

# CORPORATE FINANCING STRATEGIES EMPLOYED BY ZIMBABWEAN LISTED FIRMS IN THE MULTIPLE CURRENCY ERA

*Farai Kwenda\**

## Abstract

The aim of this study is to review the corporate financing strategies employed by Zimbabwean listed firms since the adoption of the multiple currency system which set the country on a recovery path after the decade-long political, social and economic crises. The adoption of the multiple currency system necessitated recapitalization and retooling because most firms' balance sheets were wiped away during the hyperinflation era. The study is based on secondary data of 80 firms listed on the Zimbabwe Stock Exchange. The study found that rights issues and high retention ratios were the main strategies used by firms to recapitalize their operations. The recapitalization efforts have been by liquidity challenges that have characterised the multiple currency era.

**Keywords:** Financial Strategy, Rights Issue, Dividends, Multiple Currency, Liquidity

*\*School of Economics and Finance, University of KwaZulu-Natal, Private Bag X54001, Durban, 4000, South Africa*

## 1 Introduction

The growth and survival of any business in today's highly competitive and globalized business environment and volatile financial markets largely depends on the use of right strategies in particular sound financial strategies. Financial strategies are defined as choices companies make in raising and deploying capital and distributing earnings. Sound financial strategies enable firms to raise funds at the lowest possible cost, deploy those funds in a manner that optimizes those resources and achieve the shareholder wealth creation goal. Financial strategies are individual firms' preference which, however, determine the firm's financial success and are influenced several internal and external factors. These factors are pronounced in uncertain economic conditions which contemporary literature asserts to be driven by globalization, financialisation and internationalisation, among other factors.

It is against this background that this study seeks to explore the financial strategies in a unique environment; listed firms in Zimbabwe after the adoption of the multiple currency system. In February 2009, Zimbabwe ditched its defenseless currency and adopted the multiple-currency system (hereinafter dollarization<sup>1</sup>) after a decade long political, social and economic crises which almost brought the whole country to its knees. The dollarization of the economy helped the country to achieve some stability but it has also brought a number of serious challenges; chief

among them severe liquidity challenges (Ministry of Finance, 2010, Confederation of Zimbabwe Industries 2011).

After the adoption of the multiple currency system, the corporate sector had to recapitalize in order to finance capital expenditures and day-to-day operations in the newly adopted currencies. The recapitalization exercises have been hampered by serious liquidity challenges bedeviling the Zimbabwean economy in the multiple currency era. The liquidity challenges are attributable to the general lack of confidence in the economy and the financial sector and sanctions (Reserve Bank of Zimbabwe, 2010). The enactment of the Indigenization Economic Empowerment Act 14 of 2007 in January 2010 has also been blamed for compounding the liquidity situation. The Act limits foreign ownership in Zimbabwean firms to 49% and requires foreign-owned firms with existing operations to cede 51% of their shareholding to local investors. The ownership structure required by the Act has caused foreign investors to shun Zimbabwe as an investment destination. The financial market facilitates the raising of funds by the private and the public sector. Zimbabwe's current financial market is not performing its role of facilitating the raising of funds because the decade long crises regressed Zimbabwe's financial sector development and left it shallow and under-developed. Zimbabwe's financial sector had made some positive strides in the post-independence era, in particular the liberalization of the financial sector in the early 1990s (Kwenda, 2014). According to Chinamo (2013) there are a number of challenges facing the Zimbabwe Stock Exchange (ZSE) and firms

<sup>1</sup>. The terms multiple currency and dollarization will be used interchangeably.

listed on the ZSE. These challenges include among others; ‘unjustifiably’ low market capitalisations, minimal corporate actions and no new listings, increasing number of de-listings, small stocks struggling to meet continuing obligations, activity on the market limited to a few stocks, contending with odd share prices such as US0.01c and the lost financial history<sup>2</sup>.

This study therefore, seeks to review the corporate financial strategies employed by listed firms industry in Zimbabwe to recapitalise their operations in an environment characterized by acute liquidity challenges. The rest of the paper is organised as follows; Section 2 briefly reviews the literature on corporate financial strategies. Data sources and the sample are described in Section 3. Section 4 presents and analyses the principal findings of the study. Section 5 concludes.

