Challenges Faced by Small to Medium Scale Enterprises: A Case Study of Chitungwiza, Zimbabwe

By

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ABSTRACT

The study sought to assess the challenges faced by Small to Medium scale Enterprises (SMEs) in Chitungwiza, Zimbabwe using data from 2010-2012. The other objectives were to discover whether SMEs were getting loans from financial institutions, to examine the impact of government policies on SMEs and to come up with strategies that lead to a vibrant SMEs sector. The descriptive survey method was used to elicit information from the respondents and a case study approach was used. The study was confined to Chitungwiza area where a sample of 100 SMEs was adopted. Data was obtained through interviews and distribution of questionnaires. From the research findings, it emerged that SMEs are not getting enough financial support from financial institutions. The study also revealed that an unstable macroeconomic environment was hindering SMEs sector growth. The study recommended that the government should set up a loan guarantee scheme and SMEs should formalize their activities to get financial support from the financial institutions.

Keywords: SMEs, Financial Institutions, Chitungwiza.

Since 2008 general elections, the Zimbabwean economy has been very unstable due to a number of factors, among them political instability. This political instability deteriorated further after parties to the inclusive government ruling in Zimbabwe called for an early general election in 2009 to be held by 2013. The resulting political uncertainty resulted in financial institutions being reluctant to extend loans to SMEs. The economic environment has been characterized by shortage of hard currency as the economy has struggled to match imports with exports in an economy that has no currency of its own, relying on the South African Rand, Botswana Pula and the United States of America Dollar as the medium of exchange. The resultant liquidity crunch in the financial sector meant SMEs regarded as risky and less attractive to lend to, were worst affected.

Resultantly, SMEs have been struggling to overcome the effects of currency change or dollarization of the economy (Mambo, 2010). Zimbabwean financial institutions now regarding lending to SMEs in a volatile economy as business suicide have not helped either (Makina, 2009). This is so, despite the fact that SMEs are now driving the Zimbabwean economy in a country with unemployment estimated to be over 70%.

Koushi (2008) identifies three reasons as to the significance of SMEs. Koushi (Ibid) points out enhancement of competition and entrepreneurship which brings about external benefits to the economy as a whole in terms of efficiency, innovation and productivity growth. Secondly, SMEs are more productive than large enterprises. Finally SMEs boost employment creation as they are labor intensive. Beck et al. (2005) argues that a robust SMEs sector is positively correlated to economic growth in an economy. Ayyagari (2005) opined that formal SMEs contribute about 50% of gross domestic product (GDP) on average in high-income countries.

On the backdrop of this, the government of Zimbabwe has put in place a whole ministry of Medium to Small Scale Enterprises Development (MSED) to spearhead the growth of SMEs. SMEs in Chitungwiza mainly concentrate in furniture making, manufacturing, food processing, garment making and welding.

Research Question

The study sought to answer the following questions

1. What are SMEs and how are these SMEs financed?
2. How effective are government policies in enhancing the SMEs sector development?
3. What other factors are hindering SMEs sector development in Chitungwiza?

Literature Review

Remenyi (2001) states the purpose of literature review as to establish the area of study, establish a theoretical framework for the subject area of study and to identify studies, models and cases supporting research topic. The researcher studied past work on the subject matter to appreciate what other scholars discovered.

SMEs

Beaver and Ross (2002) observes that it is easier to describe than to define a small business. Appleby (1999) states that a small business is independently owned and operated, has a capital contribution from a limited number of individuals, would operate in a local area and is probably not dominant in its field of operation. The European Union defines micro enterprise as employing 0-9, small enterprise 10-99 and medium enterprise employing 100-499 people. Storey (1994) sums up the danger of defining SMEs by size stating that in some sectors, all firms may be regarded as small while in some sectors, no firm will be regarded as small. SEDCO observes that SMEs employ up to 75 people and has a turnover of up to 3 million USD. On the other hand ADB (2004) opines that an SME employs less than 50 people.

