

HARNESSING RESOURCES FROM THE INFORMAL SECTOR FOR ECONOMIC DEVELOPMENT

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(ZEPARU)**

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Preamble

The operating environment in Zimbabwe, since the adoption of multicurrency system has been characterized by a number of challenges. These include the rapid deterioration in external sector position on account of growing import dependence against a background of poor export performance; subdued foreign capital inflows; an external debt burden; frequent power outages on the back of progressive deterioration in generation infrastructure; a limited fiscal space, low domestic output and de industrialization; and slow savings and money supply growth and a growing non-performing loan problem in the banking sector. These factors have all contributed to worsening the liquidity problem in the banking sector hence the inability of banks to continue to underwrite business.

Further, the economy has also undergone significant structural transformation in the past decade, which has seen the formal sector being replaced by a growing informal sector. This transformation of the economy towards informalisation implies that the traditional business models cannot continue to be applied hence the need to adopt new mechanisms that are best able to serve the emerging class of business clientele.

The Bankers Association of Zimbabwe in their quest to address the challenges and the exploit opportunities brought about by the new economic structure, proactively undertook this study to ascertain how the informal sector can contribute to economic development through the formal banking channels. This was achieved through unpacking the challenges faced by the players in the informal sector; reviewing the business development models being used by the informal sector; understanding the relationship challenges between the informal sector and the banking sector; and proffering alternative models of financial inclusion that can be adopted to tap into the resources circulating outside the banking system. This research study was conducted in partnership with the Zimbabwe Economic Policy Analysis and Research Unit-ZEPARU, an organization whose research expertise is well respected in Zimbabwe and in the region.

This study is therefore motivated by the desire to bring the informal sector under the ambit of the banking. This route has been mooted in an effort to harness the resources that are currently circulating outside the banking sector and mostly resident in the informal sector. The underlying premise is that once these resources are properly harnessed, the total resources available for financing productive endeavors will increase, hence contributing positively to economic growth.

1. Introduction

1.1 Background

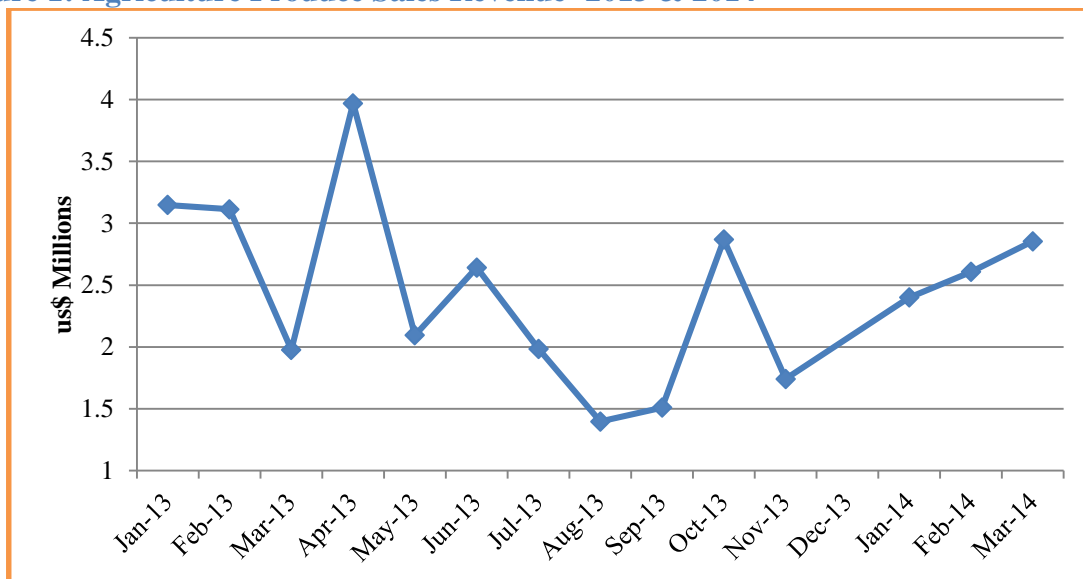
The Zimbabwean economy has undergone significant structural transformation in the last decade that has inevitably propelled the growth of informal sector. An increasing number of the active labour force is being absorbed in the informal sector. The informalisation of the economy has raised concerns and questions from several fronts. Policy makers are interested in formalizing the informal sector; the revenue authorities faced with a shrinking formal sector tax base are exploring ways of increasing the contribution of the informal sector to tax revenue and the development community in supporting players in the informal sector to improve and reduce poverty. The banking sector on the other hand is interested in promoting financial sector deepening; financial inclusion and how to nurture players in this sector to contribute towards savings mobilization. Harnessing resources from the informal sector is therefore a critical pillar in the inclusive financial sector development agenda. Deep financial markets play a critical role in the supporting economic growth and development in the country.

