

**Review.**

## **Sources of finance for Micro and Small Enterprises (MSEs) since the use of Multi-currency system in Zimbabwe.**

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**The study sought to explore the sources of finance used by Micro and Small Enterprises in Zimbabwe from the period when the country began using the Multi-currency system at the beginning of 2009 up to end of 2011. The sample consisted of 120 MSEs in Harare, 70 MSEs in Kadoma and 40 MSEs in Bindura and convenience sampling was used to select members of the sample. A structured questionnaire was sent to the respondents. The main source of start-up finance used was either business owners' savings or internal sources of funds from the company and this depended on the size of the company, nature of business and ownership structure. Very few MSEs had access to bank loans and these were mainly in the Hotel and Catering and Manufacturing sectors. Trade credit finance was the main source of external finance and this was irrespective of the MSE's nature of business, size or form of business ownership. There was not much financial support from the Government and NGOs. It is recommended that MSEs should use alternative means to finance their businesses such as sharing resources, delaying payment, reducing accounts receivables.**

**Key Words:** Finance; MSE; Multi-currency; Business sector; Business Ownership.

### INTRODUCTION

When Zimbabwe attained independence in 1980, it promulgated an industrial policy whose emphasis was to develop small and medium enterprises (SMEs). Micro and Small Enterprises (MSEs) serve as an entry point for the majority of the people into the mainstream of economic activity. In order to increase resource access towards the poor, Zimbabwe in 2002 created a Ministry responsible for the development of small to medium scale enterprises. The Ministry operates at grassroots level initiating and funding various income generating projects thereby contributing to poverty reduction. This effort was augmented by the Economic Indigenization Programme that was meant to economically empower the majority of indigenous people in Zimbabwe. Before the multi-currency regime, the government set aside budget allocations for micro-projects for rural communities to complement efforts of other development partners such as NGOs. There were a number of Micro Finance Institutions (MFIs) which provided financial services to the 'unbanked' poor and/or rural based communities as well as play a facilitating role in sustainable economic development through provision of credit, savings facilities, employment creation and

consumption smoothing to micro enterprises and the economically active poor

There has been a significant decrease in the number of registered Micro finance institutions since the period when the Zimbabwe dollar was no longer in use and the multi-currency regime was adopted. According to Microfinance Information Exchange (MIX), an organization which has membership in all countries of the world, Zimbabwe had a total of only five registered MFIs in 2009 with a gross loan portfolio of US\$474 406 and 12 777 active clients with an average loan balance per borrower of US\$37,1 and total assets of US\$875 194 ([www.mixmarket.org](http://www.mixmarket.org)). The Government seems to be failing to support MSEs financially and most banks are only advancing salary based loans to individual borrowers leaving MSEs with few financing options. It is against this back ground that this research wants to explore the sources of finance which MSEs have been exposed to since the adoption of the multi-currency system at the beginning of 2009 up to end of 2011. There has not been any study carried out to establish how dollarization has impacted on Micro and small enterprises' access to finance

## LITERATURE REVIEW

The definition of Small enterprises varies from one country to another and it can be in terms of turnover, assets, employment numbers, and management characteristics (Malhotra *et al.*, 2006). Malhotra *et al.*, (2006) gives a definition according to the World Bank which defines a micro enterprise as an enterprise with less than 10 employees, a total asset of less than US\$100 000 and turnover of less than US\$100 000 while a small enterprise is defined as an enterprise with between 11 and 50 employees, total asset of between US\$100 000 and US\$3million and turnover of between US\$100 000 and US\$3million. According to Chigumira and Masiyandima (2003) in Zimbabwe, a micro enterprise refers to an enterprise with less than 10 employees and a small enterprise refers to an enterprise with between 10 and 50 employees.

### *Theories of MSEs Financing*

According to Johnsen and McMahon (2005) there are five theories of MSEs financing namely Static Trade-off Theory, Agency Theory, Growth Cycle Theory, Alternative Resource (or Bootstrapping) explanations and Pecking Order Theory. Van Auken and Neeley (1996) defined Bootstrap Financing as a method of acquiring the use resources without resorting to debt or equity financing. They identified 28 possible sources of Bootstrap financing that in turn are categorized into five factor dimensions, namely: delaying payments, minimizing accounts receivable, minimizing investment, private owner-financing and sharing resources. Bootstrap financing claims that MSEs exhaust the possibilities of self-financing before going for external financing sources. This is in line with Meyer (1984)'s Pecking Order Hypothesis which asserts that small firms strive for external sources of finance only if the internal sources are found inadequate. This is supported by Wu; Song and Zeng (2008) who indicate that the owners of firms have a particular preference order for their choices concerning finance and they prefer to use internal rather than external finance and to use debt rather than equity.

The Financial growth model proposes that small businesses have a financial growth cycle in which financial needs and options change as the firm starts-up, grows, gains further experience and becomes more transparent with its information (Berger and Udell; 1998) According to Static Trade-off Theory, firms prefer external financing scheme to the extent that the marginal benefit due to tax shield advantage of debt is exactly equal to the marginal cost of financial distress (Ross *et al.*, 2000).

### *Sources of finance for MSEs*

Most researches have shown that banks, micro finance institutions (MFIs), Governments and Non Governmental Organizations are the main external sources of finance for MSEs. Trade finance through credit purchases from suppliers has also proven to be source of finance for most MSEs of late (Atieno; 2001). Studies have noted that banks are the major source of external finance in developed countries (Van Auken and Carter, 1989, Berger and Udell 1998, European Commission 2005). Berger and Udell (1998) in their study in USA, concluded that small businesses rely heavily on commercial banks and finance companies to provide capital. A survey by European Commission in 2005 indicated that 79% of European small businesses get their financing from banks. The situation is different in Asia and Africa. According to Garcia-Fontes (2005) a survey carried out by World Bank Investment Climate for China found that only 12% of small businesses in China and 15% in Malaysia got loans from banks. In Mozambique, only 5% of registered SMEs have access to bank finance and most firms use their own finance for both working capital and investment (World Bank 2003). Although banks play an important role in providing finance to small businesses, previous empirical findings indicated that the credits are not easily accessible and the problem is common around the globe.

