is to be decreased, the final installment will be decreased by the appropriate amount, which could result in a very minor or even a zero final installment becoming due at the end of the finance agreement (Campbell & Logan, 2008). The major benefits to the consumer associated with the financial shock absorber option are that:

- the consumer benefits from decreasing interest rates as the interest rate applicable to the credit agreement is adjusted accordingly; and
- unexpected prime rate increases can be budgeted for, thus resulting in an improved cash flow position for the consumer.

Payment holiday option

The payment holiday option allows a consumer to specify a month in the year where no installment would become due. The installment that would normally have been due in that specific month is spread evenly over the remaining period left on the credit agreement (Campbell & Logan, 2008). This allows the consumer to take a respite in cash-strapped periods or to apply the funds that would normally have been used for the installment towards any other obligation.

Comparison of balloon payment, fixed interest and installment sale agreement car finance options

The table below compares the balloon payment and the fixed interest car finance options based on scheduled monthly installments, interest rates, required minimum deposits, car purchase deal closure amounts and total repayments.

Table 1: Comparison of car finance options

Balloon payment						
Retail price	Interest rate	Deposit	Term	Balloon	Monthly installment	Total repayment
R363 990	8.28%	17% R61 878	60 Months	R127 397	R3 999	R429 215
Fixed interest rate						
Retail price	Interest rate	Deposit	Term	Final payment	Monthly installment	Total repayment
R363 990	8.28%	17% R61 878	60 Months	R108 960	R3 942.36	R407 380
Installment sale agreement						
Retail price	Interest rate	Deposit	Term	Final payment	Monthly installment	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]

In 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 installment 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 installment, the installment sale agreement attracts the highest installment due to nil final settlement payment required at the end of the contract. Balloon payment requires a relatively higher monthly installment 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).

The need for credit regulation

In the past, consumer credit was not given as much consideration as currently (Alferoff & Signoretta, 2004). Wirtz (2009) stated that the ease of access to credit facilities in the past largely resulted in many consumers entering into debt recklessly. A lack of sound lending criteria for credit facilities that were not priced optimally in line with the underlying risks was seen to be the cause of the financial difficulties experienced in most countries in world (Wirtz, 2009). Bobo (2007:34) indicates that the application of credit has therefore to be conducted responsibly in order to prevent regulation from impacting negatively on the efficient functioning of financial institutions. This is consistent with the findings reported by Falkena *et al.* (2001) that properly constructed regulation reinforces the efficient functioning of markets.

Ineffective credit regulation standards for borrowers have been regarded to be among the primary reasons that caused financial markets to experience difficulties in previous years (Jamine, 2007). The Basel Committee on Banking Supervision (2010) indicates that in order for financial institutions like banks to operate efficiently, they need to operate under well-defined sound credit-lending criteria. The credit criteria should also clearly indicate who could be eligible for credit, the category under which the credit falls, how much could be granted and the terms and conditions. Hence, it is imperative that financial institutions obtain sufficient information in order to adequately assess a borrowers' risk profile.

Danielsson, Goodhart and Shin (2002) argue that financial institutions relied too heavily on credit ratings provided by rating agencies that undertake credit assessments. These agencies have been shown to provide conflicting and inconsistent forecasts of consumers' creditworthiness as they are unregulated and the quality of their risk estimates are largely unobserved. Barron (2007) indicates that a credit operation should be responsive to both internal and external forces acting upon it. This can be confirmed by the tightening up of credit requirements by most banks across the USA in response to the market signals of the credit crunch that emerged in mid-September 2008.

Higher collateral requirements, increased interest rates and shorter repayment periods commonly resulted in more documentation and higher upfront down payments. More questions were raised and overall turnaround times increased significantly. As a result of the increased focus on credit standards, credit institutions reported more applications from customers who had conventionally banked with other financial institutions previously (EIU, 2008).

