



FINANCIAL CHALLENGES FACED BY RETAIL SMES OPERATING IN A MULTI- CURRENCY ENVIRONMENT. A CASE OF GWERU URBAN, ZIMBABWE

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ABSTRACT

The study sought to find out financial challenges encountered by retail SMEs operating in a multi-currency environment with particular reference to Gweru Urban in Zimbabwe. The replacement of the Zimbabwean dollar by foreign currencies gave birth to a multi-currency environment. The adoption of multi-currencies was necessitated by the need to curb inflationary pressures which characterized the economy up to April 2009. Convenience sampling was used to select 150 retail SMEs. The data were collected using questionnaires. The questionnaires were filled either by the owners of the SMEs or their managers. The study established that retail SMEs were facing several financial challenges in a multi- currency environment. The challenges included shortage of liquidity in the economy which resulted in low sales due to depressed consumer demand. In turn low sales negatively affected the profitability of the SMEs. High interest rates constrained the ability of SMEs to raise finance through bank loans and overdrafts. The use of personal savings and retained profits as sources of finance implies that SMEs could only raise limited amounts of capital. The financial position of the SMEs was also worsened by high operating expenses and lack of trade credit. In light of these financial challenges the study recommends that the Zimbabwean government should adopt a long-term policy on the use of the foreign currency. It is also imperative that the government of Zimbabwe swallows its pride and officially makes arrangements with South Africa or the United States of America in order to have an increased supply of the rand or US dollar. The SMEs should also devise survival strategies such as formation of strategic alliances and voluntary chains.

Keywords: Multi-currency, Financial challenges and retail SMEs.

INTRODUCTION

In the economic history of countries, Zimbabwe is one of the economies which experienced very high levels of inflation. In the period 2003 to January 2009 prices of commodities were increasing

on a daily basis. The governor of the Reserve Bank of Zimbabwe once declared inflation as the number one enemy which was causing havoc to the entire economy (The Zimbabwe Independent, 2006). In the world hyperinflation record books Zimbabwe was ranked second to Hungary's 1946 world record for inflation. According to the Zimbabwe Independent (March 2008) in mid – November 2009, Zimbabwe's daily rate was at 98% being second to Hungary which had a daily rate of 195%. Far back in March 2007, Zimbabwe's monthly inflation rate passed the 50% mark – the threshold for defining inflation. In May 2007 the inflation rate was estimated at 543% (The Financial Gazette, November 2008). In March 2008 it jumped to 3555 000%. By this time an egg was costing Z\$50 billion (Hanke and Kwok, 2009).

If compared to countries in the SADC region, Zimbabwe had experienced the highest level of inflation. For example, in July 2007 Botswana's inflation was at 6.4% and it was expected to decrease to 3.6 in 2008. In contrast Zimbabwe's rate of inflation was estimated at 5 000% by the end of 2007. As a result Zimbabwe could not qualify to be a member of the Southern African's rand Monetary Union. The Rand Common Market Area (CMA) comprises South Africa, Namibia, Lesotho and Swaziland. Zimbabwe could not qualify for membership because its rate of inflation had soared to 4 500% - the highest in the world. By joining the CMA the government thought that Zimbabwe could use a stable currency - the rand. Unfortunately the Rand Union member countries felt that Zimbabwe's economy was not in a healthy state by then. Zimbabwe's economy was like an individual infected with a contagious disease (Makoshori, 2011).

On 13th April 2009 the Zimbabwean dollar was abandoned in an effort to curb the galloping inflation which was rendering the local currency unstable (The Financial Gazette, March 2009). However, despite the registration of stability in the economy, dollarization has brought its own challenges. The purpose of this study was, therefore, to establish the challenges faced by SMEs in a multi-currency environment. SMES are drivers of economic growth and development the world over. They contribute towards the economic well being of a country through provision of goods and services, job creation and contributing revenue for the fiscus. It is because of this important role that SMEs are of interest to researchers, academics and policy makers.

