

Accessing formal financing by Small and Medium Enterprises in Zimbabwe: The case of SMEs and banks in Chiredzi Urban.

Sailas Hussein Matamanda

Faculty of Law and Commerce
Zimbabwe Open University
Box 1210, Masvingo Zimbabwe
Email: smatamanda@gmail.com,
Cell: +263 773 555908

Clainos Chidoko

Department of Economics
Great Zimbabwe University
Box 1235, Masvingo, Zimbabwe
Email: cchidoko@gmail.com,
Cell: +263 773 570 327

Abstract:

The purpose of the study was to evaluate the barriers faced by small and Medium Enterprises (SMEs) in accessing financing from banks and to identify possible solutions. The study was necessitated by the observed failure of SMEs to grow and develop into larger profitable enterprises, despite their immense contribution to economic growth. Data collection was done through key informant interviews, comprehensive analysis of secondary sources and field surveys. It emerged from the study that the biggest barriers to SME financing are lack of collateral, a small equity base and information asymmetry. The study recommends that banks and SMEs must form alliances and strategic partnerships to formulate solutions that will remove barriers and improve SME access to financing. Also, the government of Zimbabwe must adequately fund the Ministry of Micro, Small and Medium Enterprises and Co-operative Development (MMSMECD) so that it can fulfill its mandate of supporting SMEs.

Key words: Barriers, SMEs, Banks, growth, development, financing

1. Introduction:

It is universally accepted and acknowledged that Small and Medium Enterprises (SMEs) serve as effective instruments of employment creation as well as economic growth, which eventually lead to poverty alleviation not only for the entrepreneurs themselves but for the employees as well (Maunganidze, 2013). Examples are shown from the statistics on SMEs in Europe which indicate that 99.8% of all European businesses are SMEs which generate around 58% of the gross value added of the corporate sector in Europe. Therefore, national governments that are serious about their country's economic growth and development have made pragmatic commitments and steps towards enhancing SME's growth and performance. A case to note is the commitment made by the Egyptian government to introduce a stock exchange for SMEs with the intention of boosting the financial base of SMEs so that they can be in a position to raise capital and improve on the quality of their products (Maunganidze, 2013). He further observes that Zimbabwean government is no exception, as evident from the commissioning of the Ministry of Micro, Small and Medium Enterprise and Corporate Development and the Small Enterprises Development Corporation (SEDCO) which shows a great deal of commitment on the part of the government on the establishment and development of SMEs. However, despite such commitment from the government the post dollarization era in Zimbabwe has seen SMEs facing a number of obstacles in accessing funding (SME Association of Zimbabwe, 2016). This

situation thus stifles the success of SMEs in boosting the local economic development in the country. The study focused on the barriers faced by SMEs in Chiredzi urban area in Zimbabwe as they seek financial support to augment their business operations.

1.1 What are Small and Medium Enterprises (SMEs)?

SMEs are businesses that are basically privately owned and operated, with a small number of personnel, and a relatively low volume of sales (Nkuah et al., 2013). Accordingly SMEs are those companies that fulfill at least two out of three maximum requirements for employees, assets, or annual sales as defined by the Reserve Bank of Zimbabwe in the 2013 Monetary Policy Statement, their main characteristics being an asset base between \$10 000 to \$2 million US dollars, employing 5 to 75 people and having an annual turnover of \$30 000 to \$5 million US dollars. According to Manyani (2014), SEDCO (2010) has defined a small and medium enterprise as a firm that has not more than hundred employees and maximum annual sales turnover of US\$830 000.

In Zimbabwe, legally the Ministry of Small Medium Enterprise Cooperation defines a small enterprise as a business that employs not more than 50 employees while operating as a registered entity and a medium enterprise as one employing up to 75 and 100 people (et al., 2016). For the purposes of this research study, the criterion used is the number of employees since other variables were rendered useless by the hyperinflationary environment and the serious undervaluation of assets following the dollarization of the Zimbabwean economy (Nyamwanza, 2014).

