

# An Analysis of the Obstacles to the Success of SMEs in Chinhoyi Zimbabwe

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## Abstract

This paper sets out to analyze the obstacles hindering the success and development of SMEs in Chinhoyi, Zimbabwe. To achieve this, the research hypothesised that limited access and cost of finance, lack of marketing skills and market knowledge inadequate management and entrepreneurial skills, lack of access to infrastructure, inaccessible to land, lack of information and a hostile regulatory environment are some of the factors hindering the development of SMEs in Chinhoyi. This is a conceptual paper and the methodology used is a secondary research in which in depth literature review has been from books and journal as well as articles. The findings of this paper confirm that, SMEs view it as advantageous to remain part of the unregulated market because of perceived advantages like not paying taxes and other statutory dues, not having to comply with regulations that apply to formal business, being able to take short-cuts and being accountable to no-one. This then creates barriers against those same SMEs doing business with registered operators, who are the large companies. It therefore severely curtails the SME's potential market. Again the "informal" setup is the fact that the SMEs themselves do not keep proper accounting records of their activities and as such there is no track record of what the proprietor would have done and this makes banks reluctant to offer them credit facilities resulting in financial difficulties to finance operations for expansion. Again SMEs have a tendency to jump from one thing to another, depending on what will be making money at any particular time, an approach referred to as "kiya-kiya" (patchy/quick-fix) which makes them to fail to deliver the service promise and as a result they lose customers. Therefore the study concludes that SMEs firms need to transform their mindset that will see them succeed and graduate to becoming large corporations.

**Keywords:** MoSMEs - Ministry of Small and Medium Enterprises, SME- Small and Medium Enterprise, RBZ - Reserve Bank of Zimbabwe.

## 1. Introduction

The obstacles hindering the development of SMEs is currently a topical issue, especially in developing countries as governments are seeking ways to improve the efficiency in the operating environment of SMEs. The growth and success of Small and Medium Scale Enterprises (SMEs) has drawn the attention of policy makers, economists, researchers and politicians (Saeed, 2002; Wiebe, 2002). The SME sector is now regarded as the answer to most developmental problems in developing countries (Saeed, 2002; Wiebe, 2002). Worldwide, there is a growing realisation that small to medium enterprises (SMEs) have not only contributed the bulk of countries' gross domestic product (GDP), but are by far the biggest employers within economies.

### 1.1 Statement of the problem

In Chinhoyi, Mashonaland West province of Zimbabwe, the SMEs story has not been quite rosy. The recognition of SMEs as a dominant part of the economic matrix is not being realized. The Ministry's emphasis has been more on micro-enterprises. Most SMEs are subsistence-oriented, or aimed at fulfilling narrow goals or objectives and aim at ensuring survival, or pursuing maximum wealth within the shortest possible time. Up to now, a number of people starting businesses are doing so because they have failed to secure employment or are just looking for a simplest method to upkeep their families. Moreover access to finance has again become a challenge to Small and Medium Enterprises (SMEs) in Chinhoyi Zimbabwe. Given such a situation, SMEs in Chinhoyi have failed to expand their operations to harness additional demand and opportunities that come along, and as such they simply service whatever portion of the market they can, and leave the rest of the market unsatisfied. This leads to the entry of other new players, who often will have an expansionary thrust as well as the vision to employ superior production methods, thus driving the small-minded player out of business.

### 1.2 Definition of SMEs in Zimbabwe

A lot of definitions for SMEs have been put forward by a number of authors mainly concentrating on factors such as: number of employees, turnover levels, total net assets and capital base, (Hisrich et al, 2004; (Maseko 2011) Kapoor et al, 1997. Again some other authors (Siropolis, 1997; Stokes, 1995) have included legal structure and degree of formalization in their definitions of SMEs. The International Accounting Standards Committee Foundation (IASCF) (2007, p.15) cited in (Maseko 2011) defines an SME as an entity that does not

have public accountability and thus publishes general purpose financial statements for external users. The Ministry of Small and Medium Enterprises and Cooperative Development (MoSME & CD) policy document (2009), have defined a small and medium enterprise (SME) in Zimbabwe as a legal business entity considering the following factors:

- (a) Turnover of less than US\$800 000,
- (b) It is not a subsidiary or branch or associate of a large business organization and,
- (c) Maximum number of full-time permanent employees as given in the following table:

**1.3 Zimbabwean definition of SME by number of employees.**

| Sector/sub-sector of the Economy   | Size/class | Max total number of full-time employees (paid) |
|--|------------|--|
| Agriculture, manufacturing and mining  | Micro-     | 5  |
|  | Small-     | 50   |
|  | Medium-    | 100  |
| Construction, transport, retail, tourism, catering, arts and crafts, wholesale and fisheries | Micro-     | 5  |
|  | Small-     | 30   |
|  | Medium-    | 50   |