Since the mid-1990s microfinance programs and institutions have become an increasingly important component of strategies to promote MSEs development in developing countries (Green, *et al.* 2006). According to Robinson (1994) microfinance refers to small-scale financial services (primarily credit and savings) provided to people operating small (micro) enterprises. The group lending model is the dominant methodology used by a number of microfinance institutions globally. Microloans are given to a group of people and they have joint responsibility for paying back the loan (Hasmat Ali; unpublished). The advantage of this model lies in the avoidance of individual's failure to pay, characterized by the individual loans model. Group support (and pressure) provides members of the group with incentive to ensure responsible behaviour. According to Kasekende and Opondo (2003) MFIs in Uganda serve rural areas at low costs as they have flexible service delivery which makes it easy for weak MSEs to access financial services from them. Informal lenders are also able to design their contracts to meet the individual dimensions, requirements and tastes of

the borrowers (Aryeetey, 1996b). This according to Atieno (2001) contrasts with the formal lender practices, which charge relatively low interest rates, but often impose procedures on borrowers that substantially increase their transaction costs.

Majority of small industries in Nigeria use personal savings as a source of start-up finance (Ekpenyong and Nyong; 1992, Garcia-Fontes; 2005). They also rely more and more on their own or friends' and relatives' savings and informal institutions for investment capital. Family owned businesses have problems in accessing external finance because they are regarded as risky because of their failure to separate family objectives from business objectives, inexpert human resources and lack of collateral (Fernandez and Nieto; 2006). Ownership type of SMEs can influence the enterprise's decision on type of business finance to use (Allen and Phillips; 2000). Older and larger firms are less likely to be discouraged from borrowing and discouraged borrowers are good borrowers who do not apply for a loan to a bank because they feel that they will be rejected (Kon and Storey; 2003). Discouraged borrowers give up seeking loans because they expect either high costs for getting loans or they expect to face very low credit limits (Diagne; 1999).

In most countries the Government provides support to MSEs. The Malaysian Government has funds and schemes for small businesses in the form of soft loans, grants, equity financing and venture capital administered by several ministries and agencies (Abudullah and Manan, International Islamic University, Malaysia, unpublished work). Of the support provided by Malaysian Government in 2005 and 2006, on average loans made up of 65%, Grants 17%, Equity finance 3% and venture capital 10%.

In a study carried out by Fafchamps (1996) it was found that trade credit was the most important source of funds for manufacturing firms in Zimbabwe accounting for a quarter to a third of all outstanding balance. Bade and Chifamba (1994) found that firms are more likely to get

credit from their suppliers when they purchase regularly and in bulky as well as when the trade discount is large, end of year level of inventory is high relative to sales and the MSEs are more profitable. Trust and reputation play a central role in the way creditors screen debtors and in the way contractual difficulties are handled.

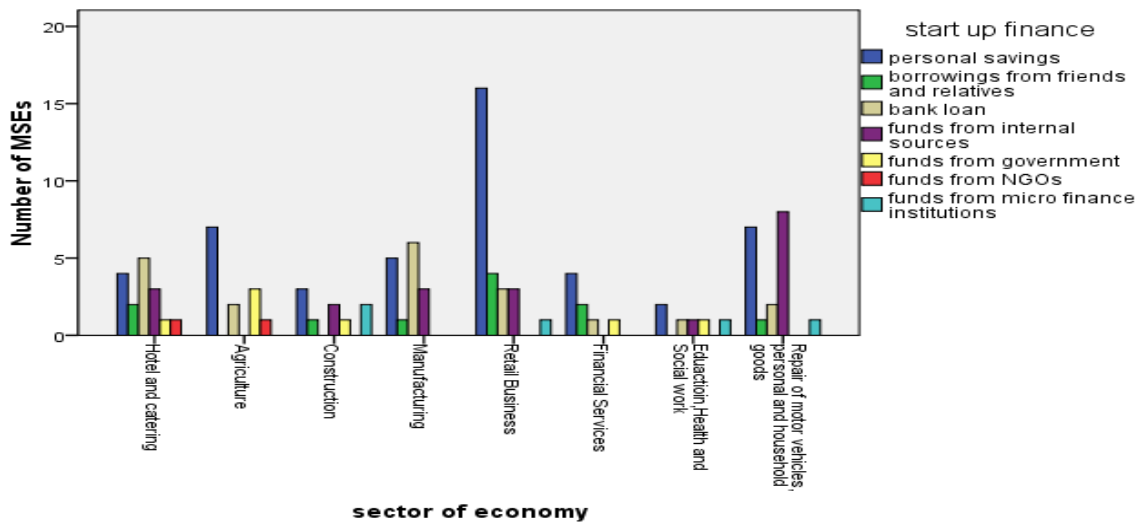
## RESEARCH METHODOLOGY

A descriptive survey method using structured questionnaires was used in this study carried out in the town of Bindura and cities of Kadoma and Harare. The city of Harare was chosen as a representative of the MSEs operating in big cities, while the city of Kadoma was chosen as a representative of MSEs in medium cities and Bindura was chosen to represent MSEs that operate in small towns in Zimbabwe in an effort to make the sample more representative. Micro and Small enterprises registered with the respective council authorities in each town were purposively sampled as respondents. A pilot study was done in the city of Gweru to 10 MSEs and the information from the study was used to correct the questionnaire that was to be used during data collection. Micro and small enterprises (MSEs) that were considered were those operating in manufacturing, construction, hotel and catering, transport, storage, communication, wholesale and retail, motor vehicle repair, education, health, social work and community services sector. The research considered those firms which have been operating for at least one year and are registered by the municipalities of the towns under study.