1.2 Statement of the problem:

The commercial banks in Zimbabwe are committed at least to some degree to the growth and development of the economy through supporting SME's by lending to them. This is in spite of constraints such as stringent bank requirements for loans, poor government support in terms of loan repayment and uncoordinated business plans leading to non bankable projects by SMEs. Past research (Chimucheka, 2011; Manyani, 2014; Gombarume and Mavhundutse, 2014) has only explored these constraints from the SME's perspective. No research, to our knowledge, in Zimbabwe has yet explored and included in its study the perspectives of both borrowers (SMEs) and lenders (banks and financial institutions).

This phenomenon gives impetus for this research to address the issues of lack of comprehensive evidence of what makes a wholesome platform where barriers hindering SMEs from accessing financing from Commercial banks in Zimbabwe are empirically assessed; and the absence of a framework that integrates all barriers and constraints confronting SMEs from the perspectives of both banks and SMEs.

1.3 Objectives of the study:

In light of the problem given above the study has the following objective;

- To explore the legislative, statutory and institutional policies and documents guiding the financial sector with regards lending of funds to SMEs in Zimbabwe.
- To identify and appraise the sources of finance available for SMEs in Chiredzi and the requirements for these SMEs to be liable to borrow.
- To suggest solutions that may be adopted to overcome the barriers so as to facilitate the efficiency of SMEs in accessing funds.

1.4 Motivation of the study:

This study was necessitated by the desire to provide a framework on which policy interventions can be formulated by nongovernmental partners and state agencies regarding SME financing in Zimbabwe, through integrating perspectives from lenders and borrowers on barriers to SME financing.

1.5 Significance of the Study:

The study is useful and beneficial to SMEs, banks and other financial institutions and relevant policy makers since it integrates both perspectives from SMEs and from banks on barriers and possible solutions to SME financing. The findings from this study contribute to SMEs development in providing answers to the pertinent questions regarding barriers faced by SMEs in accessing finance. The results gathered also help policy makers in the Ministry of Micro, Small and Medium Enterprises and Co-operative Development with valuable insights regarding the successful implementation of the SMEs and Co-operatives policy of the economic blueprint, the Zimbabwe Agenda for Sustainable Socio-Economic Transformation (ZIMASSET).

2. Literature Review:

In the Zimbabwe context, existing literature covers and provides the reality and perspective on the challenges and barriers faced by SMEs in accessing funding from the SME's point of view. Manyani (2014) investigated on venture financing on SMEs in Zimbabwe, specifically SMEs operating in the Mashonaland Central Province in the town of Bindura. He found that the majority of SMEs in Bindura use their own savings, funds from family and friends to finance their businesses. It was also established that the financing options available to SMEs in Bindura are impracticable to support the capital required for their operations because of stringent requirements and lack of collateral security. Maunganidze (2013) on the other hand, focused on the role of the government on the establishment and development of small to medium enterprises in Harare. From this research it emerged that most of the provisions offered by the government to facilitate the establishment and development of SMEs are mostly rhetoric and difficult to access. It was also indicated that the two government's institutions meant to cater for SMEs, namely the Ministry of Micro, Small to Medium Enterprises and Co-operative Development and the Small Enterprises Development Company (SEDCO, 2010) are usually underfunded by treasury, and therefore are unable to do much with regards to financially assisting SMEs. Gombarume and Mavhundutse (2014) carried out a research to assess the challenges faced by Small to Medium scale Enterprises (SMEs) in Chitungwiza, their main objective being to discover whether SMEs were getting loans from financial institutions. From their study it was revealed that the unstable macroeconomic environment in Zimbabwe was hindering SMEs sector growth, and they recommended that the Zimbabwean government should set up a loan guarantee scheme and that SMEs should formalize their activities so as to get financial support from the financial institutions.

