

SURVIVAL STRATEGIES FOR SMES IN HYPERINFLATIONARY ENVIRONMENTS: LESSONS FROM SMES IN HARARE CENTRAL BUSINESS DISTRICT

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Abstract

Lack of credit led to the failure of many Small to Medium Enterprises (SMEs) in Zimbabwe from 2005 to 2009 when inflation peaked at 231 million percent. The article attempted to determine how SMEs survived during this period. Survey data collected from 120 SMEs in Harare was analyzed using descriptive statistics. Results show that SMEs encountering credit constraints use illegal strategies such as hoarding of stock and converting cash sales to stable currencies in the black market. The article demonstrates that policy makers should create a stable operating environment in order to benefit from SME participation in the economy.

Keywords: Hyperinflation, Survival Strategy, Credit, SMEs

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Introduction

“During a financial crisis, alternative sources of finance are likely to dry out – stock markets crash and foreign lenders and investors pull out their money” (Love, Preve, and Sarria-Allende 2005).

This statement may be illustrative of conditions in Zimbabwe as its economy has been performing below its potential. The recurrent droughts, shortages of foreign currency, the withdrawal of international donor support, poor publicity of the country, low business confidence and the HIV/AIDS pandemic have perpetuated the situation. According to the International Monetary Fund (IMF) 2010 country report, “Zimbabwe’s export sector continues to run large current account deficits financed by short-term and volatile capital inflows and capital accumulation of arrears”. She is currently in debt stress – external debt. The skewed political landscape also exacerbated the economic meltdown particularly due to the land redistribution program. Zimbabwe is a landlocked country situated in south-central Africa. It is slightly smaller than California. It is bordered by Botswana on the west, Zambia on the North, Mozambique on the east and South Africa on the South. Harare is the capital city of Zimbabwe. Zimbabwe, formerly Rhodesia, was a British colony named after Cecil Rhodes of the British South Africa Company.

At the beginning of the new millennium, inflation remained a major challenge in the fight against poverty and unemployment. Inflation eroded

savings and impoverished people on fixed incomes. Zimbabwe has therefore been unable to achieve the desired socio-economic transformation and sustainable growth since the introduction of the economic reforms. Between 2000 and 2009 economic performance declined due to high levels of inflation and interest rates and shortage of foreign currency. All these factors reflected in real Gross Domestic Product (GDP) growth rates that have been negative for nine successive years since 2000, when the first double-digit decline was recorded (EconomyWatch 2009; WealthDaily 2008).

Zimbabwe experienced the worst economic decay in the world from 2000 – 2009. Hyperinflation skyrocketed to unprecedented levels of 231 000 000 per cent (Reserve Bank of Zimbabwe 2009). This resulted in a financial crisis and the disappearance of formal bank and trade credit necessary for supporting the working capital requirements of Small to Medium Enterprises (SMEs). Financial institutions (the major providers of working capital and capital expenditure finance), that failed to maintain the minimum regulatory capital requirements were closed by the regulatory authorities. Others were merged. This resulted in a significant reduction of the aggregate ability of banks to extend credit. The demand for credit thus exceeded supply. Monetary authorities responded by resorting to a very tight monetary policy. The restrictive monetary policy resulted in interbank rates rising up to 9 500 per cent per annum. High interest rates made the prospects of borrowing less commercially viable for companies, especially

small to medium-scale enterprises (Reserve Bank of Zimbabwe 2005).

Figure 1 below illustrates the location of Zimbabwe.

Figure 1. Location of Zimbabwe



Source: <http://www.infoplease.com/atlas/country/Zimbabwe.html>

SMEs have been credited for playing a pivotal role in sustaining Zimbabwe's economy, especially over the period under study during which the country faced numerous and enormous economic challenges. A lack of funding, limited access to land, poor infrastructure and strict by-laws are some of the challenges that retarded the growth of SMEs in Zimbabwe. Access to credit finance is another key factor that was critical for the sector. SMEs were underfunded and the hyperinflationary environment in which they operated, coupled with economic challenges facing Zimbabwe, made it very difficult for them to get funding from banks. Over the years of the economic meltdown many SMEs closed down, while others survived, even in the absence of the much needed formal bank credit.