The questionnaires were hand delivered to the respondents and respondents were given about two weeks to complete the questionnaires after which the questionnaires were collected in person by the researchers. Sixty-four (64) responses were received out of the 120 questionnaires administered in Harare and 32 responses out of the 70 questionnaires administered in Kadoma. In the smaller town of Bindura, a total of 19 responses were obtained from 40 questionnaires administered.

## RESULTS AND DISCUSSION

### Start-up finance used by each Sector of Economy

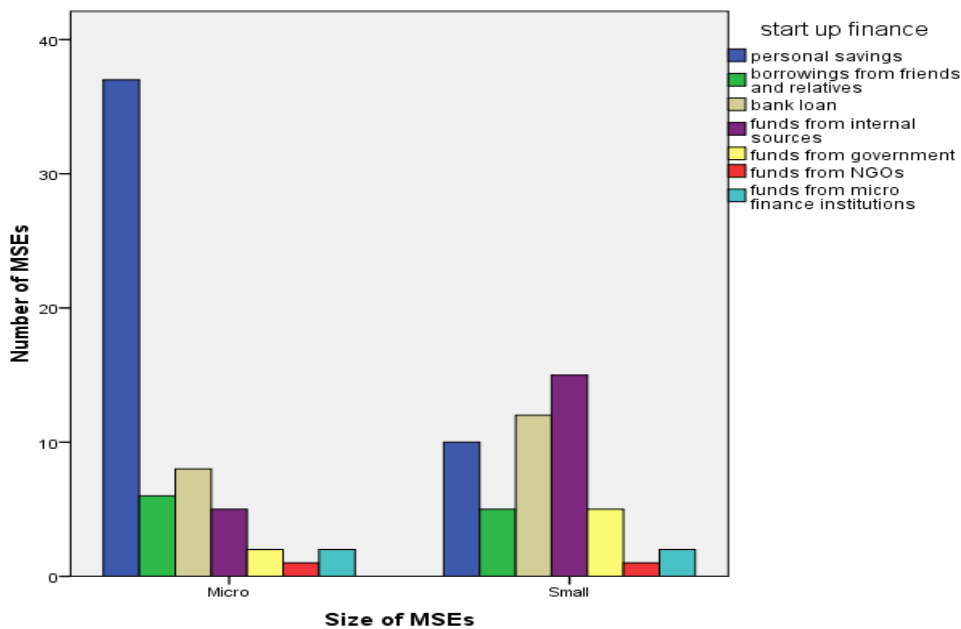


**Figure 1: Start-up finance used by each Sector of Economy**

Personal savings was the main source of start-up finance used by Retail Business sector, Agriculture and financial services sector when the country moved on to the use of multi-currency system at the beginning of 2009. Use of personal saving as a source of start-up finance by small firms is also confirmed by Ekpenyong and Nyong(1992). Hotel and catering sector and Manufacturing sector got funds to start-up mainly from banks while Repair of vehicles and household goods

sectors used funds from internal company sources. Pearson Chi-square test ( $p=0.056$ ) confirm that the start-up finance used by the MSEs is independent of the sector of the economy of the firm.