Source: *MoSME & CD Policy Document 2009.*

**2.0 Literature Review**

**2.1 Importance of SMEs development in Zimbabwe**

The contribution of the SMEs sector to the Zimbabwean economy is crucial for the achievement of the broader development objectives such as poverty alleviation, spreading of employment opportunities and increasing indigenous ownership of resources in the economy (Chidoko et al, 2011). The SMEs benefit Zimbabwe since they have the potential to innovate, are flexible, need low start-up costs, have the potential for rapid development (Maseko 2011). SMEs provide a solution to the employment problems facing Zimbabwe since the majority of the people are employed in this sector of the economy, (RBZ, 2009). The medium term experience in the economy has been that investment levels are not sufficient to generate employment for the 300 000 graduates in Zimbabwe on an annual basis (Nyoni, 2002:2; Rwafa, 2006:8). SMEs are a vehicle for economic growth, improvement of standards of living and employment creation (Mawadza, 2006). The fact that large companies are closing down and others are downsizing their operations, SMEs have the capacity to absorb people for employment (Zindiye et al, 2008). The SMEs sector, if supported, will help resuscitate the economy by creating jobs, new products and services and new technology. The increasing numbers of school leavers and university graduates will be absorbed by the growing firms. This will also help to nurture the entrepreneurial spirit in the society (Maseko 2011). SMEs benefit the economy through mobilising and stimulating the vast potential for entrepreneurship, facilitating a wide economic base and the creation of wealth, Increasing the nation's wealth through fuller utilisation of all the country's human resource capabilities, developing an economic structure that is self-sustaining with a high degree of sectoral linkages and Increasing indigenous ownership of investment in the economy (Nyoni, 2008).

**2.2 Barriers to SMEs Development in Zimbabwe**

The Zimbabwean SMEs has been affected by a number of constrains and various studies has pointed out that the major ones are as follows (Nyoni, 2002:10):

- Limited access and cost of finance;
- Lack of marketing skills and market knowledge;
- Inadequate management and entrepreneurial skills;
- Lack of access to infrastructure;
- Lack of access to land;
- Lack of information; and
- A hostile regulatory environment.

SMEs have problems in securing adequate finance since they are deemed to lack collateral security and banks are not interested to fund their business activities. The cost of financing SME operations is very high in terms of the interest rates that they pay at banks. A lack of marketing skills and inadequate knowledge of the market adversely affects SMEs business operations since they fail to attract and retain customers. The inadequate knowledge of the market also results in SMEs failing to satisfy the needs of the customers. Furthermore, a lack of managerial and entrepreneurial skills hampers the growth of SMEs in Zimbabwe (Nyoni, 2002:10). There is also a huge shortage of infrastructures such as land, buildings, machinery and equipment to effectively carry out their business activities. The lack of sufficient information in the market and changing customer trends and preferences negatively affect SMEs, this is coupled with a hostile regulatory environment which also contributes to the poor performance of SMEs in Zimbabwe. This is due to the continuous changes in 14 government policies

which make it difficult for SMEs to function properly (Ngwenya & Ndlovu, 2003:5). SMEs in Zimbabwe also face a serious challenge to get transport, inadequate equipment and insufficient resources to execute planned business activities. Manufacturing SMEs experience difficulties in accessing transport facilities to deliver their finished products to the market. The internal environment of the firm is crucial to the performance of the firm (Chew et al, 2004) cited in (Chadamoyo, 2012). The major element of the internal environment of the SMEs is the top managers' ability to develop effective strategies. The SME sector in Zimbabwe is, furthermore, experiencing problems such as a lack of appropriate management skills to run their business entities. Lack of formal management training in the management of the SMEs is a weakness inherent in these forms of businesses and automatically becomes a critical factor limiting the growth and expansion of such businesses (Yan, 2010). This is further compounded by lack of access to loans, inhibiting legal frameworks, access to markets, quality products and registration bureaucracy (Masuko & Marufu, 2003:29). SMEs in Zimbabwe lack the necessary human resources skills, marketing skills, financial management skills and general management skills to ensure the continued survival of the sector in the country. Lack of management skills therefore has a serious negative impact on the growth of the SME sector in Zimbabwe. The legal framework again is not favourable towards the establishment of SMEs in Zimbabwe. SMEs have limited access to the market since it is dominated by giant companies. SMEs are still backwards in the production of quality products which meet international standards due to their inability to purchase quality raw materials as a result of financial constraints. SMEs are regarded as being poorly managed, badly organised and reliant on outmoded technologies to produce inferior products and services that do not attract clients (Mason and Harrison, 1990), cited in (Chadamoyo, 2012). SMEs are also facing cutthroat competition due to due globalisation. Globalisation presents both challenges and opportunities to SMEs (Bowen, Morara and Mureithi, 2009). The dynamics of small-scale industries have become more challenging. As SMEs are required to offer products to the required international standards they cannot compete in a globalised world. This is due to the fact that SMEs have limited access to finance which reduces their ability to get quality raw materials and as such they become less competitive (Nyoni, 2004:9). Moreover, SMEs in Zimbabwe are also experiencing bad publicity in the western media and fuel shortages which, contributes to the high failure rate of SMEs in the country (Ndlovu, 2004:19). This negative publicity results in low foreign direct investments which consequently increase the SMEs' challenge of limited access to sources of finance.