But how did they weather the storm? The SMEs that managed to remain afloat from 2000 through to 2009 were studied and particular attention was given to their survival strategies. This article highlights the SME survival strategies under conditions of hyperinflation in an economy that gets no formal financial support from the banking sector.

This article offers an exposition of the extent of entrepreneurial acumen in SMEs in Zimbabwe and argues for profit retention and equity accumulation as

a means of survival in the absence of bank and trade credit. The article proceeds as follows: the next section, which presents the literature related to alternative financing strategies for SMEs, is followed by data collection methods to identify survival strategies. Finally the results and the analysis of the survey guide the conclusions of the study.

Literature Review

Defining SMEs

To date a conclusive definition of an SME, which is universally accepted, has been elusive. There is no clear-cut definition from the Ministry of Small to Medium Enterprises as to what constitutes an SME in Zimbabwe (Gogo 2007). There are disparities in the official definitions of SME used by national governments because of the geographical and economic diversity. Table 1 is an example of the various government-specific definitions. The group of these governments is first listed by each country's rank in per capita gross national income (PC-GNI) and then by their rank as to the maximum number of employees of an SME according to the national government.

Table 1. Official national definitions of SMEs

Country by PC-GNI	Maximum no. of employees	Country by SME size	Maximum no. of employees
Belarus	250	Vietnam	300
Moldova	250	Belarus	250
Switzerland	250	Moldova	250
Australia	200	Switzerland	250
Morocco	200	Australia	200
Peru	200	Morocco	200
Thailand	200	Peru	200
Brazil	100	Thailand	200
Norway	100	Bangladesh	100
Egypt	50	Brazil	100

PC-GNI: Per capita gross national income

Source: Gibson and Van der Vaart (2008)

Gibson and Van der Vaart (2008) argue that, logically, these rankings should at least *tend* to be similar. One should assume that the wealthier the economy, as defined perhaps by per capita income, the larger the size of any business considered being small or medium relative to other business in the country. Yet the largest Vietnamese SMEs are, officially, three times the size of the largest Norwegian SMEs. What is officially an SME in Egypt may not exceed half the size of the upper limit in Ghana, despite the fact that Egypt's PC-GNI is roughly three times as large. Gibson and Van der Vaart (2008) suggest that "given that the economic contribution of SMEs depends critically on initial success in their home markets, the size parameters of SMEs should be scaled relative to their home base".

For the purpose of this study, a definition was adopted based on workforce size, namely enterprises which employ 5 – 100 workers. This is a definition which is widely accepted in Southern Africa (Japan International Cooperation Agency 1998; Jobs For Africa (JFA)-PRESA-Zimbabwe 2000; Liedholm and Mead 1993; Malawi Government 2003). Other definitions which set criteria based on turnover or assets are rather problematic since most SMEs do not keep proper records, (JFA-PRESA-Zimbabwe 2000).

Types of Finance Used by SMEs

The main categories of SMEs in Zimbabwe can be divided into two broad categories, namely off-farm and on-farm oriented activities (Ngwenya and Ndlovu 2003). The first category (hereafter referred to as category 1) largely comprises urban dwellers while the second (category 2) is predominantly those found in peri-urban and rural areas. Category 1 activities include retailing, tailoring and dressmaking, cross-border trading and light industrial work, for example carpentry, arts and crafts and welding, among others. The on-farm activities include agricultural enterprises engaging in poultry farming, market gardening, animal husbandry, cereal production and small-scale

irrigation projects. This article is limited to the urban retail businesses because they were more easily accessible to the researcher than those outside the city.

The financial crises experienced by emerging markets during the nineties present extreme cases of collapse of institutional financing and, consequently, can be useful in studying the role of alternative sources of financing during periods of severe monetary contraction (Love et al. 2005). Petersen and Rajan (1997) found that firms with weaker banking relations use more trade credit. Nilsen (2002) shows that small firms and large firms without bond ratings increase reliance on trade credit during monetary contractions. Fisman and Love (2003) argue that in countries with undeveloped financial intermediaries trade credit provides an alternative source of funds, which allows higher growth rates in industries that can be characterized as intense trade credit users. Wilner (2000) claims that suppliers tend to assist customers in distress to maintain long-term commercial relationships.