**Source of Start-up finance according to Size of firm**

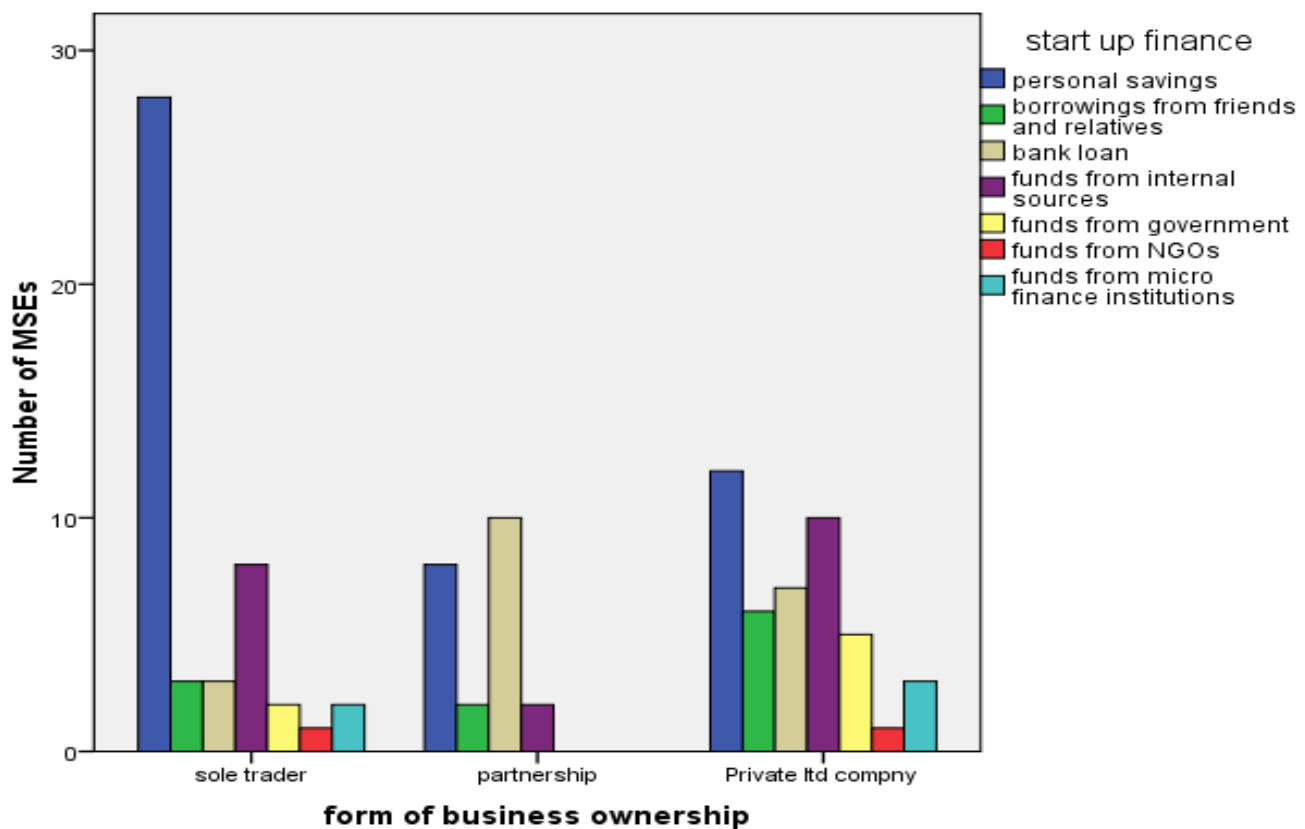


**Figure 2: Source of Start-up finance according to size of MSE**

The main start-up finance for micro enterprises (those with less than 10 employees) was personal savings of owners of the business and for small enterprises it was internal company sources. Small firms seem to be discouraged from applying for loans because they feel that their applications will be rejected and this is supported by Kon and Storey (2003) and Diagne (1999). Start-up finance was dependent upon the size of the enterprise as shown by a Pearson Chi-square ( $p=0.001$ ).

### Start-up finance for different forms of Business Ownership

The owners' personal finance was the main source of start-up finance for sole traders when the country adopted the foreign currency as a legal tender at the beginning of 2009. Partnership business used bank loans as the main source.

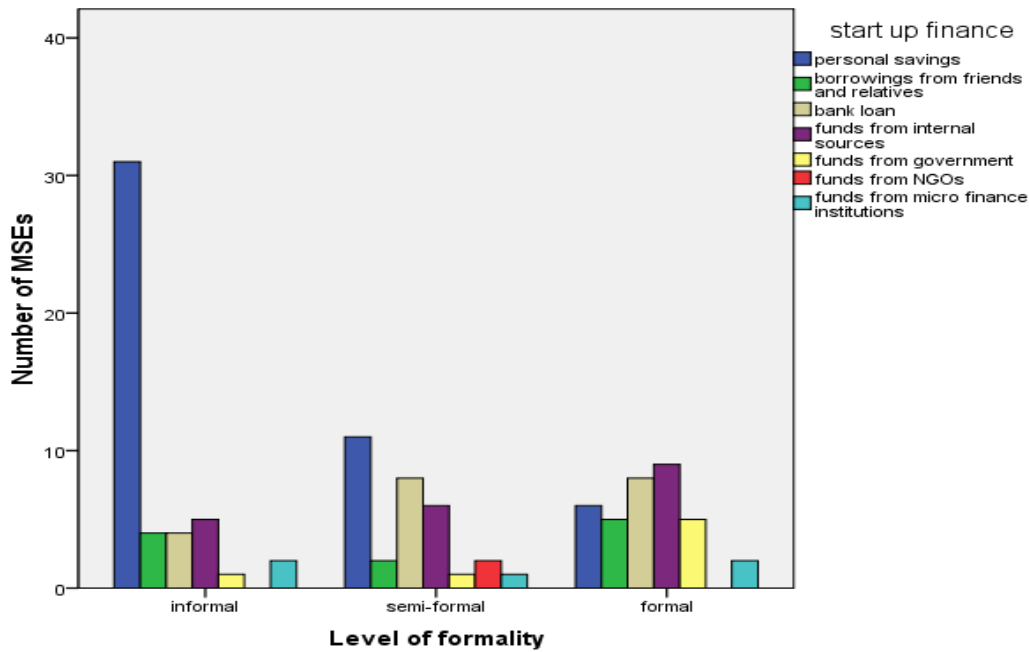


**Figure 3: Start-up finance according to form of business ownership**

Results from a Chi-square test ( $P=0.007$ ) also indicates that source of start-up finance is related to the form of business ownership as found by Allen and Phillips (2000). Partnership business found it easier to obtain bank loans than sole traders and private limited companies. Family owned businesses had problems in accessing external finance probably because of the perception by lenders that they are risk as confirmed by Fernandez and Nieto (2006).

### Source of Start-up Finance for each level of formality

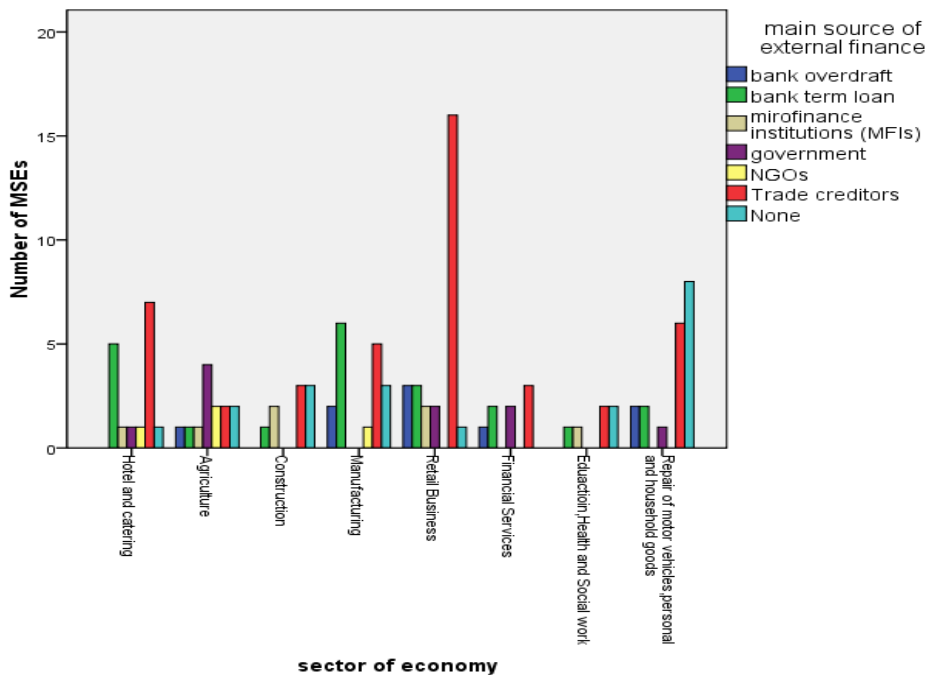
The start-up finance for most informal firms was owner's personal savings. The reason could be that informal firms do not have easy access to funds from external sources. This is similar to other developing countries and more developed countries such as China as found by Garcia-Fontes (2005).