In the USA, Wirtz (2009) reported that a financial institution survey conducted by the Federal Reserve Bank of Minneapolis found that banks and other financial institutions were not necessarily short of capital to lend, but that borrowers were more reluctant to apply for credit as their uncertainty about what the future would hold for them increased. That uncertainty, coupled with higher credit standards, led to substantial declines in credit facilities granted in the economy. According to Stigler (2007), the classical assumption on protecting consumers argues that efficient markets are much more effective than formal regulations. Critics of this theory propose that retail financial services are not efficient since there are cases of market failures due to an absence of information, a lack of financial literacy by buyers, and information asymmetry between providers and purchasers. It therefore appeared to be a case for taking action and introducing statutory regulation in monitoring and governing retail financial services (Richards *et al*., 2007). Most lenders in the UK were affiliated to voluntary trade associations, for instance, the Association for Payment Clearing Services and the British Bankers' Association, whereby they committed themselves to follow those associations' codes of conduct. However, Cowton (2008) found that not all lenders were interested in following the prescribed responsible lending practices. Thus, formal legislation rather than self-regulation was deemed to be desirable (Cowton, 2008).

On the other hand, those in favour of a higher level of social equality argued that a less regulated credit environment allows consumers in lower income brackets to access overdraft and credit facilities. It enables them to obtain funds that could be applied towards academic studies, which would improve their employability levels, thus allowing them to break free from the poverty trap (Richards *et al*., 2007). It is also argued that the first principle of social policy should be to treat users of consumer credit as adults who are entirely capable of managing their own financial affairs, and not to restrict their freedom of access to it in order to protect the relatively small minority who get into difficulties (Crowther Committee Report, 1971). Ironfield-Smith *et al.* (2005) found that, with the changes taking place in the global credit economy, the increase in those consumers with real difficulties and who were unable to service their loan payments suggested that some form of sound credit lending regulation might be required to protect vulnerable groups.

Principles of credit regulation

Falkena, Bamber, Llewellyn and Store (2001) define the term "regulation" as a generic term encompassing: Regulation (the establishment of specific rules of behaviour); Monitoring (observing whether the rules are obeyed); Supervision (the more general observation of the behaviour of financial firms) and Enforcement (ensuring the rules are obeyed).

A major argument for financial regulation has been centred in market imperfections and market failures. Information problems, externalities, conflicts of interest and agency problems highlight the fact that financial services do not operate in a perfectly competitive market. Consumers frequently possess insufficient information, and, as such, are not as well informed about all repercussions of the possible decisions they make. Additionally, not all consumers have the ability to assess the quality of offerings, as most financial products are technical in nature. According to Jamine (2008), the ultimate rationale for the aspect of regulation designed to protect the consumer is to correct market imperfections or market failures that would compromise consumer welfare in a regulation-free environment.

According to Cokayne (2007), one of the major hazards in the financial services industry has been the gridlock problem. Many financial institutions are aware of what is expected of them and how they should conduct business from a corporate governance point of view. The problem is that they are not always convinced that other competitors in the market will operate along ethical lines. In a bid to maintain their market share, some organisations may be induced to adopt perilous strategies (Cokayne, 2007). The role of financial regulation in this instance is therefore to set certain minimum standards that all organisations in the sector must adhere to and that can be applied equally to all competitors. Thus, regulation could have the positive and beneficial effect of breaking the gridlock by offering a guarantee that all participants will behave in accordance with certain standards (Falkena *et al*., 2001). Regulation does not have to impact negatively on competition between financial organisations.

In as far as consumer protection extends, additional financial regulatory objectives strive to impart dimensions of integrity and fairness to financial institutions in their dealings with customers, and enhance competence through designing and implementing suitable, fit and proper standards for directors, management and staff to enhance compliance. Ultimately, the regulatory goals aim to instil a dimension of transparency and disclosure in a manner that makes adequate information about financial services and products and the institutions that provide them available to consumers (Cokayne, 2007).

In practice, consumers are usually not in a position to judge the safety and soundness of financial institutions. Prudential regulation operates in protection of consumers against imperfect market information asymmetry, agency problems associated with the nature of financial institutions' business, and the rent-seeking behaviour of most financial institutions. Therefore, prudential regulation of financial markets is essential, as no amount of information that comes available to the consumer after an agreement has been concluded can protect consumers against the subsequent behaviour of the financial institution (Houghton, 2008).

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).

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 provides information on the above indicators for selected major economies in the world.

Table 2: 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
India	Consumer Protection Act (1986)	3.9	5
Brazil	Consumer Protection Code (1990)	3.2	5
South Africa	Consumer Protection Act (2008)	4.2	6
New Zealand	Credit Controls &Consumer Finance Act (2003)	4.8	5

Source: World Bank (2014)

As shown in Table 2, Brazil is a country with relatively hard access to credit. In the middle band, South Africa (score = 4.2) and India (score = 3.9) have moderate access to credit. In the upper band, United Kingdom, United States of America and New Zealand demonstrate equal levels (score = 4.8) of access to credit. Regarding the credit depth of information, all countries covered in the analysis demonstrate high availability of credit information in their economies.