Conceptual Framework

Dollarization

According to (Kessy, 2011) dollarization does not refer just to the use of the United States dollar. It is a generic term used to refer to the use of any foreign currency. Zimbabwe is not the first country to adopt dollarization. For example, the liberalization of the financial sector in Tanzania saw the increased use of foreign currency in that country. As part of Tanzania's financial sector reforms, commercial banks were allowed to open foreign currency deposit accounts in the third quarter of 1992. The United States dollar is being used as a means of holding wealth and a medium

of exchange in Tanzania. The economy of Tanzania was liberalized from a centrally planned to a market based system in the early 1990s. In Zimbabwe the use of multi-currencies was adopted on 30 January 2009 in an attempt to arrest the hyper-inflationary trend. The Zimbabwean dollar was then totally abandoned on 13th April 2009 (Wenzel, 2009).

Meyer (2000) in Kessy (2011) distinguishes three types of dollarization: official dollarization, official semi-dollarization and unofficial dollarization. According to Meyer official dollarization is a complete replacement of the domestic currency by a foreign currency. The chosen foreign currency becomes the legal tender of the dollarizing country. Zimbabwe, Panama and Ecuador are good examples of countries which adopted foreign currency and abandoned their local currencies. The United States dollar, the pound, the rand and the pula are currencies which are being used as legal tender in Zimbabwe.

Official semi-dollarization is described by Meyer as a situation where both domestic and foreign currencies are freely used in the domestic market. This means that foreign currencies are used alongside the local currency. For instance, in Lesotho and Swaziland the South African Rand is used alongside domestic currencies. Unofficial dollarization occurs when the government does not openly declare the adoption of foreign currencies. Countries that opt for official or semi-official dollarization are either small countries or countries that suffer from severe macroeconomic problems. Hyperinflation was the driving force behind official dollarization in Zimbabwe. Both official and semi-official dollarization has the potential to succeed in fighting hyperinflation and bring about economic stabilization. Ecuador's annual inflation rate declined from over 90% in 2000 to a single digit in 2002. According to The Zimbabwean (June, 2010) adoption of the multicurrency system has reduced Zimbabwe's monthly inflation trend from above 49 billion percent to less than 1% since February 2009. In some months negative inflation rates were recorded.

Definition of SMEs

In this study conceptualization of SMEs is of paramount importance. Many efforts have been made to define the term small and medium enterprises. The reason is that there is no generally accepted or universally agreed definition. The definition may differ from one country to another. SMEs maybe defined using criteria such as the number of employees, sales volume, and total value of assets and ownership of a business. SMEs can also be defined in terms of characteristics which distinguish them from large firms. However, it is even harder to define these characteristics and draw a precise line which separates SMEs from large firms. In other words, SMES do not conform to any clearly defined parameters. The criteria used to define these enterprises may also depend on the industry in which they operate. Consequently, it is difficult to make generalizations of any kind in defining SMEs (Stokes, 1995). Siropolis (1997) points out that the size of a business can be measured taking into account its total assets, owners' equity, sales revenue and the total number of

its employees. Business size can also be defined in terms of ownership and geographical location (Longnecker, 2006). These authors concur that SMEs have a small asset base, low volumes of sales and a small number of employees. They also say that SMEs tend to be owned by individuals and families.

The number of workers employed by a business is the most commonly used measure of business size. According to Stokes (1995) a manufacturing firm which employs 200 workers or less is classified as a small or medium enterprise. Stokes goes on to say that in the construction industry a Small and Medium Enterprise is one which employs 25 workers. Morrison (2002) says that in some contexts a total of 499 employees are used as the upper limit of a medium-size business while in other contexts including the legal definition under the United Kingdom Act 1985, an upper limit of 249 workers is applied. Morrison further says that for businesses owned by individuals the number of workers ranges from 0 to 49. Medium businesses employ 50 up to 249 workers. Morrison says that a larger business employs at least 250 workers. In Zimbabwe a Small and Medium Enterprise is a business which employs 75 workers or less. However, this Zimbabwean definition is not yet in black and white. The researcher established the definition applied in Zimbabwe through consulting the Small and Medium Enterprises Corporation in Gweru Urban.

