



THE UNIVERSITY OF ZAMBIA

**CHALLENGES FACED BY SMALL AND MEDIUM SCALE ENTREPRENEURS IN
ACCESSING CREDIT FACILITIES FROM ZAMBIA NATIONAL COMMERCIAL
BANK PLC HEADQUARTERS IN LUSAKA**

By

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**A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT FOR THE AWARD OF
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ABSTRACT

The study sought to establish the factors influencing access to credit among small and medium enterprises at Zanaco Head office. The aim of the study was to investigate the challenges faced by SMEs in accessing credit facilities from Zambia National Commercial Bank PLC headquarters in Lusaka. A cross sectional study design was employed. Data was collected by the use of questionnaires and interviews. Data analysis included the use of descriptive and inferential statistics. Descriptive statistics involved the use of frequency tables, pie charts, graphs and percentages. ZANACO offers the following as credit facilities; Over Drafts, a long term loan, a bridge loan and a Letter Of Credit. Though the bank offers these credit facilities, it hardly offers a start-up loan and packing credit facility. ZANACO does not offer a wider range of credit facilities because agricultural lending is both risky and expensive. The NPL on agricultural sector currently exceed 37% against 13% across all other sectors of the economy and this is considered to be very high. It is not possible to provide start-up loans and this is compounded by the fact that there is no history of the business or how the farmer will perform if availed a facility. It is also not possible for the bank to guarantee quality. Lack of collateral by some SMEs was also a factor in most instances. This was complicated by a high default risk. Risks could be mitigated by taking collateral, considering applications for SMEs who have invested a sufficient amount of their own capital into the business and by considering only those SMEs who have experience. The key recommendation was that information symmetry should be enhanced between CRBs and financial institutions on one hand and SMEs on the other hand.

Key words: Challenges, Small And Medium Scale Entrepreneurs, Credit Facilities, Zambia National Commercial Bank

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DEDICATION

I dedicate this award to my two beautiful daughters Tiloleko Kimberly Mwanza and Wanipa Christine Mwanza. I further wish to dedicate this award to my late Dad Mr Solomon Misheck Daka who always mentored me to be a responsible woman and made me realise the value of education. May Your Soul Continue Resting in Perfect Peace.

STATEMENT OF AUTHENTICITY

The views and opinion contained in this report do not represent ZANACO position nor that of The University of Zambia in the absolute terms but rather are the result of the author's findings, conclusion and perception. Therefore, the author declares that the findings, development and delivery of the research was the outcome of the author's own efforts and that the contents of the research are NOT a duplication of previous presentations. Furthermore, the figures, tables and graphs was collected from the field except contained in the report were generated the output for those whose source has been acknowledged.

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APPROVAL

On behalf of The University of Zambia, I approve this research for Alice Daka submitted to the partial fulfilment of the award of Master Of Business Administration (MBA)

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LIST OF ACRONYMS

CEEC	Citizen Economical Empowerment Commission
FDI	Foreign Direct Investment
GDP	Gross domestic Product
SMEs	Small, Medium Enterprises
SED	Small Enterprises Development
PACRA	Patents And Companies Registration Agency
ZANACO	Zambia National Commercial Bank
ZATAC	Zambia Agribusiness Technical Assistance Centre

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CHAPTER ONE

INTRODUCTION

1.0 Overview

This study will investigate the challenges faced by Small to medium enterprises in obtaining loans from ZANACO Bank in Lusaka, and suggest measures that can be put in place by both SMEs and the banks in order to improve the formers access to banks credit facilities. This research was arranged in three parts. In the first part, the research discussed the background to the study, problem statement, research questions, significance of the study, the scope of the study, and limitations to the study. In the second part of the research: literature review, conceptual and theoretical framework, previous studies and lastly personal critique. In the last part of the proposal, the research methodology, research design, data collection methods, data collection tools, data analysis methods and finally data analysis tools that was used in the study

1.1. Background of the Study

There is growing recognition of the important role small and medium enterprises (SMEs) play in economic development. The SMEs constitute about 90% of total business units in Zambia and account of 60% of Zambia's employed labour force (KDI, 2008). They are often described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic engines. Even in the developed industrial economies, it is the SME sector rather than the multinationals that is the largest employer of workers (Mullineux, 1997). This is also supported by a research done on small businesses in the United States by Dr. Charles Ou in June 2006, which indicated that U.S. small businesses numbered 23 million in 2003, and it employed about half of the private sector work force, and also produces about half of the nation's private sector output.

The Korean Development Institute (KDI) in its study, "Building the Foundations for the Development of SME in Zambia" (September 2008) noted rather grimly, the obstacles these SMEs face daily in Zambia. The study enumerated these as smaller sizes of the SMEs; they

are few in number and lack competitiveness internationally. These factors affect the SMEs in many ways. For instance, over 80% of SMEs in Zambia are reportedly having employees numbering less than ten. The smaller size of these SMEs means less value addition as fewer processes are possibly involved in the production.

Small and medium enterprises (SME'S) however, are very critical to the development of any economy. Small to medium enterprises (SMEs) provide an important source of employment and economic activity in all countries. They account for roughly 60-70 percent of employment in Organization for Economic Cooperation and Development countries, and 30 percent of the world export of manufactures (FSS 2020, SME sector Report, 2007). In Zambia, small enterprises in Zambia are said to be a characteristic feature of the production landscape and have been noted to provide employment in Zambia (Steel and Webster, 1991; Aryeetey, 2001). SMEs are also believed to contribute about 70% to Zambia's GDP and account for about 92% of businesses in Zambia.

There are however success stories elsewhere especially in Asia. The economic boom in some of these Asian countries which is connected to SMEs has lifted hundreds of millions of people out of poverty and created tens of millions of new middle-class consumers (Tanzer, 2005). SMEs are responsible for driving innovation and competition in many economies. In India, the SMEs account for about 39% of manufacturing output and 33% of total exports. SMEs possess great potential for employment generation, improvement of local technology, output diversification, development of indigenous entrepreneurship and forward integration with large scale industries (CBN, 2011).

Of the three quarters of the world's poor that live in rural areas, 80 percent directly or indirectly depend on goods and services from Small and Medium Scale Entrepreneurs (IFC 2014). These smallholders also play a key role in increasing food supplies, more so than large farms in poor countries. Despite their socioeconomic importance, smallholders tend to have little or no access to formal credit, which limits their capacity to invest in the technologies and inputs they need to increase their yields and incomes and reduce hunger and poverty, both their own and that of others (IFC 2014)

Financial institutions interested in serving Small and Medium Scale Entrepreneur markets face myriad risks and challenges associated with security and lending (IFC, 2014). While

these risks apply generally to all lending be it Small and Medium Scale Entrepreneurs lending or large scale lending, it is more challenging to serve some smallholders than others. With smallholders in tight value chains where a strong relationship between the farmer and buyer exist such relationships can be leveraged to reduce the costs and risks of agricultural lending through shared credit screening, monitoring and collection, and/or use of alternative collateral, such as sales contracts. The challenges become greater when trying to provide financing to smallholders in “loose” value chains, particularly for low-value staple crops, where SMEs do not have strong relationships with other value chain actors. The challenges are compounded when trying to provide financing to subsistence SMEs (IFC 2014).

According to Sebatta et al (2014) Small and Medium Scale Entrepreneurs are a vital sector in Zambia in terms of its contribution to the economy and the number of employment opportunities it creates within local communities. The agricultural sector in Zambia supports about 80% of the Zambian population that is solely dependent on agricultural related livelihoods many of whom are poor people in the rural country (Budget, 2013). In many developing countries such as Zambia, the rural population for instance depends on agricultural activities for their survival and Small and Medium Scale Entrepreneurs add up a substantial proportion of Zambia’s Gross Domestic Product at 21.5% according to a study by UNDP (2006). As a way to improve current levels of poverty, access of financial services by small holder dealers is of vital importance. One way of increasing access to finance by small holder dealers is for governments to focus on improving access to banking services and credit facilities in rural areas. A study by Agri-ProFocus (2014) on the availability of Finance to the agricultural sector found that the linkage between small holder dealers and financial institutions can be improved. Banks however often provide stringent conditions e.g. collateral which some customers cannot provide and this yet to be affirmed for Zambia National Commercial Bank (ZANACO). Which bank has the most presence in Zambia.

The major questions to be asked about SMEs in Zambia and accessing credit facilities are: what has been the role of the SMEs to the economic development of Zambia? And what is the contribution of the SMEs to the manufacturing output and total export in Zambia. Evidence has shown that SMEs in Zambia have underperformed and have not made significant contribution to the nation’s economic growth and development (FSS 2020, SME sector Report, 2007). The key issues affecting the SMEs in Zambia can be grouped into four, namely; unfriendly business environment, poor funding, low managerial skills and lack

of access to modern technology (FSS 2020, SME sector Report, 2007). Lack of access to modern technology and low managerial skills (which may be due to lack of funds to acquire relevant technology and hire skilled staff) can be checked if the SMEs are properly funded. Financing of SMEs in Zambia is therefore very critical if they are to perform the growth and developmental role in the nation's economy.

Another issue has to do with the inadequate capital base of most SMEs in the country to meet the collateral requirement by the banks before credit is given out. In the situation where some SMEs are able to provide collateral, they often end up being inadequate for the amount they needed to embark on their projects as SMEs assets- backed collateral are usually rated at 'carcass value' to ensure that the loan is realistically covered in the case of default due to the uncertainty surrounding the survival and growth of SMEs (Binks et al., 1992).

SMEs in Zambia do not also have the luxury of picking a financing scheme that will be appropriate for their businesses. The major type of financing open to them is debt financing from the financial institutions, which most often comes with a long list of requirements that most SMEs find them difficult to meet. The other type that is Asset financing, aside the long list of criteria also requires operators of SMEs to provide 50% of the funds and the financing institution providing the other half to fund the purchases of the assets. This type of financing do not allow for growth of the SMEs sector since they are all short term in nature (Meyer, 2011); AUC and MFW4A, 2012; Budget 2013). The major problem being addressed by this study is challenges faced by Small and Medium scale enterprises in accessing credit facilities from commercial banks in Lusaka and with particular reference to Zambia National Commercial Bank PLC which bank has permeated both rural and urban areas of Zambia. This presupposes that there are no or limited credit facilities being offered to people as well as the perceived or actual risks involved in offering the excluded facilities.

1.2 Statement of the Problem

There is a problem among SMEs in accessing credit facilities from Zambia National Commercial Bank PLC headquarters in Lusaka. SMEs are concerned that their businesses are not growing as expected because the only Zambian Bank places limitations on obtaining

credit. Some SMEs seem not to be aware of the credit facilities which ZANACO offers. While there are credit facilities, to date research is yet to be conducted to outline the challenges faced by SMEs as this is something undesirable. Perhaps a study which investigates the credit facilities which are offered by ZANACO plc and the challenges faced by SMEs in accessing credit facilities from Zambia National Commercial Bank PLC headquarters in Lusaka could help to appraise the problem.

1.3 General Objective

To investigate the challenges faced by SMEs in accessing credit facilities from Zambia National Commercial Bank PLC headquarters in Lusaka.

Specific Objectives

- 1) To determine which credit facilities the Zambia National Commercial Bank PLC offers to SMEs.
- 2) To estimate from the population of SMEs, the proportions that have had a credit facility availed to them by Zambia National Commercial Bank PLC.
- 3) To describe the challenges faced by small and medium scale in accessing finance from the Zambia National Commercial Bank PLC headquarters in Lusaka?
- 4) To understand from the point of view of Zambia National Commercial Bank PLC staff the reasons for offering to some and not offering to some SMEs credit facilities.

1.4 Research Questions

Drawing from the statement of the problem, the research questions that the study will try to answer are:

1. What proportions of SMEs have had a credit facility availed to them by Zambia National Commercial Bank PLC.
2. From the ideal package of credit facilities, what credit facilities are being offered by ZANACO to SMEs?
3. Why does ZANACO not offer a wide range of credit facilities to Zambian SMEs?

4. What are the perceived or actual risks involved in offering the excluded credit facilities to Zambian SMEs?

1.5 The Scope of the Study

This study focused on challenges faced by Small and Medium scale entrepreneurs in accessing credit facilities from the Zambia National Commercial Bank PLC headquarters in Lusaka. The field survey was limited to the Zambia National Commercial Bank PLC headquarters in Lusaka. The study is limited to SMEs that had approached ZANACO.

1.6 Significance of the Study

1. The existing linkages between SMEs and the financial sector need to be improved and the logical way to improve this linkage is to have a better understanding of the kinds of products available to the agricultural sector as well as which banking institutions offer this facilities. There also exist a number of risks and challenges associated with this linkage as such understating the dynamics could ultimately contribute to poverty reduction by encouraging efficient and profitable Small and Medium Scale Entrepreneurs.
2. Additionally, although a number of studies in Africa have been done on this topic such as Obilor (2013), Burritt (2016) and Mwanamambo (2007) to the best of my knowledge, a study of this nature has not been done in Zambia hence the Zambia government can also take advantage of the suggestions and formulate more result oriented policies towards increases availability of finance for the agricultural sector in Zambia.
3. The results of this study point to the fact that ZANACO may not have a robust risk analysis system or does not wish to explore measures of enhancing risks.
4. To other researchers, the study will be useful since it will add knowledge to other researchers intending to study about SMEs financial credit accessibility, their strategies and operations. To Small and Medium Scale Enterprises,

the present research will build an understanding of the challenges and prospects of SMEs in regard to financial credit markets. This will provide them with a high range choices, opportunities and knowledge of the challenges that are being faced by business entrepreneurs, especially the small and medium enterprises

1.7 Conceptual Framework

The dependent and independent variables of this study are as illustrated in the figure below:

DEPENDENT VARIABLES

- **UNBANKABLE BUSINESS PLANS**
- **UNSECURED COLLATERAL/ NO COLLATERAL**
- **ABSENCE OF KNOWLEDGE ON BANK LOANS**
- **NO SERVICEABLE BANK ACCOUNTS**
- **NO CAPACITY FOR PAYING BANK LOANS**
- **LOW/POOR CREDIT RATING**

INDEPENDENT VARIABLES

NO / ACCESS TO CREDIT FACILITY



1.8 Limitations of the Study

The following are the limitations of the study:

Sensitivity Of The Information To Be Collected: Information concerning Credit Facilities Offered By Commercial Banks To SMEs In Zambia quite sensitive, thus there is a possibility that ZANACO has not expressed the full truth of what is happening on the ground for fear that the researcher might have been was collecting information on behalf of the their competitors on the market. Hence there is a possibility that some of the information was not disclosed. This is likely to reduce the perfection of this study.

The fact too that this study was only about 8 respondents, the picture may not be the correct one. It is recommended that a national study be done in order to provide a much more and robust sample from which generalizations could be made.

1.9 Definitions of Key concepts

The study will adopt the following terms that will be used throughout this study:

Small Medium Enterprises

This study will adopt the definition of SMEs as provided by the Small Enterprises Development (SED) Act of 1996 which defines SMEs as follows:

Firstly, an enterprise is defined as an undertaking engaged in the manufacture or provision of services or any undertaking carrying out business in the field of manufacturing, construction and trading services but does not include mining or recovery of minerals.

Micro: - an enterprise whose total investment excluding land and buildings does not exceed 50 million Zambia Kwacha; annual turnover that does not exceed 20 million Zambian kwacha and employing up to 10 persons.

Small:- an enterprise whose total investment excluding land and buildings does not exceed 50 million Zambian Kwacha, in case of manufacturing and processing enterprise and 10

million Zambian Kwacha in case of a trading and service enterprise; an annual turnover that does not exceed 80 million Zambian kwacha and employing up to 30 people.

The European Commission (EC) defined SMEs largely in term of the number of employees are firms with 0 to 9 employees - micro enterprises; 10 to 99 employees - small enterprises; and 100 to 499 employees - medium enterprises. Thus, the SME sector is comprised of enterprises (except agriculture, hunting, forestry and fishing) which employ less than 500 workers. In effect, the EC definitions are based solely on employment rather than a multiplicity of criteria. Secondly, the use of 100 employees as the small firm's upper limit is more appropriate, given the increase in productivity over the last two decades (Storey, 1994).

The UNIDO also defines SMEs in terms of the number of employees by giving different classifications for industrialized and developing countries (Elaiian, 1996). The definition for industrialized countries is given as follows: Large - firms with 500 or more workers; Medium - firms with 100-499 workers; and Small - firms with 99 or less workers.

CHAPTER TWO - LITERATURE REVIEW

2.0 Overview

This chapter reviews various literature selected to the study. It relates, analyses and evaluate the gaps within existing literature relating to the present study. Various concepts in financial sectors and SMEs socio-economic operation are evaluated, based on several authors and researchers.

This chapter introduces the reader to a review of the literature related to the study. The Chapter begins with a discussion about the background, characteristics of SMEs and their sources of funds. Moreover, it provides an overview on the situation of SMEs in Zambia and the challenges faced by SMEs. Finally, it identifies the knowledge gap.