## **2 Literature review**

Financial strategy basically involves the raising of funds needed by the business and deployment of funds and distribution or reinvestment profits generated (Bender and Ward, 2013, Mallette, 2006). The raising of funds involves decision such as the appropriate mix of debt and equity in line with the company’s desired capital structure. The deployment of capital involves decision about the investment projects to undertake, investment in fixed and current assets. The distribution decision relates to the firm’s choice of either paying any profits generated by the business to its shareholders or reinvesting them in the business. The financial strategy of a company should be changed over the life cycle to ensure survival and growth of the company. Mallette (2006) laments that while key components of operations are frequently scrutinized and updated many organisations do not have overarching framework for systematically assessing their financial strategy to ensure it is internally consistent and aligned with the operations of the company. Frequent evaluations and adjustment are necessary because of the rapid changes that take place in the firm’s operating environment in today’s fast moving and globalized world.

Mhlanga and Sibanda (2013) contend that firms need appropriate financial strategies during different stages of their life cycle for them to achieve their primary objective of creating and maximizing shareholder value. The firm’s net asset requirement grows over time; therefore in order for the firm to grow and survive it must have enough financial resources to support its growth in asset requirements (Bender and Ward, 2013, Firer et al., 2012). Firms have a number of financial strategies mainly debt and equity at their disposal which can enhance their survival and growth.

In selecting a financial strategy, a company makes its choice on selecting whether to raise or

deploy its finances, and these are supported by four strategic decisions which need to be made by the company’s directors. These four strategic decisions are; how large should the asset base be, how much of the finances should be debt, and how much should be in equity, how much profit should be paid out in dividend, and how much should be retained, and should new equity be issued? (Bender and Ward, 2013). Appropriate financial strategies encompasses transactions such as raising seed-capital, start-up capital, flotation on a stock exchange, managing for corporate control and dividend payout policies. For a firm to survive any operating environment, it needs to formulate appropriate strategies to beat competition in the sector in which it operates. We briefly discuss some of the financial strategies that can be employed by firms throughout its life.

### **2.1 Initial Public Offerings (IPOs)**

An IPO is the first sale of shares to the public by a company on a stock exchange. Generally IPOs are underwritten by an investment bank or an underwriting syndicate (Firer et al., 2012). Underwriters undertake to take up any shares that remain unsold, thus giving the issuing firm the assurance that all shares will be bought and the desired funds will be raised. IPOs are used as a way of getting to list on a stock exchange. According to Bender and Ward (2002) a company might seek a listing for either “cash in” or “cash out” reasons. Cash in float is one that is done for raising funds for the company’s continued expansion and usually done by growth companies, which issue shares for the funds they need (Mhlanga and Sibanda, 2013). On the other hand cash out float’s main purpose of listing is to allow exit for some existing shareholders. Firms in the growth phase of their life cycle usually want to either cash in to finance expansion programmes or cash out to provide exit for start-up investors (Bender and Ward, 2002). The primary purpose for listing on a stock is to raise cheap money through either IPOs on listing or rights issues for those already on the bourse according to The Financial Gazette (2015). Once listed, firms are required to adhere to certain rigorous reporting and accounting standards, and maintain certain minimum internal and external audit and disclosure benchmarks. Other stringent measures include maintaining register of investors, adhering to acceptable corporate governance guidelines, have specialist external financial and legal advisors and adhere to certain board standards. Failure to comply with such requirements will result in a suspension of the non-complying firm from the exchange.

### **2.2 Rights issues**

A rights issue is a method of raising additional capital by issuing more shares to existing shareholders in

<sup>2</sup>2009 is the new starting point.

proportion to their existing shareholding<sup>3</sup>. A rights offer gives the firm's existing shareholders the right of first refusal that is the existing shareholders will be given an option to exercise their right of buying shares. These new shares would be issued at a discount; hence existing shareholders' proportion of shareholding will not be diluted by the new issuing of shares. A rights issue can also be used to finance a company in the growth stage of the firm's life cycle (Bender and Ward, 2013).

### **2.3 The distribution decision**

Dividends are payments made out of a firm's earnings to its owners, either in the form of cash or shares (Firer et al., 2012). Cash dividends represent a source of cash flow to shareholders and provide information about the firm's current and future performance (Gitman et al., 2010). The payment of cash dividends is constrained by factors such as the ability to afford cash outflow from the company, the financial performance, the future outlook and recent dividends paid. Zimbabwean firms have been operating in an environment characterized by severe liquidity challenges, low profitability and limited access to credit. Given the difficult operating conditions in the country, it is worth investigating the trends in dividend payments by firms as a corporate financial strategy. Firms experiencing rapid growth usually do not pay dividends because they need funds to further finance their growth. On the contrary, mature firms can afford high dividend payout ratios because they generally have limited investment opportunities to undertake and therefore can afford to pay out most of their earnings as dividends. Firms with difficulties in accessing external funds may opt to retain most of their earnings than pay dividends even if they report good earnings.