The NCA and motor finance

According to NAAMSA (2009:2), the sharp decline in consumer and business spending on new vehicles in South Africa in 2009 was a reflection of high interest rates, compounded by the inability of many customers to obtain vehicle finance. The implementation of the NCA in June 2007 changed the motor finance sector landscape significantly. Cokayne (2007) reported that motor industry analysts, motor manufacturers and retailers, and finance providers regarded the NCA as a more effective tool for the control of credit demand than interest rate increases because it only affects new credit applicants and does not influence the marginal cost of credit.

Chris de Kock (2009), the then executive head of sales and marketing at WesBank, indicated that WesBank had also recorded a decline in the number of applications being made for motor finance in the period concerned. WesBank, which uses an index to report on the number of applications received, reported that as at June 2006, the index figure was 100 and

in March 2007 it rose to as high as 110. Since the inception of the NCA in June 2007, the index figure dropped significantly and as at July 2008, it was recorded around the 90 benchmark (Houghton, 2008).
As opposed to the above, Marcel de Klerk from Absa Vehicle & Asset Finance (2009) states that certain sections of the NCA makes motor finance easier to come by because it allows motor finance agreements to be concluded over longer terms; namely 72 months or even 84 months, instead of the maximum 54 months previously allowed by the Credit Agreements Act.

In this regard, De Klerk (2009) is of the opinion that the NCA does not necessarily do enough "to educate the consumer as to the implications of stretching the motor finance agreement to its maximum term". As less capital is settled with each installment, the longer the motor vehicle repayment period, the higher is the ultimate cost of the vehicle (Summet TV, 2007). Therefore, consumer education is regarded as a critical element of the overall strategy to market complex services and in the context of particular groups of consumers (Burton, 2002a; 2002b). In the UK, many educational initiatives are directed at young people in formal education environments (Knights, Sturdy, & Morgan, 1994).

Consumers who make use of the option to finance a motor vehicle over these extended periods are considered as mostly marginal applicants for whom the only way to obtain the required motor finance and to qualify for the vehicle applied for is to conclude the finance over a contract term of 84 months. From a consumer protection point of view, which is ultimately the main aim of the NCA, these extended finance terms do not match up with the optimal economic life of the asset. De Klerk (2009) states that, at an average annual rate of 25 000 kilometers, it implies that in six years the vehicle would have covered 150 000 kilometers, which would be well outside the warranty. This is so because it would cost huge sums of money to maintain the outstanding balloon payment due by the customer (Furlonger, 2008:2). Haughton (2008) indicates that the inclining point, which is the stage where the value of the motor vehicle would cover the outstanding balance on the motor finance agreement, is at 31 months for a 48-month contract term and at 57 months for a 72-month agreement.

In this respect, such an effect would not impact on the consumer alone, but it would also have a profound impact on the motor industry as a whole, as it would result in a decline of the average replacement frequency of passenger vehicles. Karl Bauermeister (2008) of Standard Bank Vehicle and Asset Finance states that the fact that the number of applicants for vehicle finance who do not qualify for financing is 15% higher than before the introduction of the NCA demonstrates prudent lending by financing institutions, which is a clear signal of the protection of consumers (Van Vuuren, 2008:1). Another benefit of the NCA, highlighted by Bauermeister (2008), is that it resulted in increased competition between banks and finance houses. This increased competition favours the consumer, as the financing institutions are now differentiated from one another by the structure of their financial products. The NCA also created an opportunity for consumers who had previously not been able to afford purchasing a vehicle because they did not have the minimum 10% deposit, as prescribed by the Credit Agreements Act, despite being able to afford the monthly installments. This option had previously been available only to those consumers who received a car allowance (Cokayne, 2007).

OBJECTIVES AND RESEARCH DESIGN

Previous section addressed the credit regulation systems of selected major world economies by country, coupled with recent reviews of levels of ease of access to credit, depth of credit information and a comparison of car purchase finance methods. For 2013, Brazil recorded relatively hard access to credit, while South Africa and India recorded moderate access to credit. The United Kingdom, United States of America and New Zealand demonstrated equally high levels of access to credit, while credit information availability was high in all countries. With regard to purchase options, the balloon payment option was the most expensive method in terms of the total repayment compared to other finance options. Consumers should carefully consider what they would do if they were to become unable to refinance their cars at better rates at the end of the loan contract, as they would still be liable for the balloon payment.