2.1. Background of SMEs In Zambia

The concept of entrepreneurship was first established in the 1700s. Many simply equate it with starting one's own business. To some economists, the entrepreneur is one who is willing to bear the risk of a new venture if there is a significant chance for profit. Others emphasize the entrepreneur's role as an innovator who markets his innovation. In the 20th century, economist Joseph Schumpeter (1883-1950) focused on how the entrepreneur's drive for innovation and improvement creates upheaval and change. Schumpeter viewed entrepreneurship as a force of "creative destruction." The entrepreneur carries out "new combinations," thereby helping render old industries obsolete. Established ways of doing business are destroyed by the creation of new and better ways to do them. Business expert Peter Drucker (1909-2005) took this idea further, describing the entrepreneur as someone who actually searches for change, responds to it, and exploits change as an opportunity. A quick look at changes in communications – from typewriters to personal computers to the Internet – illustrates these ideas.

According to the Business and Industry Advisory Committee to the Organization for Economic Cooperation and Development (OECD) in 2003, "Policies to foster entrepreneurship are essential to job creation and economic growth." Government officials

can provide incentives that encourage entrepreneurs to risk attempting new ventures. Among these are laws to enforce property rights and to encourage a competitive market system.

Before and after independence Zambia had no policy on the private sector development relating to Small and Medium scale enterprises. It had no special legal framework promoting the SMEs since the economy was enjoying the high prices of copper hence ignoring SME sector. The country depended much on mining copper and only the public sector was visible by then. When the copper prices slumped in 1975 and at the same time oil prices soared. With decreasing profitability in the copper business, the Zambian government had to find other means of sustaining the economy. After 1981 it began to initiate policies targeted at promoting SMEs and hence came up with Small Industries Development Act of 1981 which was later succeeded by Small Enterprises Development Act of 1996.

In the past, Zambians were not very enterprising due to the public sector led economic growth model which excluded them from participating in business activities with the threat of nationalization if an enterprise grew beyond a certain size. This led a lot of Zambians to depend on formal employment as way of earning income. However, after the 1990's when Zambia adopted the free market economy that was instituted and established by the World Bank and the International Monetary Fund, the country experienced severe economic difficulties. Opening the economy to the outside world led to competitive markets. The inefficient producers were left out and this led them to restructure their businesses so as to compete on the market place. This led to the drop of the Gross Domestic Product (GDP) and poverty levels increased by 70% placing Zambia among the poorest countries in the world. The formation of SMEs was inevitable since most Zambians were now out of formal employment and they had to find other means of surviving, also because of the availability of the market from poor people who preferred to buy goods and services to SMEs providing the market with goods and services.

The Zambian Government through its Sixth National Development Plan (SNDP) which covers the period 2011–2015, charts an ambitious path to transform the lives of Zambians and recognizes that a vibrant and productive private sector is the key to promoting growth and prosperity in the country. This Plan is the successor to the Fifth National Development Plan (FNDP), 2006 – 2010, the first in the series of medium-term plans aimed at making Zambia “a prosperous middle - income country by 2030. The policy of Government is to

accelerate private sector investment so as to achieve increased and diversified growth. Government will, therefore, continue with the strategy of attracting investment through facilitation by Zambia Development Agency and improving the overall business and investment climate. Deliberate efforts will be made to linking FDI to the domestic economy in order to broker linkages with SMEs with the view of increasing their productivity, capacity and ability to penetrate into larger markets. The overall effect intended is the creation of decent employment in the various areas of investment.

According to the Zambia Business Survey (ZBS, 2010), of the 4.1 million employed Zambians, 88 per cent work for informal enterprises with less than five employees. Most of these microenterprises are owner operated businesses with no paid employees and resemble home based income generating activities rather than clearly structured businesses. 81 per cent of these microenterprises are located in rural areas where they account for 91 per cent of employment and 70 per cent are involved in agriculture production. The average Zambian Micro Small Medium Enterprise (MSME) in the agricultural and service sectors produces only about one sixth of the average large enterprise in the same sectors. The Task force on SMEs identified poor work culture in Zambia as being a factor that negatively affects the ambition and attitude of the labour force. An attitude of dependency on the government and donors further aggravates the situation and leads to a lack of commitment to progress. Such a constraint can be combated through capacity building programmes and awareness raising of the gains from entrepreneurship. Additionally, the Zambian government has put in place policies and other initiatives to support SMES. These include the following:

2.2 National MSME Development Policy

The government through the Ministry of Commerce Trade and Industry launched a national policy on MSME development and its Implementation plan. This is a step in the right direction as the policy will provide the much needed strategic direction. However, having these documents in place is one thing and having them implemented is most definitely another. Government commitment is what will determine the success or failure of this policy.

2.3. Other Government Initiatives

2.3.1. Zambia Development Agency

The establishment of a one stop shop on investment is a boost to the MSME sector, in particular the establishment of the SME Division at the Zambia Development Agency whose mandate among other things is to coordinate and monitor all national efforts on MSME development. The ZDA though fully operational now, has provided little noticeable support to the sector. There is need to strengthen the SME Division so that it can effectively execute its mandate.

2.3.2 The Citizens Economic Empowerment Commission

The provisions of the CEEC Act are in line with the general aspirations for a strong citizen driven economy. At this stage in the Zambian economy this implies strengthening the MSME sector. The CEEC seems to have a number of efficiency issues though such as poor disbursement capacity, inadequate information outreach, nepotism etc. that have led to low absorption of funds by would be beneficiaries.

The recent partnering of the CEEC with another government agency, the Patents and Companies Registration Authority (PACRA) is an initiative aimed at developing MSMEs through formalization. In addition, the government of Zambia recently introduced a law (Moveable Property- security interest, Act No. 3 of 16) that allows the general public especially the SMEs to obtain credit from banks and other financial institutions using movable property as collateral. The government institutions that are spearheading this act are PACRA and Bank of Zambia in collaboration with the World Bank.

2.3.3 Poverty Reduction Budget Support

The Ministry of Finance and National Planning through Projects and programmes support and initiatives such as the Poverty Reduction Budget Support has streamlined and prioritized issues aimed at reducing poverty through programme support and allocation of funds to areas most likely to benefit the impoverished. This has seen a number of even private sector organizations such as ZCSMBA, ZBF getting support through annual budgetary allocations. The Government is also partnering with the private sector through the Public Private Partnerships as means of empowering citizens.

2.3.4 Tax Administration

In 2008, Zambia Revenue Authority embarked on a modernization program with the intention of enhancing overall performance and effectiveness of tax administration. This is to be achieved through a service delivery that focuses on the taxpayer unlike previously when focus was on revenue collection. Under this project, taxpayers were segmented according to their turnover, i.e. Large, Medium and Small Taxpayer offices. This segmentation is aimed at helping to provide services to taxpayers according to their needs, it also allows for the allocation of audit resources and enforcement of areas of greater risk.

2.3.5 Technical Education, Vocational and Entrepreneurship Authority

Key to the mandate of TEVETA is entrepreneurship skills training. With the Shrinking Formal Sector currently employing only about 12% of the Labour Force, job opportunities have become scarce leading to high rates of unemployment among people with various skills.

2.3.6 National Technology and Business Centre (NTBC)

NTBC was established with the main objective of linking developed and proven technologies from various local and international sources with the local technology seekers i.e. business community and MSMEs, for creation of wealth and employment.

Their key role is to assist in the transformation of new ideas, innovations into products and new businesses that are financially viable. Through their range of services, investment and innovation resources they aim at graduating products at prototype stage into commercialized products.

2.3.7 New Financing initiatives for MSMEs

There has been in recent times a proliferation of financing options from Commercial Banks and Micro Finance Institutions (public and private) for MSME related business activities. This is a positive development and can help stabilize the operations of MSMEs. This financing however is mostly short term and suitable for working capital requirements only. What is needed for the sector in addition to this, however, is long term investment financing

to drive the expansion of the sector as a whole and for individual enterprises. Lending rates are also too high.

So far, in all these support efforts, the government and its implementing agents is more of a participant than the driver of development efforts.

2.3.8. The Need for a Secure Transaction Law

2.3.8.1. Background to the Movable Property (Security Interest) Act

The Movable Property (Security Interest) Act No. 3 of 2016 seeks to promote movable property based lending and thus ultimately increase access to credit by small scale businesses, in particular. Owing to a number of factors including the absence of a unified registry through which to verify whether a movable asset is subject to other third party interests (encumbered) and difficulties associated with enforcement, collateral in form of immovable or fixed assets has been preferred by banks and other creditors. Unlike immovable or real property (houses and land) whose records have been kept at the Lands and Deeds Registry, no equivalent registry existed in relation to movable property. While a number of security interest registries for movable property existed prior to the enactment of the Movable Property (Security Interest) Act, no unified registry existed. These isolated registries included the register of charges and mortgages under the Companies Act, which was restricted to security interests created by companies and those established under the Trade Charges Act and the Agriculture Credits Act. The Trade Charges Act provides for the creation of charges to secure loans advanced by financial service providers to persons licensed under the Act. The Act allows for small-scale entrepreneurs, who are usually unincorporated businesses, to access finance using their trading stock and other personal assets. However, the Office of the Registrar of Trades Charges, which falls under the Ministry of Commerce, has been none functional. The Agricultural Charges Act equally provides for charges over agricultural equipment to be registered in the registry. These charges are mostly registered by unincorporated small scale farmers. With the exception of agricultural charges, priority over registered securities is determined by the date of registration. An agricultural charge takes precedence over a fixed or floating charge granted by a borrower, including charges both granted and registered prior to the agricultural charge. As such, lenders could not be fully secure of their interests in collateral in form of agricultural equipment. The above secure transaction registries were supplemented by registries that, despite providing for registration of security interests, had

not been primarily established to protect security interests. A case in point is the motor vehicle register maintained by the Road Transport and Safety Agency (RATSA). The registration of third party interests in motor vehicles was merely incidental to its role of recording ownership of motor vehicles. Accordingly, the security interest registration system in Zambia was fragmented across registries, depending on the nature of security interest (agricultural charges) or type of asset (vehicles), or the type of debtor (company). The lack of a unified registry meant that a lender could only be assured that an asset was free of any third party interest (encumbered) after searching all the registries. This was not only cumbersome but expensive.

Further, the multiplicity of registries led to confusion as to priority ranking of security interests. Thus, in case of default, it was difficult to determine which of the several lenders was entitled to a priority claim over the asset pledged as collateral. The net result was reluctance to accept movable property as collateral and preference for immovable or fixed assets which have a relatively lower risk or to companies. The implication was that none incorporated bodies and small businesses were practically excluded from using their movable assets as collateral. This included motor vehicles which are readily available. This was compounded by the lack of a cost effective enforcement mechanism. The Movable Property (Security Interest) Act responds to the above challenges by providing for the establishment of a unified registry (the Collateral Registry) in which security interests in all types of movable property will be registered. The Act supersedes other statutes on security interests and provides for a simplified enforcement mechanism while elevating the Collateral registry above all existing registries for security interests. Ultimately, the Act provides lenders with guarantees required to accept personal or movable property as collateral.

In Australia, Canada and a few other jurisdictions, laws equivalent to the Movable Property (Security Interest) Act are generally referred to as 'Personal Property Security Interest' (PPSI) laws. The substitution of 'personal property' with 'movable property', in Zambia, was a deliberate attempt to ease understanding of the Act. Such laws are further categorised as Secure Transaction Laws as they secure payment or performance of an obligation. As the name of the Act suggests, the 'Zambian Act' like similar statutes elsewhere, is confined to movable property

2.3.8.2. Objectives of the Movable Property (Security Interest) Act

The overall objective of the Movable Property (Security Interest) Act is to make it attractive for lenders to accept movable property as collateral and thereby diversify the nature of movable assets used as collateral, leading to increased lending. In essence, the Act seeks to make movable property a reliable form of collateral. The Act provides a mechanism by which to determine whether a movable property is not subject to other third party interests; ensures certainty as to priority vis-à-vis competing claims over a movable asset pledged as collateral; and provides for a simplified enforcement mechanism in case of default. This is achieved through a unified Collateral Registry in which creditors register their security interests and conduct searches before lending against collateral; and providing for clear and predictable priority and enforcement rules.

2.3.8.3. Scope of Movable Property (Collateral)

Evidently, the intention of the Act is to cover all forms of movable assets. As such, movable property is defined in a non-exhaustive manner. Movable property is defined as including goods, intangibles, securities, money, negotiable instruments and negotiable documents¹⁰. Similarly, ‘collateral,’ is defined to mean movable property, whether tangible or intangible that is subject to a security interest. Thus, the Act applies to both tangible and intangible goods. The broad categories of movable property are: tangible assets, farm produce, inventory, consumer goods and accounts receivables and are defined as follows: -

- a) **Tangible Asset:** every form of movable property, including inventory, equipment, consumer goods, accession, negotiable instruments, negotiable documents and money;
- b) **Consumer Goods:** goods that a debtor predominantly uses or intends to use for personal, family or household purposes. However, the Act does not define ‘goods’ per se. Goods nonetheless constitute tangible assets and are generally sub-categorized into ‘consumer goods’, ‘inventory’ and ‘equipment’.
- c) **Equipment:** tangible asset used by a person in the operation of its business, and includes plant and machinery.

- d) **Negotiable Document:** a document such as a warehouse receipt or a bill of lading, that embodies a right to delivery of tangible assets and satisfies the requirement for negotiability under the law governing the document.
 - e) **Inventory:** tangible assets that are held for sale or lease in the ordinary course of business, raw materials or work-in-process.
 - f) **Account Receivable:** a right to payment of a monetary obligation, excluding a right to payment evidenced by a negotiable instrument and to payment of money credited to a bank account.
 - g) **Bank Account:** an account, maintained by a bank or financial institution, to which monies for a customer are credited, and includes monies received by the bank but not yet credited into the customer's account.
- (i) **Farm products:** includes— (i) crops grown, growing or to be grown, harvested and their produce and fruit; (ii) timber, both standing and growing; (iii) fish stocks, livestock, bees and poultry and the produce and progeny thereof; (iv) seeds, fertilizers and manure; and (v) other supplies and equipment used or produced in a farming operation.

Parties are required determine the categorization of the collateral, whether consumer goods, equipment, farm products or inventory, at the time they execute the security agreement.

2.3.9. Private Sector Initiatives

The private sector and the donors have also initiated activities aimed at the development of the MSME Sector. These efforts though a good step in the right direction need to be coordinated, monitored and channeled towards achievement of set national goals.

There are very few MSME support institutions besides the government. One of these is the Zambia Chamber of Small and Medium Business Associations (ZCSMBA). ZCSMBA is the largest and most successful chamber for MSMEs in Zambia.

Apart from engaging the Government interfaces at a national level to represent interests of its members, more than sixty (60%) of the ZCSMBA members are in the rural areas and interface with Government and local authorities on various committees on behalf of their

members. Despite this the effective participation of the Micro, Small and Medium Enterprise (MSME) sector has been a real challenge.

There are a number of broad theories that are relevant to the understanding of matters relating to entrepreneurship.

According to Hagen's theory, entrepreneurship reveals general model of the social-interrelationship among physical environment, social structure, personality and culture. He also goes on to say that economic theories are inadequate and that political & social change is the catalyst for entrepreneurs. Hagen rejects follower's syndrome imitating western technology and he states that technology is an integral part of socio-cultural complex and historic shift as a factor initiates change.

Schumpeter's theory of innovation: Development implies carrying one of new combinations of entrepreneurship. 'Entrepreneur' is an innovator— who carry new combination of: new goods/ services, new method of production, new market, new source of supply, new source of supply of raw materials and new organization.

Peter F Drucker's theory on entrepreneurship: "An entrepreneur is one who always searches for change, rapidness to it and exploits it as an opportunity." He emphasizes on: Innovation and Resource. A thing is regarded as resource when its economic value is recognized. Example- Fixed salary can also be an opportunity. Thus instalment purchase was introduced.

2.4 SMEs Contribution to Economic Development and Growth

"The private sector is the engine of growth of the economy therefore they must be given the necessary tools to increase their growth".(Anyima-Ackah, 2006)

Economic development is a process of economic transition involving the structural transformation of an economy through industrialization, rising Gross National Product (GNP), and income per head. Economic growth on the other hand, contributes to the prosperity of the economy and is poverty is most severe. Since they employ poor and low income workers and are sometimes the only source of employment in the rural area, their contribution cannot be overlooked and the roles that they play are as follows:

Engine of growth

- The sector is the largest provider of employment in most countries, especially of new jobs
- SMEs are a major source of technological innovation and new products
- A major contributor to the Gross Domestic Product (GDP)

Poverty reduction

- SMEs tend to employ poor and low-income workers
- SMEs are sometimes the only source of employment in poor regions and rural areas
- Self-employment is the only source of income for many who are poor
- SMEs play a particularly important role in developing countries where poverty is most severe.

