

INFORMAL SECTOR FINANCIAL CHALLENGES: A CASE OF MANUFACTURING INFORMAL SMALL MEDIUM ENTERPRISES (SMES), HARARE

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ABSTRACT

The study made an evaluation on the financial challenges in relation to manufacturing informal enterprises (SMEs) in Harare. The research adopted the mixed research methodology. Primary data collection tools used were: interviews and surveys. The study's major finding was that informal small and medium enterprises were virtually excluded from accessing working capital formal credit from established financial institutions due to a myriad of challenges, the key challenge being none or inadequate bookkeeping practices. Furthermore, the study revealed that The informal SMEs contribute significantly over 60% to the Zimbabwe's formal economy through various taxes and informal employment. The study recommended that Ministry of Small and Medium enterprises should provide assistance in form of formal credit basing on according records kept by informal sector.

KEYWORDS

informal sector (Smes, financial challenges, formal credit , record keeping

1. INTRODUCTION

Nwabu, Faboyede and Onwuelingo (2015) supported the assertion made by International labour Organisation (ILO, 2008) that the manufacturing informal SMEs that were used in this study were those defined as HUEMs (Household Unincorporated Enterprises). The main objectives are to generate employment and the production of goods and services on a regular basis for a country's domestic consumption or exports. A study of SMEs (formal and informal) is therefore critical given their immense contribution to individual national accounting systems, economic systems, employment and poverty reduction. Access to formal credit by SMEs is indeed critical, just like for larger corporate, for capitalization and working capital requirements.

The main purpose of organisations is to maintain proper accounts and a complete set of financial statements. A comprehensive accounting record keeping system is a key determinant for sustainable performance of any organisation and enables entrepreneurs to draw up timely financial reports that reflect sound planning for the future, enhance business performance, aids access to credit and financial services and invites potential investors (Zotorvie, 2017). Accounting record keeping practises by SMEs play a vital role is the determination of operational and financial performance. The informal sector which employs the majority of the economically active population contributing to the informal economy and informal employment is a serious challenge to policy makers who lack the requisite data to improve legal, social protection and

working conditions and productivity in the informal sector activities through regulatory framework, advocacy, training, access to credit and financial services(Pant and Suwal, 2009).

There is no general or agreed consensus among the academic fraternity regarding the definition of SMEs that adequately capture all the characteristic facets of SMEs regarding fundamental issues including size, number of employees, annual turnover, accounting records and business organisational set up (European Commission, 2008).

According to Howard (2009) failure by small businesses to maintain adequate bookkeeping records has been the major cause of business failures. Many researchers on SMEs have been enticed by their immense contribution to the national economies of developed and developing countries especially in terms of GDP, GNP, employment creation, trade and poverty reduction. But very few or no researches have focussed on the effects of lack of adequate accounting record keeping and its impact on formal credit have been made so far . It is therefore upon this and other previous articulated research gap basis that this study is premised upon.

Argument for the SMEs intrinsic definition is largely perceived as composed of scale of operation units owned by one or more individuals who do not possess adequate capital, no lines of credit, lack of access to financial services with lack of cognitive skills who are motivated by lack of formal alternative employment opportunities(UN, et al 1993).The informal sector enterprises has been defined by the 15th ICLS in terms of characteristics of production units (enterprises approach) as opposed to their jobs (labour approach) as private unincorporated enterprises owned by individuals or household with no accounting systems or procedures that discloses financial separation of production activities .

Financial records, for example the sales day book (sales journal), purchases day book (purchases journal), cash receipt book, cheque payments book, petty cash book, general journal, nominal ledger, debtors' ledger and creditors' ledger must be kept and maintained in a sound accounting system .Bookkeeping is a financial control key tool that makes an accurate reflection of the financial position and corporate performance displaying decision making information for internal and external stakeholders (Eric and Gabriel, 2012)

Informal enterprises like formal SMEs and large organisations require access to formal credit for day to day economic activities (working capital management, purchase of raw materials etc) and also for investment in machinery and equipment(Floridi et al., 2014). Informal enterprises mainly rely on personal savings and self financing options which yield marginal benefits (Floridi et al., 2014), since financial institutions and Development Institutions are reluctant to offer formal credit to them due to their high degree on informality and also lack of accounting records. Argument for the SMEs intrinsic definition is largely perceived as composed of scale of operation units owned by one or more individuals who do not possess adequate capital, no lines of credit, lack of access to financial services with lack of cognitive skills who are motivated by lack of formal alternative employment opportunities(UN, et al 1993).The informal sector enterprises has been defined by the 15th ICLS in terms of characteristics of production units (enterprises approach) as opposed to their jobs (labour approach) as private unincorporated enterprises owned by individuals or household with no accounting systems or procedures that discloses financial separation of production activities .

Accounting information and record keeping is vital for determination of profits and taxation purposes, since they provide management of all organisations regardless of its size with useful information for decision making and also for outside stakeholders like financial institutions who

require the information for access to credit and loan facilities and also tax authority for Income tax purposes (European Commission (EC), 2008).

UYAR(2010) contends that accounting practices are varied depending on the size of the organisation and management decision framework, composed of : bookkeeping, budgeting, planning and control, performance measurement and evaluation, strategic planning

2. STATEMENT OF THE PROBLEM

Cases of informal manufacturing small and medium enterprises (SMEs) collapsing as a result of hosts of challenges chief among them being non funding by government and other developing partners such as banks are on the increase. How can the informal sector operate without necessary funding? The purpose of the study was to assess the effects of financial challenges on the manufacturing informal Small Medium Enterprises (SMEs), during the current Zimbabwe's economic growth and employment creation.