Finance

Like any other business an SME needs finance in a variety of areas. A business' potential for growth and survival depends to a greater extent on its ability to raise finance when need arises. Finance is a key resource which lubricates the operations of a business. A new business cannot take off if it fails to raise adequate finance. An existing business will come to its knees if its financial position is unhealthy. Finance can be categorized into permanent capital, asset finance and working capital (MacLaney, 2006). Permanent capital takes different forms. It can be start-up, expansion or development capital (Stokes, 1995). Start-up capital is the initial amount of capital invested into a business at its commencement. For a business to start its promoters should raise start-up capital. Expansion capital is the amount of finance required for expansion purposes. Expansion involves acquisition of additional premises and assets such as motor vehicles and equipment. Development or improvements also need to be financed. Seliet. (2000) says that one of the aims of many businesses is to grow. In order to grow a business needs finance to invest in new equipment, in more raw materials, in developing new products and larger building.

Asset finance is also referred to as medium or long-term finance. SMEs require this form of finance for the purchase of tangible fixed assets such as plant, machinery, equipment, fixtures and fittings, company vehicles and buildings. For a business to operate it needs machinery, equipment, buildings and vehicles. A retail business requires equipment such as counters, mirrors, cash registers, security systems and pricing guns (Meyer and Allen, 1994).

Any business, small or large, requires working capital to finance its day-to-day operations. For instance, working capital is used to buy consumables and trading inventory. A retail business should have adequate working capital so that it can replenish its inventory or merchandise. A small firm also requires working capital to close the debtor-creditor gap. Temporary losses caused by seasonal fluctuations are also financed using working capital. A business may also use its working capital to pay for expenses such as insurance and rent (Stokes, 1995).

Sources of Finance

There is a bewildering variety of sources of business finance. The entrepreneur's most puzzling question is how best he or she can raise capital. In choosing the source of finance he or she has to consider the cost of raising the finance, security required, rate of interest and repayment terms. The two broad categories of capital are equity and debt capital. Debt capital is obtained through borrowing while equity capital is raised through the sale of shares (Ross *et al.*, 2010). How a business raises capital depends on its size, its life cycle stage and growth prospects.

Equity financing takes different forms. The entrepreneur can use his or her personal savings to finance a small business. If personal savings are not adequate he or she can attempt to gain access to the savings of family members, relatives and friends. The other option is to raise the finance through formal channels such as banks and outside investors (Modgettes. and Kuratko., 2001). However, the ability of a business to sell its shares depends on its profitability. Private investors consider the profitability of a business before they commit their funds. A business which has high prospects for generating profit will not find difficulties in attracting investors.

Sources of debt capital are far more numerous. With debt financing SMEs may borrow money to finance their operations. Debt financing includes supplier credit and bank loans (Modgettes. and Kuratko., 2001). Suppliers of goods and services provide credit to businesses. SMEs can get the goods and services and make payment later. The proceeds they get from selling the goods can be used to pay the supplier. Supplier credit enables a business to get stocks of goods even if it does not have cash (Siropolis, 1997). Bhattacharya (2001) says that trade credit provides a business access to finance that it is unable to raise through normal institutional channels because of the business' inability to meet the given standards of credit worthiness. Sellers provide better terms of payment to their customers. SMEs can use trade credit as a survival strategy. They can buy goods from suppliers who extend credit to their customers. Trade credit addresses financial constraints since SMEs can sell the goods and use the proceeds to pay suppliers. However, for the supplier to extend credit the SME should have a good credit rating. According to Siropolis (1997) the SME's credit history with other suppliers provides essential information for credit rating. The credit worthiness of a business can also be assessed taking into consideration its profitability.