Characteristics and Roles of SMEs

Du Toit and Motlatla (2001) observes that in developing countries with capital shortages and growing labour surpluses, SMEs are generally more labor intensive than larger businesses and on average generate more employment opportunities per unit of capital employed. Cook and Nixon (2000) states that notwithstanding the importance of SMEs in the economies of third world countries, the SMEs still face serious financial constrains. Ross (2005) points out that SMEs are usually self-financed as they find it difficult to meet stringent demands set by financial lenders who often demand collateral security which SMEs do not readily have.

Nyoni (2010) opined that SMEs help in employment creation, poverty alleviation and contributes significantly to the GDP of an economy. The Reserve Bank on Zimbabwe (2007) indicated that SMEs employed 61% of the labor force in Zimbabwe. RBZ (ibid) further states that SMEs are contributing over 50% of GDP in Zimbabwe. Lall (2001) found out that most SMEs are small and argued that smallness is dangerous just like in the animal kingdom where small animals are easy prey for predators. SMEs are usually financially weak in the developing world mainly due to lack of access to loans.

Other Constraints

Arinaitwe (2006) states that despite the potential for growth shown by SMEs in the developing world, a number of mitigating factors have had a negative impact on their growth performance resulting in most of them failing. These factors include unfavorable economic conditions, gross under-capitalization, poor infrastructure, high operating costs, corruption and lack of government support. SMEs sector development is hampered by lack of managerial skills, equipment, technology and access to international market (Gockel and Akoena, 2002). According to Lall (2001) SMEs in general tend to face three sets of competitive challenges and these are related to their size, distortions in markets and government policy interventions. Abor and Quartey (2010) observe that in most cases SMEs acquire foreign licenses thereby increasing operational costs in the process.

Lewis Paul Jnr (2008) postulates that management mistakes accounted for 88.7% of SMEs failures such as being in business for the wrong reasons. Lack of adequate managerial skills has been associated with new business failure (Shane and Stuart, 2002). Inkoun (2003) discovered that SMEs performance is closely linked to the entrepreneurial skills of the proprietor. He further argues that those entrepreneurs with a management qualification have a 30% better chance for survival in business compared to those with none.

Katindi et al. (2007) reckons that unavailable business information provided by SMEs to potential funders for analysis before making a decision whether to fund a certain project or not is a cause for concern. Business information reduces information asymmetry. As a result, a comprehensive business plan reduces risk perception and the likelihood of obtaining capital increases. A negative perception by potential lenders has negatively impacted on the growth of SMEs (Green et al., 2002). Beck et al. (2005) argues that although business environment indicators refers to business, previous research has shown that financial and institutional underdevelopment constraints SMEs significantly more in their operation and growth than larger firms. This has mainly been attributed to lack of networking in the developing world (Atieno, 2009; Coulth and Loos, 2007, Nyoni, 2010).
Djankov et al. (2002) opined that high entry costs prevent informal SMEs to turn formal whilst Nyoni (2004) observed that in Zimbabwe in particular, bad publicity of the country impacted negatively on the SMEs development.

**Government Policy and Support**

Ramis (2002) discovered that SMEs faced with stiff competition are three times more prone to failure than those without competition. There is need for government policies that protect SMEs from both internal competition (from large corporate) and from external competition. Kaufman et al (2003) opined that in Africa, SMEs are weak because of very difficult business conditions, which include cumbersome official procedures and unattractive tax regimes. Imports competition is negatively impacting on SMEs (Koush, 2008). Regulatory constrains also pose a serious threat to SMEs. These include start up points and licensing and regulatory requirements. World Bank (2004a) states that in Zimbabwe for example, it takes 952 days to deal with licensing issues. It is recognized that although various initiatives have been put in place to support the SMEs sector there is need for an integrated and coherent policy and strategy for the development of the SMEs sector in Zimbabwe (Nyoni, 2008).