Essential for a competitive and efficient market

- Ensure none of the participants have significant market control because of a large number of players
- Competitive markets achieve an efficient allocation of resources

Play a particular role in developing countries

- SMEs can be used as a tool for political stability
- SMEs as a tool for financial inclusion
- SMEs as a tool to curb or reduce social vices to a manageable proportion
- SMEs as a tool to grow government tax base

Small and Medium Enterprises (SMEs)



Source: SME Finance and Financial journal

SMEs are a very heterogeneous group of businesses ranging from single unincorporated entrepreneurs to medium-sized listed companies on exchange usually operating in following economic sectors among others. Some are dynamic, innovative, and growth-oriented while others are satisfied to remain small and perhaps family owned. SMEs usually operate in the formal sector of the economy and employ mainly wage-earning workers.

For both developing and developed countries, small and medium scale firms play important roles in the process of industrialization and economic growth. Apart from increasing per capita income and output, SMEs create employment opportunities, enhance regional economic balance through industrial dispersal and generally promote effective resource utilization considered critical to engineering economic development and growth. However, the seminal role played by SMEs notwithstanding its development is everywhere constrained by inadequate funding and poor management. The unfavourable macro-economic environment has also been identified as one of the major constraints which most times encourage financial institutions to be risk-averse in funding small and medium scale

businesses. The reluctance on the part of financial institution to fund SMEs can be explained by the insufficient capital base of banks and information asymmetry that often exists between SMEs and lending institutions.

2.5 Overview of Zambia National Context- Local Perspective

Zambia is currently ranked 139 out of 188 on the UN Human Development Index (2015) and is currently classified as a lower middle income country. According to the World Bank (2016) reports Zambia economy grew at a average annual rate of 7% between 2010 and 2014. However due to global domestic pressures strained the Zambian economy this lead to a reduction in the growth rate of 3% in 2015.

Again, from an economic perspective, however, enterprises are not just suppliers, but also consumers; this plays an important role if they are to position themselves in a market with purchasing power: their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demand of their clients. Demand in the form of investment plays a dual role, both from a demand-side (with regard to the suppliers of industrial goods) and on the supply-side (through the potential for new production arising from upgraded equipment) (Berry et al., 2002).

In order for the Zambian SME's to continue to fulfil the above and much more, they need access to finance to carry out their business operation and expansion. The seeming lack of finance for SMEs is not only retarding their expansion but also the growth of the nation's economy. Macroeconomic conditions in Zambia in recent years have severely constrained private sector access to credit. High levels of government borrowing have also contributed to pushing interest rates up and crowded the private sector out of the financial markets. With government treasuries paying real interests, banks have little incentive to take on what they perceive as riskier private sector debt.

In view of the perennial financing challenge faced by these SMEs, many interventions have been made by the government through its recent monetary policy and financial sector reforms. These have substantially increased banks' lending to the private sector but limited access to credit, high interest rates and prohibitive collateral requirements still pose significant constraints to the growth of many SME's. Access to medium to long- term financing necessary for capital investment is still tight.

Another area of constraint, which tends to block the flow of credit to SMEs, is lack of information. Small business owners most often possess more information about the potential of their own businesses but in some situations it can be difficult for business owners to articulate and give detailed information about the business as the financiers want. Additionally, some small business managers tend to be restrictive when it comes to providing external financiers with detailed information about the core of the business, since they believe in one way or the other, information about their business may leak through to competitors (Winborg and Landstrom, 2000)

Aside their unwillingness to disclose information to financiers, SMEs in Zambia are also faced with the challenge of proper book keeping practices that makes it difficult for financiers who are even willing to assist to do so.

Africa's economy is a deprived economy and it is a well-known fact that Africa's private sector consists mostly of informal Small to Medium scale enterprises operating alongside with large firms. Hence concerted efforts need to focus on unlocking the potential of these SMEs so that they contribute meaningfully to the nation's economic growth. A common error made by most countries in Africa is that they tend to target large companies at the expense of SMEs. However, they do not realize that a good environment for large small enterprises may not be favourable for SMEs but if there is a good environment for SMEs then it will also be favourable for large companies. For this to happen SMEs must have access to finance. Commercial banks and other financial lending institutions must accord SMEs easy access to finance.

As a county, Zambia has been struggling on how it can best address the issues that constrain the SMEs from performing at the frontier. For a long time now, the manufacturing sector which mainly consists of SMEs has been stagnant. The Ministry of Commerce Trade and Industry, states that finance is one of barriers that hinder the growth of this sector.

The above mentioned point is worrisome as we expect the SME's to be the driving force for economic growth and wealth. The UNIDO 2004 report on industrial development stated that the growth of SMEs has a more multiplier effects in economies than those of large scale firms.

2.6 Overview of the Banking Sector in Zambia

According to Simaata (2012) the two main institutions that act as regulators in the Banking sector are the Bank of Zambia and the Securities and Exchange Commission. The Bank of Zambia is the central bank and was established to formulate and execute monetary and financial system stability, while the Securities Exchange Commission regulates supervising and developing the securities industry in Zambia. Both are always poised to regulating the banking system in the country. The banking sector is also monitored by the Banking and Financial Services Act of 1994 (Simaata 2012)

In December 2012, the central bank of Zambia introduced a margin cap on lending interest rate for bank and non-bank financial institutions (BOZ, 2016). This was in an effort to bring down the annual inflation rate to single digit figure, however in October 2015, the Central Bank removed the cap on lending rates with the view of improving the functioning of the Zambian credit market. Such regulations and counter deregulation have encouraged competition in the banking sector (BOZ 2016). Concern about the high cost of borrowing has in the last few years prompted a number of policy measures. The aim to lower lending rates was the main motivation for the reduction in late 2011 of the reserve requirement and core liquid asset ratios by 200 basis points each. Also aimed at encouraging lower lending rates, the corporate income tax for banks was reduced from 40 to 35 percent in April 2012. And, in a more interventionist approach, banks were in that same month required to link their lending rates to the new Bank of Zambia policy rate.

In an even more direct approach, lending rates were in early 2013 subjected to a legal maximum of at the time 18.25 percent. The impact of different policy approaches to reduce lending rates will depend on how banks determine the interest rates that they charge. If high lending rates are primarily a reflection of high costs of doing business, as one survey (BOZ, 2010) has indicated, then measures to reduce these costs could be the most effective response. If, however, high interest rates are a consequence of insufficient competition, other more appropriately targeted measures may be justified.

In 2004, the Government embarked on the Financial Sector Development Programme (FSDP), a comprehensive strategy aimed at building and strengthening financial sector infrastructure to enable it support economic diversification and sustainable growth (GRZ, 2004). The Financial Sector Development Plan proposes the expansion of rural financial

services under the framework of Rural Finance Program to facilitate access to financial services among rural entrepreneurs (APF, 2014).

2.7 The financial Institutions (Banks)

Most literature states that differences in the financial institution structure and lending infrastructure affect the availability of funds to SMEs (A.N, Berger & G.F Udell, 2004). These differences may significantly affect the availability of funds to SMEs by affecting the feasibility with which financial institutions may employ the different lending technologies (be it transaction lending or relationship lending) in which they have comparative advantage to provide fund to different businesses. Transaction lending technologies are primarily based on “hard” quantitative data such as the financial ratios calculated from certified audited financial statement among others. Relationship lending on the other hand is based on “soft” qualitative information gathered through contact overtime with SMEs. This soft information may include the character and reliability of the SME’s owner based on direct contact overtime by the financial institution.

Also by lending infrastructure, they were talking about the rules and conditions set up mostly by governments that affect financial institutions and their abilities to lend to different potential borrowers desirable because it enables the economy to consume and contribute to more goods and services by increasing investment, increase in labour force, efficient use of inputs to expand output, and technological progressiveness. Any nation that experiences economic development and growth will benefit from improvement in the living standards especially if the Government can assist in growth by implementing complementary and growth-enhancing monetary and fiscal policies (Pass et al. 1993)

The SME sector is considered very important in many economies because they provide job, pay taxes, are innovative and very instrumental in countries participations in the global market. Beck and Kunt (2004) state that SME activity and economic growth are important because of the relatively large share of the SME sector in most developing nations and the substantial international resources from sources like the World Bank group, that have been channeled into the SME sector of these nations.

SMEs account for nearly 93% of the registered businesses in Zambia and therefore play an important role in economic development by providing employment opportunities, opening up new business opportunities, enhancing entrepreneurship, and fostering creativity among many other things. Kayanula and Quartey (2000) recognize them as the engines through which the growth objectives of developing countries can be achieved and are potential sources of employment and income in many developing countries. Mensah (2005) makes the analogy that SMEs act like sponges by soaking up surplus labour to provide a large share of employment and income in Zambia.

Many researchers have observed that SMEs enhances competition and entrepreneurship therefore they suggest that direct government support can boost economic growth and development. Also SMEs growth boost employment more than large firm because they are labour intensive and make better use of scarce resources with very small amount of capital. Hellberg (2000) also states that developing countries should be interested in SMEs because they account for large share of firms and development in these countries. Young (1994) contended that SMEs are not only important because they are a source of employment but also because they are a source of efficiency, growth and economic decentralization.

Finally, they are very important in the fight against poverty as they help in the poverty reduction strategy for most government especially those in the developing countries where poverty is most severe. Since they employ poor and low income workers and are sometimes the only source of employment in the rural area, their contribution cannot be overlooked.

2.8 Importance of Financial Institutions in SME Development

“Finance is the oil for growth. It is indeed the life-blood of the economic system. The financial system is the vessel that carries this life-blood through the economic system. Faulty vessels prevent the life-blood from reaching essential parts of the economic system”. (Sowah N.K., 2003)

Gockel and Akonea (2002) offer a historical account of the banking industry in Zambia. They write that Zambia Commercial Bank (GCB) entered the banking market with the

purpose of providing credit to large indigenous enterprises since the expatriate banks refused to offer assistance. National Investment Bank (NIB), established in 1963, provided credit facilities for manufacturing and agro-based industries with Agricultural Development Bank (ADB), which was established in 1976 with the aim of providing financial assistance for the development of agricultural and allied industries. SSB (now SG-SSB) and NSCB (National Savings and Credit Bank) emphasized not only consumer credit but also finance for small-scale projects. Even though banks were established to cater for all sectors in the economy financing small businesses was still a problem therefore government started rural banking to mobilize funds and channel them to SMEs and other informal activities in their localities.

As time progressed, Zambia's monetary system went from the best in Sub-Saharan Africa to the worst. According to Steel (1998), this was affected by the deteriorating economy and high inflation rates. The financial sector was fragmented with different institutions using different lending technologies to serve clients, which resulted in funds not flowing from one segment of the financial system to the other. This resulted in the implementation of two major financial liberalization programs, ERP and FINSAP.

ERP led to the liberalization of financial markets, removal of restrictions and the deregulation of interest rates but it had a minute effect on the conditions that inhibit banks from financing SMEs leaving their demand for credit unsatisfied (Aryeety et al., 1994). In 1988, FINSAP was embarked upon with the main objectives to restructure financially distressed banks, improve savings mobilization and enhance credit allocation especially to SMEs, enhance soundness in the banking sector by promoting competitive banking practices, develop money and capital markets and establish NPART(non-performing assets recovery trust). In a study conducted by Galindo et al.(2002), financial liberalization leads to improvement in the efficiency with which investment funds have been allocated. Antwi-Asare and Addison (2000) state that FINSAP sought to ensure that businesses have access to institutional credits and deposit mobilization. Unfortunately, Gokel and Akonea (2002) state that SMEs have rather been marginalized from the credit market after financial liberalization and therefore they are still suffering from credit scarcity.

Llewellyn (1997) argues that financial system play a crucial role in development through the reduction of information and transactions cost and its efficiency in reducing those cost influences savings rates, investment decisions, technological innovation and long run growth rates. Patrick (1966) stated in his work that financial institutions play a major role in promoting economic growth by ensuring the availability of cash flow cost credit to potential investors. Likewise, King and Levine (1993) agree with the above that countries with better financial systems have superior economic growth while Arestis and Demetriades (1996) add that this varies across countries. Goldsmith (1969) and Gerschenkron (1962) argued that in the early stages of economic development suppressed interest rates, credit policies and institution building provided the financial impetus necessary for economic development.

It is in the interest of financial institutions to ensure that the economy is growing efficiently by playing an intermediary role between suppliers and lenders of funds in any economy by gathering surplus funds in the economy and then lending these funds to those who need them. According to Mishkin (2001), banks are the most important source of external funds especially for loans. This suggests that bank play an important role in financing business activities especially in developing countries.

Even though banks may be faced with constraints, Aryeetey et al. (1994) suggest that they do active banking by mobilizing resources and distributing them to needy SMEs. Sowah (2003) further suggest that bank should be urged to take “reasonable risk” in vetting loan applications from small and medium enterprises, especially for business ventures in new areas and technology.

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distressed banks, improve savings mobilization and enhance credit allocation especially to SMEs, enhance soundness in the banking sector by promoting competitive banking practices, develop money and capital markets and establish NPART(non-performing assets recovery trust). In a study conducted by Galindo et al. (2002), financial liberalization leads to improvement in the efficiency with which investment funds have been allocated. Antwi-Asare and Addison (2000) state that FINSAP sought to ensure that businesses have access to institutional credits and deposit mobilization. Unfortunately, Gokel and Akonea (2002) state that SMEs have rather been marginalized from the credit market after financial liberalization and therefore they are still suffering from credit scarcity.

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2.9 Small and Medium Scale Entrepreneurs and Finance in Zambia

As stated above, approximately 80% of rural households are involved in Small and Medium Scale Entrepreneurs with the agricultural sector contributing about 16% to Zambia' GDP (Budget 2013) however in spite of this, investment in many of these sectors is constrained by lack of access to financial services especially credit facilities. According to the Finscope (2015) report, the government of Zambia's national target of 50% financial inclusion has

been exceeded. The Finscope (2009) survey found that only 37.3% of adults were formally banked with more than two thirds of the population lacking access to financial services. The situation for women was markedly worse in that only 11% of women were banked compared to 18% of men. However as of Finscope 2015, 59.3% of adults were financially included, this represents a significant increase from 2009 (37.3%) and 2005 (33.7%). Inclusion in urban areas increased more significantly than in rural areas additionally inclusion amongst females increased more significantly than inclusion amongst males.

Improvements to Zambia financial infrastructure continue to be uneven with limited opportunities for the inclusion of very poor and rural households. According to Agri-ProFocus (2014) access to finance is impacted by a number of factors, including limited outreach of banks and non-bank financial institutions, and gaps in policies and regulations governing the financial sector.

A study by African Development Bank (2000) revealed that some of the most critical constraints faced by financial institutions in expanding financial services to rural households in Zambia are exogenous and endogenous to the sector. The factors include but are not limited to:

- High population growth rates (about three percent per year) which put tremendous pressure on low input and low output agricultural systems.
- Heavy dependence on rain fed agricultural and exposure to intermittent occurrence of severe and prolonged drought.
- Inappropriate policy environment for agricultural investment including relatively high taxation on primary agricultural commodity exports.
- High post-harvest losses and poor adoption of available technology and
- The declining trend of real international prices for most agricultural commodities.

Despite this Small and Medium Scale Entrepreneurship especially in Small and Medium Scale Entrepreneurs remains the main economic activity and employs the majority of the people in most low income countries. According to (IFC, 2014) globally, there are approximately 450 million households whose main activity is revolves around Small and Medium Scale Entrepreneurship. Small and Medium Scale Entrepreneurs in developing

countries, particularly those in low income countries, face a number of hurdles including low productivity, limited access to markets for their products, lack of adequate risk management products and services and limited access to finance. While Small and Medium Scale Entrepreneurs remain a key economic activity in Africa employing about 55% of the population, only approximately 1% of bank lending goes to the Small and Medium Scale Entrepreneurs. Furthermore, only 4.7% of those in rural areas in developing countries globally have a loan from a formal financial institution and only 5.9% a bank account (Findex data 2014).

2.9.1 Background of Small and Medium Scale Entrepreneurs Financing in Zambia

Zambia like many developing countries faces a challenge of high interest rates (Budget 2013). The high interest rates in the end affect access to agricultural finance negatively with the number of borrowers reducing with reducing amounts borrowed especially from the formal financial sector (Sebatta et al 2014).

In Zambia, the history of agricultural lending dates back to as far as 1992/93 when Zambia under took financial sector reforms which saw a marked increase in the number of Microfinance Institutions (MFIs) and by 1999 there were about thirty MFI's (Maimbo & Mavrotas,2003) . Prior to 1992, the Lima Bank, Zambia Cooperative Federation-Financial Services, the Credit Union and Savings Association (CUSA), the National Saving and Credit Bank (NSCB), the Small Industries Development Organization (SIDO) and the Village Industry Service were the major providers of rural financial services (Kingombe 2004)

According to Sebatta et al (2014) the whole purpose of accessing agricultural finance for small holder dealers would be to facilitate operational and capital investment where SMEs get credit to buy seed, fertilizer and other equipment during the planting season. However, in many cases this is not the case in fact many interventions aimed at facilitating SMEs' access to credit have failed to deliver it at the right time and in the right proportions.

