ASPECTS OF SMALL AND MEDIUM SCALE ENTERPRISE FINANCING IN ZIMBABWE

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ABSTRACT

Small and medium scale enterprises (SMEs) are incredibly important from an economic and political point of view. They play a significant role in generating jobs, tax revenues, social stability and economic growth. In developing countries, particularly those with macro-economic instability such as Zimbabwe, the most significant challenge facing small to medium scale enterprises is access to capital. Utilizing institutional analysis, this thesis examines the physical, legal, financial and managerial infrastructure capacity for mobilizing capital for SMEs in Zimbabwe. It suggests that for reasons of institutional path dependency, SMEs have been over reliant on bank financing in Zimbabwe. Bank finance has limitations for companies wishing to grow, because it tends to be in the form of short term loans and overdrafts. Long-term debt is usually beyond the reach of SMEs because of lack of collateral and information asymmetries. In situations of macro-economic instability, bank debt becomes expensive and mostly unavailable to SMEs. Banks discriminate against SMEs in comparison to large-scale enterprises by rigid enforcement of claims, limiting credit, charging higher interest and insisting on real security as a condition for lending.

The thesis therefore suggests the introduction of new financial instruments to supplement the existing debt instruments. A working hypothesis is that bank debt, when available, can service the needs of SMEs up to a certain level. Once this level is reached, the rates of return by companies relying on bank debt may become static. At this point for companies that want to grow, equity may offer a more advantageous financing alternative. Offering equity gives companies greater flexibility in economic down turns. Cognizant of the risks often associated with equity finance, the thesis suggests private equity in the form of venture capital and pooled funds as viable mechanisms of mitigating those risks.