Success Factors for SMEs

The economic success of SMEs in many countries derives from the degree to which they are able to overcome market and institutional failures by being embedded in private institutional support systems. In some cases, long-term business relationships act as a substitute for weak public institutions. In other cases, large firms provide private institutional support mechanisms to SMEs by way of various business linkages, for example through sub-contracting networks (Biggs and Shah 2006). Prominent examples of such private orderings can be found in the inter-firm relationships and informal credit arrangements in many Asian and Eastern European countries (McMillan and Woodruff 1999), as well as in the satellite networks in Japan, industry clusters in Taiwan, and industrial districts in Italy and the United States (Becattini 1990; Piore and Sabel 1984).

Others have reasonable networks with peer SMEs, but these are either kinship-based or with the owner's friends. Some business advice is exchanged, and the SMEs help each other through informal loans. This, and their overall informality, suggests that networks are really about helping each other out, to maintain survival, rather than being concerned with learning (Chipika and Wilson 2006). Chipika and Wilson concluded that networks that are based on kinship and friendship are founded on high levels of trust and can be excellent support mechanisms for small firms that lack access to finance and where attention to other pressures of daily life means owners cannot give their enterprises the full attention they need.

Firms with a high share of short-term debt are likely to be the most disadvantaged by a financial crisis, due to increased interest rates and difficulties in rolling over debts. Before the crisis, when short-term debt is abundant and (relatively) cheap, firms with a higher percentage of short-term debt provide more credit to their customers and rely less on credit from suppliers. However, after the crisis, these firms face a disadvantaged financial position, and consequently they significantly cut credit extended to their customers, and use more credit from suppliers. That is, firms with higher reliance on short-term debt are the main suppliers of trade credit during non-crisis periods, but they reduce trade credit provision relatively more in response to the aggregate collapse of bank credit (Love et al. 2005).

While it is likely that some firms benefit from a crisis, on average most firms are hurt by it. Michaelas, Chittenden and Poutziouris (1999) support this view. In their study of financial policy and capital structure choice of U.K. SMEs, they concluded that in general terms, average short-term debt ratios in small firms appear to increase during periods of economic recession and decrease as the economic conditions in the marketplace improve, indicating the sensitivity of small firms to macroeconomic changes. According to Michaelas et al. (1999), small business owners tend to use retained profits as much as possible and then raise debt only when additional finance is essential. This is in line with Myers's pecking order theory. Given the collapse of alternative sources of financing (which suddenly dry up or become very expensive), it is natural to expect an increase in trade credit demand in the immediate aftermath of the crisis, as firms move down in the pecking order (Love et al. 2005). While they cannot decisively disentangle intended from unintended credit, their study makes it apparent that trade credit can provide a very short-term source of "emergency capital" due to the flexibility in credit terms, which allow for temporary extension of credit maturity.

This article is based on research that investigated the extent to which credit was available to SMEs in Zimbabwe in view of the high borrowing cost during the period 2005 to 2009. Cunat (2000)

argues that this assistance in case of temporary illiquidity is one of the reasons why trade credit is so expensive. Love et al. (2005) advance their findings which suggest that while trade credit could serve as a source of very short-term "emergency credit", it could not fully substitute for constrained bank credit in the aftermath of the crisis. While this is a true analysis, this conclusion omits to say whether bank credit can be substituted during the crisis. In the case of Zimbabwe, bank credit as well as trade credit literally vanished from commerce, which prompted this study on how businesses in general and SMEs in particular survived the scourge of the hyperinflationary operating environment.