2.9.2 Role of Small and Medium Scale Entrepreneurs in the Economy

Small and Medium Scale Entrepreneurship is the largest economic sector in most African countries and remains the best opportunity for economic growth and poverty alleviation on the continent (Hussain, 1992). Yet, sadly, the sector has been in decline over the past 40 years, and SMEs especially have largely remained poor. This failure is due to many factors, including collapsed development banks, corruption and inadequate infrastructure. It has also

occurred because Small and Medium Scale Dealers lack access to critical information, market facilitation, and financial intermediation services.

The table 1 below shows the percentage growth SMEs per sector between 2013 and 2015.

Table 1: Percentage Growth to Overall GDP, Zambia 2013-2015

Kind of Economic Activity	2013	2014	2015
Agriculture, forestry and fishing	-4.1%	8%	-7.7%
Mining and quarrying	3.6%	-2.2%	0.3%
Manufacturing	6.2%	4%	4.4%
Electricity, gas, steam and air conditioning supply	8%	8.4%	-1.5%
Water supply; sewerage & waste mgmt.	28.6%	-7.9%	6.9%
Construction	-2.7%	8.9%	18.9%
Wholesale & retail trade; repair of motor vehicles	19.7%	3.5%	3.6%
Transportation and storage	-19.7%	6.7%	1.4%
Accommodation and food service activities	3.5%	3.5%	0%
Information and communication	-3.5%	7.4%	2.5%
Financial and insurance activities	-5%	-3.6%	8.3%
Taxes less subsidies on products	5.1%	5%	3.2%
Gross Domestic Product (GDP) Growth	5.1%	5%	3.2%

Source: BOZ annual reports 2015

Growth in Small and Medium Scale Entrepreneurship especially in maize and forestry and fishing sectors contracted by 7.7%, mainly due to a reduction in yields in the 2014/15 season following the late onset and poor distribution of rainfall. Output for 13 of the 18 major crops declined. For example, maize production contracted by 21.9% to 2,618,221 metric tonnes from 3,350,671 metric tonnes in the previous farming season. Production of other crops such as sorghum, rice, groundnuts, seed cotton, sweet potatoes, mixed beans and virginia and burley tobacco also declined (see table 2).

Table 2: Comparative National Crop Production Estimates (metric tonnes) for 2012/13 – 2014/15

Crop	2012/13	2013/14	2014/15	Growth (%)
Maize	2,532,800.00	3,350,671.00	2,618,221.00	-21.90%
Seed cotton	139,583.00	120,314.00	103,889.00	-13.70%
Sorghum	14,971.00	11,557.00	8,123.00	-29.70%
Rice	44,747.00	49,640.00	25,514.00	-48.60%
Sunflower	33,733.00	34,264.00	34,726.00	1.30%
Groundnuts	106,792.00	143,591.00	111,429.00	-22.40%
Soya beans	261,063.00	214,179.00	226,323.00	5.70%
Mixed Beans	56,411.00	61,749.00	50,398.00	-18.40%
Irish Potatoes	22,038.00	33,833.00	45,902.00	35.70%
Sweet Potatoes	188,355.00	150,158.00	118,330.00	-21.20%
Virginia Tobacco (kg)	21,195.00	26,105.00	19,811.00	-24.10%
Burley Tobacco (kg)	8,704.00	9,564.00	6,083.00	-36.40%

Source: BOZ annual reports 2015

2.10 Empirical Studies on Small and Medium Scale Entrepreneurs Finance

A study by Mwanamambo et al (2007) compared the mechanisms employed by major microfinance institutions focused on lending to agricultural produces with successful lending institutions in Zambia that serves agricultural businesses. The findings were that the Zambia Agribusiness Technical Assistance Centre (ZATAC) used progressive lending and group lending contracts adapted in some ways to suit seasonal agricultural production credit requirements. The institutions also used various forms of collateral substitutes like other microfinance institutions. The study also concluded that ZATAC used other mechanisms such as automatic loan repayments tied to production, corporative, sanctions, contracted production and provision of business development services that eventually improved loan repayments significantly and enabled the lender to lower interest rates.

Mataa (2012) assessed the risks associated with commercial banks financing small scale dealers in Zambia. The study evaluated six banks in Zambia and assessed what risks are involved in lending to small scale dealers. The study employed the use of primary and secondary data obtained from questionnaires distributed to a sample of 10 banks in Zambia as well as historical data on defunct institutions like agricultural finance Company, Lima Bank and Ministry of Finance. The data from the questionnaires was analysed using Microsoft Excel and Spss programs. The study reviewed that Small and Medium Scale Entrepreneurs that have access to banking services are 44% more productive than those that do not have access to financial services. Additionally, interest rates in Zambia at the time were high at 20-30% especially for small borrowers which meant they could not afford facilities from the bank. The study concluded that there was a need to strengthen the legal and regulatory framework for Small and Medium Scale Entrepreneurs (Wichern et al., 1999).

Although Small and Medium Scale Entrepreneurs' accessing and efficient utilization of credit finance is very vital in increasing farm productivity, increasing rural household incomes and reducing poverty levels in agrarian societies. In Zambia in particular and Africa in general, access to Small and Medium Scale Entrepreneurs finance is still low. A study by Meyer (2011) stated that the reasons why agricultural finance has not been able to meet the needs and expectations of clients. This the authors reported was in terms of both sustainable access and suitability of financial products and services are mainly; reluctance of financial institutions to lend to the agricultural sector, high risks associated with lending to the agricultural sector especially smallholder dealers who lack collateral and production and political risks prevalent in Africa.

Smallholder dealers in many parts of Africa and in Zambia in particular access agricultural finance or credit through a number of channels. Some of these channels are formal while others are informal. The same SMEs have a wide range of ways of utilising the agricultural finance once it is accessed. Burritt (2006) reported that the majority of households in Malawi lacked access to finance from either formal (Banks, NGOs, etc.) or informal sector sources (money lenders, family and friends, Rotating Savings and Credit Associations, etc.). The study further added that in many economies households rely on a combination of formal and informal sector suppliers of finance, often making trade-offs in terms of convenience (informal sector players tend to be better positioned) and depth of services offered (formal sector players tend to offer a wider variety and more stable sources of finance).

Finally a study by Agri-ProFocus (2014) focused on Microfinance services in Zambia in order to understand existing opportunities for alternative finance in microfinance to small holders and agro enterprises in Zambia. The goal of the study was to gather market intelligence on MFI's particularly involved in Small and Medium Scale Entrepreneurs and rural financing. The study focused on 4 districts i.e. Choma, Chipata, Kasama, Mkushi/Serenje and Lusaka and highlighted the state of financial inclusion in Zambia with particular focus on Finscope surveys (2005 & 2009). The conclusions of the study were that a lot of ground remains uncovered by MFI's in terms of agricultural and rural finance. This is in spite of existing opportunities and models being used by commercial banks and input suppliers that MFI's in Zambia can learn, contextualize and replicate.

2.11 Overview of the Banking Sector in Zambia

According to Simaata (2012) the two main institutions that act as regulators in the Banking sector are the Bank of Zambia and the Securities and Exchange Commission. The Bank of Zambia is the central bank and was established to formulate and execute monetary and financial system stability, while the Securities Exchange Commission regulates supervising and developing the securities industry in Zambia. Both are always poised to regulating the banking system in the country. The banking sector is also monitored by the Banking and Financial Services Act of 1994(Simaata 2012)

In December 2012, the central bank of Zambia introduced a margin cap on lending interest rate for bank and non-bank financial institutions (BOZ, 2016). This was in an effort to bring down the annual inflation rate to single digit figure, however in October 2015, the Central Bank removed the cap on lending rates with the view of improving the functioning of the Zambian credit market. Such regulations and counter deregulation have encouraged competition in the banking sector (BOZ 2016). Concern about the high cost of borrowing has in the last few years prompted a number of policy measures. The aim to lower lending rates was the main motivation for the reduction in late 2011 of the reserve requirement and core liquid asset ratios by 200 basis points each. Also aimed at encouraging lower lending rates, the corporate income tax for banks was reduced from 40 to 35 percent in April 2012. And, in a more interventionist approach, banks were in that same month required to link their lending rates to the new Bank of Zambia policy rate.

In an even more direct approach, lending rates were in early 2013 subjected to a legal maximum of at the time 18.25 percent. The impact of different policy approaches to reduce

lending rates will depend on how banks determine the interest rates that they charge. If high lending rates are primarily a reflection of high costs of doing business, as one survey (BOZ, 2010) has indicated, then measures to reduce these costs could be the most effective response. If, however, high interest rates are a consequence of insufficient competition, other more appropriately targeted measures may be justified.

In 2004, the Government embarked on the Financial Sector Development Programme (FSDP), a comprehensive strategy aimed at building and strengthening financial sector infrastructure to enable it support economic diversification and sustainable growth (GRZ, 2004). The Financial Sector Development Plan proposes the expansion of rural financial services under the framework of Rural Finance Program to facilitate access to financial services among rural entrepreneurs (APF, 2014).

2.11.1 Types of credit facilities available to SMEs

Some sources of finance are **short term** and must be paid back within a year. Other sources of finance are **long term** and can be paid back over many years. Achieving the goals of corporate finance requires appropriate financing of any corporate investment. The sources of financing are, generically, capital that is self-generated by the firm and capital from external funders, obtained by issuing new debt and equity. Management must attempt to match the long-term or short-term financing mix to the assets being financed as closely as possible, in terms of both timing and cash flows.

Short term business finance facilitates businesses and financiers to seize quick business opportunities that require transactions to be completed in short time. The highlight of this kind of finance is its prompt availability to the businessman. Here it is imperative to get the transaction conducted as quickly as possible. Short term business finance is appropriate for both new and existing businesses.

While looking through the resource of short term business finance, it is important to remember that some sources of finance will be suitable for some businesses, but not for others. When dealing with new businesses, some banks will grant only shorter term loans, because these loans are less risky than loans with longer terms. Short term business finance can be a suitable way to raise working capital and cover accounts payable. Businesses often

need short term financing when they are experiencing cash flow problems. This can happen even to businesses that are quite sound. There are a number of sources where short term financing can be obtained

Boom et al.(1983) and Longenecker et al.(1994), like most writers on the subject of SME financing, describe two basic types of financing, namely debt and equity. Hisrich and Peters (1995) and Anderson and Dunkelberg (1993) describe debt as funds borrowed to be paid at a future date and a fee, referred to as interest to be paid at an agreed time schedule. The payments of interest are supposed to be done regardless of whether the firm makes profit or loss. Equity, on the other hand, is defined as funds contributed by entrepreneurs or investors who become owners or part owners of the firm and whose returns are primarily based on the profits. This implies that if a firm fails to make profits its owners do not get any returns. Generally, equity funds are long-term funds but debt may be short to medium or long-term. Hisrich and Peters (1995) mention another basic classification of funds: internal and external funds. Internally generated funds come from a number of sources within a company and are more frequently employed. They include operational and investment profits, sales of assets, extended payment terms, reduction in working capital and accounts receivable. Another important source of internally generated funds is expediting the collection of receivable accounts. This releases funds that may be locked up with suppliers and distributors for the firm's use. Sources that are external to a firm include owners, friends and relatives, commercial banks suppliers and distributors, government and non-government agencies.

Equity versus Debt

It is very important to carefully evaluate the reasons for the choice of one form of funding against another or a particular mix. A number of factors must be considered and they include the following:

2.12 Purpose of funds

The choice of the type of financing, that is, whether to use equity or debt depends on several factors and one such important factor is the intended purpose of the funds. Wert and Henderson (1979) note that the suitability of funds obtained and project for which funds are obtained is very important. Long-term funds as long-term debt may not be suitable for short-term projects. This will burden the firm with the cost of servicing an unnecessary debt.

Similarly, short-term debts are not appropriate for financing long-term projects since the loan may have to be repaid before the end of the project. Wert and Henderson (1979) concluded that a more flexible short-term debt is more suitable for short-term projects, whereas long-term funds such as long-term debt or equity are more suitable for long-term financing such as acquisition of equipment or the construction of a new plant. The phenomenon is described by Brealey and Myers (1996) as “matching maturities”.

Purpose of Short-term Finance After establishment of a business, funds are required to meet its day to day expenses. For example raw materials must be purchased at regular intervals, workers must be paid wages regularly, water and power charges have to be paid regularly. Thus there is a continuous necessity of liquid cash to be available for meeting these expenses. For financing such requirements short-term funds are needed. The availability of short-term funds is essential. Inadequacy of short-term funds may even lead to closure of business. According to Brealey Richard et al (1996:138) Short-term finance serves following purposes;

1. It facilitates the smooth running of business operations by meeting day to day financial requirements.
2. It enables firms to hold stock of raw materials and finished product.
3. With the availability of short-term finance goods can be sold on credit. Sales are for a certain period and collection of money from debtors takes time. During this time gap, production continues and money will be needed to finance various operations of the business.
4. Short-term finance becomes more essential when it is necessary to increase the volume of production at a short notice.
5. Short-term funds are also required to allow flow of cash during the operating cycle. Operating cycle refers to the time gap between commencement of production and realisation of sales.

2.13 Leverage and Owner's Equity

Borrowing creates financial leverage since payments of interests add to financing costs. Thus a percentage of increase in the earnings before interest and tax of a firm will result in a higher percentage increase in the net earnings of the firm. Consequently, the value of the owner's equity will appreciate. Similarly, a percentage reduction in net earnings before interest and tax will lead to a greater percentage reduction in net earnings, and consequently,

the depreciation of owner's equity. Therefore the use of debt results in higher earnings volatility and increase the risk to owner's equity. Equity capital does not result in financial leverage (Brealey and Myers, 1996; Wert and Henderson, 1979).

Riskiness

Apart from the increased risk to earnings and owner's equity, debt financing poses another risk. When a firm has to honour its debt obligations with difficulty or is unable to honour the obligation at all, then it is said to be in financial distress. The probability of financial distress increase as a firm's debt-to-equity ratio increases. So to avoid financial distress affirm must guard against excessive debt. Financial distress is costly. Investors take the potential for financial distress in the future into consideration in the valuation of firms. The attitude of suppliers towards a firm may change when a firm becomes financially distressed. Also valuable management time will be lost to the firm. Financial distress may result in bankruptcy. Filing for bankruptcy involves heavy legal fees, which comes from the remaining value of the firm's assets. So costs of financial distress and bankruptcy must be considered carefully. (Wert and Henderson, 1979).

Flexibility

A firm's ability to adapt to a changing economic environment, particularly, with respect to its future financing decisions, is very important. According to Wert and Henderson (1979), if a company takes on too much debt it may be forced to use equity financing at a time that the market for equity may be unattractive. Alternative options under such circumstance may be equally unattractive. For instance a firm may be forced to take more debt at very high interest rates, since lenders will demand higher returns from a firm that already has high levels of debt. Otherwise, the firm may have to forego very attractive business opportunities due to major cuts in capital expenditures. On the other hand, too much equity can give rise to a similar problem. In this case the problem arises if a company decides to contract operations. Wert and Henderson (1979) recommend that to be truly flexible a company must maintain its options by maintaining a good balance of capital mix. This will allow an easier choice of expansion or contraction as and when necessary.

2.14 Sources of Financing for SMEs

A number of sources of capital exist but many of them may not be accessible to companies of small and medium sizes.

Debt - Friends and Relatives

Loans and contributions from friends and relatives are common source of funds, especially for new business since the financial institutions are reluctant to providing funding for start-up business because of the risk involve. This source of funds, however, bears a potentially dangerous price. Many friends' relatives find it very difficult to stay as passive creditors or investors. They usually try to interfere with policy and operational issues (Kuriloff et al.1993; Longenecker et al. 1994). As a remedy to this problem, Kuriloff et al. (1993) recommended the treatment of such loans like bank loans by putting in writing all the terms including interest rates and payment schedule.

Commercial Banks

Hisrich and Peters (1995) make an assertion that commercial banks constitute the most widely used source of debt financing for small companies. This assertion is also supported by longenecker et al. (1994). Again Longenecker et al. (1994) claim that commercial banks loans to small companies are mostle short-term loans, though some do offer long-term loans to small and medium size companies. According to Kuriloff et al. (1993), commercial banks usually provide loans for working capital or for the purchase of fixed assets. They demand evidence of a company's ability to pay the interest and principal as scheduled. This evidence is usually in the form of cash flows statements. They also demand some form of security. Collaterals are the most widely used form of security demanded by commercial banks. Longnecker et al. (1994) classify commercial bank loans as line of credit and term loans.

Business Suppliers

Companies can enjoy some form of credit from their business suppliers. This is a very important source of credit, especially for SMEs. The suppliers allow the company some time to pay for the supplies. The credit periods varies from a few days to several years according to Broom et al. (1983). Credit from business suppliers may be trade credit or equipment loans and leases.