**Figure 4: Start-up finance for each level of business formality**

The Chi-square test revealed that start up finance depends on the formality of the business (p=0.002).

**Main source of External Finance for each Sector of Economy**

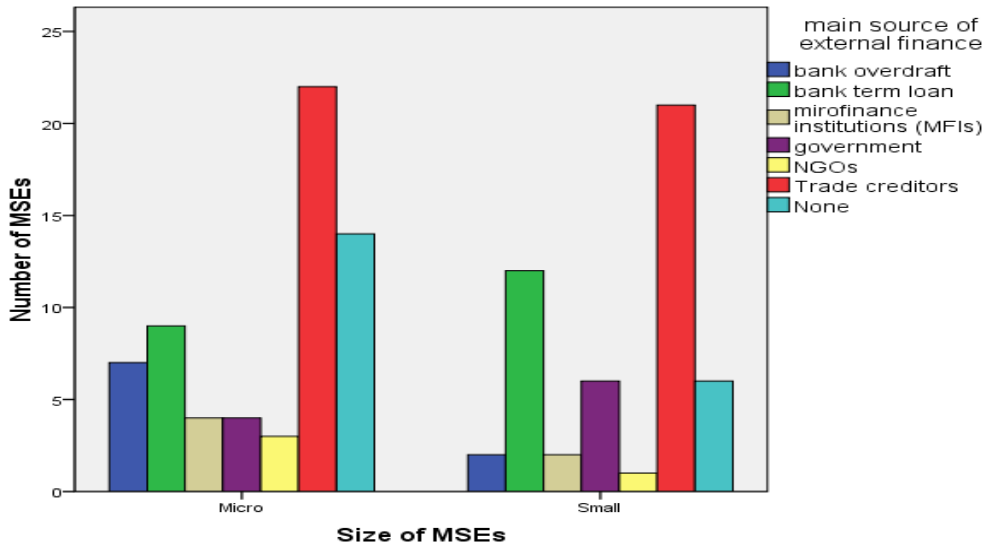


**Figure 5: Main source of external of finance**

Trade creditors was the main external source of finance used by most sectors especially Retail business sector and this confirms findings by Atieno (2001). However,

bank loan was the main external source for the manufacturing sector. Main sources of external finance were dependent upon the sector of the economy, since the Pearson Chi-square statistic test was  $p=0.04$ .

**Size of Firm and Main sources of external finance**

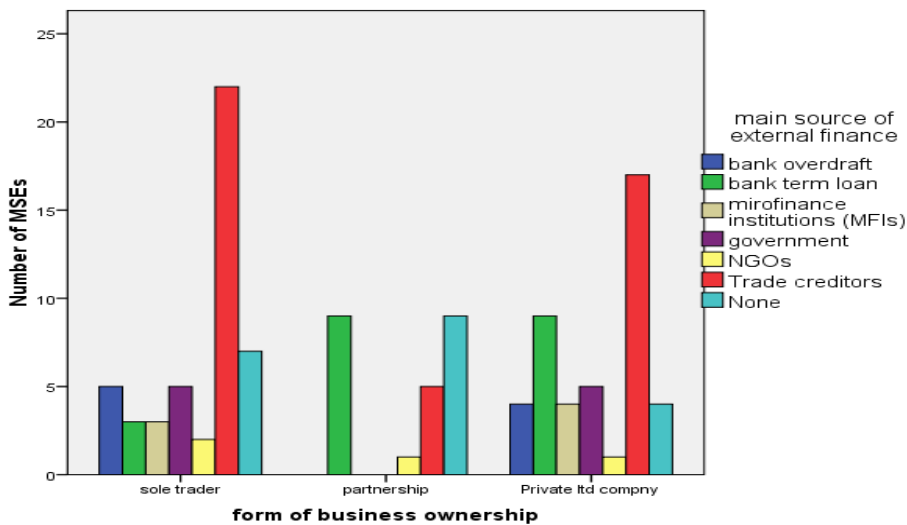


**Figure 6: Source of external finance according to size of MSEs**

The main source of external finance used by the firms irrespective of their sizes was trade finance and this is in line with what was found by Fafchamps (1996) for manufacturing firms in Zimbabwe. This is also confirmed by Pearson Chi-square test results ( $p=0.312$ ) which show that source of external finance is independent of the size of the MSE firm.