Given the above background, the following research objectives were considered:

- to measure customer understanding of the NCA in relation to entering into a balloon payment contract as a method to finance vehicles;
- to assess the modes used in educating customers with regard to the purchase of vehicles using balloon payment; and
- to assess the alignment of balloon payments offered to customers within the provisions of the NCA.

Sample and sampling procedure

In this study, the sample size comprised 78 first time car buyers who used balloon finance method in Pretoria; out of which 71 of the participants provided valid and fully completed responses. The simple random sampling technique was used to select research participants.

Questionnaire design

A self-administered structured questionnaire was used as the primary data collection instrument for this research study. The questionnaire was handed to the relevant participants together with a letter containing confirmation of the purpose, ethical considerations of confidentiality and the assurance that the anonymity of participants would be guaranteed. The questionnaire was based on the five-point Likert scale.

The questionnaire used for data collection had four sections dealing with biographic information of the participants; understanding of the NCA in relation to the provisions of the balloon car loan; consumer education modes on vehicle purchase using balloon payment and alignment of balloon car loan with the provisions of the NCA. The four sections are reported below.

Section A: Biographical information

A1. What is your gender?			Male	Female
A2. Age				
A3. What is your **highest** educational qualification?				
Matric/Below	Diploma	Bachelor's degree	Honours degree	Master's/PhD
A4. To which of the following **categories of employment** do you belong?				
Permanent	Fixed-term	Temporary	Self-employed	

Section B and C

B.	**Understanding of the National Credit Act in relation to the provision of the balloon car loan**
B1.	To what extent do you consider the NCA provisions on balloon payment car loans to be easily understandable?
B2.	The car balloon payment issues are adequately dealt with in the NCA.
B3.	The formal terms related to car balloon payment in the NCA are easily

	understandable.
B4.	The provisions of the NCA on consumer credit are easily understandable.
B5.	Are the different consumer credit plans contained in the NCA clearly explained?
B6.	To what extent do you understand that the NCA provides for up to 84-month finance contracts as opposed to the previous maximum of 54 months?
B7.	To what extent do you understand that the bank is the official owner of the leased car during the period of the contract?
B8.	To what extent do you understand that once the lease is up, you have to pay the remaining balance in full or obtain new finance?
B9.	To what extent do you understand that if your credit rating is bad at the expiry of the lease, the bank might not finance the car?
B10.	To what extent do you understand that if you fail to meet the obligations of the balloon payment, the car will be repossessed by the bank?
C.	**Indicate the extent to which each of the following *consumer education modes* has provided knowledge to you on vehicle purchase using balloon payment:**
C1.	SA Debt Counselling forums
C2.	National Consumer Forum programmes
C3.	SA National Consumer Union forums
C4.	Provincial Consumer Affairs Offices programmes
C5.	Credit marketing and advertising
C6.	Television and radio consumer awareness programmes
C7.	Other (specify and indicate the relative extent)
D.	**Indicate the extent to which each of the following provisions applied in the balloon car loan are *aligned* with the provisions of the NCA:**
D1.	To what extent do you understand that the tenure of the balloon car loan can be negotiable within the provisions of the NCA?
D2.	To what extent are you aware that the amount of deposit paid determines the installment to be made or the amount of the balance?
D3.	To what extent do you understand that during the loan term, most of the payment goes towards interest instead of to paying the principal debt?
D4.	To what extent are you aware that balloon car loans are structured to reduce monthly

	payments by shifting a huge portion of the loan to one final payment?

The questionnaire was physically distributed to the participants. The structure of the questionnaire was explained to participants in terms of the information it contained and the recommended expected time for completion and return of the questionnaires for data capturing and analysis. Based on the Likert scale, the respondents were requested to respond to questions raised on every construct specified in the questionnaire. The rationale for delivering the questionnaires physically to research participants was to ensure that the questionnaires were handed to the participants to yield an effective response rate. To determine the degree to which the chosen set of items measured a single unidimensional latent construct, the internal consistency (scale reliability) of the questionnaire items was examined based on the Cronbach's alpha criterion. The value of Cronbach's alpha (= 0.709) indicated that the survey instrument's items were statistically reliable; thus the items measured a single unidimensional latent construct.