Trade Credit

Basically it involves the purchase of goods and services from a supplier on credit. The purchasing firm is given a few days, usually between 30 and 120 days, to settle the debt (Broom et al. 1983). This type of credit is very important to SMEs for a number of reasons:

- Broom et al. (1983) and Moyer et al. (1992) assert that suppliers are more flexible in dealing with SMEs than the banks. Suppliers may only check the credit standing of an SME whereas a bank is likely to demand financial statement and cash flow budgets before extending a credit facility. Generally, suppliers are very eager to add to their customers (irrespective of the size of firm) and thereby increase their sales hence they are more willing to assume greater risk.
- Suppliers are more flexible regarding adherence to terms of credit. Banks required strict adherence to loan terms and monitor borrowers more closely than suppliers do.
- The amount of trade credit granted may be readily increased just as the volume of a company's purchases increases. It may not take a lot of negotiations to make this possible. Banks are less willing to substantially increase the amount of credit they grant to customers, especially small and medium scale companies (Peirson et al., 1990)

Trade credit may come with an offer of cash discount. A cash discount may be quoted as 3/12 net 40. This means that the customer has 40 days to pay the full amount but can enjoy a 3 percent discount if payment is done within 12 days. Failing to take cash discount may constitute an opportunity cost of trade. In the above quote, for example, failing to utilize such discount implies borrowing the amount for 28 days (i.e. 40-12) days at 3 percent. Therefore it is important to compare the cost of forgoing a trade discount and the cost of other available short-term credit facilities before decision is made (Moyer et al., 1992; Brealey et.al, 2001).

Equipment Loans and Leases

Many SMEs find it very difficult to raise funds for outright purchase of certain equipment and machinery. They resort to purchasing such equipment on installment basis. Longenecker et al. (1994), noted that down payment of about 25 to 30 percent of the price of the respective equipment are usually made initially. The remainder may be amortized over 3 to 5 years. This practice is referred to as equipment loans. An alternative to this is equipment leasing. This arrangement allows firms greater investment flexibility; and smaller amounts of capital are required by the firm at any given time. However, the total cost involved in equipment leasing is usually higher than the cost of outright purchase. On the other hand, in a situation where continuous specialized maintenance and protection against obsolescence are required, leasing may be more suitable (Broom et al., 1983)

Equity-Personal Resources

Again Longenecker et al. (1994) observe that personal savings of the owners and partners of businesses constitutes an important source of funds, particularly in the formative stages of a firm. Personal contributions also help to raise additional funds from other sources.

Significant financial commitments made by owners of a company tend to build a lot of confidence among potential investors. Karloff et al. (1993) also note other personal resources apart from personal savings. These include borrowing using one's personal assets such as house and bonds as collateral.

Other individuals (business Angels)

There is a category of private individuals who invest in business ventures. These individuals are referred to as 'business angels'. Many of such individual investors tend to have some experience in business and/or are affluent professionals, who may have a lot of money to invest. Business angels constitute the informal capital source. They are said to represent the informal capital because there is no formal market place where their investment transactions are carried out. They are usually contacted through dealmakers such as business associates, accountants and lawyers (Longenecker et al. 1994)

Venture Capital

Venture capital, according to Stevenson et al., (1999), is a pool of equity capital contributed by wealthy individuals, as limited partners, and professionally managed by general partners for a fee and a percentage of the gain on investments. Thus venture capital firms are investment firms.

Owing to the highly risky nature of the investments they undertake, venture capitalists demand very high returns on their investments, with target returns of about 50 percent or 60 percents being considered normal (Stenvenson et al. 1999). Tuller (1994) notes that owing to their high expected returns, venture capital companies usually target companies that have prospects of rapid growth and above average profitability. The targeted companies must also have the prospect of going public in the foreseeable future – usually within five to seven years. Venture capital firms aim to capitalize on initial public offerings (IPOs) and cash in on their investments if prices are substantially above their initial investments in the respective companies.

Apart from the provision of capital for very promising business ventures, venture capital firms also provide useful advice to these young enterprises, having acquired much more experience in business. They also provide additional financial assistance in the future if a firm they have invested in runs into financial difficulties. It will not be considered prudent to stand aside and watch their investments go to waste with a firm for lack of cash provided throwing in more cash will not amount to reckless investment. (Tuller, 1994; Longenecker et al.1994). Tuller (1994) summarizes this as “future availability of funds can be an enormous boost to achieving long-term strategic goals”.

One of the clear weaknesses in the Zambian financial system is the limited medium and long-term financing available to the private sector in the market place (Morse et al, 1996). While commercial banks are the major source of loanable funds in the market, they focus on providing only short-term financing for their clients. As a consequence, many companies inappropriately use short –term funds to finance long-term project (Morse et al, 1996). The short term nature of the loans from the banks does not support the expansion programs of SMEs.

As another measure with the intended purpose of assisting SME overcomes their financing difficulties, Venture Trust Funds has been set by State and other developing partners. As defined in the Cambridge dictionary, a venture capital is money that is invested or is

available for investment in a new business or company, especially risky one. In 1991, U.S. Agency for international Development (USAID) and the Commonwealth Development Corporation (CDC) sponsored the formation of a venture capital fund in Zambia in respect to a perceived need for financial products and services designed to meet the long-term financing requirements of growing businesses in Zambia within the context of Zambia's financial sector reform program (Mensah, 2004).

In the absence of a regulatory environment, the sponsors agreed to establish, a non-bank finance institution to hold the funds –Zambia Venture Capital Fund (GVCF), and a management company, Venture Fund Management Company (VFMC) to make investment decisions. It became operational in November 1992, and was fully invested with 13 investee companies of which their average investment was \$250,000 (Mensah, 2004). In addition to the management of GVCF, VFMC was awarded the management of a \$4 million Enterprise Fund, promoted by the European Union. According to Mensah, 2004, all these funds have been targeted at growth oriented large enterprises simply because the risks and cost involved in managing shareholdings in SMEs have so far rendered those investments not interesting.

Joint Venture

Various forms of strategic alliances have become important and common practice in business today. One such important form of strategic alliances is joint ventures. A joint venture typically involves two or more companies coming together to form a new entity. The main objective of joint venture formation is to gain competitive advantage and become more profitable. Combining the resources of the firms involved in a joint venture most often leads to the attainment of synergy. The new company may be able to perform a service more efficiently, produce a product at a less cost or utilize a facility or funds more effectively. This ultimately results in greater profits for the firms involved than they would have achieved as separate business entities. Financing is also a common goal of joint venture. Smaller firms in particular tend to benefit from the usually better financial positions of larger firms. In addition, joint venture stand a better chance of obtaining credit or raising more equity as creditors and investors' confidence in the new firm is often greater. As a joint entity, they provide better guarantee for creditors fund as their assets base is widened.

Constraints Faced by SMEs in Accessing Credit

Cuevas et al. (1993) indicates that access to bank credit by SMEs has been an issue repeatedly raised by numerous studies as a major constraint to industrial growth. A common explanation for the alleged lack of access to bank loan by SMEs is their inability to pledge acceptable collateral.

In their view the current system of land ownership and transfer regulations clearly retards and to some extent limits access to formal credit. First, due to lack of clear title to much usable land in Zambia, there is a limited amount of real property that can be put up as collateral. Second, a Government embargo on transfer of stool and family land has further restricted land availability for collateral. Finally, where title or lease is clear and alienable, transfer regulation needlessly delay the finalization of mortgages and consequently access to borrowed capital (p 24). Aryeetey et al. (1993) supported the view of Cuevas et al. (1993) that from the view point of private sector, problems related to finance dominate all other constraint to expansion (p 50).

They claimed that the available of collateral plays a significant role in the readiness of banks to meet the demand of the private sector. Collateral provides an incentive to repay and offset losses in case of default. Thus collateral was required of nearly 75 percent of sample firms that need loans under a study, which they conducted on the demand supply of finance for small enterprises in Zambia (p 19). The study also indicated that 65 percent of the total sample firm had at various times applied for bank loans for their business. Nevertheless a large proportion of the firm had their application rejected by banks. For firms that put in loans applications there was almost 2:1 probability that the application would be rejected. Firms receive loans for much less than they requested for. Among firms that had their applications rejected, lack of adequate collateral (usually in the form of landed property) was the main reason given by banks. Aryeetey et al. (1994) suggest that banks can offer alternative to property as collateral such as guarantors, sales contract and liens on equipment financed.

The above was also corroborated by Dr. Kwadwo Ansah Ofei (JEL: G21, I30, N27). In his view small and medium enterprises are unable to assess loans because of the conditions attached to the banking methodologies. This he grouped into two:

Formal bank methodologies: These consist of several techniques to pre-screen clients and concentrate on relatively few large transactions. They include; feasibility studies, collateral, track record and minimum deposits. **Informal banking methodologies include:** personal relations family connections and knowledge business relations.

Also it is contained in Dr. Ansah Ofei's Journal that the fear of risk, especially the loss of their (SME operators) wealth prevented them from pursuing a loan.

SMEs face more challenges in doing business than large enterprises because of the difficulties in financing start-up and expansion. Schiffer and Weder (1991) found that small firms tend to experience more difficulties than medium-sized firms, which also experience more difficulties than large firms. In most countries, especially developing nations, lending to small businesses and entrepreneurs remain limited because financial intermediaries are apprehensive about supplying credit to businesses due to their high risk, small portfolios, and high transaction cost.

According to Cuevas et al. (1993) cost of transaction contributes to the inability of the SMEs to access finance. They are of the opinion that "if transaction cost of lending are high the net margin banks expect from loans operation do not compare favourably against safe investment represented by treasury bonds" (p 30). Aryeetey et al. (1993) also shares the same view that if a lender face information asymmetry, the issue often becomes somewhat persuasive authority he or she holds in ensuring repayment. These push up transaction cost as the probability of default is assumed to be high and has to be contained. Thus lenders may avoid lending to smaller or lesser known clients or impose strict collateral requirements when they do. They may perceive clients in ways that would overcome the latter own perception of the difficulty in obtaining formal finance.

In investigating "whether lending to SMEs in Zambia was more expensive that lending to larger enterprise in terms of loan screening, loan monitoring and contract enforcement, banks estimate that screening to gather information about the applicant and project, review the feasibility study, do the credit analysis and make a decision, an average of 16 man days for large scale applicant and that of small scale applicants takes 24 man days.

Similar results obtained for loan monitoring and contract enforcement suggest that the transaction cost of SME lending were higher than those for large enterprise per loan though a similar study undertaken in 1992 by Aryeetey and Seini on the transaction cost of lending covering sixty bank branches in Zambia suggested that there was no statistically significant difference in the cost of administering loans to smaller and larger enterprises”.

They further state that the internal organization of most banks is such that SMEs applying for loans deal with branch staffs that have little say in the decision, whereas major decisions are taken at the head office of official who know little about the enterprise. This arrangement ensures that many potential SME borrowers do not have the chance to interact with the few trained project personnel before applications are made. There is a high probability that many potential good project are turned down because distant credit officers lack enough undocumented information to form an opinion on the projects and especially on entrepreneurs.

Despite SMEs strong interest in credit, commercial banks’ profits orientation may deter them from supplying credit to SMEs because of the higher transaction cost and risk involved. First, SMEs loan requirement are small so the cost of processing the loan tend to be high relative to the loan amounts. Second, it is difficult for financial institutions to obtain the information necessary to assess the risk of new unproven ventures especially because of the success of small firms often depends heavily on the ability of the entrepreneur. Third, the probability of failure for new small ventures is considered to be high (Ibid pp 24-27)

Cuevas et al (1993) however indicates that other alternatives to loans secured by real and movable property have practical constraints. For example, it is possible to take security interest in liquid assets, the foreclosure upon which is much quicker than that for real and movable property. However many debtors especially traders are not in the habit of saving money in liquid accounts, rather they turn to either move it into the informal economy or re- invest in their business. Another alternative would be for the banks to accept the assignment of contractual benefits from borrowers. Though this arrangement is known in Zambia, it is not chosen by banks as they prefer to stay out of other contracts. Cuevas et al.(1993).

2.15 The Challenges Of Accessing Credit Facilities From Micro Finance Institutions Faced By Small Scale Enterprise

Access to financial products is still a major limiting factor for small and medium enterprises (SMEs) in most countries and particularly in developing countries of which Zambia is one typical example. The country's economic set-up and direction however, demands that the tide should change (Mobile market magazine, 2010).

In general, banks refuse credit facilities to SMEs because they are perceived as risky and unprofitable. Conversely, experience in the field shows that SMEs lending can be profitable and does not necessarily involve more risk for the bank than lending to large enterprises or the public sector. It is possibly because of this factor that we have seen a recent boom in micro financing institutions who have made themselves more friendly to SMEs than commercial banks and there is no doubt that they are making good business from SMEs.

All too often, banks see risk as dangerous. Yet, any type of transaction that provides credit involves a chance of failure. Normally return on investment is directly related to risk profile. Rather than categorically turning down requests for credit facilities from SMEs, banks can learn how to calculate the risk. By developing an entrepreneurial attitude, they can start generating profits from this client segment too. To do so, banks may wish to improve their risk-evaluation skills. One international trade organization (ITC) study revealed that this was one of their major shortcomings that successful entrepreneurs in least developed countries (LDCs) noted in developing county bankers.

Banks can also adopt specific tools such as credit scoring which enables bankers to calculate and compare risks against an average bench mark. It introduces a degree of objectivity in the analysis and it can assist credit officers with limited experience. To help them, ITC has developed a guide for bankers on how to evaluate trade credit requests and software called the score card system. It offers a risk analysis tool to the loan officers who is responsible for these decisions.

Proper financial records and security are not the only criteria banks look to. Small scale enterprises have a major challenge of financial record keeping. Fundanga C. (2010) asserted that 60% of SMEs do not keep financial records.

The other challenge is inability to develop business plans. Banks also expect borrowers to have sophisticated business plans. Many of the SMES are first generation startup ventures, and do not have the knowledge or the access to persons with the required skills to put their

business ideas into bankable documents. The critical question that requires answering is who will address this issue is of crucial importance, if SMEs are to benefit from the low cost finance, facilities on offer from banks and micro finance.

Furthermore, the lack of equity capital and the high sensitivity of SMEs to political and economic changes also make lending to SMEs a higher risk than to corporates. Are these factors mere perceptions of bankers or is the SMEs sector really too risky to lend to?

SMEs would continue to be very vital part of the economy. Then is it the government's duty to motivate the formal financial sector to take note of the needs of SMEs or would the banks on their own consider the importance of lending to this sector which comprise of 85% of the business units in the country, and employs a big chunk of the total industrial employment? Will the bankers take a less conservative approach to lending in today's scenario? Is the burning questions in the minds of the majority of small and medium enterprises?

Non-performing loans as a challenge

Non-performing loans are sometimes the result of lack of knowledge about business reality and market dynamics and this unfortunately is a weaknesses of a lot of small scale entrepreneurs have. In order to minimize their number, it is advisable for banks to offer SMEs business support and development services, in addition to credit facilities provided.

Officers in charge of lending to SMEs have to know the customers, the market and the financial counterparts involved. Financing has to be adopted to regional customs, law and regulations.

Terms and conditions of lending as a challenge

In order to identify the challenge for providing credit facilities, the researcher reviewed the different criteria used by MFIs before extending credit to SMEs. According to Zimmer and Scarborough (2006), commercial banks will rarely be a new venture's source of capital because a bank's return is limited by interest rate it negotiates, and its risk could be the entire amount of loan if the new small scale business fails. For this reason, the SMEs owner needs to be aware of the criteria lenders use when evaluating the credit-worthiness of entrepreneurs seeking financing. Lenders generally refer to these criteria as the five Cs of credit, namely, character, capital, collateral, capacity and conditions. These are now discussed below:

Character

Before making a loan or making an investment in a small business, lenders and investors must be satisfied with an entrepreneur's character. The evaluation of character frequently is based on intangible factors such as honesty, integrity, competence, determination, intelligence and ability to pay (Zimmer and Scarborough, 2005)

Capacity

A synonym for capacity is cash flow. Lenders and investors must be convinced of the firm's ability to generate sufficient cash flow and meet its regular financial obligations and to repay loans. This takes cash and experience shows that most small scale businesses fail from lack of cash flow (liquidity) than from lack of profit.

Collateral

Collateral includes any assets an entrepreneur pledges to a lender as a security for repayment of a loan. If a small scale enterprise fails on the loan, the lender has the legal right to sell the collateral and use the proceeds to satisfy the loan requirements. Most small scale enterprises do have collateral to secure their loan applications. This increases the challenges of accessing credit facilities from micro finance institutions. The micro finance institutions further complicates this process by demanding guarantors.

Capital

The amount of contributions the owners put in the business is called capital. It can be cash contribution and asset finance. Small businesses are expected to have a stable capital base before any lender is willing to grant a credit facility to small scale enterprise, otherwise the lender would be making, in effect, a capital investment in the business. Most small scale enterprises have limited capital requirements for their business. This challenge is very big for most SMEs.