**Main source of external finance for different forms of business ownership**

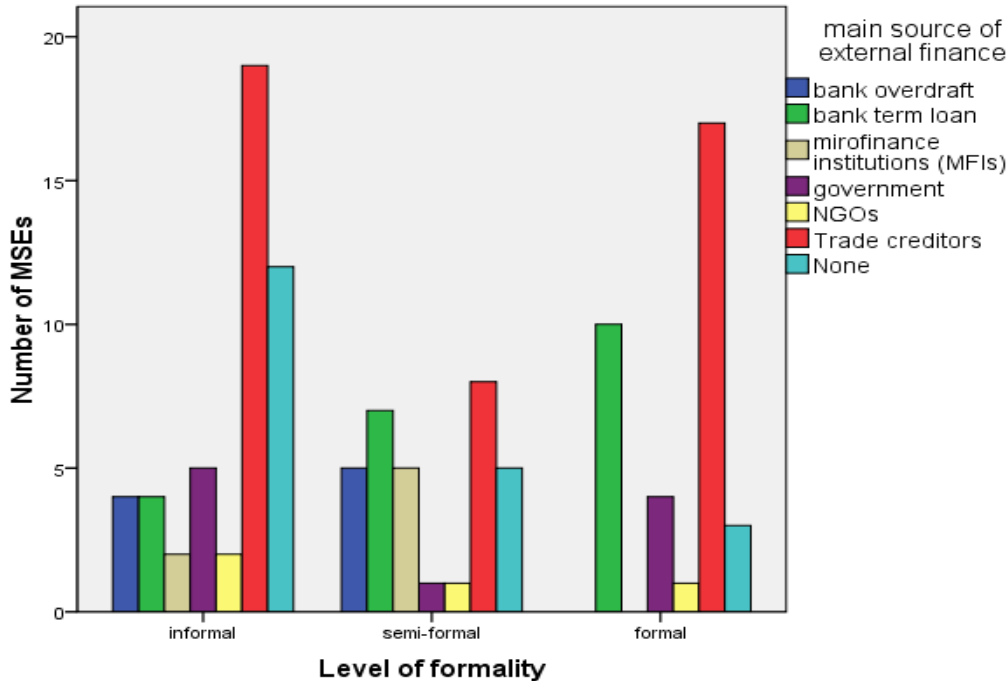
The form of business ownership influences the main source of external finance. The sole traders and companies had trade creditors as their main source of external finance. The Pearson Chi-square test had a p-value of 0.009 implying that there is a relationship between the two variables.



**Figure 7: Main source of external finance for each form of business ownership**

**Main source of external Finance for each level of formality**

The main source of external finance for most firms was trade credit finance and this was irrespective of the level of formality of the firm.



**Figure 8: Main source of external finance for each level of formality**

A Chi-square confirmative test ( $p=0.016$ ) however, indicated that main source of external finance depended on the level of formality of the business

**Business Loan Application for each Sector of Economy**

Table I: Percentage of MSEs which applied for business loans for each sector

Sector of Economy	Business Loan Application	
	YES (%)	NO (%)
Hotel and Catering	69	31
Agriculture	69	31
Construction	56	44
Manufacturing	59	41
Retail Business	48	52
Financial Services	63	37
Education, Health and social welfare	33	67
Repair of motor vehicles	47	53
Total	57	43

The number of firms which applied for loans in the Hotel and catering, Agriculture, Construction, Manufacturing and financial services sectors was higher than those who did not apply. In the Retail business sector, Educational, health and social work sector and repair of motor vehicles, personal and household goods sector the

number of firms which did not apply for loans was higher than those who applied for the loan. However the Pearson Chi-square confirmative test ( $p=0.710$ ) revealed that there was no existing relationship between the sector

of the economy and the business loan application. This implies that firms applied for loan irrespective of the

sector in which they operate.

### Size of Firm and Business Loan Application

Table 1: Loan application according to size of MSE.

Size of Firm	Business loan application		
	Yes	No	Total
Less than 10 Employees	27	37	64
Between 10 and 50 Employees	37	14	51
Total	64	51	115

The number of micro enterprises which applied for loans was lower (42%) than those who did not apply whereas the number which applied was higher (73%) than those who did not apply in the case of small enterprises. The reason could be that larger firms are less likely to be discouraged from borrowing as suggested by Kon and

Story (2003). The Pearson Chi-square test ( $p=0.002$ ) also shows that business loan application is dependent upon the size of the company.

### Business loan application for each form of business ownership

Table IV: Loan application for each form of business ownership

Form of business ownership	Business loan application		
	Yes	No	Total
Sole Trader	22	25	47
Partnership	13	11	24
Private	29	15	44
Total	64	51	115

There was not much difference in the number of firms which applied or did not apply for loans among sole trader and partnership business categories. More firms (66%) in the private limited category applied for loans compared to those who did not apply. The Chi-square test ( $p=0.184$ ) indicated that there is no relationship

between form of business ownership and business loan application. This implies that private companies prefer use of debt more than family owned businesses.