The structural validity of the measurement tool was examined using factor analysis in which total correlation analysis of items was evaluated. Prior to conducting factor analysis, the Keiser-Meyer-Olkin (KMO = 0.655) analysis was undertaken to determine suitability of the size of sampling for factor analysis.

The Bartlett's test of sphericity of the research items of 680.238 ($p < 0.05$) confirmed that factor analysis could be performed on the data. Moreover, the determinant of 0.268 also indicated that the scale observed was one-dimensional; thus the items were not an identity matrix.

Principal component analysis was performed. The total variance explained by each component extracted was as follows: The first principal component (Component 1) accounted for 24% of the total variance while the second, third, fourth, fifth, sixth, seventh and eighth principal components (Components 2, 3, 4, 5, 6, 7 and 8) accounted for 11%, 8%, 7%, 6%, 5%, 5% and 4% respectively. Together, the eight principal components cumulatively explained 71% of the variation in the data set.

RESULTS AND ANALYSIS

Demographic profile

Of the 71 respondents surveyed in the study, approximately 34% were males and 66% were females. The composition of the gender variable reflects that female respondents constituted more than 50% of the sample. The modal age group explored in the study comprised respondents aged between 30 and 34 years. Nearly 49% of the respondents fell in this age group, followed by about 20% aged between 40 and 44 years. Approximately 17% were aged between 35 and 39 years. The smallest age group comprised respondents aged between 25 and 29 years. This group accounted for only 6% of the sample used in the study.

Regarding educational qualifications, 75% of the respondents surveyed had diplomas, followed by those who had bachelor's degrees, accounting for nearly 17% of the sample. Respondents who had honours degrees accounted for only 6%, while those who had a matric certificates or below accounted for 3% of the sample. Approximately 9% of the respondents surveyed were aged 45 years and above.

About 41% of the participants surveyed were employed on a permanent basis, followed by approximately 23% who were employed on fixed-term contracts. The remaining 37% comprised 17% temporarily employed and 20% self-employed respondents.

Understanding of the National Credit Act in relation to the provisions of the balloon payment car loan

This section discusses the response regarding the extent to which respondents understood the National Credit Act in relation to the provisions of the balloon payment car loan. Table 3 shows the average scores for each variables measured and its standard deviation for N=71.

Table3 showing average scores

Variable	**Mean**	**SD**	**Variable**	**Mean**	**SD**
B1	1.44	.579	B6	1.24	.492
B2	1.30	.490	B7	3.76	1.259
B3	1.62	.663	B8	1.15	.467
B4	1.42	.525	B9	1.41	.667
B5	1.46	.651	B10	2.92	1.350

Tenure of balloon car loan(B1)

Of the sample surveyed, only 35.2% indicated that such NCA provisions on the balloon car payment loan were easily understandable and nearly 61% of the respondents indicated that the NCA provisions on the balloon car payment loan were to no extent easily understandable.

Only 4% revealed that they understood the NCA provisions on the balloon car loan. Overall, the results show that car buyers did not understand the NCA in relation to the tenure of the balloon payment car loan with an average score of 1.44 on 5.0 point scale.

Car balloon payment issues(B2)

Nearly 72% of the respondents revealed that the car balloon payment issues dealt with in the NCA were to no extent adequately covered, while only 27% stated that such car balloon payment issues were adequately covered to a small extent. Quite insignificantly, only 1% of the respondents perceived that car balloon payment issues were adequately dealt with in the NCA only to a moderate extent. Based on the results, respondents perceived that car balloon payment issues were on average not adequately dealt with in the NCA. The average score for the respondents was 1.30, which further confirms that car balloon payment issues were not dealt with in the NCA.

Formal terms of car balloon payment (B3)

Regarding formal terms, the majority of the respondents indicated that the formal terms of car balloon payment in the NCA were not easily understandable. Of the surveyed sample, 48% indicated that formal terms of car balloon payment in the NCA were to no extent easily understandable. Moreover, 42% perceived that the respective formal terms were to a small extent easily understandable, while only 10% revealed that the terms were not easily understandable. The average score of 1.62 from 71 respondents further confirms this finding.

NCA provisions on consumer credit (B4)

Nearly 59% of the respondents indicated that the NCA provisions on consumer credit were to no extent easily understandable, while 39% indicated that the provisions were to a small extent easily understandable. On average, the NCA provisions were not easily understandable (average score of 1.42).