Other financial strategies that can be employed by firms include private placements, mergers and acquisitions and convertible loans. A private placement involves the sale of new security (typically bonds and preferred shares) directly to an investor or a group of investors (Gitman et al., 2010, Damodaran, 2011). A merger is formed when two companies combine and usually a new company is formed while in an acquisition, one firm (the offeree) is acquired by another (the offeror) either directly by a purchase of assets or indirectly by obtaining control of management or by acquiring shares (Firer et al., 2012). Convertible loans or debentures can be swapped for shares at a prior agreed rate and time (Gitman et al., 2010, Marx et al., 2011).

This section reviewed literature on corporate financial strategies such as initial public offerings, rights issues and dividend policies. The next section will present the data sources.

### **3 Data sources**

Since this study reviews corporate financial strategies of listed firms in Zimbabwe since the adoption of the multi-currency era, it is based on historic data from 2009 to 2014. Data was collected from company annual reports and financial statements for the accounting period 2009 to 2014 from the INET BFA online database, the Zimbabwe Stock Exchange, corporate announcements, company websites and press releases. We use descriptive statistics guided by an analytic approach to ascertain corporate financial strategies used by the listed firms in Zimbabwe.

### **4 Discussion of results**

In this section we review the corporate strategies used by Zimbabwean listed firms which were divided into fund raising activities, distribution of profits and other survival strategies employed by these firms.

#### **4.1 IPOs, new listings and delistings**

Table 1 Column 1 shows that there were two new listings on ZSE in 2011 and 2012. However, none of these two listings were IPOs. The 2011 new listing was an unbundling by a listed firm which listed through a dividend in specie. The 2012 new listing was result of a poorly subscribed rights issue which resulted in the investment bankers (the underwriters) taking up the unsubscribed shares and this resulted in the underwriters with a significant shareholding in their client which triggered a takeover. The lack of IPOs validates the lack of liquidity that has characterised the multi-currency era. The lack of liquidity in the Zimbabwean economy means that it difficult for firms with ambitions to use listing as a means of raising funds on the ZSE.

Column 2 of Table 1 shows that a total 16 firms were delisted from the ZSE over the period under review. The delistings were distributed as follows; 5 firms delisted after being placed judicial management, 5 firms delisted after buyouts 5 firms delisted as a result liquidation or being placed curatorship<sup>4</sup> and 1 firm delisted after merging with another listed firm. The liquidity crunch in Zimbabwe has made it impossible for firms to realise the benefits of listing; (raising cheap money through either IPOs on listing or rights issues). According to The Financial Gazette (2015) the companies that successfully managed to raise funds did so by raising those funds from offshore investors and this has necessitated delisting from the ZSE because existing shareholders were left with inconsequential shareholding proportions. The massive dilutions suffered by listed firms in raising new equity funds are blamed on low valuations (Chinamo, 2013, The Financial Gazette, 2015). Some of the firms delisted in order to raise funds using Net Asset Valuation instead of stock market valuation because of depressed stock prices.

<sup>3</sup>BREALEY, R. A. & MYERS, S. C. 2003. *Financing and risk management*, McGraw Hill Professional. call them privileged subscriptions or rights issues

<sup>4</sup>Of these 5 firms, 3 were banks that delisted after being placed curatorship/ liquidation and 2 were non-financial services firms that were liquidated.

**Table 1.** Corporate financing activities by Zimbabwean listed firms

<i>Year</i>	<i>New listings</i>	<i>De-listings</i>	<i>Judicial management</i>	<i>Curatorship/ liquidation</i>	<i>Private placements (\$ m)</i>	<i>Rights issues (\$ m)</i>
2009	0	2	1	0	6.62	23.89
2010	0	0	0	0	4.6	64.08
2011	1	0	0	0	10.3	0
2012	1	0	0	0	40	108.09
2013	0	12	4	4	10	53.34
2014	0	2	0	1	16.2	40
Total	2	16	5	5	87.72	289.40

Source: Own calculations based on press releases company annual reports and the ZSE