### **2.3 Assistance provided to SMEs in Zimbabwe**

#### *2.3.1 Investment Promotion*

In an effort to attract foreign investors, the government has formulated the following strategies for intervention to stimulate the growth and development of the SME sector in Zimbabwe (Gono, 2006:

#### *2.3.2 Tax Relief*

SMEs are not subjected to the full rate of tax, they have a lower corporate and capital gains tax threshold. Moreover SMEs are also given a five year grace period on taxation during their start up phase. This tax incentive is also used as a transitional process to encourage the graduation of small businesses from the informal to the formal sector and to widen the tax base. Further to that the Zimbabwean government has also introduced tax breaks for companies which subcontract to SMEs or which earmark funds for the sector such as 'business angels'. Business angels are financial backers who provide venture capital funds to small start-ups or entrepreneurs (Zindiye et al, 2008).

#### *2.3.3 Discounts and rebates*

Rate rebates or discounts on land and services can represent a valuable incentive. These are viewed as some of the most effective incentives in that a discount in land cost will result in a reduced cost of production which will increase the viability of SMEs.

Other support mechanisms include credit finance, credit guarantees, business linkages, technical skills training, marketing and distribution support and trade facilitation through Zimtrade.

### **2.4 Operating Environment**

Traders in the SMEs sector constantly suffer new challenges. The operating environment is ridden with the following issues; city councils hike their rates without notice and the traders are accused of smuggling goods in order to avoid paying duty to ZIMRA. The Committee observed that this is due to fact that this is due to the strained relations between the traders and city council officials and ZIMRA (Moyo, 2010).

### **2.5 Legal and Regulatory Environment**

There are a number of legal and regulatory impediments faced by SMES in Zimbabwe, which discourage investments and growth in the sector. The sector has been affected by laws such as the Statutory Instrument 216 of the 1994 Regional and Town Planning Act, Land Use Act and the Environmental Management Act. In one instance, small scale miners were being hampered in their operations by stringent regulations imposed by Environmental Management Agency (EMA). The Committee was told by the Permanent Secretary that the legal and regulatory environment could only improve with the support of other line Ministries. (Moyo, 2010). While a regulatory framework is necessary for the operation of businesses, overregulation is a worldwide threat to the

competitiveness of the business sector. Furthermore, complex regulations can create an environment for avoidance as prospective entrepreneurs will be reluctant to engage in business activities as a result of stringent regulations (Zindiye et al, 2008).

Policy makers need to ensure that regulations in place are pro-active and do not impose disproportionate costs on businesses or the consumer. Legal instruments and regulations are aimed at ensuring minimal administrative work. The regulatory remedies should focus on the following:

- \_ Simplification of Complex Regulations;
- \_ Improved Access to Information; and
- \_ Centralizing and Streamlining Procedures. (Ndlovu, 2002:7) cited in (Zindiye et al, 2008)

A strong institutional framework supporting the development of SMEs is already in place in Zimbabwe, as evidenced by such long- standing institutions as SEDCO, Empretec, and UNIDO, the ILO arms, among several other institutions currently providing technical and financial support to the sector (RBZ, 2006:8). However, RBZ (2009:13) recommends that these institutions must be reconfigured into tangible activities in support of the SMEs. The primary role of government should be to provide an enabling business environment that opens access to markets and reduces policy-induced biases against SMEs (Maseko, 2011).

### 2.6 Infrastructure and utilities

SMEs in Zimbabwe face challenges of inadequate business shelter, the majority of them do not have sheds to protect their finished products when it is raining. Moreover there is also a shortage of water and electricity and this is a major concern as these shortages affect the production of these SMEs. The SMEs also are being affected by the high tariffs being charged by these parastatals (Moyo, 2010). Zimbabwe's public infrastructure continues to disintegrate. This is invariably the case in the country's four major sectors of infrastructure: roads, railways, electricity and water (World Bank (2006). It is reported that for the past decade Zimbabwe has experienced lack of growth in water and sanitation coverage in both the urban and rural sectors. The capacity of water and sanitation infrastructure is estimated to be 30% below requirements in the urban areas. A significant section of the rural sector primary water supply infrastructure has broken down, mainly due to the collapse of institutional structures from the NAC down to the village level as a result of inadequate funding (World Bank, Ibid. p.51).

### 3.0 Conclusion

Zimbabwe now have a strong institutional framework that support the development of SMEs, therefore what the SMEs in Chinhoyi need to do is to transform from operating as an individual and adopt a team work approach so that they have a strong bargaining power and a strong leverage towards their stakeholders.

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