Effects of Hyperinflation on the Supply of Finance to SMEs

During a financial crisis, alternative sources of finance are likely to dry up – stock markets crash and foreign lenders and investors pull out their money. Small companies with few assets reduce the efficacy of legal actions. There are few assets to seize in the case of default, and transactions are generally too small to justify the time and money involved in formal court actions. Many business deals simply avoid problems by engaging in self-enforcing, cash-on-delivery spot transactions. These kinds of business relationships facilitate exchange in many cases, but if exchange is confined to such forms of governance, it can be costly in terms of foregone profitable opportunities requiring more complex contracting arrangements (Biggs and Shah 2006). This is true for Zimbabwe; as inflation rose, interest rates responded by acute upswing leaving bank credit finance not an option for short-term financing. Leading investors and providers of credit pulled out their investments, relocating in neighboring countries. This obviously affected most of the beneficiaries of short-term credit as well as short-term bank financing. In the process SMEs were not spared, especially given their perceived high risk profiles. Consistent with their argument, Love et al. (2005) also found that countries that experience a sharper decline in bank credit also experience a sharper decline in trade credit. Their results are also consistent with patterns observed by Demircuc-Kunt and Maksimovic (2001) who found that the provision of trade credit across countries is positively correlated with the level of development of financial intermediaries.

The periods of financial crisis are usually characterized by a high rate of liquidations and consolidations. Domac and Ferri (1999b), for instance, used a conceptual framework based on "credit view" of monetary policy to analyze the existence of a credit crunch in Indonesia, Korea, Malaysia, the Philippines, and Thailand. Specifically, they argue that a widening of the spread between the lending rate and a representative rate on risk-free assets while at the same time real bank credit is

falling represents evidence that the demand for loans could not have declined by more than the supply of credit. They found evidence (based on the spread between bank lending rates and corporate bonds) consistent with this view and thus concluded that the credit crunch was widespread, affecting particularly small-sized firms, for whom close substitutes for bank credit are unavailable. Agenor, Aizenman and Hoffmaister (2000), like Ito and Pereira da Silva (1999) and Domac and Ferri (1999a), also found that small and medium-sized firms in Thailand faced binding constraints in accessing credit markets in the aftermath of the crisis.

Thus far the article has examined the impact of the absence of formal finance on SME performance. There appears to be consensus that a lack of formal finance has an adverse effect on the profitability and therefore the growth of SMEs. After analyzing firm growth internal funds availability and financial environment characteristics, Saeed (2009) has varying views on the impact of financial sources on small firm growth. He suggests that formal financing has a positive impact on firm growth while informal finance retards growth. This observation supports the view that better developed financial systems containing well-functioning banks, credit companies and security firms improve resource allocation and accelerate firm growth.

Data and Methodology

The statistical analysis utilized a sample containing 200 SMEs all from the Harare central business district. These were drawn from a list of SMEs supplied by the Ministry of Small and Medium Size Enterprises containing 945 registered SMEs. The SMEs were randomly selected and surveyed using a structured questionnaire containing 17 questions. The survey asked detailed questions about various dimensions of business and access to finance quantitatively. Questions asked were based on demographic, financial and environmental topics. The purpose was to have a good understanding of the background of the respondents, financial interface with the financial institutions, non-bank credit providers as well as how the SMEs responded to the

challenges posed by the operating environment. The sample was limited to 200 due to financial constraints. Of these, 125 responses were received of which five were excluded from the analysis due to missing data. The quantitative data collected was analyzed using SPSS. Descriptive statistical measures were used to explain the results of the survey.

Under demographic questions respondents were asked to provide details of when they started operating and the number of employees in 2005 and 2009. Using the number of employees for the two periods as an indicator, the purpose was to determine whether the respondent SMEs were growing or declining. The research acknowledges that a decrease in the number of employees may be a result of other factors such as mechanization. These factors are controlled for because capital expenditure was low due to high borrowing costs. Respondents were asked to provide information on the level of both bank and trade credit for 2005 and 2009. This information was meant to assist in the determination of whether external financial intervention was sought for supporting cash flow management. The respondents were asked to give feedback to only one open-ended question on the techniques they used in order to remain in business. The year 2005 was used as the base year since the hyperinflation began enunciating itself during that year, while 2009 was the year when the Zimbabwean economy was dollarized, thus slowing down hyperinflation. Since then the rate of inflation retreated to single digit. According to the latest report of the Central Statistical Office (CSO), the year-on-year inflation rate stood at 3% as at February 2011 (Central Statistical Office 2011).