2.1 Small and Medium Enterprises (SMEs):

In spite of the significant contributions made by SMEs to GDP, employment and livelihoods, Sub Saharan Africa's SMEs continue to face a plethora of challenges that inhibit their growth and development beyond mere survivalist modes of activity (Tadesse, 2009). According to Dalberg (2011) SMEs in developing countries face a financing gap that undermines economic prosperity. Fafchamps, Pender and Robinson (1994) talk about the credit rationing theory, which predicts that no credit will be offered by banks if the maximum that the debtor can credibly be forced to repay is smaller than the opportunity cost of money to the lender, subject to the borrower accepting the contract. They go on to highlight several factors that increase the chances of credit rationing, namely; Low ability to enforce repayment, Statistical differences

across borrowers' categories, Greater uncertainty about borrowers' types, High costs of screening loan applicants and monitoring their actions, Greater dependence of contractual performance on borrower's type and effort, High opportunity cost of money and Controlled interest rate. Most SMEs seem affected by these factors hence making it very hard if not nearly impossible to access financing.

2.2 Banks:

The financial services sector in Zimbabwe which largely comprises the insurance sector, the securities sector, the banking sector and the microfinance sector, has a significant role to play in the promotion of the development of SMEs (Dhliwayo, 2014). Banks do need SMEs for them to expand their customer base so that they can sell to them their diverse range of products. CABS, Zimbabwe's largest building society concede they need SMEs since SMEs provide significant revenue opportunities within the group through their ability to cross sell group products (Loans, Pension Funds, and Funeral Policy).

2.3 Importance of SMEs and their contribution to economic growth and development:

Keskin et al.,(2010) mention that the importance of the SME sector is well recognized worldwide due to its significant contribution to gratifying various socio economic objectives, such as higher growth of employment, output, promotion of exports and fostering entrepreneurship. The role played by SMEs in any society is undoubtedly important, for instance, in Portugal around 98% of the industrial fabric is composed by SMEs (Duarte, 2004). In Zimbabwe the SMEs sector contributes over 60% to the country's GDP and employs about 5.8 million people (Fin scope Survey of 2012) compared to the SMEs sector in South Korea which contributes over 52 % to the economy's GDP and employs 12.6 million people (Majoni et al., 2016). Nowadays, Tadesse (2009) points out, that it is more deeply understood and widely acknowledged that SMEs play a key role in generating a pattern of economic growth that is generally labour intensive, pro-entrepreneurship and competitive. The new ideology of neo liberalism and globalization emphasizes the role of SMEs as promoters of a healthy business climate, economic efficiency and power for economic development, especially in developing countries (Keskin et al., 2010). It is generally accepted by both the practitioners and academicians that SMEs serve as catalysts for the economic growth of the economy of any nation (Gbandi and Amissah, 2014).

Also, it is universally acknowledged that they (SMEs) are effective instruments of employment creation and economic growth, which ultimately lead to poverty alleviation for the entrepreneurs themselves as well as their employees (Goriwondo, 2012). In Zimbabwe 15% of the total formal employment is in the SME sector (Katua, 2014).

2.4 Sources of credit for SMEs:

Access to finance has been identified as a key element for SMEs to succeed in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries (Ricupero, 2002). Financing is the lifeblood of business enterprises. Adequate financing allows SMEs to expand, compete with larger firms and create new markets for themselves. Every enterprise is financed either through debt or equity or a combination of both, seed startup capital or venture capital.

2.5 Government of Zimbabwe's support of SMEs:

In 1983, the government of Zimbabwe, through an Act of Parliament, chapter 24:12, established the Small Enterprises Development Corporation (SEDCO), a leading development finance institution for the promotion and development of micro, small and medium enterprises in the country (SEDCO, 2016). It is a parastatal

which falls under the Ministry of Micro Small and Medium Enterprises and Co-operative Development (MMSMECD). The Corporation has six branches across the country with offices in Harare, Bulawayo, Gweru, Bindura, Masvingo and Mutare. SEDCO offers various training to help SME's develop, start up and manage their businesses. According to SEDCO (2016) the Corporation offers training to all SME's at all the branches countrywide, and vital capacity building trainings have been offered to numerous SME's and have helped these better manage their businesses.