#### **4.2 Rights issues**

\$290 million was raised through rights issues on the ZSE over the six year period under review. Table 1 shows the trend of rights issues by ZSE-listed firms between 2009 and 2014. \$24 million and \$64million were raised in 2009 and 2010 respectively through rights issues. There were no rights issues in 2011. The table shows that rights issues peaked up at \$108 million in 2012, then declined to at \$53 million in 2013 and further declined to \$40 million in 2014. These rights issues had varying degrees of subscription success ranging from 2% to 95%, with a majority of them failing to attract significant support. The declining trend is attributable to the tightening liquidity situation and sluggish foreign investment. Some of the reasons given for raising funds through rights issues included raising funds for capital expenditure and working capital, recapitalization and retiring expensive short term debt. Financial sector firms used rights issues to raise funds to meet the high minimum capital requirements<sup>5</sup> set by the Reserve Bank of Zimbabwe (RBZ). The indigenization and economic empowerment laws explain raising equity capital from foreign shareholders was not tenable because the depressed low share prices resulted in new foreign shareholders exceeding the 51% foreign ownership threshold set by the Indigenization Economic Empowerment Act. The depressed prices on the ZSE had two negative effects on firms raising additional funds through rights issues; small amounts of capital raised through rights issues and massive ownership dilution (The Financial Gazette, 2015).

#### **4.3 Private placements**

Table 1 shows the trend of funds raised through private placements by ZSE-listed firms between 2009 and 2014. Private placements did not follow a defined pattern over the six year period under review. Table 1

shows that \$7million was raised through private placements in 2009. This figure declined to \$5million in 2010 before doubling in \$10million in 2011. The private placements figure peaked up at \$40 million in 2012, then declined to \$10million in 2013 before rising to \$16 million in 2014. Like right issues, the trend exhibited by private placements is also attributable to the tightening liquidity situation and sluggish foreign investment.

#### **4.4 Dividend policies**

Of the 80 listed firms between 2009 and 2014, only twenty three firms paid cash dividends. Figure 1 shows cash dividends paying firms and losing making firms. Four firms paid dividends once, five firms paid dividends twice, four firms paid dividends three times and six firms paid dividends four times. Only one firm managed to pay dividends each of the six years under review. The average payout ratio over the six year period was 32% suggesting that most firms employed a residual dividend policy. Low dividend payout policies from 2009 to 2014 are in line with severe liquidity challenges that reached unprecedented levels during this period. Firms retained earnings in order to preserve cash and recapitalize the operations, to finance existing operations and to exploit acquisition opportunities in the industries.

The results of the analysis suggest that firms do not pay dividends over the study period mainly as a survival strategy. Retained earnings are playing a critical role in the recapitalization of Zimbabwean firms. This validates the statement that are a form of internal financing and significantly affects the firm's external financing requirements (Gitman et al., 2010).

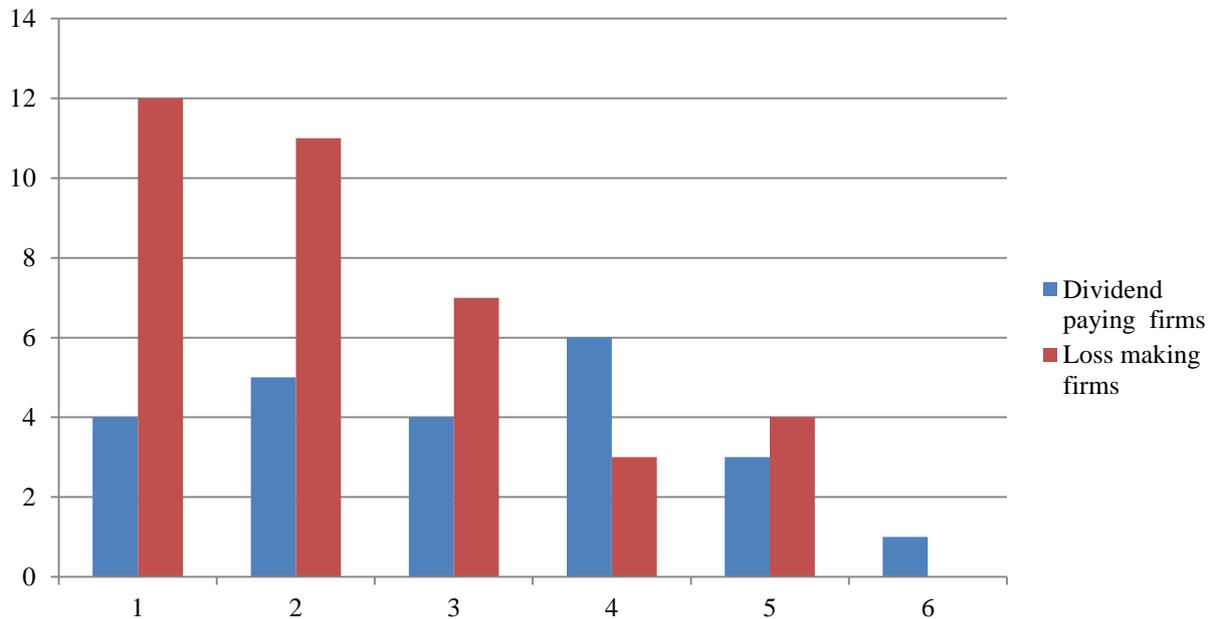
A review of company annual reports found the most common reasons cited for not paying dividends were as follows; loss making positions or accumulated losses, low profitability, the need to preserve cash for reinvestment, debt reduction, recapitalization and the need for turnaround, to preserve cash for working capital and to address working capital challenges. 12 firms recorded posted losses once during the six year period under review. 11 firms record losses in two periods. 7 firms and 3 firms reported losses in three and four years respectively of the six years under review. 4 firms consistently made losses over the