Discussion of Results

Ninety-three percent of the respondents had been in business for up to 15 years. Table 2 indicates the age analysis of the respondents. These respondents were drawn from the manufacturing, retail, agriculture, services and wholesale sectors. This means that they were in existence before, during and after the hyperinflationary period under review making them appropriate units of analysis.

Table 2. Age Analysis of SMEs Surveyed

Age of SME	0 – 5 yrs	6 – 10 yrs	11 – 15 yrs	16 – 20 yrs	Over 20 yrs
percent of respondents	34.6	44.4	13.6	3.7	3.7

Analysis of Number of Employees

Respondents were asked for the number of employees in their books in 2005 and 2009. This data was required for the determination of growth of the

business measured by the increase or decrease in the number of workers in the business. Table 3 shows the levels of employment in the two comparative periods.

Table 3. Number of Employees

No. of employees	2005 (% respondents)	2009 (% respondents)	Variance (percent)
≤10	72.8	80.2	+7.4
11-20	19.8	9.9	-9.9
21-30	6.2	7.4	+1.2
30≤	1.2	1.2	0

Results indicate that the number of SMEs with 10 or fewer employees increased during the period under review. While 72.8 percent of the respondents indicated that they had fewer than 10 employees in 2005, by 2009 the situation had deteriorated with 80.2 percent reporting fewer than 10 employees. The number of SMEs that employed 11 – 20 workers had declined by 2009. This explains the increase in the number of businesses employing up to 10 workers by 2009.

Analysis of average bank credit used between 2005 and 2009

Regarding when the respondents last accessed credit, 68.1percent reported that they had last used bank

credit in 2007 suggesting a reduction in the supply of bank credit at the height of hyperinflation in 2008 and 2009. This result was confirmed by 85.2 percent of the respondents who reported that banks played a peripheral role in the survival of their businesses. In some cases there was no involvement of banks at all (33.3 percent) while in others there was moderate assistance from banks (51.9 percent).

Analysis of Use of Trade Credit

Respondents were asked when they last used trade credit before 2010. This was meant to include the year 2009 when the economy was stabilized through dollarization. The results are presented in Table 4.

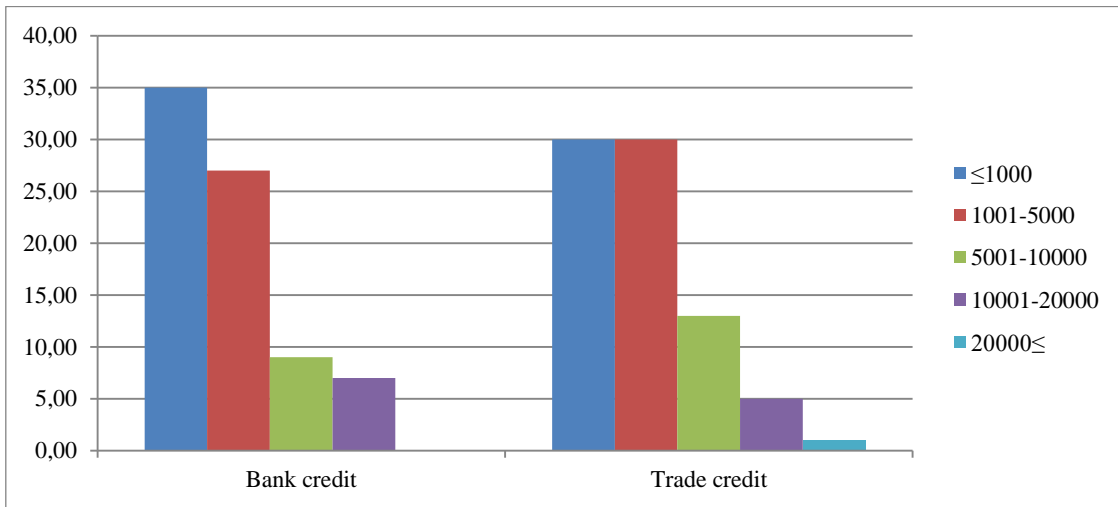
Table 4. Access to Trade Credit

Year last accessed trade credit	No. of respondents (percent)
2005	29.3
2006	12.0
2007	17.3
2008	20.0
2009	21.3