Credit plans (B5)

In respect of credit plans, 61% of the participants revealed that different consumer credit plans contained in the NCA were to no extent clearly explained. Moreover, 34% indicated that consumer credit plans were clearly explained only to a small extent; and only 4% perceived that the credit plans contained in the NCA were to a moderate extent clearly explained. On average, respondents perceived that different credit plans in the NCA were not clearly explained supported by average score of 1.46.

Tenure of contracts (B6)

In the dimension of tenure, 79% of the respondents revealed that they were to no extent knowledgeable that the NCA provides for up to 84-month contracts, as opposed to the 54 months generally known by the majority. Only 18% of the participants revealed that they were aware, but only to a small extent that the NCA provides for up to 84-month contracts; longer contracts than the generally known 54-month contracts. The results indicated that car buyers generally were not aware that the tenure of car balloon contracts was increased by the NCA from 54 months up to 84 months. This is supported by average score of 1,24.

Official owner of the leased car (B7)

Approximately 76% of the respondents revealed that they were aware that the bank remains the official owner of the leased car during the balloon payment contract and 47% were aware to a large extent, while 30% were to a very large extent aware that the bank remains the official owner of the leased car. With an average score of 3.76, it can be concluded that results showed that respondents were aware of leased cars' ownership.

Lease expiry (B8)

Furthermore, 87% of the participants surveyed in the study revealed that they were to no extent aware that, upon lease expiry, either full payment of the remaining balance or new finance is required to finance the car, while only 11% indicated that they were aware of that condition. Overall, the results revealed that buyers of cars through balloon payment were to a large extent unaware that either cash or new finance was required upon expiry of the lease. The average score from the respondents was 1.15, thus supporting this finding.

Bad credit rating (B9)

Nearly 68% of the survey respondents indicated that they were to no extent aware that bad credit rating upon lease expiry might cause the bank not to refinance the car. Additionally, only 25% were to a small extent aware of the possibility of such action by the bank. Regarding the condition that failure to meet obligations of balloon payment leads the bank to repossess the car, 20% were to no extent aware of it, while 21% were to a large extent aware of that condition. With average score of 1.41, the results revealed that car buyers were generally unaware of such implications of a bad credit rating.

Car repossession (B10)

Nearly 20% of the respondents revealed that they to no extent understood that failure to meet the obligations of the balloon payment leads to repossession of the car, while 21% were aware to a small extent, and 21% were aware to a moderate extent that balloon payment failure by the car buyers leads the bank to repossess the leased car. Furthermore, nearly 24% revealed that they were to a large extent aware that failure to pay the installment causes repossession by the bank. Lastly, 14% of the respondents indicated that they were aware of such a condition. The average score of 2.92 indicates that respondents were aware that failures to meet obligations will lead to repossession of their cars.

In conclusion and based on scores, it is revealed that the respondents surveyed in the study did not understand the National Credit Act in relation to the provisions of the balloon car loan except that the failure to meet the obligations of balloon payment leads the bank to repossess the leased car and that the bank remains the official owner of the leased car during the balloon contract.

Consumer education modes on vehicle purchase using balloon payment

This section discusses the responses regarding the extent to which each of the given consumer education modes provided knowledge on vehicle purchase using balloon payment. Table 4 shows the average scores for each variables measured and its standard deviation for N=71.

Table4 showing average scores

Variable	**Mean**	**SD**
C1	1.89	.934
C2	1.35	.563
C3	1.15	.467
C4	1.20	.496
C5	1.99	.765
C6	1.77	.814

SA debt counselling forums (C1)

From the sample surveyed, 39% of the respondents viewed that the South African debt counselling forums to no extent provided knowledge to them on vehicle purchase using balloon payment, while 42% indicated that the respective debt forums provided such knowledge only to a small extent. Lastly, only 9% indicated that those forums provided knowledge to a moderate extent on vehicle purchase using balloon payment, while 10% indicated that the forums provided such knowledge to them. The average score of 1.89 supports the fact that respondents believed that SA debt counselling forums provided very little knowledge to the customers.

National Consumer forums (C2)

Nearly 69% of the respondents revealed that national consumer forum programmes to no extent provided knowledge on vehicle purchase using balloon payment. Furthermore, 27% perceived that those programmes educated consumers on car purchase using balloon payment to a small extent, while 4% indicated that the forums provided such knowledge to a moderate extent. This was supported by average score of 1.35.