3. Materials and Methods:

The study applied the mixed research design which is a mixture of qualitative and quantitative research methods. This is supported by Bulsara (2009) who states that both qualitative and quantitative research, in combination, provide a better understanding of a research problem or issue than either research approach alone. This is also substantiated by Teddlie and Yu (2007) who argue that combining the two orientations allows the mixed method researcher to generate complementary databases that include information that has both depth and breadth regarding the phenomenon under study. The open ended questionnaires and semi structured interviews constituted the primary data source. 60 questionnaires were distributed to Chiredzi Urban SMEs. 54 responses were received from respondents which represents a 90% response rate. Convenience sampling was the most appropriate sampling method in coming up with 60 SMEs.

4. Data presentation, analysis and discussion:

From the findings, of the sampled SMEs, 15% (8 SMEs) were able to access funding from banks through loans, 22% (12 SMEs) fund their businesses using personal savings 11% (6 SMEs) use retained profits whilst the majority of the SMEs-52% (28 SMEs) use funds obtained from their families and friends. From the findings it can be concluded that access to bank loans is minimal for many SMEs who have to rely on alternative sources of funding with the biggest source being family and friends. It can be concluded also that apart from family and friends a lot of SME owners use their own personal savings to finance their business projects.

13 SMEs (24%) indicated they had business plans whilst 41 SMEs (86%) indicated that they did not have such a document. These results indicate that the majority of SMEs do not view planning as of much importance in their businesses 80% of the SMEs indicated that they do not keep financial statements. This means that basing on these results only 20% with financial statements have a higher probability of having their loan applications approved. Banks require SME loan applicants to have company financial statements that are validated by auditors.

Banks also require SMEs to show them their capital budgets so that they can assess their financial planning and credit worthiness. The study results showed that only 17% of the sampled SMEs keep capital budgets. The other 83% do not keep capital budgets at all. This reveals that in most SMEs there is no financial planning and decisions are made on a whim. In SMEs with capital budgets it was found that most did not fully appreciate their capital needs, therefore there were a lot of underestimations in terms of costs incurred in operations, business investments and working capital required to realize targeted turnover. In line with this finding, only 11% of the sampled SMEs were found to have a qualified accountant who maintains their books and manages their financial transactions. The majority (89%) did not have a qualified accountant.

With regards to SME staff complement, among the 54 sampled SMEs the highest category was those with less than 5 employees, with 46% (25 SMEs), followed by the between 5 and 10 employees category which had 28% (15 SMEs), followed by the between 10 and 20 category which had 17% (9 SMEs) and lastly the above 20 employees category which had 9% (5 SMEs). Number of employees in the employ of a SME can

evoke varying interpretations in bankers. A high staff complement might be an indicator that a business is stable since it has the capacity to employ many people. Banks prefer lending to bigger firms since they pose less risk and costs. This notion is supported by Nkuah, et al (2013) who posits that lending to small businesses can be seen to be time consuming and costly for banks and other financial intermediaries.

From the findings it also emerged that of the sampled SMEs 9% (5 SMEs) earn a monthly turnover of less than 1000 US dollars, whilst (10 SMEs) 19% earn between 1000 and 5000, 52% (28 SMEs) earn between 5000 and 10000, and the remaining 20% (12 SMEs) earn more than 10 000. The monthly cash flows are a good indicator of the performance of a business. High monthly turnovers will increase the likelihood of a SME getting a loan from a bank as compared to low turnovers as they are a signal of a financially viable business which has the capacity and resources to service the loan. Thus low turnovers are a barrier to SME financing since they discourage banks from extending credit to those SMEs with low turnovers.

4.1 Banks' perspectives on barriers to SME financing and evaluation of potential partnerships between SMEs and banks:

9 banks were sampled and the following results came out 67% of the banks view lack of collateral as the major barrier standing in the way of SMEs and preventing them from accessing credit 22 % cite small equity base as one of the major barriers, and 11% cited information asymmetry as the barrier hindering SMEs form accessing financing. It interesting to note that the barriers cited by banks as the two foremost when it comes to hindering SME access to credit are the same as those identified by SMEs as their major barriers. This means that SMEs and banks agree on what constitutes the major barriers of SME financing. Banks and SMEs can therefore take advantage of this common ground and use it to form partnerships and strategic business linkages that will yield gains for both parties.