**RESEARCH METHODOLOGY**

In this study, a case study approach was applied to carry-out an in-depth analysis of challenges faced by SMEs using case study of Chitungwiza covering the period 2011-2012. Saunders et al (2003) defines a case study as the development of intensive knowledge about a single case or a small number of related cases. The case study is appropriate for research because of the accessibility of the SMEs in Chitungwiza which will provide the researcher with the understanding of the SMEs needed to make an analysis of the study findings to make recommendations for further research. The research targeted the whole SMEs in Chitungwiza as the population. A sample of 100 SMEs was chosen using simple random sampling.

**DATA PRESENTATION AND DISCUSSION**

**Sources of funds for SMEs**

The study sought to identify major sources of funding for SMEs in Chitungwiza. From the findings, 40% of the respondents indicated that they were self financing their operations. A further 34% indicated that they were getting financial assistance from various financial institutions while the remaining 26% got assistance from their families and friends. This view supports the observations made by Green et al. (2002); ADB (2009) and Lall (2001). Interviewed respondents indicated that the cost of borrowing funds, terms and conditions of borrowing coupled with a cumbersome process to be followed in applying for financial assistance was one of the reasons why they were failing to get financial assistance from financial institutions. This view is supported by Nyoni (2010) who postulates that it is common for entrepreneurs to depend on personal savings, friends and relatives to prop up their business. Ross (2005) shares the same view. Daniels and Ngwira (1993) opined that financial challenges handicapped the operations of SMEs.

**Government Policy**

From the findings, 53% of the respondents indicated that they had benefited from government policies such as black empowerment programmes resulting in them accessing loans from the Ministry of Small to Medium Scale Enterprises. A further 47% of respondents said they had not benefitted in any way from government policy on SMEs. This observation is similar to that of Kaufman et al (2003) who opined that cumbersome legal procedures and unattractive tax regimes militates against the operations of SMEs in Africa. Respondents interviewed felt that the government was not doing enough to protect SMEs from cheap imports crowding them out of business in the process. Pack (1993) is of similar view. Ramis (2002) observed that SMEs exposed to stiff competition from within and without the country’s borders are three times more likely to collapse than those protected from competition.

**Management Skills and Competition**

The study showed that 45% of the respondents felt that they had no requisite skills in management of business, while a further 15% were indifferent. The remaining 15% indicated that they believed they had what it takes to manage their SME skills wisely. Katindi et al. (2007) concurs as they say business management information
reduces information asymmetry and a comprehensive business plan reduces risk perception and increases the likelihood of getting loans. Shane and Stuart (2002) argue that inadequate managerial skills are associated with small business venture failure. The respondents without management skills indicated that it had negatively impacted on their businesses. Loos (ibid) shares the same view.

RECOMMENDATIONS

In light of the above findings, the researchers proposed the following recommendations:

SMEs should engage government to formulate policies that enhance their business operations. Entrepreneurs should undertake business management courses so that they will appreciate the concept of running a viable business entity. The SMEs must keep proper accounting records so that when they approach financial institutions seeking loans, they will be evaluated against their past performance enhancing their chances of securing a loan. SMEs should network and pooling their resources together as a way of circumventing the financial resource gap. SMEs to improve on the quality of their products so as to penetrate new markets to make up for lost market to cheap imported products.

CONCLUSIONS

The responses indicate that SMEs were getting little financial assistance from financial institutions. The study revealed that there is management deficiency in the SMEs which results in their collapse mainly due to poor decision making. The study further revealed that government policies were not clearly spelt out so as to enhance the performance of SMEs. The current tax regimes and regulatory framework is making business by SMEs difficult. Competition from imports and larger corporations coupled with shortage of raw materials compounded the operations of SMEs. The study concludes that a coherent SMEs policy, sound business management and availability of financial resources to SMEs by the financial services sector will be a welcome relief to the challenges faced by SMEs in Chitungwiza.

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