SMEs can also obtain loans from commercial banks which provide short- and long-term loans. Short- term loans are a source of working capital used to purchase trading stock. Long term loans satisfy the SME's permanent need for finance. The purchase of long-lived assets such as buildings, land and machinery is financed using long-term loans (Longnecker, 2006). However for a business to qualify for a bank loan it should have the capacity to repay the principal amount and to service the interest. The banker also assesses the business' capacity to pay by analyzing its profitability, liquidity and solvency. The financial statements of the business shed some light on its performance and financial position (Modgettes. and Kuratko., 2001).

The banker also considers the capital structure of the business. A business which has too much debt will find it difficult to settle its debts as they become due for payment. Such a business might also struggle to service the interest on the loan. The business' Statement of Financial Position provides information on the extent to which it is debt-financed (Modgettes. and Kuratko., 2001). The owner of the business may also be required to offer his or her personal assets as collateral. If the business defaults on loan repayment, the bank can recover its money by selling the assets which were pledged as collateral. The bank can also recover its money from the guarantor of the loan. Another standard of credit worthiness relates to the conditions of the environment in which the business is operating. If the economic environment is hyperinflationary it becomes risk to advance loans to businesses. Political instability makes it impossible for borrowers to think of settling debts (Modgettes. and Kuratko., 2001). Leasing is another source of finance which can be used by SMEs. It allows a business to obtain the use of expensive equipment, machinery or vehicles. Under a lease, ownership of the asset is retained by the leasing company although in some cases the lessee has a purchase option at the end of the lease period. Finance houses lease equipment, buildings and motor vehicles to businesses (Meyer and Allen, 1994). In addition to leasing, finance houses also provide hire purchase finance. Under hire purchase a business gets immediate use of the asset. However, it has to pay installments according to the hire purchase agreement. The customer acquires ownership of the asset on paying the final installment (Stokes, 1995).

Seliet. (2000) has also identified personal finance as an important source of capital for financing the operations of SMEs. He has identified different sources of personal finance. Seliet says that an individual can use earnings from a job to raise finance for a business. Benefit payments made by the government to unemployed or disabled people are also a source of personal finance. People who are on pension can use their pension benefits to raise capital for their businesses. It is possible to use personal finance as a source of capital because SMEs require little start- up capital.

The reviewed literature has revealed that there are various sources of capital which can be used by SMEs to raise finance. The purpose of this study was therefore to find out if there are any financial constraints faced by SMEs operating in a multi-currency environment. Zimbabwe adopted the use of multi- currencies to contain hyperinflation.

DATA PRESENTATION AND ANALYSIS

Work Experience

The table below shows the work experience of managers and retailers who participated in the study.

Table-1. Work experience

Work Experience in Years	Frequency	Percentage (%)
0-2	15	10%
3-5	10	6.67%
6-8	100	66.67%
9 and above	25	16.67%
Total	150	100

The table shows that 16.67% of the respondents had at least 9 years of work experience, 66.67% had 6 to 8 years, 6.67% had 3 to 5 years and 10% had 2 years and less. The data show that most of the respondents had witnessed the introduction of the multi-currency system in Zimbabwe. As a result they had knowledge of the financial challenges faced by SMES in a multi-currency environment.

Source of Finance

Responses on sources of finance used by SMES are shown on the table below. The data on the sources of finance used the SMEs provide some insight into the financial constraints faced by SMES operating in a multi- currency environment.

Table-2. Source of business finances

Main Source of Finance	Frequency	Percentage (%)
Personal savings	70	46.67%
Relatives and friends	20	13.33
Bank loans and overdrafts	5	3.3
Equity capital	0	0
Trade credit	0	0
Lease agreements	0	0
Retailed profits	55	36.67
Total	150	100

The table shows that 46.67% of the owners of the SMES raised capital through personal savings. The second major source of capital was retained profits. The data reveal that 13.33% of the SMEs were financed using money borrowed from relatives and friends while 3.33 were financed using bank loans and overdrafts. Equity capital, lease finance and trade credit were not used at all.