### Business Loan Application according to level of formality

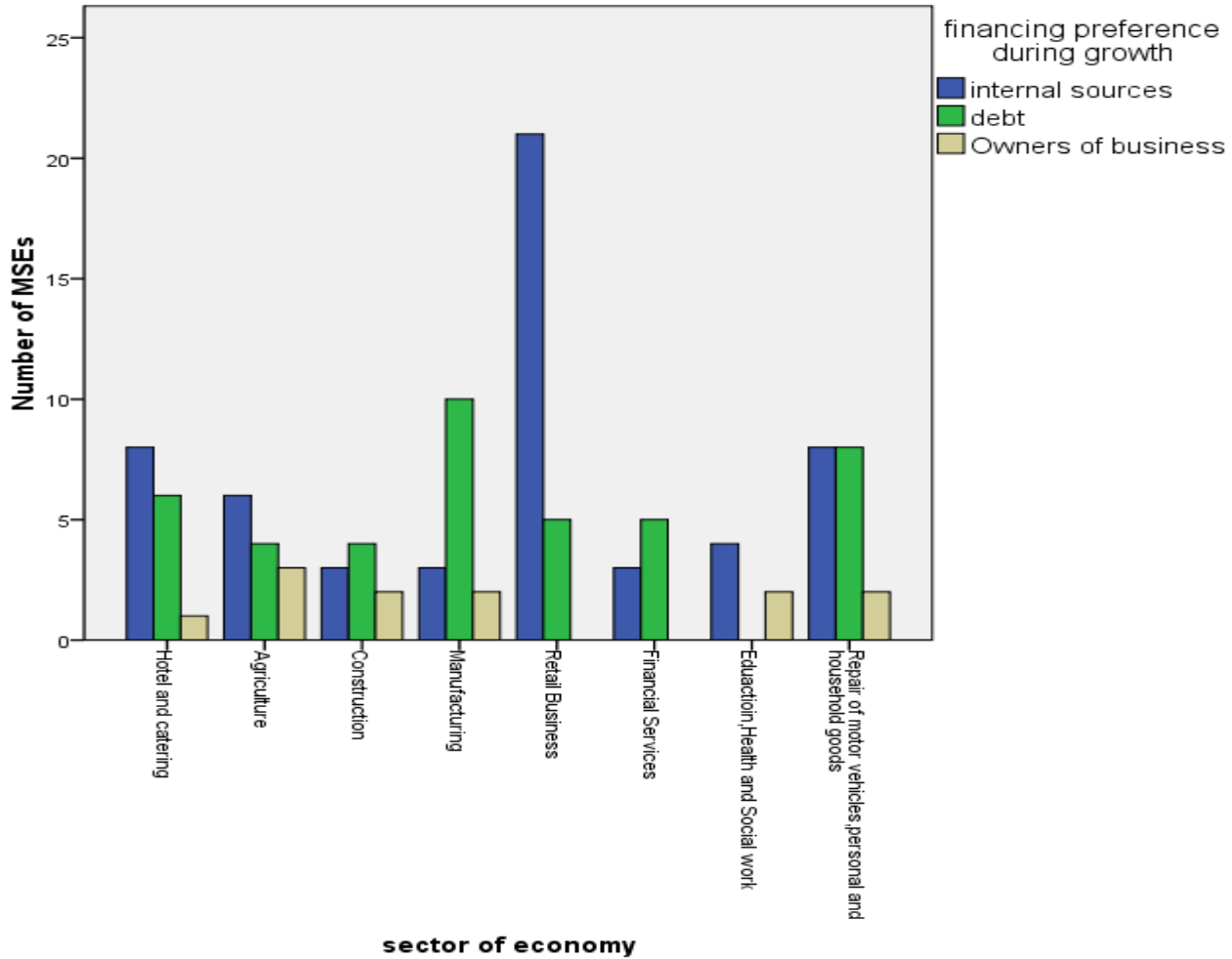
Table 3: Business loan application according for each level of formality

Level of formality	business loan application		
	Yes	no	Total
Informal	18	30	48
Semi-formal	22	10	32
Formal	24	11	35
Total	64	51	115

Most informal firms (62.5%) did not apply for loans while the number which applied was high for semi-formal businesses (69%) and formal businesses (69%). These

results are also supported by Chi-square test which indicates that business loan application depends on the level of formality of the business ( $p=0.004$ )

**Financing preference during period of growth for each sector of economy**



**Figure 9: Financing preferences of MSEs during period of growth**

Internal source was the most preferred financing source during period of growth by most sectors except the manufacturing sector and the financial services sector which prefer debt. This confirms Meyer (1984)'s pecking order hypothesis and findings by Wu; Song and Zeng

(2008) that small firms prefer internal sources of finance to external sources

**Size of Firm and financing preference during period of growth**

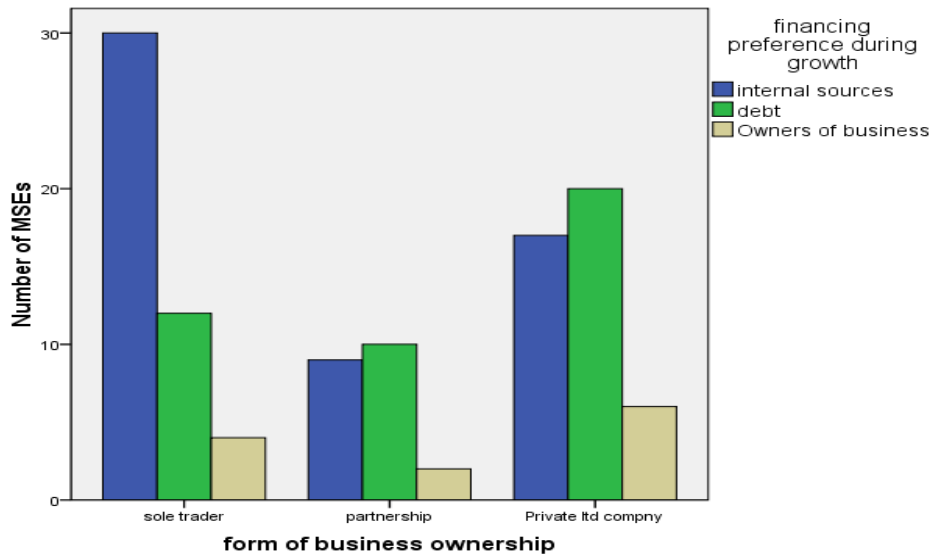
Table 4: Financing preference during period of growth according to size of MSE

Size of Firm	Financing preferences during period of growth			
	Internal Sources	Debt	Equity	Total
Micro Enterprise	42	17	5	64
Small Enterprise	16	27	8	51
Total	58	44	13	115

A Pearson Chi-square test ( $p=0.004$ ) showed that the size of the firm influences financing preference during

period of growth. Micro enterprises prefer to finance their business using internal sources as indicated by 66% of the micro enterprises while small enterprises prefer debt as indicated by 53% of the small firms.