SA National Consumer Union forums (C3)

Nearly 87% of the respondents showed that South African National Consumer Union forums to no extent provided knowledge to customers. Additionally, 11% indicated that the respective forums educated consumers to a small extent on car purchase using balloon payment. The results with an average score of 1.15 revealed that National Consumer Union forums were not an effective mode for educating car buyers with knowledge on car purchase using the car balloon payment method.

Provincial Consumer Affairs Offices programmes (C4)

Nearly 83% of the respondents indicated that Provincial Consumer Affairs Offices programmes provided the knowledge under discussion to no extent. Moreover, 16% revealed that the respective offices' programmes provided consumers with knowledge on car purchase using balloon payment to a small extent only. With an average score respondent score of 1.20, Provincial Affairs offices' programmes were not perceived to provide effective consumer education on car purchase using the balloon payment method.

Credit marketing and advertising (C5)

Comparatively, credit marketing and advertising did not effectively provide consumers with knowledge on car purchase using the balloon payment option. Based on the results, 30% of the respondents revealed that credit marketing and advertising to no extent provided such knowledge, while 42% indicated that credit marketing and advertising to a small extent provided car buyers with knowledge on car purchase using balloon payment. Lastly, nearly 28% perceived that the mode under discussion provided consumers with knowledge of car purchase using balloon payment to a moderate extent. Average respondents score of 1.99 further supports this finding.

Television and radio programmes(C6)

Nearly 45% of the respondents revealed that television and radio consumer awareness programmes to no extent provided relevant knowledge on balloon car purchase, while 34% indicated that those programmes provided such knowledge to a small extent. Moreover, 20% revealed that the respective programmes provided as a consumer education mode on car purchase using balloon payment method only to a moderate extent. The results on average score of 1.77 revealed that television and radio consumer awareness programmes were not effective consumer education modes for the provision of knowledge on car purchase using balloon payment.

In conclusion, the results indicated that the respective consumer education modes to no extent provided respondents with knowledge on vehicle purchase using the balloon payment method. Only the South African debt counseling forums, credit marketing, advertising and television and radio consumer awareness programmes provided such knowledge on car purchase using the balloon payment method to some extent, with the final average score of 1.56.

Alignment of balloon car loan with the provisions of the NCA

This section summerises responses regarding the respondents' perceptions of the extent to which provisions applied in the balloon car loan agreement were aligned with the provisions of the NCA. Table 5 shows the average scores for each variables measured and its standard deviation for N=71.

Table 5 showing average scores

Variable	**Mean**	**SD**
D1	1.27	.608
D2	2.93	1.060
D3	1.08	.280
D4	1.31	.667

Tenure of balloon car loan (D1)

Of the respondents, 78% indicated that they did not understand that the tenure of the balloon car loan contract could be negotiated. Furthermore, 21% indicated that they were to a small extent that the tenure of the balloon car loan contract was negotiable within the provisions of the NCA. Further, based on the average score of 1.27, consumers perceived that negotiability of the tenure of the balloon car loan contract was not clearly aligned with the provisions of the NCA.

Deposit and installment(D2)

Approximately 23% of the respondents were aware to a large extent that the amount of deposit paid determines the monthly installment to be paid or the amount of the remaining balance due for settlement, while 27% were aware to a small extent. Nearly 35% of the respondents revealed that they were aware to a moderate extent that the amount of deposit paid determines the monthly installment to be paid or the amount of the remaining balance due for settlement. The results, supported by average score of 2.93, revealed that consumers were aware of the link between the deposit paid and the settlement amount required at the end of the balloon contract.

Payment, interest and principal debt (D3)

Quite significantly, 92% of the respondents indicated that they were to no extent aware that, during the loan term, a huge payment goes towards the interest rather than the principal debt, while the remaining 9% revealed that they were aware to a small extent of this condition. The results clearly indicated that consumers were not familiar with the existence of this condition supported by average score of 1.08 for this item.

Car loans structure (D4)

Marginally more than three-quarters (76%) of the respondents surveyed indicated that they were to no extent aware that balloon car loans are structured to reduce monthly payments by shifting a huge portion of the loan to one final payment. Additionally, nearly 20% of the respondents were aware to a small extent of the existence of this condition. The average score of 1.31 suggests that respondents were not aware of car loan structure.