Conditions

The conditions surrounding a funding request also affect an entrepreneur's chance of access to credit facilities from Micro finance institutions because lenders consider factors relating to a business' operation such as potential growth in the market, competition, location, strengths, weaknesses, opportunities and threats (Parker Follet, 2005)

The cost of capital as a challenge (interest rates in Zambia)

Interest rates are the determinants of a survival of a micro finance institutions but they can also significantly alter the demand for loan products. As asserted by Dr. Caleb Fundanga (2006), a former Bank of Zambia governor, the interest rates for Micro finance institutions are set commercially too high at above 30% on average despite the falling inflation rates bringing the questions of how affordable the loans are to the poor. Horne James (2002:102) argues that the net present value leaves the borrower in a negative after the loan has been repaid while the lender enjoys their positive net present value and supernormal profits. While the author believes that Micro finance institutions have to provide financial services profitably, if they are to remain sustainable, well managed MFIs have demonstrated that they can become profitable and sustainable while making major contributing to growth of SMES and poverty reduction to their clients. The author further believes the cost of credit facilities from Micro Financial Institutions MFIs and commercial banks are too exorbitant for most of SMEs to meet. However, in the recent past, the PF government has designed a capping policy to avoid exploitation of SMEs by MFIs. In the commercial bank, the bank of Zambia has introduce a policy rate which will guide the maximum lending rates banks will charge. This hopefully will reduce the cost of capital in Zambia and reduce the challenges of access to credit facilities.

2.16 Significance of SMEs in Zambia

The significance of SMEs in Zambia can be traced in terms of labour absorption, creation of entrepreneurial spirit and innovation, promotion of linkages and complementary role of companies, wealth creation among others. In Schumpeter's book the theory of Economic

Development (1912) emphasized the role of entrepreneur, as prime causes of economic development, being this development achieved through innovation. Therefore, it is evident that SMEs have been considered to be very vital in any society as early as the beginning of the 20th century. At the local level, SMEs seem to be perfect and an important piece for local development since they have a greater flexibility and ability to change and to respond quickly to changing market demand and supply situations.

In Zambia, SMEs constitute 95 percent of all firms yet most of them are marginalized. Most of the large enterprises in Zambia are final goods producers which make them well recognized since their products reach the final consumers directly. Furthermore, the number of employees by the SME's also highlights the significance of SME's in the economy. It is estimated that only 500,000 (12.5%) of the potential labor force of over 4 million Zambians are in the formal employment. The remaining 3, 500,000 (87.5%) are engaged in the informal sector. There is also evidence that SMEs have generated skills transfer among themselves more especially in the few available clusters such as in the garment sector. The predominance of SMEs is also translated into their contribution to the production value in the manufacturing sector. (Chibwe Chisala 2012: 09).

2.17 Previous Studies

Chisala (2013: 9) highlights the status of SMEs in Zambia. He states the following: “for SMEs to have a more positive impact on any nation's economy, entrepreneurship in SMEs must be seen on the enterprise start- ups, as well as on the enterprise growth. This growth may be the source for more entrepreneurship through spill over to the firm, and because it can originate some sip off that will contribute to economic development. However, SMEs require special attention for them to graduate to larger firms. For many decades most of the SMEs have not grown to larger firms they have maintained a stagnant micro level.”

One of the factors that has contributed to this stagnation is the lack of vocational skill. Mazumdar and Mazaheri (2003) found that only 13.4% of micro entrepreneurs in Zambia have at least completed vocational training which is regarded as an important tool for growth of their firms.

Chisala (2013:12) lists some of the barriers that prevent SMEs from growing into big firms. He points out the following:

- Administrative barriers
- Corruption in public places
- Socio cultural attitudes
- Criminality as some of them are involved in some illegal activities such as selling smuggled goods, dealing in stolen goods, employing under age workers or engaged in illegal activities such as brothels prostitution business or pornographic movies prohibited under the Zambian laws. This explains why 55% of micro enterprises are not registered.

Muzyamba Chibbabuka (2007) highlights the constraints met by SMEs in Zambia. He states the following: firstly, access to finance is often seen as one of the most important constraint to SME development. 38% of the SME surveyed mentioned credit as a constraint. This stems from the fact that SMEs have limited access to capital markets, both locally and internationally, in part because the perception of higher risk, informational barriers, and the higher costs of intermediation for small firms.

- A survey undertaken by the Ministry of Commerce, Trade and Industry in 2007 outlines the major constraints that SMEs face in Zambia. They tabulated these constraints in a table format. Below is the table that shows the major constraints faced by SMEs.

CHAPTER THREE - RESEARCH METHODOLOGY

3.1 Introduction

This section outlines the methods used to collect and analyse data to fulfil the research objectives. It comprises of the research design, data collection, and data collection methods, sampling procedure, population, and sample size, mode of administration, data collections instruments and ethical consideration.

3.2 Research Design

The nature of the research under study perfectly suits the usage of an exploratory and descriptive design. This is because very little is known about the subject and it is research prudent to pursue an exploration and description of phenomena. This is what such designs are for according to Blaikie (2010) and Neuman (2002).

3.3 Data Collection Methods

In order to come up with thoroughly done study, the research used both primary and secondary data as forms of data for the study.

3.31 Primary Data

Primary data was collected through the use of questionnaires. Where there were uncertainties or other clarifications to be made, one-to-one interviews were also used to rule out uncertainties regarding Credit Facilities Offered by Commercial Banks to SMEs in Zambia by the respective banks under study.

3.32 Secondary Data

Most of the secondary data was sourced from, Media publications, the internet, Journals and Library textbooks.

3.4 Population and Sample

The study focused was on ZANACO and its customers who classified as SMEs by ZDA. The target population in this study consisted of key stakeholders concerned with issuance of credit facilities in ZANACO Headquarters in Lusaka and also SME's who have accounts with ZANACO. These SMEs were drawn from Kamwala Trading area.

Relying on a sampling frame of traders who are registered with PACRA and trading in Kamwala, it was possible to sample respondents. The researcher used simple random and purposive sampling methods during the process of data collection. Simple random sampling is a type of sampling in which the sample is selected in such a way as to afford every element in the population an equal opportunity of being selected for the study.

Purposive sampling was employed to enlist bank staff in the credit department. With regard to purposive sampling, the researcher chose only those who had served the bank for 5 years and were in the credit department for 5 years. Five years was considered to be appropriate as the researcher believed respondents would be in a better position to render reliable information.

3.5 Data collection Tools

The Researcher used the questionnaire and structured interviews as tools to collect data. The questionnaire was Pre-tested in a Barclays Bank branch which was not part of the study. Pre-testing is the process or trying out the questions in the questionnaire or interview guide on a similar group or population the researcher is about to interview before the actual research. During the process of Pre-testing the Researcher was availed with a chance by trying out of the instrument of research on the small group of similar characteristics. The Pre-testing of the questionnaire or interview helped the Researcher to determine the following:-

Test the questions. The Researcher will have a feel or get an insight of whether the questions in the questionnaire are very difficult, simple to answer, ambiguity, or alright. Depending on the responses, the Researcher would be able to adjust the questionnaire accordingly.

Timing. The Researcher would be able to estimate how long it will take to conclude the exercise. The time taken by the respondent to answer the questionnaire or the time it takes to interview an interviewee will help the Researcher to determine the overall time required.

Response to the subject matter. The Researcher will be given an insight of how the respondents will be responding to the subject matter e.g. is it a sensitive matter, how should the sensitive questions be phrased etc.

Unforeseen problems. The Pre-testing will bring out if any, some of the problems which might crop up in the actual research when the Researcher is in the field. It will help the Researcher to examine the problems that were not anticipated at the beginning of the research.

3.6 Data Validity and Reliability

In order to find out the reliability and validity of the secondary data obtained, the Researcher used the method of triangulation. Triangulation helps establish reliability and validity of the study with the aim of instilling confidence that the results were not fudged in any way and that is other researchers were to undertake the same methods themselves, they will end up with the same results (Greener S 2008)

3.7 Ethical Considerations

Ethical considerations in research are critical as they are the norms or standards for conduct that distinguish between right and wrong.

Confidentiality – Respondents were assured that identifying information will not be made available to anyone who is not directly involved in the study.

Informed consent – Respondents were fully informed about the procedures and risks involved in research and gave their consent to participate.

CHAPTER FOUR – DATA ANALYSIS AND INTERPRETATION

4.0 Introduction

When presenting the findings, the researcher will use the points of view within the two paradigms and these are the positivist and the naturalistic points of view. This is determined by the initial application of the mixed methods approach. In order to show what the findings are, the researcher has opted to use de Vaus (2001) and Yin (2009) recommendations of presenting findings. They advise case study researchers to use research questions as thematic guides. The results in this chapter are sequentially arranged in two forms. The first form is quantitative in nature and the second form is qualitative in nature.

In the second form, the researcher uses nom de plumes which are an assumed name used by a writer instead of their real name. The researcher has opted to do so in order to give life to the accounts and to crowd easy recognition of respondents (Eagan, 1989; Mantzoukas, 2004). The researcher has made sure that the results show what the men and women spoke about and this evident in their own voices and they explain their own experiences. In the sections that appear below, the researcher present the results in two sections. The first section is related to the quantitative part and the second is ascribed to the qualitative part.

4.1 Quantitative Findings from the Staff Survey Tool

4.1.1 Background Variables – Credit Staff

This study took place between September 1 and October 15th 2017. Eight bankers who were enlisted into this study were drawn from the Credit Department at ZANACO Head Office (unspecified for ethical reasons). In this sample, three respondents were females and five were males. The sample was rather youthful and the youngest was 25 and whereas the oldest was 39. The sample μ age was 32.7 (SD \pm 4.7). (Table: 3).

Table 3: Age of respondents

Mean	32.7
Median	33.5
Mode	36.0
Std. Deviation	4.7
Range	14.0
Minimum	25.0
Maximum	39.0
Male	5
Female	3

4.1.2 Service Profile

At the time of the study, n = 5 had been with the bank for just under five years whereas n = 3 had served the bank for over six years (Table: 4).

Table: 4 Duration of Service with ZANACO

	Frequency	Percent
less than 1 year	2	25.0
1-5 years	3	37.5
6-10 years	2	25.0
more than 10 years	1	12.5
Total	8	100.0

4.2 Credit Facilities

ZANACO has a farmer customer base numbering 485. Out of this number, in the month prior to the study, the credit profile was as follows:

Table 5: Profile of Rendered Credit facilities in the month prior to the study

Credit facility	Number accessed	
	Frequency	Percent
A startup loan	0	0
Line of Credit	140	29
Cash credit over draft	140	29
A long term loan	158	32.5
Packing credit	0	0
Bridge loan	10	0.2
Letter of credit	137	28.2
Bank guarantee	5	0.1

Within ZANACO the extent within which a credit facility called ‘Fund Base Credit which involves direct outflow of Bank’s fund to the borrower’ is offered varied much according to the bankers. It can however be said that the banker offers this facility frequently and this is shown in table 6.

Tab 6: Fund Base Credit

Type of credit facility	Never	Rarely	Sometimes	Frequently	Always
Fund Base Credit which involves direct outflow of Bank’s fund to the borrower.	0	1	1	4	2

Within the fund base credit, the bank hardly offers a startup loan, a line of credit as well as a Cash Credit as sub credit facilities. This is shown by more staff selecting rarely, never and sometimes (see Table: 7).

Table 7: Frequency of sub types of Fund Base Credit

	Never	Rarely	Sometimes	Frequently	Always
A start up loan being a credit facility that is repayable in a definite period. (e.g. Term Loan Demand Loan)	2	6	0	0	0
Line of Credit. Framers need a ready flow of money to keep operating especially with the economic ups & downs	1	1	4	0	2
Cash Credit being a credit facility in which borrower can borrow any time with in the agreed limit for certain period for their working capital need.	2	1	3	0	2

Whenever a start up loan is offered, rarely or never does ZANACO consider securing this loan by way of a business premises or by the inventory or by using a business plan to purchase in – order to function. The bank does not secure a line of credit by way of a collateral. The bank sees it to be risky even if it considered hypothecation of stock by way of mortgage of immovable properties (see table 8).

Table 8 Securing sub types of Fund Base Credits

	Never	Rarely	Sometimes	Frequently	Always
If it is a startup loan, it can be secured by the business premises or by the inventory, the business plans to purchase in – order to function, or it might be an unsecured loan based on assets and credit worthiness of the person starting the business.	3	4	0	0	1
A line of credit, is secured within ZANACO by the facilities or inventory of the business, allows the business to draw from readily available funds the company can pay back overtime & draw again without constantly going through the loan process. Collateral and repayment terms are established on an annual basis and tailored to the farmer’s needs.	1	1	3	3	0
ZANACO overcomes the risk by way of hypothecation of Stock (goods) and Debtors and all other current Assets of the business generated during the course of business. Cash credit can also be secured by way of mortgage of immovable properties (as collateral security)	2	1	2	0	3

Within ZANACO the extent within which a credit facility called ‘Over Draft, is frequently or always offered. This shown in table 9.

Table 9: Frequency of Overdrafts

	Never	Rarely	Sometimes	Frequently	Always
Over Draft which allows a current account holder to withdraw in excess of their credit balance up to a sanctioned limit.	0	0	0	4	4

When this credit facility is offered, ZANACO overcomes the risk almost always by way of mortgage of immovable properties and pledge of F.D., Bonds, Shares securities, Gold & silver and any physical asset. It also considers and hypothecation of stock and debtors and all other current assets of the business generated during the course of business. ZANACO does not require collateral or no collateral is involved since the bank will request the borrower remit interest (table 10).

Table 10: Securing Over Drafts

	Never	Rarely	Sometimes	Frequently	Always
ZANACO overcomes the risk by way of Mortgage of immovable properties and pledge of F.D., Bonds, Shares securities, Gold & silver and any physical asset and Hypothecation of Stock and Debtors and all other current Assets of the business generated during the course of business.	0	0	0	4	4
ZANACO does not require collateral. When a farmer breaches he will just remit interest.	7	0	0	0	1

Related to Long term loans within ZANACO, respondents indicated that such loans were rather frequently secured with cash, inventory, equipment, securities, or real estate (see table: 11).

Table 11: Long Term Loan credit facility

	Never	Rarely	Sometimes	Frequently	Always
A long term loan with a repayment period of more than one year, generally 5 to 15 yearly repayment.	0	0	1	5	2

When this credit facility is offered, ZANACO overcomes the risk almost always by way of re secured with cash, inventory, equipment, securities, or real estate (table 12).

Table 12: Securing Long Term Loan credit facility

	Never	Rarely	Sometimes	Frequently	Always
Long term loans within ZANACO are secured with cash, inventory, equipment, securities, or real estate	0	0	1	4	3

When the respondents were asked about the packing credit facility, it is evident that ZANACO hardly provides such a facility (see table: 13).

Table 13: Packing Credit

	Never	Rarely	Sometimes	Frequently	Always
Packing Credit given to a farmer who is an exporter to purchase raw materials at competitive rates and manufacture or produce goods according to the requirement of the buyer and organize to have it packed for onward export. It is a credit facility which sanctioned to an exporter in the Pre-Shipment stage	2	3	2	1	0

If at all ZANACO provided this facility, it would overcome the risk by way of Hypothecation of Stock of goods (Table 14).

Table 14: Securing a Packing Credit facility

	Never	Rarely	Sometimes	Frequently	Always
ZANACO overcomes the risk by way of Hypothecation of Stock of goods and Debtors and all other current Assets of the business generated during the course of business.	2	5	1	0	0

Table 15 A bridge loan

ZANACO gives bridge loan sometimes to SMEs who might be in need of instant cash flow to finance a project (Table 15).

	Never	Rarely	Sometimes	Frequently	Always
A bridge loan given to a farmer who might be in need of instant cash flow to finance a project.	1	1	5	1	0

While ZANACO gives bridge loan sometimes to SMEs who might be in need of instant cash flow to finance a project, the bank does not require the customer to have excellent credit and proof of income (Table 16).

Table 16: Securing a bridge loan

	Never	Rarely	Sometimes	Frequently	Always
For bridge loans, ZANACO requires excellent credit and proof of income.	2	2	4	0	0

ZANACO does not always provide some other fund based credit facilities which can be Bill Discounted, Bill Purchased, Advance against hypothecation of Vehicles (Transport Loan), House Building Loan, Lease Financing, Hire Purchase, and Import Financing – Loan Against Imported Merchandise (LIM) – Payment Against Document (PAD). If the bank does it is once in a while (Table 17).