<sup>5</sup> The RBZ announced that commercial and merchants banks were now required to have minimum capital requirements of US\$100 million from US\$12.5 million and US\$10 million respectively. Banks are supposed to be fully compliant with these capital requirements by the end of year 2020. RESERVE BANK OF ZIMBABWE, R. 2012. Monetary Policy Statement. . Harare: Reserve Bank of Zimbabwe..

study period. The high number of loss making firms over the period under review is attributable to the difficult operating environment prevailing in Zimbabwe which has resulted in many company

closures (Confederation of Zimbabwe Industries 2014, Mangudhla and Mambo, 2013). It is not surprising that the number of dividend paying firms over the six year period under review is low.

**Figure 1. ZS-listed dividend paying firms and loss making firms 2009-2014**



Source: Author's construction based on financial reports obtained from INET BFA online database and company annual reports

#### 4.5 Mergers and acquisitions

During the period under review 42 mergers and acquisitions<sup>6</sup> were witnessed. Different types of M&As concluded are as follows, two horizontal involving two listed firms, five foreign firms acquiring listed firms, and listed firms acquiring unlisted firms. For the banking sector mergers were motivated by the need to meet the high capital requirements imposed by the Reserve Bank of Zimbabwe to avoid future bank failures. In the financial sector, in 2012 a commercial bank merged with a building society with the main motive of meeting the capital requirements set by the Reserve Bank of Zimbabwe. Two reverse takeovers were witnessed, one in the financial sector and another in the furniture industry. The mergers and acquisitions wave did not sweep as would have been anticipated as Zimbabwean companies are struggling to recapitalize. In addition one would have anticipated foreign firms to target more Zimbabwean firms because the low share prices make ZSE-listed firms real bargains. The low M&As activity has been partly blamed on the country's indigenization law which compels foreigners to limit their shareholding in domestic companies to 49% (Nleya, 2013).

#### 5 Impact of corporate strategies on capital structure

<sup>6</sup> This number includes deals involving listed and unlisted firms.

Financial strategies employed by firms impact their capital structures. Trend analysis was employed to examine how the corporate financial employed by these firms affected their capital structures<sup>7</sup>. Table 2 below shows the trends and composition of capital employed by Zimbabwean listed firms over the six year period under review. The results in Table 2 reveal that equity to total assets (ETTA) trended downwards from 55% in 2009 to 42% 2014 while the total debt to total assets; TDTA (which is debt ratio) trended upwards from 28% in 2009 to 47% 2014. ETTA measures the extent to which equity financed total assets and is an inverse of the Equity Multiplier<sup>8</sup>. We disaggregate TDTA into long term debt to total assets (LTDTA) and current liabilities to total assets (CLTA) in an attempt to understand the structure of debt financing of total assets. LTDTA trended upwards from 1% in 2009 to 8% in 2014, indicating that long term finance increased in financing assets but remained low.

<sup>7</sup> For this section, financial services firms were excluded because their capital structures are highly levered and different from non-financial sector firms.