Financial Challenges

The respondents were also asked to indicate the financial challenges faced by their businesses in a multi- currency environment. Their responses are shown on the table below.

Table-3. Financial challenges faced by SMEs N=150

Financial Challenge	Frequency	Percentage
Expensive supplies	150	100
Lack of capital	150	100
Shortage of liquidity	115	76.67
High interest rates	145	96.67
Conversion of currencies	95	63.33
High electricity bills	80	53.33
High rentals	85	56.67
Low rentals	115	76.67

The table shows that SMEs faced quite a number of financial challenges in a multi- currency environment. The challenges included expensive supplies, lack of capital, shortage of liquidity, low sales, conversion of currencies, high interest rates, high electricity bills and high rentals. The distribution of the responses reveal that these financial challenges were being faced by the majority of SMEs.

DISCUSSION

Lack of Capital

All 150 SMEs which were studied faced the problem of limited capital. A business' potential for growth and survival depends to a greater extent on its ability to raise finance when need arises. For a new business to take off it should be able to raise adequate finance. An existing business also needs adequate finance to lubricate its day-to-day operations. Limited capital makes it difficult for SMEs to finance the purchase of fixed assets such as machinery, equipment, motor vehicles and buildings. SMEs should also have adequate working capital in order to be in a position to replenish their inventories or merchandise.

The study also established that personal savings, assistance by relatives and friends and retained profits were the main sources of capital used by the SMEs. These sources can only provide small amounts of capital. Probably that is the reason why all the respondents cited lack of capital as a problem faced by their businesses. There was not even a single SME which was financed through equity capital. The use of equity capital could have given the SMEs some leverage because more investors can raise a substantial amount of capital. [Modgettes. and Kuratko. \(2001\)](#) have cited equity capital as an important source of finance for a business. However, [Seliet. \(2000\)](#) has also cited equity capital as an important source of finance for a business. [Seliet. \(2000\)](#) says that the ability of a business to attract private investors depends on its profitability.

The financial position of the SMEs was worsened by the unavailability of trade credit. The study established that not even a single SME obtained trade credit. This implies that the SMEs were required by their suppliers to purchase inventories on a cash basis. Trade credit could have enabled the SMES to get the goods and pay later using the proceeds they obtained after selling them. [Siropolis \(1997\)](#) says that supplier credit enables a business to get stocks of goods even when it does not have cash. [Bhattacharya \(2001\)](#) also points out that trade credit is of critical importance where a business is unable to raise finance through normal institutional channels such as banks.

All 150 respondents also cited expensive supplies as another challenge faced by SMEs. To purchase expensive socks of goods on a cash basis implies that SMEs could only obtain limited supplies. High cost prices could also make it difficult for SMEs to sell their stocks at competitive prices.

Interest Rates

The study established that banks were charging high interest rates on loans and overdrafts. Only 3.33% of the SMES which were studied raised finance by obtaining bank loans and overdrafts. In other words 96, 67% of the SMEs could not afford to obtain bank loans and overdrafts. Exorbitant interest rates constrained the ability of these SMEs to raise capital for the purchase of trading stock and fixed assets. [Longnecker \(2006\)](#) say that for a business to qualify for a bank loan it should have the capacity to pay the principal amount and to service the interest. Probably interest rates were high due to the liquidity problem which characterized the economy.