**Financing preference during period of growth for each form of business ownership.**

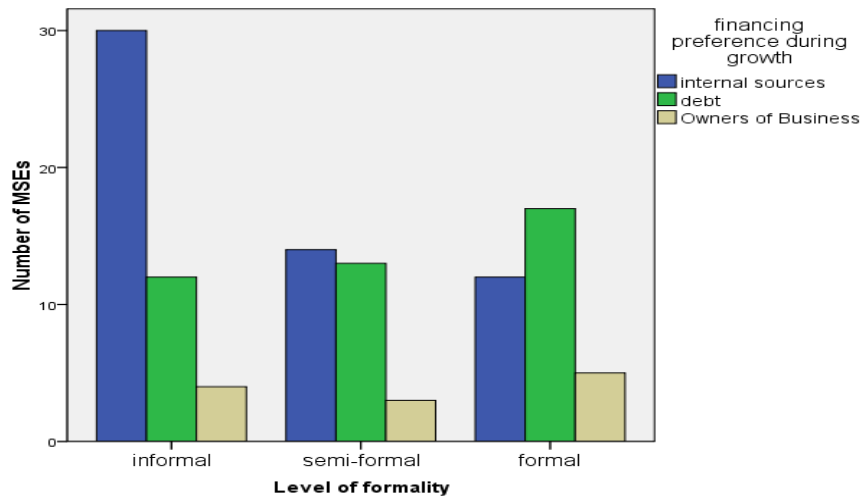


**Figure 10: Financing preferences for each form of business ownership**

Most sole traders would prefer to use internal sources to finance their growth while there is not much difference in the use of debt and internal sources for Partnership business and Private Limited firms. Pearson Chi-square test ( $p= 0.144$ ) confirms non- existence of a relationship between the form of business ownership and financing preference during growth.

**Financing preference during period of growth for each level of formality**

Informal businesses would prefer to use internal sources of finance to support their growth while there is not much difference in preference between debt and internal sources for semi-formal businesses and formal businesses. A Chi-square test indicated that financing preference during period of growth is not influenced by the level of formality of the firm ( $p=0.113$ ).



**Figure 11: Financing preference during period of growth for each level of formality**

## CONCLUSION

Micro and small Enterprises in Zimbabwe had to use mainly owners' personal savings and retained earnings as start-up capital when the country adopted use of multi-currencies in 2009. Use of multi-currency system has negatively affected the ability of MSEs to access external finance and the only readily available external source of finance is trade finance.

## RECOMMENDATION

MSEs should explore other financing alternatives such as delaying payments; reducing investment in accounts receivable and sharing resources. MSEs can also borrow as groups and provide joint collateral and guarantee thereby enhancing their chances of getting external lines of credit.

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## Appendix

### Questionnaire administered to micro and small enterprises

We are researchers from Bindura University and we carrying a study on the financing of MSEs in Zimbabwe since 2009, when the country began using the multi-currency system. Data is being specifically sought from MSEs operating in the Municipalities of Harare, Kadoma and Bindura. We therefore kindly request you to complete the questionnaire below. The information submitted will be used for the purpose of this research only. Thank you.

### Instructions

- Do not write your name on the questionnaire
- Tick your options in the box provided.

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### SECTION A: CHARACTERISTICS OF THE ENTERPRISE

1. In which sector of the economy do you operate in?

- i. Hotel and catering
- ii. Agriculture
- iii. Construction
- iv. Manufacturing
- v. Retail Business
- vi. Financial services
- vii. Education, Health and Social work
- viii. Repair of motor vehicles, personal and household goods

2. What form of ownership is your business?

- i. Sole trader
- ii. Partnership
- iii. Private Ltd company

3. For how long have you been operating?

- i. Less than 1 year
- ii. Between 1 year and 3 years
- iii. Between 3 years and 5 years
- iv. Above 5 years

4. How many employees does your enterprise have?

- i. Less than 10
- ii. Between 10 and 50

5. How many of your employees have a written contract of employment?

- i. None
- ii. One or more

6. Is your business registered with Zimra?

- i. Yes
- ii. No

7. Is your business registered for VAT?

- i. Yes
- ii. No

8. Does your business strictly separate business from personal finance?

- i. Yes
- ii. No

9. Which form of financial records does your business keep?

- i. Simple bookkeeping
- ii. Double entry bookkeeping
- iii. Audited annual financial statements
- iv. Management Accounts
- v. No financial records

**SECTION B: FINANCING OF THE ENTERPRISE**

10. Have you ever applied for a business loan?

- Yes
- No

11. If the answer to the above question is "Yes" what has been the results of the loan application?

- i. Got the entire amount applied for;
- ii. Got part of amount applied for;
- iii. Got nothing.

14. If the answer to the above question is No which of the following are the reasons for not applying:

- i. Had own capital
- ii. Interest rates too high
- iii. No sufficient collateral
- iv. Repayment period too short
- v. Scale of activities small
- vi. Activities too risky

- vii. Lack of accounting system
- viii. Business not registered

15. What was your start up finance when the country dollarized in 2009?

- i. Personal savings
- ii. Borrowing from friends and relatives
- iii. Bank loan
- iv. Funds from internal sources
- v. Funds from government
- vi. Funds from NGOs
- vii. Funds from MFIs

16. Rank the following according to what has been the **main source** of external finance for your business since 2009?

- i. Bank overdraft
- ii. Bank term loan
- iii. Micro Finance Institutions(MFIs)
- iv. Government
- v. NGOs
- vi. Trade creditors(suppliers)

17. What is your financing preference during the period of growth?

- i. Internal sources
  - ii. Debt
  - iii. Equity finance
-