4.2 Ministry of Micro Small and Medium Enterprises and Cooperative Development (MSMECD):

One of the important stakeholders of the SME sector in Zimbabwe is the MMSMECD. Established in 2002, it is one of the government's key vehicles for the driving of the SME growth and development agenda. The MMSMECD provides financial support through its Small and Medium Enterprises Revolving Fund and Micro Portfolio Loans. The fund is accessed through SEDCO, which is an arm of the ministry with regards to SME support. The major drawback has been the issue of the Ministry being underfunded in the National budget. According to Bomani, et al (2015) in 2013, the MMSMECD had budgeted for US\$9,479,000, but the Ministry of Finance allocated US\$3,605,977 to the SME ministry. Makoshori (2014) further supports this by presenting that in the National budget statement of 2014, the MMSMECD was allocated US\$8,695,000 when they needed US\$81,269,937. Resultantly the Ministry has not been able to fully execute its agenda of capacity building through entrepreneurship training and allocation of credit for SME growth and development. Hence underfunding of the Ministry has constituted one of the barriers to SME financing since funds are unavailable from the ministry to fully support SMEs.

4.3 Small and Medium Enterprise Development Corporation (SEDCO):

In 1984, the Government of Zimbabwe established a parastatal (SMEDCO). SEDCO was formed after the government realized that most SMEs were failing to grow and develop due to lack of financing. Most SMEs could not meet the eligibility criteria for loans from financial institutions due to the fact that they were informal and lacked the requisite collateral. Due to a myriad of macroeconomic constraints the Zimbabwean Government has not been able to adequately fund SMEDCO so that it can fulfill its mandate and so resultantly SME growth and development has remained crippled.

5. Conclusions:

Results from the study revealed that SMEs in Chiredzi Urban have almost insurmountable barriers standing in their way to accessing financing. It emerged that the barriers included among others, lack of collateral to back up loan applications, a small equity base that is unable to sustain loan servicing, lack of experienced management and information asymmetry between banks and SMEs. It can be seen from the study that there are a lot of stringent requirements as SMEs must meet a certain eligibility criteria before they can access financing from banks, this stemming from the fact that banks perceive SME lending as high risk. Banks, therefore, prefer lending to large firms who have adequate asset bases to satisfy the banks collateral requirements. Large firms are established and with their stable turnover levels can sometimes even lend to SMEs. However, when their own need for credit increases, large firms have the power to reduce trade credit: they protect themselves from catastrophe while small firms are forced into bankruptcy (Collier, 2009).

6. Recommendations:

The following recommendations have been proposed in light of the findings;

Small and Medium Enterprises:

- 1) SMEs must improve structure in their firms with regards to their accounting, management control, administration and human resources so as to attract financing.
- 2) SME owners must employ qualified professionals such as accountants and managers to manage their financial systems and the entire business.
- 3) Unlicensed SMEs must join the formal sector so that they can have access to more lines of credit.
- 4) Pursue other financing options like venture capital funding, and seeking for credit from other non financial institutions.
- 5) With regards to collateral SMEs must form strategic linkages, networks and partnerships amongst themselves so that they can mobilize resources and acquire collateral such as property and title deeds which they can use to back up their loan applications.

Banks:

- 1) Should have SME specialized departments with credit analysts trained in SME lending and in dealing with the diverse SMEs from all industries. These departments will also work at reducing the information asymmetry between banks and SMEs and thus bridge the divide between the two.
- 2) Form partnerships with institutions, both public (e.g SEDCO) and private, micro financial institutions and nongovernmental organizations (NGOs) that have more in depth knowledge and working experience with SMES and formulate solutions and strategies that will increase SMEs access to credit.

Government:

1. Improve financial intermediation so as to improve SME access to financing.
2. Improve systems for collateral and credit guarantees.
3. SMEs must also be supported with non-financial assistance such as financial management tools, market relevant advice, networks with suppliers and larger firms.
4. Government should provide tax incentives to banks that lend to SMEs.
5. Harness information technology to create systems and structures that bridge the gap between SMEs and banks.
6. The national treasury must fully fund the MSMECD so that it can efficiently fulfill its mandate of supporting SMEs.

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