2.1 Objectives of the Study

To assess the bookkeeping practices including challenges encountered by the various informal manufacturing SMEs and their usefulness to external financiers, based on a study of sixty (60) informal enterprises (SMEs)

2.2 Research Question

Are the record keeping records effective enough to consider when making key decisions by external financiers on informal SMES in Harare?

3. METHODOLOGY

The population of the study consisted of 60(sixty) members from the informal manufacturing industry. To identify the root cause of reasons for demise of most informal manufacturing enterprises, the study employed, the mixed method approach. The study took a purposive approach to select 45(forty –five) members who participated in the study. An in-depth interviews that allowed respondents to answer certain questions in order to secure desired information and surveys were the data collection tools.

4. DATA PRESENTATION, ANALYSIS AND DISCUSSION

The study wanted to find out challenges facing the informal sector, chief among them being non recognition in terms of formal funding . The following results were obtained.

Table 1: SMEs challenges

Challenges:	Agree	Not Sure	Disagree
1. Do you encounter operational challenges?	85%	5%	10%
2. Are the challenges momentary?	90%	2%	8%
3. Are there Capital budgeting challenges?	95%	--	5%
4. Operational Budgets are critical?	60%	5%	35%
5. Working capital is critical for performance?	95%	5%	--

(Source : Primary data 2019)

Do SMEs encounter logistical challenges?

The study wanted to establish the logistical challenges faced by SMEs. The following results were obtained:

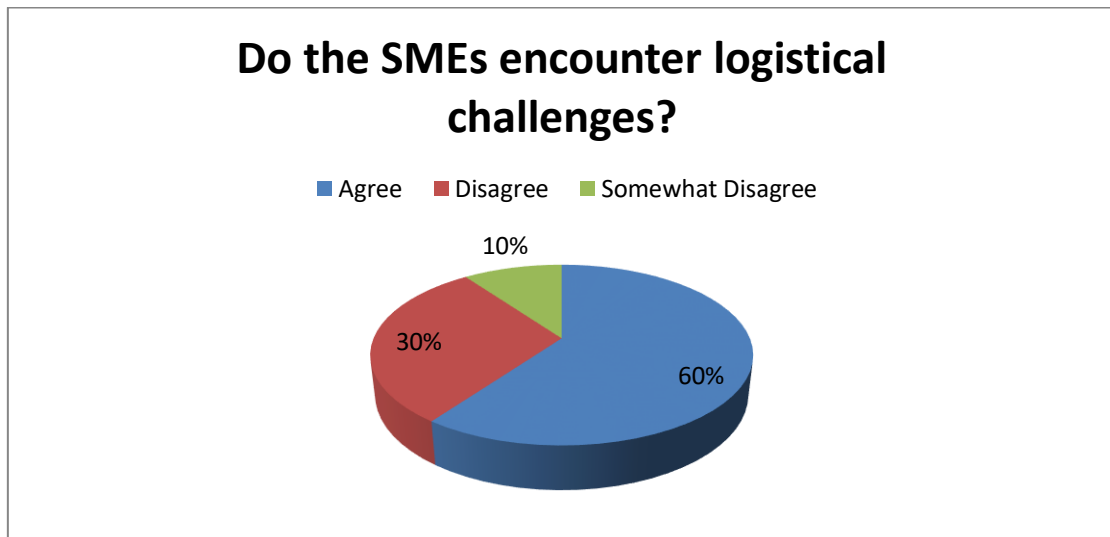


Fig 1: Do SMEs encounter logistical financial challenges?

(Source : Primary data 2019)

The majority of customers agreed (60%) that SMEs encounter logistical financial challenges, with a minority in disagreement (30%) and (10%) strong agreement.

Main challenges for the informal sector provided by the respondents included , non funding by external financiers, poor or no bookkeeping records, poor budgeting, planning and control, poor performance measurement and evaluation, Interviews data gathered with the informal sector players indicated that they were aware of no funding by formal financiers, and requirement that they prepare and present proper books of accounts. Furthermore, data gathered through surveys concurs with data collected from interviews. Thus, this shows that the informants were aware of

major challenges facing them of not being funded by formal financiers such as banks, among other challenges. The study also wanted to find out if the informal sector in Zimbabwe was willing to obtain formal credit and prepare proper books of accounts. Interview data gathered with the informants indicated that were willing to get funding so as to expand in their operations, but were not willing to prepare proper books of accounts as it was too expensive for them. In addition, data gathered through surveys concurs with data collected from interviews.

5. FINDINGS

The study revealed that formal credit from Banks and other external financiers require proper financial statements as a precondition for accessing formal credit, thus it complies with the understanding at the continental level. The informal sector was not able to prepare proper bookkeeping records because of the costs involved.

CONCLUSIONS

The study concluded that basic bookkeeping practices and pro-forma financial statements must be drawn and kept by SMEs, and not necessary based on IFRSs accounting standards, which are mainly relevant for listed companies, and the results were confirmed statistically.

RECOMMENDATIONS

This study recommends that the Ministry of Small and Medium Enterprise should provide assistance in form of formal credit basing on records kept by informal sector.

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