Summary of key findings

Overall, the results of the above analysis revealed that, with regard to understanding the National Credit Act in relation to the provisions of the balloon car loan method, the majority of the respondents did not understand (average score of 1.77) the National Credit Act in terms of the provisions of the balloon car loan plan. Moreover, respondents only understood to a moderate extent that failure to meet the obligations of balloon payment leads the bank to repossess the car. The only provision in the NCA that respondents indicated they understood very well was that the bank remains the official owner of the leased car during the balloon contract.

The study also revealed (average score 1.56) that various education modes were not effective in disseminating the balloon car payment information. Further most of the provisions applied in the balloon car loan were not aligned with the provisions of the NCA Act.

Relationships between demographics profiles and variables studied:

The chi-square degree of association results revealed that there were no statistically significant relationships between gender and level of understanding of NCA provisions in relation to the provision of the balloon car loan. Similarly, the results revealed no evidence to claim that there were statistically significant relationships between gender and car buyers' perceptions of the extent to which balloon car loan provisions were aligned with the provisions of the National Credit Act. Further results revealed that there was no evidence to suggest that there were statistically significant relationships between educational qualification and levels of understanding NCA provisions in relation to the provisions of the balloon car loan. In conclusion the demographics profiles of respondents did not had any relationship with the variables tested under the study.

CONCLUSIONS

This study found that the majority of participants surveyed in the study showed that they did not understand the NCA in relation to the provisions of the balloon car loan plan. Such results are consistent with the observation by 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. Moreover, it was only to a moderate extent that the respondents understood that failure to meet the obligations of balloon payment leads the bank to repossess the leased car. This finding supports the finding reported by De Kock (2011) that since the introduction of the NCA in June 2007 nearly 65% of the customers have either failed to make final installments for their cars or have had their cars confiscated by banks.

The only provision in the NCA that respondents indicated they understood very well was that the bank remains the official owner of the leased motor vehicle during the entire tenure of the balloon contract. Generally, the findings revealed that consumers who purchased motor vehicles using balloon payment did not understand the NCA in relation to the provisions of the balloon payment method. Consistent with NAAMSA comment (2009), the findings also indicated that the sharp decline in consumer and business spending on motor vehicle purchases in South Africa was a reflection of high interest rates, compounded by the inability of many customers to obtain vehicle finance.

Regarding consumer education modes used to provide knowledge to customers on vehicle purchases using the balloon payment plan, the respondents indicated that the educational methods covered in this study did not provide balloon payment car buyers with knowledge of vehicle purchases using balloon payments. Only the South African Debt Counselling forums, credit marketing, advertising, television, and radio consumer awareness programmes provided such knowledge, but only to a small extent. In respect of credit marketing, the results provided some support to the assertion by De Kock (2011) that the NCA is associated with a certain lack of protection of the consumer with regard to undesirable advertising practices. To minimise the danger of trapping consumers in debt, the credit regulation authorities should place stringent restrictions on advertisements to prevent prospective borrowers from being enticed to enter into burdensome loan contracts by attractive advertisements offering easy terms.

Based on the results reported above, the results clearly reveal that the consumer education modes used in educating customers with regard to purchasing of vehicles using balloon payment are primarily dominated by credit providers' interpretation of the balloon payment contract. This clearly indicates that customers entering into balloon payment contracts to purchase vehicles are not being sufficiently educated to make informed decisions prior to purchasing vehicles by means of balloon payments.

With respect to the extent to which each of the provisions contained in the balloon car loan are aligned with the provisions of the National Credit Act, the respondents indicated that majority were not aware that the tenure of the balloon car loan contract could be negotiable. The respondents also to no extent understood that a substantial portion of the payment goes towards interest rather than to the principal debt amount during the loan term. Lastly, the respondents indicated that they were to no extent aware that balloon car loans are structured to reduce monthly payments and shift a huge portion of the amount due to one final payment. In general terms, this reveals that more provisions of the car balloon payment plan exist that are not clearly aligned with the provisions of the National Credit Act.

Following the conclusions about the main findings discussed above, the results from this study contributed significantly to the existing body of knowledge on the purchase of motor vehicles using balloon finance in relation to the provisions of the NCA. Furthermore, the findings generated new insights about the factors determining customers' level of understanding of all the contractual obligations integrated with the financing of motor vehicle purchases using balloon payment plans. This study will help lending institutions, customers and regulators in improving the current status of car finance industry in South Africa which is marked with high default rate.

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