The results presented in Table 4 show that only a few SMEs accessed trade credit between 2005 and 2009. An average of 20 percent accessed trade credit between 2005 and 2009. This is below the 2005 level of utilization. A total of 29.3 percent of the respondents indicated that they accessed trade credit in 2005. The results suggest that there was a decrease in the supply of trade credit during the period under review. An analysis of whether SMEs borrowed on loan from other businesses revealed that 50.6 percent did not engage in this type of financing while 49.4 percent did, which could be an indication that SMEs turned to nonbank providers of finance to support their cash flows.

The declining amount of credit accessed by SMEs is illustrated in Figure 2. This confirms earlier studies in Ghana by Tagoe, Nyarko and Anuwah-Amah (2005) that in times of economic distress [for example during financial sector liberalization] the supply of credit diminishes. Results from the survey revealed that 44.9 percent received under US\$1000 and 34.6 percent received between US\$1001 and US\$5000 annually as bank loans. In the same period, 38 percent of the respondents accessed less than US\$1000 annually in the form of trade credit. A further 38 percent accessed trade credit ranging from US\$1001 to US\$5000.

Figure 2. Access to Bank and Trade Credit

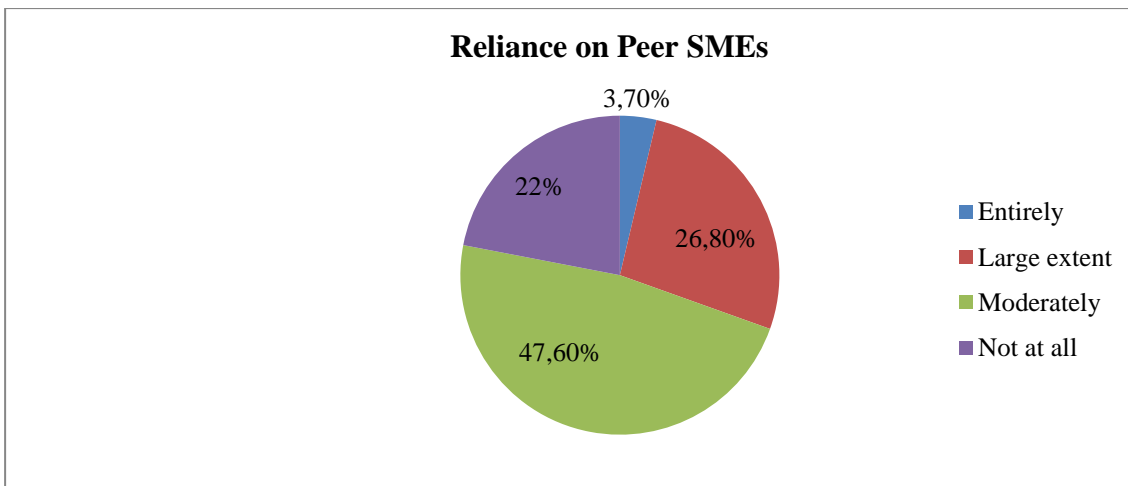


Detailed Analysis of Institutional Reliance on Peer SMEs Linkages

Respondents were asked to state the extent of their reliance on institutional linkages such as sub-contracting. The extent of reliance was described as “large extent”, “moderate” and “not at all”. A total of 42.7 percent utilized this window while 57.3 percent indicated that they did not use institutional linkages at all.

An analysis was done of the extent to which SMEs relied on peer SMEs. Results indicate that only 22 percent of the respondents did not rely on peer SMEs to support their operations. The majority were found to have moderately or entirely relied on peer SME support. Approximately 95.1 percent confirmed that they relied on advice from peers. Figure 3 illustrates the extent to which respondents relied on advice from peer SMEs.

