

# [The role of small and medium scale enterprises in zambia’s economic development](https://assignbuster.com/the-role-of-small-and-medium-scale-enterprises-in-zambias-economic-development/)

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Small and medium scale enterprises (SMEs) are generally regarded as the engine of economic growth and equitable development in developing economies. They are labor intensive, capital saving and capable of helping create most of the one billion new jobs the world will need by the end of the century. They are also perceived as the key to Zambia’s economic growth, poverty alleviation and employment generation. But their unimpressive performance in employment generation in recent years has generated a lot of research interests on their challenges and prospects.

Zambia is a developing country characterized by a minimally diversified economic structure. The country’s economic activity suffers from a dominant mining sector and high unemployment among the country’s youth (approximately 21% per IMF 2011). The country’s economic performance strongly depends on changes in copper prices. The mining sector generates more than 70% of the country’s budgetary revenue and approximately 45% of the country’s GDP and more than 97% of the country’s export. Zambia’s economic attention began to turn to the private sector, particularly on SMEs due to their major role in economic development and their ability to provide jobs. Statistics from the Zambian Ministry of Industry, Trade and Commerce SMEs and Investment Promotion indicate that the SME sector has ensured its increasingly important role in the national economic structure. By the end of 2013, Zambia’s registered small- and medium-size enterprises exceeded 748, 000. Despite the vital role of SMEs in building a competitive private sector and contributing significantly to economic growth and job creation, SMEs are facing more challenges around the world in general and in developing countries in particular. Likewise, Zambian SMEs face numerous and serious challenges to their growth: the cumbersome legal and regulatory constraints, lack of access to external financing, low human resources capacities, lack of management skills and training, and low technological capacities.

For Zambia to develop and achieve its Vision 2030, investment in the economy is essential. This investment comes from FDI and domestic private sector investment. The SME sector makes a large component of the domestic private investment. To invest, create jobs and to grow their businesses, and contribute to economic growth, the SMEs need access to finance.

The Zambian financial system has mainly been a bank based financial system implying that it’s a bank dominated financial system. The development of Zambia’s financial system can be attributed to the bank failure that the financial system encountered around the 1990s and this saw a number of banks closing. In order to deal with the problem of bank failure, the government introduced a program aimed at increasing access to financial services by coming up with a policy that promoted growth of micro financial institutions in the early 2000s aimed at financially including 2 million people. This has led to establishment of many financial institutions.

According to BOZ (2015), Zambia had 364 bank branches and agencies in 2015 indicating an increase from the 247 branches recorded in 2011. These increased as a result of competition through a wider coverage. Of the 27 newly opened branches, 18 were in Lusaka and Copperbelt Provinces mainly due to the concentration of economic activity in these regions. Furthermore, the number of Non-Bank Financial Institutions (NBFIs) rose to 126 at End-December 2015 from 116 at End-December 2014. The micro finance institutions increased to 35 in 2015 respectively.

Despite the increase in the financial institutions, there has been very minimal access to credit by many SMEs in Zambia. According to FinScope (2015), Zambia has a total adult population of 8. 1 million of which 54. 8% of adults live in the rural areas and 45. 2% in urban areas, the adult population is characterized by 49% male adults and 51% female. The financial inclusion rate increased from 37. 3% in 2005 to 59% recorded in 2009, this exceeded the Zambian government’s target of financially including 50% of the adult population by the year 2015. It can be noted that financial inclusion in urban areas increased more significantly than in rural areas and more in females than the male adult population.

Despite the Zambian economy growing in terms of GDP over the past decade, Zambia has continued to face challenges relating to ongoing poverty particularly in rural areas where more than half of the population lives. Zambia’s economic growth rates averaged 6. 7% in the period between 2010 and 2015, with 2010 having recorded the highest growth rate pegged at 10. 3%. This dropped to 6. 7% in 2013, and further down to 5. 6% in 2014 and 4. 6% in 2015. Nuwagaba (2015) notes that reasons for the low rates of access to finance can be attributed to the high cost of providing financial services by financial institutions. This is particularly in rural areas and to poorer populations and that serving poorer communities generally results in lower revenue for financial service providers. This is simply because poor households have limited investment opportunities and small transaction amounts due to low income levels characterized low income generating activities. This often means banks and Micro Finance Institutions lack the incentives, information, and sometimes the ability to mitigate perceived risks of operating beyond urban markets or with poor clients.

Small and medium enterprises play an important role in Zambia’s economic development. The sector is contributing to the government’s objective of creating employment opportunities, and reduce poverty through industrial development and economic diversification. SMEs play an important role in Zambia’s economic growth, as they constitute 97. 2% of the companies in Zambia Clapham (2001). Despite the SMEs being one of the key players in employment creation, the sector faces many constraints that have inhibited them from contributing to national development at full potential.

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Despite the increase in the financial inclusion rate, the SME sector faces two key challenges that include inter alia poor access to markets and limited access to financial services with limited access to financial services being the most severe. Limited access to financial services seem to stem from lack of tangible collateral security and procedural bureaucracies of credit borrowing were some of the facts highlighted that constrain small-scale entrepreneurs from accessing credit from formal credit institutions (Nuwagaba, 2015). The impact of limited access to financial services has led to under performance of the majority of the SMEs and reduced profit margins. Adversely, most of the SMEs are stagnating and retrogressing while others close within a few years of operation. According to the Finmark survey (2010), SMEs don’t find it easy to access credit, 55% of Zambian MSMEs reported access to finance as their main obstacle, and furthermore, 85% of MSMEs in rural areas don’t have access to a financial product of any kind, not even a bank account.

There is little information on the factors that influence the access to credit by SMEs in Zambia despite the critical role it plays in consumption smoothing and its possible consequences for the economy ‘ s macroeconomic and financial stability, a study by Nuwagaba (2015) found that interest rate and education are the key factors affecting access to credit; another study by Kingombe (2004) found that access to finance was mainly affected by the limited number of micro finance institutions and their high interest rates; Other studies had different conclusions on factors affecting access to credit. This makes factors affecting access to credit by SMEs inconclusive and this leads to an information gap which limits policy makers from implementing policies that would improve SMEs’ welfare based on empirical evidence. Consequently, a study of factors influencing access to finance is worth pursing as the associated policy implications are important steps in providing a foundation for rational and evidence-based decision making.