Table 17: Some other fund based credit facilities

	Never	Rarely	Sometimes	Frequently	Always
Some other fund based credit facilities which can be Bill Discounted, Bill Purchased, Advance against hypothecation of Vehicles (Transport Loan), House Building Loan, Lease Financing, Hire Purchase, and Import Financing – Loan Against Imported Merchandise (LIM) – Payment Against Document (PAD).	1	4	3	0	0

Noting that ZANACO does not always provide some other fund based credit facilities, it never considers overcoming the risk by way of Hypothecation of Stock of goods and Debtors and all other current Assets of the business generated during the course of business (Table 18).

Table 18: Securing some other fund based credit facilities

	Never	Rarely	Sometimes	Frequently	Always
ZANACO overcomes the risk by way of Hypothecation of Stock of goods and Debtors and all other current Assets of the business generated during the course of business.	2	5	1	0	0

The letter of credit in the bank is provided rather frequently (is shown in table 19).

Table 19: Letter Of Credit

Type of credit facility	Never	Rarely	Sometimes	Frequently	Always
Letter Of Credit ¹ : – When a buyer or importer wants to purchase goods from an unknown seller or exporter. He can take assistance of ZANACO in such buying or importing transactions.	0	0	3	5	0

Though the letter of credit in the bank is provided rather frequently, the bank frequently or sometimes guarantees to fulfill the loss of money based on what the contract stipulates (Table 20).

¹ Bank issues a LETTER OF CREDIT in addressed to the supplier or exporter after it, supplier or exporter will supply the goods to such unknown buyer or importer. A signed Invoice with Letter Of Credit is presented to the bank of buyer/importer and the payment is made to the seller/exporter DIRECTLY by the bank.

Table 20: Securing Letter Of Credit

	Rarely	Sometimes	Frequently	Always	Always
Bank Guarantee issued by ZANACO that, in case of an occurrence or non-occurrence of a particular event, the bank guarantees to fulfill the loss of money as stipulated in the contract. It may of various types like Financial Guarantees, Performance Guarantees and Deferred Payment Guarantee	0	4	4	0	0

4.4 Reasons for the elicited services

There were a number of reasons that were advanced as to why ZANACO does not offer a wider range of credit facilities to SMEs. One manger indicated the following:

ZANACO does not offer a wider range or credit facilities because agricultural lending is both risky and expensive. Most products that we offer require very high collateral and high risk premium which most farmer are not able to provide also the history in terms of non-performing loans for agricultural sector is not very assuring. NPL on agricultural sector currently exceed 37% against 13% across all other sectors of the economy. This is very high.

A credit officer had this to say about the reasons

I would like to give you an example of the perceived or actual risks involved in offering the excluded facilities to SMEs in Zambia. I mean a start-up loan and a packing credit facility. We have considered Default risk, Lack of collateral by many SMEs. There is also inconsistent income and revenue especially from small scale SMEs. Additionally SMEs do not take adequate measure to manage risks on their own. SMEs especially the small scale SMEs do not provide sound and accurate financial data.

A manager observed the following:

You wanted to know why we are averse to a line of credit. Line of credit facilities are more common that startups although we rarely finance them because our policy just

does not allow. As for the Packing Credit, the bank does not normally do packaging credit because we cannot guarantee that the quality of crops that the farmer will produce will be good quality hence risk of default. We also are afraid of startup loans. Normally startup companies have little or no collateral in most cases and they cannot be securitized by the asset purchases with the loan. Interest rates offered by most banks are high as such most startups may not be able to afford them

Relating to a bridge loan, a supervisor noted

This is done under the Commercial Property Finance unit however not often and it is done on a case by case basis.

When they were asked how they could overcome the risks or be mitigated, a supervisor identified the following:

- *Assessing company history and context before lending*
- *Through risk assessment by identifying and characterizing of risk.*
- *Development of risk profiles*
- *Monitoring and review evaluating the balance between costs and benefits and assessing the operational difficulties of lending those facilities*
- *Taking crop insurance or livestock insurance to spread the risk*

A manger argued that risks could be mitigated by taking collateral for the facilities, ensuring you lend to SMEs who have some level of experience or have worked on another farm for over 5years, Assessing company history and context before lending. Two credit officers added the following measures that included:

- *Through risk assessment by identifying and characterizing of risk.*
- *Development of risk profiles*
- *Monitoring and review evaluating the balance between costs and benefits and assessing the operational difficulties of lending those facilities*
- *Taking crop insurance or livestock insurance to spread the risk*

SMEs

There were a total of 100 questionnaires that were administered to the various SME's that are clients of ZANACO. Out of 100 questionnaires only 64 % were returned. Some claimed that they were busy and could not spare some time to respond to the questionnaires while others were not interested in the responding due to personal reasons. The table below shows the educational background of the respondents to the study.

Table 21: Educational Background of the respondents

<i>Academic Qualifications</i>	<i>Number of Respondents</i>	<i>Percentage%</i>
High School Certificate	20	31.25%
Diploma	10	15.63%
Degree	15	23.44%
Masters	19	29.69%
Total	64	100%

This table and pie chart above show that of the 64 respondents in the survey, 31.25% were holders of a High School Certificate, 15.63% were holders of a College Diploma, 23.44% were holders of a university Degree and 19% were holders of a Master Degree.

The type of business that the respondents owned

The table below shows the type of the business that the respondents were operating.

Table 22: The business type of the respondents

Type of Business	Number of respondents	Percentage%
Sole trader Business	21	33
Partnership	05	8
Private Limited Company	38	59
Public Limited Company	0	0
Family Owned Business	0	0
Total	64	100

The table and pie chart above shows the business types run by the respondents. 33% of the respondents are sole traders, 8% are running partnerships, 59 % are running private limited companies.

The type of business undertaking

The table below shows the various types of business undertakings of the respondents to the survey.

Table 23: Type of undertaking / Sector

Type of undertaking	Number of respondents	Percentage%
Manufacturing	10	16
construction	5	9
Farming	12	19
Consultancy	4	6
Wholesale and Retail	25	39
Real Estate	8	13
Total	64	100

It can be seen from the table and figure above that 16% are in the manufacturing sector, 9% are in the construction sector, 19% are in the farming sector, 6% are in consulting business, 39% of the respondents are in wholesaling and retail and the remaining 13% are in the Real Estate business sector.

4.5 Challenges Faced In Obtaining Credit Facilities from The Bank

This part will outline the major challenges that respondents faced in obtaining credit facilities from the ZANACO BANK.

Lack of awareness on the credit facilities provided by the banks.

The table bellows shows that results when the respondents were asked if they were aware of the credit facility provided by the bank.

Table 24: Lack of awareness on the credit facilities provided by the banks

Awareness of credit facilities	Number of respondents	Percentage%
Aware of credit facilities	12	19
Not aware of the credit facilities	42	66
Total	64	100

From the above table above, it can be seen that 66% of the respondents were not aware of the credit facilities that the bank offered and their specific of the credit facilities. The remaining 12 % stated that they were aware of the credit facilities that the bank.

Lack of information provided on the suitable types of the credit offered to meet the required needs of the SME.

The table and figure below shows what the respondent stated on the information provided by the bank pertaining to the suitable types of credit facilities offered to SMEs.

Table 25: Lack of information provided on the suitable types of the credit offered to meet the required needs of the SME

Advised on the suitable credit facility	Number of respondents	Percentage%
yes	10	16
no	54	84
total	64	100

From table and chart above it can be deduced that 16% of the respondents were advised on the suitable credit facility that could fit their requirements. The remaining 84% of the respondents were not advised on the suitable credit facility that met their credit requirements.

Frequency of the provision of credit facilities to SMEs.

The table below shows respondents position on if the bank was frequently giving out credit facilities to SMEs or not.

Table 26 Frequency of the provision of credit facilities to SMEs

Does the bank frequently provide credit facilities to SMEs?	Number of respondents	Percentage%
NO	8	13%
Yes	56	87%
total	64	100

It can be seen that the bank does not often give out credit facilities to SME's. From the table above, it can be seen that 87 % of respondent think that the bank does not frequently provide credit facilities while 13% stated vice versa.

Unsuitable credit terms and conditions

The following table and figure shows the respondent's position on terms and conditions of the credit facilities offered by the ZANACO.

Table 27: Unsuitable credit terms and conditions

Unsuitable credit terms and conditions	Number of respondents	Percentage%
Yes	50	78%
No	14	22%
Total	64	100

From the table above, it can be seen that 78% of the respondent considered the credit terms and conditions that were supplied in the credit facility by the bank were not suitable to them and the remaining 14% stated that the terms and conditions in the credit facilities were suitable.

Tedious procedures when obtaining a loan

The following table and figure highlights the respondent's view on the procedures employed when obtaining a loan (table 28).

Table 28: obtaining a loan from the bank

How do you view the procedure for obtaining a loan from the bank	Number of respondents	Percentage%
Tedious and rigorous	52	81%
Not tedious and manageable	12	19%
Total	64	100

81% of the respondents to the survey found that the banks procedures employed when obtaining a loan for the business were not manageable, tedious and rigorous and the remaining 19% stated that they found the procedure was manageable and they did think of it as a rigorous.

Too strict and unfavorable bases for loan approval.

The table and figure bellows shows the respondents take on the bases that ZANACO uses to approve the loans and other credit facilities.

Table 29: Too strict and unfavorable bases for loan approval

Do you think that the Bank's bases for loan approval are unfavorable?	Number of respondents	Percentage%
Yes	60	94%
No	4	6%
Total	64	100

The table above depicts that 98% of respondents think that the banks bases for loan approval are not favorable while only 6% of respondents said the bases were favorable.

4.6 Summary of findings

ZANACO offers the following as credit facilities; Over Drafts, a long term loan, a bridge loan and a Letter Of Credit. Though the bank offers these credit facilities, it hardly offers a start-up loan and packing credit facility. ZANACO does not offer a wider range of credit facilities because agricultural lending is both risky and expensive. The NPL on agricultural sector currently exceed 37% against 13% across all other sectors of the economy and this is considered to be very high. It is not possible to provide start-up loans and this is compounded by the fact that there is no history of the business or how the farmer will perform if availed a facility. It is also not possible for the bank to guarantee quality. Lack of collateral by some SMEs was also a factor in most instances. This was complicated by a high default risk. Risks could be mitigated by taking collateral, considering applications for SMEs who have invested a sufficient amount of their own capital into the business and by considering only those SMEs who have experience.

CHAPTER FIVE - DISCUSSIONS AND CONCLUSIONS

5.0 Introduction

This section renders a critical appraisal by systematically examining the research outcomes. This section allows the researcher to critically appraise the research outcomes.

5.1. Credit facilities offered by Zanaco

It was surprising to note that ZANACO only offers four types of credit facilities from a horde of possible credit facilities. The bank offers a start-up loan and packing credit facility. From these results, it is possible to argue that ZANACO is doing rather well in this area. The study has shown that ZANACO as a commercial bank is essentially a dealer in credit for SMEs. Collateral, Interest and the farmer's ability to do the business are the prices that guide ZANACO in making business decision to continue to offer credit. It appears that ZANACO cannot provide the whole battery of credit facilities because of liberalisation and the absence of a legal framework that does not provide directions. This makes ZANACO as a commercial bank not to put restrictions on the credit creation power.

5.2. The reasons why some Small and Medium Entrepreneurs cannot have access to credit from ZANACO

The non-consideration of start-up loans and packing credit facilities seems to suggest that the facility is rather risky to consider. It is not possible to provide start-up loans and this is compounded by the fact that there is no history of the business or how the farmer will perform if availed a facility. It is also not possible for the bank to guarantee quality. Lack of collateral by some SMEs was also a factor in most instances. This was complicated by a high default risk.

The results are unexpected. At a time of disappointing economic growth and weak trade and investment in Zambia, small and medium-sized enterprises (SMEs) and entrepreneurs have emerged as a driving force for more inclusive and prosperous societies. Fostering SMEs financing can ensure that benefits of growth are shared more broadly. This calls for a renewed policy focus to a level the playing field for SMEs across all dimensions of the business environment, and in the area of access to finance in particular. Yet, when seeking bank credit, SMEs continue to face more stringent financing conditions and higher interest rates compared to

large businesses, and find themselves even more at a disadvantage when attracting alternative sources of finance. While banks point to risks when SMEs have credit, the researcher is arguing that risks could be mitigated by taking collateral, considering applications for SMEs who have invested a sufficient amount of their own capital into the business and by considering only those SMEs who have experience.

5.3. Challenges faced by SMEs in accessing Credit

Based on the responses received through the questionnaires circulated, it became evident that Several SMEs have had their loan application rejected before by Zanaco and the reasons assigned to the rejection of the loan applications or in other words major problems faced by SMEs in securing funds are: Lack of collateral/guarantees, Inadequate compiled financial records and accounts, Poor credit experience or history; Inexperienced management team or lack of professionalism; Inadequate technologies; and Limited knowledge of business opportunities. SMEs were not satisfied with the reasons and explanation put forward for the rejection of loans; and that SMEs were not required to provide personal assets as collateral by the bank to guarantee of loans.

Because of these constraints, which relate to access to bank loans and the difficulties SMEs have in managing their receivables, mainly due to delays in receiving payment for goods and services rendered, SMEs in Zambia are not able to mobilise cash as quickly enough to grow and expand in a way that they are supposed to. They still remain small without expanding their businesses to the other regions of the country, even though SMEs have expressed the desire to do so when they have the financial assistance required.

5.4. Proportions of SMEs that have accessed credit facilities From ZANACO

ZANACO Bank has this year (2016) injected K150 million to support the growth of small and medium-scale enterprises (SMEs) in the country. Zanaco provided finance to SMEs in sectors like transportation, hospitality, construction, manufacturing, trading, education and information communication technologies. The bank has positioned itself to support various sectors to stimulate economy growth.

On the bank overall performance, Zanaco recorded growth rates of 9 percent while its deposits and total assets grew by 11percent. The bank loans and advances posted a 15 percent

growth in the period under review. Although the banking credit penetration (loans and advances as a percentage of gross domestic product) in Zambia is still relatively low as compared to other countries in Sub-Saharan Africa, the banking sector has continued to strongly contribute to the economic development through its increased credit extension to key productive sectors like agriculture, and manufacturing. These sectors constitute 18 percent, and 12 percent of the banking loans and advances portfolio. Lending to households has continued to remain strong at 32 percent of the banking loans and advances portfolio demonstrating the sectors contribution towards improving access to credit, and financial inclusion.

Looking at table 3, the researcher believes that ZANACO economists ought to look at the issue of credit creation and control afresh in a more definitive way and this study has shown that the bank could set the ball rolling. Looking at the non-consideration of other credit services, the researcher perceives that there may be an uncalled for alarm about the possible losses. The bank may have to examine its credit policy. While this may be the case, the researcher is cautious by stating that credit is not a free gift of nature; it has a cost, even in an interest free system. Cost apart, the legal environment for banking in a country also impacts the volume of credit the system can create (Hoshi, 2006: 2). It follows that the power to create credit ZANACO carries does not imply that the bank could use that power not to generate any amount of lending it wishes unless there is a corresponding demand for the same. Given the rate of interest, ZANACO has power to keep the supply of credit perfectly elastic, but what amount of it would actually be generated depends on the demand side of the market. This calls for the bank to consider a credit demand analysis from the customer base.

There are a number of studies that have explored Micro determinants of the SME credit constraint as factors explaining the presence of the financing gap experienced by SMEs which could be applicable to this study. The determinants of the SME financing gap can be classified broadly into two: the macro factors (various macroeconomic variables, e.g. inflation, interest rates, etc.) and micro factors (the SME owner characteristics and business characteristics).

Educational level

Empirical evidence on the effect of SME owner educational level on access to credit has been mixed. Zarook et al. (2013) in a survey of 600 SMEs in Libya had evidence to conclude that the educational level has significant positive effects on access to finance. Similarly, Pandula

(2011) provided evidence from Sri Lanka that there is a positive and significant relationship between education of SME owners and access to bank loan. Irwin and Scott (2010) found that in the UK, highly educated SME owners had less difficulty in accessing credit from banks. This has been attributed to the fact that educated SME owners are in a better position to meet the requirements of formal lenders. For instance, they can easily provide convincing business plans, they possess good managerial capability and as Irwin and Scott (2010) put it, they can maintain good relationship with lenders which is vital ingredients to obtaining finance.

It is thus expected that SME owners with formal education will be less rationed relative to SME owners with no formal education.

Age.

The age of the SME owner to a large extent determines the SME's ability to access credit. Ajagbe (2012) identified age among other features of small-scale entrepreneurs in Nigeria to have influence on access to credit. From a supply-side perspective, it is believed that information asymmetries (which can be a barrier to credit access) tend to decrease with increase in age (Abdulsaleh and Worthington, 2013). A study by Kristiansen et al. (2003) also showed that there is a significant positive relationship between age and the success of a business due to the wealth of business experience acquired by the entrepreneur over the years. For this reason older entrepreneurs are better positioned to access credit easily than younger ones. Hence, the level of credit rationing experienced by SMEs is expected to reduce with the age of the owner.

Level of experience.