Figure 3. Reliance on Peer SMEs



Analysis of Government Support

Respondents were asked about the extent to which government regulations supported their business. The feedback was to be on a scale ranging from “entirely” to “not at all”. Results show that only 11 percent indicated that government regulations were supportive of their businesses.

Other Survival Techniques Used by SMEs

Respondents were asked to list other techniques which they used to remain in business during the hyperinflationary period. Table 5 presents a detailed analysis of those methods used by the respondents to save their businesses from collapse.

Table 5. Methods Used to Sustain the Business

Strategy	Respondents (percent)
Hedging with forex	42.6
Repricing inventories	16.2
Buying in bulk and hoarding	14.7
Importing stocks from RSA	10.3
Reducing man hours	16.2
	100

Respondents mentioned a wide range of business management practices that helped to sustain their business. From those given in the questionnaire, hedging the trade receipts of the business with foreign exchange was the most popular, with 42.6 percent of the respondents finding it the most secure option. Zimbabwe Dollar denominated sales receipts were immediately translated into hard currencies such as US Dollars, British Pounds, South African Rands and Botswana Pula. Stocks were also repriced in order to keep in line with the replacement cost. Other respondents (16.2 percent) indicated that they reduced man hours in order to maintain profitability. To ensure that businesses remain operational, inventories were purchased in bulk and hoarded (14.7 percent). Most of the inventories were imported from South Africa (10.3 percent), as the manufacturing sector was badly affected by shortages of raw materials and was therefore operating at far below capacity.

Conclusion and Recommendations

The purpose of the article was to determine the survival strategies used by SMEs in the Harare central business district during the hyperinflationary period experienced in Zimbabwe. At a macro level, most businesses failed due to severe economic instability leading to poor corporate governance the results of which filtered down to the micro level. The study focused on those SMEs that managed to sustain their operations from 2005 until 2009 when the economy was stabilized by a deliberate government policy to dollarize. The aim was to determine what the surviving SMEs did differently from those that failed in order to mitigate the high risk of hyperinflation.

Previous studies on the same subject have shown that during periods of chronic economic disorder, markets fail. Most SMEs fail to respond positively to challenges such as rising interest rates and a drop in the supply of both trade and bank credit. This normally leads to constrained financing options for those businesses that have a significant reliance on external sources of finance. Results of the survey have confirmed that there is a significant reduction in the external financing options when an economy is subjected to conditions of hyperinflation.

Although SMEs play an important role in the economic growth process, particularly in employment creation in many developing economies, they are faced with many constraints that limit their potential.

Limited access to finance is one of the reasons why it is difficult for SMEs to achieve these objectives. This research has brought to light some of the major challenges that SMEs in hyperinflationary economies encounter, such as a lack of trade and bank credit. This limits their operating capacity at firm level. The focus of this study was on the survival strategies that SMEs operating in a hyperinflationary environment would employ to remain in business. The research concluded from the results that in times of hyperinflation, SMEs resort to hedging strategies such as holding high volumes of inventories (hoarding), converting weak domestic currency into a stable foreign currency, and constantly repricing inventories. Unlike large companies that continue to enjoy access to formal credit, SMEs have to rely on assistance from peer SMEs for advice and loan increases.

The research sought to clearly spell out the strategies used by SMEs in a hyperinflationary environment. It is, however, acknowledged that the study that was restricted to the Harare central business district could have been extended to other provinces of Zimbabwe in order to have more generalizable results. The research could not cover a larger sample due to financial and other logistical limitations. The summary of this research is set to motivate further research on what could enhance SME growth in developing countries. To this end a qualitative approach in which captures data from SMEs which failed and those which survived is recommended. The prevalence of political crises in African countries in 2010 and early 2011 should be read as a potential cause of economic crises which stagnate SME efforts to contribute to employment creation and economic growth. Considering the confirmation by this research that formal and informal sources of finance shrink, it is recommended that further research be conducted on alternative ways of survival of SMEs in other sectors. It is also recommended that in formulating both economic and political policies, the strategic importance of SMEs should be taken into account.

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