<sup>8</sup> The equity multiplier measures the extent to which total exceed to total equity and is calculated as total assets divided by total equity

**Table 2.** ZSE-listed capital structure and financing pattern for the period 2009-2014

Year	ETTA (%)	TDTA (%)	LTDTA (%)	CLTA (%)	TCTA (%)	STBTA (%)
2009	54.70	28.36	1.27	27.09	18.98	7.49
2010	49.32	34.57	1.40	33.17	21.13	11.31
2011	47.68	41.58	3.69	37.89	22.13	15.15
2012	47.15	42.92	5.55	37.37	22.04	14.65
2013	43.00	46.65	6.21	40.42	21.51	15.71
2014	41.95	46.63	8.14	38.48	23.65	13.73
Overall	47.21	40.29	4.37	35.92	21.60	13.17

Source: Authors' calculations using an unbalanced panel over the period 2009 to 2014. Data obtained from the INET BFA online database

The low LTDTA (below 10% over the six year period) attest to the difficulties Zimbabwean firms in accessing long term funds and banks not lending long. The average CLTA is almost nine times higher than LTDTA which further supports the lack of access to long term finance. CLTA represents short-term finance mainly made up of Trade credit to total assets (TCTA) and short-term borrowings debt to total assets (STBTA). TCTA consistently exceeded STBTA over the six year period. While this finding is not surprising as such results have been obtained in developed market) in Zimbabwe's multiple currency era this is attributable to limited bank credit availability.

## 6 Conclusion

The aim of the study was to review the corporate financing strategies employed by listed firms in Zimbabwe since the adoption of the multiple currency era in 2009. The study found that rights issues, private placements and convertible loans were the main strategies employed by ZSE-listed firms. These firms paid out low dividends in an attempt to recapitalise themselves. The trend analysis of the capital structure of these firms showed a declining trend of the contributing of equity in financing total assets and a simultaneous increase in the proportion debt in financing total assets. The financing strategies employed by the listed firms were affected by the tightening liquidity conditions caused by lack of confidence in the country and the economy and laws that scare away investors. Commercial banks employed financial strategies mainly geared towards meeting the minimum capital requirements set by the RBZ.

## References

- Bender, R. & Ward, K. 2002. *Corporate financial strategy*, Routledge.
- Bender, R. & Ward, K. 2013. *Corporate financial strategy*, Routledge.
- Brealey, R. A. & Myers, S. C. 2003. *Financing and risk management*, McGraw Hill Professional.
- Chinamo, T. Critical Analysis of Challenges and Successes of Zimbabwe's Capital Market. 2013 Lusaka , Zambia.
- Confederation of Zimbabwe Industries, C. 2011. Manufacturing Sector Survey. Harare Confederation of Zimbabwe Industries
- Confederation of Zimbabwe Industries, C. 2014. Manufacturing Sector Survey. Harare Confederation of Zimbabwe Industries
- Damodaran, A. 2011. *Applied Corporate Finance*, New Jersey, John Wiley & Sons
- Fire, C., Ross, S. A., Westerfield, R. W. & Jordan, B. D. 2012. *Fundamentals of Corporate Finance*, Berkshire McGraw-Hill Education
- Gitman, L. J., Beaumont Smith, M., Hall, J., Lowies, B., Marx, J., Strydom, B. & Van Der Merwe, A. 2010. *Principles of Managerial Finance : Global and South African Perspectives*, Cape Town, Pearson Education South Africa
- Kwenda, F. 2014. Trade Credit In Zimbabwe's Economic Recovery. *Mediterranean Journal of Social Sciences.*, 5, 431-439.
- Mallette, F. 2006. A framework for developing your financial strategy. *Corporate Finance Review*, 10, 11.
- Mangudhla, T. & Mambo, E. 2013. Zimbabwe: 700 Harare firms close. *Zimbabwe Independent*.
- Marx, J., De Swardt, C., Beaumont Smith, M. & Erasmus, P. 2011. *Financial Management in Southern Africa*, Cape Town, Pearson Education South Africa.
- Mhlanga, R. & Sibanda, M. 2013. An Investigation of Corporate Financial Strategies Used by Banking Institutions during the Hyper-Inflationary Period in Zimbabwe. *Mediterranean Journal of Social Sciences*, 4, 609.
- Ministry of Finance, M. 2010. Budget Statement. Harare: Government Printers.
- Nleya, D. 2013. Cash crunch exposes firms to predators *The Financial Gazette*
- Reserve Bank of Zimbabwe, R. 2010. Monetary Policy Statement. . Harare: Reserve Bank of Zimbabwe.
- Reserve Bank of Zimbabwe, R. 2012. Monetary Policy Statement. . Harare: Reserve Bank of Zimbabwe.
- The Financial Gazette, T. 2015. Zimbabwe: Demise of the Stock Exchange. *The Financial Gazette*