Liquidity

The study revealed that there was a shortage of liquidity in the economy. The data show that 76.67% of the respondents cited shortage of liquidity as a critical challenge faced by SMEs. The foreign currencies used in the economy were limited in supply. The reason being that Zimbabwe did not officially make arrangements with the countries concerned to adopt their currencies. The shortage of liquidity is also due to the fact that people are earning low incomes. High prices charged by suppliers also magnified the liquidity problem. Expensive supplies of trading stock ,coupled with limited liquidity ,has culminated in depressed demand for goods and services. As a result 76.67% of the respondents cited that SMEs were realizing low sales. The purchasing power of consumers was constrained by the dire shortage of cash in the economy.

Currency Conversion

In a multi-currency environment businesses quote prices of commodities indifferent currencies. Prices of products were quoted in Rands, Pulas and United Sates dollars. Where the price is quoted in one currency, some conversion has to be done when a customer pays using a different currency.

The data show that 63.33% of the respondents cited currency conversion as another challenge faced by SMEs operating in a multi-currency environment.

Operating Expenses

The study revealed that SMEs were struggling to pay high rentals and electricity bills. High operating expenses could make it difficult for SMEs to raise finance internally since profits would be low. Probably the adoption of multi-currencies had given rise to distortions in the pricing of goods and services. Exorbitant operating expenses could constrain the working capital and profitability of the SMEs. Furthermore, high operating costs could probably make it difficult for SMEs to sell their stocks at competitive prices, hence the problem of low sales.

CONCLUSIONS

An analysis of the findings has led to the following conclusions:

- Aggregate demand in the economy was depressed due to low consumer disposable incomes.
- The shortage of liquidity on the market negatively affected the volume of sales realized by SMEs.
- Interest rates charged by banks were so high that it was difficult for most SMEs to raise capital through bank loans and overdrafts.
- The fact that SMEs raised capital mainly through personal savings and retained profits implies that they could only raise limited amounts of capital, otherwise they could raise more finance through share capital by widening their shareholder base.
- The use of multi-currencies made pricing of products and payment difficult since one currency has to be converted to another currency.
- High operating costs constrain the operations of SMEs, thereby affecting their profitability.

RECOMMENDATIONS

In light of the above conclusions the study suggests the following recommendations:

- The Zimbabwean government should adopt a clear policy on the use of foreign currency. There is need to indicate to businesses, banks and other stakeholders that the multi-currency system will be in operation well into the long-run. Such a policy statement will help to clear uncertainties thereby enabling banks to extend loan repayment periods. This will make it easier for SMEs to raise finance through bank loans. The banking system will significantly contribute towards the development of the entire economy if its credit facilities do not have restrictive terms of payment. The Zimbabwean government should also officially adopt a single currency. It can officially seek the authority to use the Rand

or United States dollar from the respective government. Such an official arrangement will mean that Zimbabwe will be supplied with an adequate stock of the Rand or United States dollar. An increase in the supply of currency will go a long way in addressing the shortage of liquidity in the economy. As liquidity improves SMEs are likely to realize increased business since aggregate consumer demand will be high. Adoption of a single currency will also alleviate the need for currency conversion when pricing commodities and when consumers pay for goods and services.

- The study also suggests that SMEs form strategic alliances with suppliers in order to obtain goods on favourable terms. When SMEs get goods at low prices, they can also sell them to customers at competitive prices. Strategic alliances will also provide SMEs an opportunity to get venture capital from large companies. In Nigeria during a period of economic turbulence SMEs formed industrial clusters and cooperative movements in order to gain access to micro finance (Eneh, 2010). Strategic alliances also mean that large companies cease to view SMEs as rivals. There is a possibility that large businesses can subcontract some of their operations to SMEs.
- SMEs can also form voluntary chains so that they can buy goods in bulk as a group directly from the manufacturers. Bulk buying will enable SMEs to obtain goods at low prices since they will be offered trade discounts. The profitability of SMEs will be enhanced since there will be an increase in sales.
- The Zimbabwean government should also improve the supply of electricity to enable manufacturing firms to operate at full capacity. An increase in supply will lead to low prices of commodities.
- SMEs can also raise more capital if they extend their shareholding to the public by becoming registered companies.

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