SME owners/managers who have been in business for long have rich experience regarding the very line of business they are into. As a result, Dobbs and Hamilton (2007) argued that such SME owners have greater likelihood to avoid serious mistakes that could be detrimental to the growth of the business than owners with little or no prior experience. Consequently, experienced owners may be preferred candidates for bank loans than inexperienced owners. In South Africa, Fatoki and Asah (2011) recorded a positive and significant relationship between experience of SME owners and access to credit. Similarly, Zarook et al. (2013) found management experience of owners to be an important determinant of SMEs access to credit. The level of credit rationing experienced by SMEs is expected to reduce with experience; the more experienced the owner, the lesser their level of constraint is likely to be.

Gender.

There is extant empirical literature on the gender gap and access to credit. Muravyev et al. (2007) in a cross-country study provide evidence that women are less likely to get credit from formal financial institutions and even if they do, they do so at a very high interest rate. In analyzing loan denial rates, Calcagnini and Lenti (2008) confirm the presence of gender discrimination. Bellucci et al. (2010) show that female entrepreneurs in Italy encounter greater difficulties in accessing credit than male when they borrow at the same rate of interest. Asiedu et al. (2013) have evidence to show that female-owned firms in Sub-Saharan Africa are more likely to be financially constrained than male-owned firms whilst there is no evidence of a gender gap in the other developing regions. Ongena and Popov (2013) investigate the gender disparity in access to credit by considering a sample of 17 European countries. Results of their study show that women-led businesses face greater constraints than male-led businesses in obtaining bank loans. In Ghana, where lending is often collateral based, female business owners who very often do not own property could encounter greater difficulty accessing credit. Hence, one would expect the level of credit rationing experienced by SMEs to be higher for female-owned SMEs.

Firm characteristics.

Age of firm.

In general, the age of a firm refers to how long the firm has been in existence. This could range from days, weeks to years. Haltiwanger et al. (2012) use five years as a benchmark and describe younger firms as those that are five years or less in business whilst those above five years in business are described as old or mature firms. A firm's age speaks well of its reputation, managerial competence and its ability to remain in business (Diamond, 1991). Martinelli (1997) argues that the lack of reputation for younger firms makes it more constraining for them to access credit. Pandula (2011) argues that new and young firms often fail to meet collateral requirements of banks and this affects their ability to access credit. Thus, their operation within a small span of time does not offer them the opportunity to accumulate assets to pledge as collateral. Makoni and Ngcobo (2014) show that mature firms in Zimbabwe have access to bank credit easily than younger firms because contrary to younger firms, mature firms have capacity, collateral and performance track record to support

their applications. From the above, the level of credit rationing experienced by SMEs is expected to reduce as the business matures.

Size of the firm.

The size of a firm seems to have some association with the firm's ability to access credit. Bigsten et al. (2003) report that small firms are less likely to have access to credit than large firms. Levenson and Willard (2000) assert that constrained firms are smaller, younger and more likely to be owned by their founders. Similarly Levy (1993) observes that credit access is a major constraint for smaller and less established firms.

Several reasons have been advanced for the small firm effect. First, greater constraints may be faced by small firms due to market imperfections, in the form of greater informational opacity. Though not unique to small firms, this may be considerably more relevant because of relatively poor quality and provision of financial information by small firms. This leads to greater difficulties in credibly conveying their quality or the quality of their projects (Binks and Ennew, 1996). Also small firms do not have publicly known contracts (supplier, customer or labor related), and do not trade securities that are continuously priced in public markets. Moreover, unlike large firms, their performance is not regularly assessed by independent market analysts, and they may be unable to provide audited financial statements (Saito and Villanueva, 1981; Berger and Udell, 1998). Kumar and Francisco (2005) use investment climate data to assess SME credit constraints in Brazil. They had evidence to conclude that medium and larger firms are less credit constrained than smaller firms. It is expected that the degree of credit rationing will be higher for smaller SMEs.

Industry sector.

The sector in which a firm operates is another determining factor of the ease with which a firm could access credit. Byiers et al. (2010) assert that firms' sector is very crucial to their access to credit; using data from Mozambican manufacturing firms, their results indicated that the metal-mechanic and wood-furniture sectors have significantly lower credit access than the food processing sector. Similarly, Chakraborty and Mallick (2012) investigate the credit gap in small businesses in the USA; they have evidence to conclude that the magnitude of the finance gap varied considerably across industries with manufacturing firms facing higher credit constraints. Firms in sectors with more capital requirements may most likely face greater credit constraints (Kumar and Francisco, 2005).

In the service sector, Silva and Carreira (2010) argue that the service sector usually lack physical assets to pledge as collateral since they deal in intangibles (service rather than physical products) and therefore are more likely to be credit constrained. There is also evidence that survival rates differ among firm sectors (Storey and Wyncarczyk, 1996; Gimeno et al., 1997). The crux of the matter is that banks prefer to lend to firms in sectors with high profitability and growth potential. On the basis of this, the level of credit rationing experienced by SME is expected to vary across sectors. Indeed, the agricultural sector is expected to be more highly rationed relative to other sectors.

Collateral.

The willingness of borrowers to pledge collateral could be a signaling tool for borrower's ability and willingness to repay loans. Bester (1987) saw collateral as a screening device for lenders; borrowers with low probability of default will reveal themselves by accepting collateral requirements which would be unattractive for high risk borrowers. Atanasova and Wilson (2004) in their study in the UK found collateral to be an important determinant of loan supply as it alleviated credit rationing in the UK formal credit market. Voordeckers and Steijvers (2008) showed that in Belgium, firms with insufficient financial strength and lack of collateral were more credit rationed for short-term debt. In a study in Nigeria, Azende (2012) showed that SMEs had difficulty in accessing funds from formal sources because of stringent collateral security requirements and inadequate risk-mitigating schemes for formal sources of finance. Zambaldi et al. (2011) analyzed credit granting decisions in Brazil, with probability of loan approval as dependent variable and concluded that there is limited supply of credit to SMEs mainly because of transaction cost, collateral dependency and constraints due to asymmetric information. Most banks in Africa appear to be collateral dependent in the lending process; hence, it is expected to facilitate credit access. Therefore, SMEs with more assets to use as collateral are more likely to experience lower degree of rationing.

6.0. Conclusion

The results reflect that credit facilities offered to SMEs by ZANACO are rather few. ZANACO should by now have developed risk adjusted return on capital for risk pricing and give importance to offering credit. ZANACO could benefit from its customers by way of regular inspections of creditor's premises and financial statement analysis as well as considering using risk management (if not used) and these are benchmarking, credit score, credit worthiness analysis, risk rating and collateral.

Proper financing of SMEs in is an essential tool for promoting and leveraging small and medium enterprises development in Zambia. The question here is, what are the financing options for SMEs in Zambia? Various policies put in place have targeted both financial and non-financial institutions. Some of these financial institutions include the commercial banks, microfinance banks, international development agencies, like the African development bank, etc.

Despite the role of SMEs in the Zambian economy, the financial constraints they face in accessing credit and their operations are daunting and this has had a negative impact on their development and also limited their potential to drive the national economy as expected. This is worrying for a developing economy without the requisite infrastructure and technology to attract big businesses in large numbers (Coleman, 2000).

The researcher observed that small and medium scale firms with opportunities to invest in positive net present value projects may be blocked from doing so because of adverse selection and moral hazard problems. Adverse selection problems arise when potential providers of external finance cannot readily verify whether the firms have access to quality projects. Nonetheless, the liquidity ratio of the financiers plays a major role. Moral hazard problems are associated with the possibility of SMEs diverting funds made available to them to fund alternative projects or develop the propensity to take excessive risks due to some pervasive incentive structure in the system. On the other hand, because SMEs do not have access to public capital markets they naturally depend on banks for funding. Dependence on banks makes them even more vulnerable for the simple reason that shocks in the banking system can have significant impact on the supply of credit to SMEs. Thus, SMEs are subject to funding problems in equilibrium and these problems are exacerbated during periods of financial instability.

6.1. Recommendations

The researcher is making the following recommendations. In relation to ZANACO's practice of risk management is to consider embracing in the contract and assessment of credit the following:

- 1) There be regular inspections of creditor's premises and financial statement analysis.
- 2) ZANACO may consider using the following techniques used in risk management (if not used) and these are benchmarking, credit score, credit worthiness analysis, risk rating and collateral.
- 3) ZANACO may have to consider looking into the challenges faced by SMEs.
- 4) The enactment of the Movable Property Security Interest Act No. 3 of 2016, ZANACO should consider accepting movable assets as collateral when offering credit to SMEs.
- 5) ZANACO should consider setting up an SME division or department to provide specialized services to SMEs. Specially trained SMEs credit officers who could manage such a unit in the bank. Elevating the importance or status of SME divisions would encourage greater interest and focus on the SME sector.

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APPENDIX 1

Questionnaire

You have been selected purposefully by the Credit Department to help in the survey on credit facilities that the bank offers to SMEs. I shall be pleased if you participated.

SECTION A: HUMAN CAPITAL RESOURCES

1. What is your age

2. Your Sex

Male Female

3. How many years of experience do you have in this present activity?

a) less than 1 year	
b) 1-5 years	
c) 6-10 years	
d) more than 10 years	

SECTION B: CREDIT FACILITIES

4. To what extent does your bank offer this first type of credit facilities to SMEs? Using a five point scale rate the frequency your bank offers such loans as follows: 1 for Never, 2 for rarely, 3 for sometimes, 4 for frequently and 5 for always.

Type of credit facility	Never	Rarely	Sometimes	Frequently	Always
	1	2	3	4	5
5. Fund Base Credit which involves direct outflow of Bank's fund to the borrower.					

The Fund base credit may include the following: Indicate the level of frequency that you offer this sub type of credit facility and indicate the level of frequency that ZANACO offers this sub type of credit facility as follows: 1 for Never, 2 for rarely, 3 for sometimes, 4 for frequently and 5 for always.

6. A start up loan being a credit facility that is repayable in a definite period. (e.g. Term Loan Demand Loan)	1	2	3	4	5
If it is a startup loan, it can be secured by the business premises or by the inventory, the business plans to purchase in – order to function, or it might be an unsecured loan based on assets and credit worthiness of the person starting the business.	1	2	3	4	5

7. Line of Credit. Framers need a ready flow of money to keep operating especially with the economic ups &	1	2	3	4	5
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downs					
A line of credit, is secured within ZANACO by the facilities or inventory of the business, allows the business to draw from readily available funds the company can pay back overtime & draw again without constantly going through the loan process. Collateral and repayment terms are established on an annual basis and tailored to the farmer's needs.	1	2	3	4	5

8. Cash Credit being a credit facility in which borrower can borrow any time with in the agreed limit for certain period for their working capital need.	1	2	3	4	5
ZANACO overcomes the risk by way of hypothecation of Stock (goods) and Debtors and all other current Assets of the business generated during the course of business. Cash credit can also be secured by way of mortgage of immovable properties (as collateral security)	1	2	3	4	5

9. Over Draft which allows a current account holder to withdraw in excess of their credit balance up to a sanctioned limit.	1	2	3	4	5
ZANACO overcomes the risk by way of Mortgage of immovable properties and pledge of F.D., Bonds, Shares securities, Gold & silver and any physical asset and Hypothecation of Stock and Debtors and all other current Assets of the business generated during the course of business.	1	2	3	4	5
ZANACO does not require collateral or no collateral is involved. When a farmer breaches he will just remit interest.	1	2	3	4	5

10. A long term loan with a repayment period of more than one year, generally 5 to 15 yearly repayment.	1	2	3	4	5
Long term loans within ZANACO are secured with cash, inventory, equipment, securities, or real estate	1	2	3	4	5

11. Packing Credit given to a farmer who is an exporter to purchase raw materials at competitive rates and manufacture or produce goods according to the requirement of the buyer and organize to have it packed for onward export. It is a credit facility which sanctioned to an exporter in the Pre-Shipment stage.	1	2	3	4	5
ZANACO overcomes the risk by way of Hypothecation of Stock of goods and Debtors and all other current Assets of the business generated during the course of business.	1	2	3	4	5

12. A bridge loan given to a farmer who might be in need	1	2	3	4	5
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of instant cash flow to finance a project.					
For bridge loans, ZANACO requires excellent credit and proof of income.	1	2	3	4	5

13. Some other fund based credit facilities which can be Bill Discounted , Bill Purchased , Advance against hypothecation of Vehicles (Transport Loan) , House Building Loan , Lease Financing , Hire Purchase , Import Financing – Loan Against Imported Merchandise (LIM) – Payment Against Document (PAD).	1	2	3	4	5
ZANACO overcomes the risk by way of Hypothecation of Stock of goods and Debtors and all other current Assets of the business generated during the course of business.	1	2	3	4	5

The Non-fund base credit is a credit facility where there is no involvement of direct outflow of Bank’s fund on account of borrower rather the outflow of the Bank’s fund on account of third party on behalf of borrower. Such credit facilities may include the following and indicate the level of frequency that ZANACO offers this sub type of credit facility as follows: 1 for Never, 2 for rarely, 3 for sometimes, 4 for frequently and 5 for always.

Type of credit facility	Never	Rarely	Sometimes	Frequently	Always
14. Letter Of Credit ² : – When a buyer or importer wants to purchase goods from an unknown seller or exporter. He can take assistance of ZANACO in such buying or importing transactions.	1	2	3	4	5

15. Bank Guarantee issued by ZANACO that, in case of an occurrence or non-occurrence of a particular event, the bank guarantees to fulfilled the loss of money as stipulated in the contract. It may of various types like Financial Guarantees, Performance	1	2	3	4	5
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² Bank issues a LETTER OF CREDIT in addressed to the supplier or exporter after it, supplier or exporter will supply the goods to such unknown buyer or importer. A signed Invoice with Letter Of Credit is presented to the bank of buyer/importer and the payment is made to the seller/exporter DIRECTLY by the bank.

Guarantees and Deferred Payment Guarantee					
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16. Buyer Credit: which is availed by an Importer from overseas lenders (i.e. Banks & Financial Institutions) for payment against the farmer's imports. The overseas bank usually lends the farmer being an importer based on letter of credit, bank guarantee issued by ZANACO as the importer bank.	1	2	3	4	5
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<p>17. Suppliers Credit: – Under such credit facility an exporter extends credit to a foreign importer to finance his purchase. Usually the importer pays a portion of the contact value in cash and issues a Promissory note as evidence of his obligation to pay the balance over a period of time. The exporter thus accepts a deferred payment from the importer and may be able to obtain cash payment by discounting or selling such promissory note created with ZANACO as his bank.</p>	1	2	3	4	5
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18. How many SMEs as customers do you have?
19. What proportion of these SMEs in the last one month have accessed the following credit facilities?
20. Relating to a startup loan.....out ofof the farmer population
21. Relating to a Line of Credit.....out ofof the farmer population
22. Relating to a Cash Credit Over Draftout ofof the farmer population
23. Relating to a long term loanout ofof the farmer population
24. Relating to a Packing Creditout ofof the farmer population
25. Relating to a bridge loanout ofof the farmer population
26. Relating to some other fund based credit facilitiesout ofof the farmer population
27. Relating to a Letter Of Creditout ofof the farmer population
28. Relating to a Bank Guarantee issued by ZANACOout ofof the farmer population
29. Relating to a Buyer Credit andout ofof the farmer population
30. Relating to a Supplier credit.....out ofof the farmer population

Appendix II - Interview with Credit Staff or Manager

1. Why does ZANACO not offer a wide range of credit facilities to SMEs?
2. What are the perceived or actual risks involved in offering the excluded facilities to SMEs in Zambia?
3. How can the risks be mitigated?

I have just noted that you only offer the following credit facilities to SMEs (Probe for the reasons)

Please share with me the reasons (To tease out only those that are offered by ZANACO)

- 1) Relating to a startup loan
- 2) Relating to a Line of Credit.
- 3) Relating to a Cash Credit Over Draft
- 4) Relating to a long term loan
- 5) Relating to a Packing Credit
- 6) Relating to a bridge loan
- 7) Relating to some other fund based credit facilities
- 8) Relating to a Letter Of Credit
- 9) Relating to a Bank Guarantee issued by ZANACO
- 10) Relating to a Buyer Credit and
- 11) Relating to a Supplier credit

What could be the reasons for these facilities?

I have just noted that you do not offer the following credit facilities to SMEs (Probe for the reasons).

Please share with me the reasons (To tease out only those not offered)

- 12) Relating to a startup loan
- 13) Relating to a Line of Credit.
- 14) Relating to a Cash Credit Over Draft
- 15) Relating to a long term loan
- 16) Relating to a Packing Credit
- 17) Relating to a bridge loan
- 18) Relating to some other fund based credit facilities
- 19) Relating to a Letter Of Credit
- 20) Relating to a Bank Guarantee issued by ZANACO
- 21) Relating to a Buyer Credit and
- 22) Relating to a Supplier credit

Could there be some risks and what are they if any or what could be the other reasons?

How can the risks be mitigated if any regarding the credit facilities that are on offer in case the bank opted to introduce them as a new product?