The structural change that has taken place calls for an in-depth analysis of the growth and dynamics on the informal sector. A deeper understanding of products requirements; the nature of business; risk factors and constraints faced by players in the informal sector will better inform product development and other intervention strategies designed to harness the funds circulating outside the formal banking system.

It is in the banking sector's long term interest to nurture clients with potential for growth and develop financial products that have requisite features to attract funds circulating outside the banking system. For example, over the period January 2013 to April 2014, the agricultural produce market earned an average of US\$2 450 713.664 (see fig 1) as revenue. These resources might not directly be channeled through the formal system if the banking sector fails to develop financial products with attractive features to buyers and sellers in the farm produce markets around the country. This may entail investing in data gathering of different segments of players in the informal markets as well as quantifying the resources generated from/required by the different sub-sectors dominated by informal sector players.

Figure 1 below shows one such attempt by eMkambo to collect and analyze data from produce markets around the country. The eMkambo data base provides estimates of the quantity and value of products sold on the produce market. This information can be helpful to different partners who want to support small holder farmers who trade in these markets.

Figure 1: Agriculture Produce Sales Revenue -2013 & 2014



Source: Emkhambo Agriculture produce market data base

A growing informal sector can act as an important shock absorber, especially for an economy where there is sluggish growth or a decline in formal sector jobs. The economic crisis (2000-2008) resulted in company closures and the remaining companies were operating at low capacities which did not accommodate the increasing labour force from the educational system. Consequently, most of the graduates from the education system who were desperate for jobs found themselves being engaged in low income and insecure informal sector jobs. It is from this stand point that policy makers worry about the growing trend of informality in the country and the shrinking formal sector. There is growing interest from different policy actors to understand the structural constraints facing the country's formal sector that are facilitating growth in informality. Chief among these concerns is the need to harness and grow the financial resources circulating in the informal sector to support economic growth and prosperity.

The nature and characteristics of the informal sector include; ease of entry; reliance on indigenous resources; family ownership of enterprises; small-scale of operations and adapted technology; capacity to generate new jobs; paucity of data on informal sector operations; skills acquired outside the formal education system and unregulated and competitive markets; and largely having little access to government services. These characteristics have been cited as the major challenge hindering the majority of the informal sector players from turning formal, hence leading to the situation of more resources remaining outside the formal financial system.

1.2 Study objectives

In light of the above, this study seeks to ascertain the nature of the challenges currently faced by the informal sector players which have forced them to keep their resources outside the formal financial system and how the banking can harness these resources. The study will specifically focus on the following:

- Unpack the challenges currently faced by the informal sector in accessing the financial sector;
- Propose solutions on how banks can realize benefits from the growing informal sector;
- Explore ways of nurturing the growth of informal sector enterprises and facilitate their formalisation;
- Proffer recommendations on how the banking sector can harness resources circulating outside the banking system.

1.3 Methodology

An extensive literature review was undertaken to contextualize the study and draw some insights from both the theoretical and empirical literature that provided a framework of analysis for the study. Documents were reviewed to get a general understanding of the framework on how the informal sector in Zimbabwe operates, within the country's socio-economic context. A review of the empirical literature assisted in the design of the questionnaire that was used in this study to collect primary data. In this regard this study borrowed heavily from previous studies on informal sector that have been done in Zimbabwe and elsewhere, paying particular attention to models that were used by other researchers.

Primary data was collected through a questionnaire that was administered to informal sector players as well as interviews with key informants from the representative bodies. Primary data was intended to reveal disaggregated statistics on informal sector variables in Zimbabwe. The study focused on the informal sector players that operate in designated areas provided by the different country municipalities. This was intended to make it realistic for follow up strategies to be able to locate the players.

The structured questionnaire focused on the following key research questions among others:

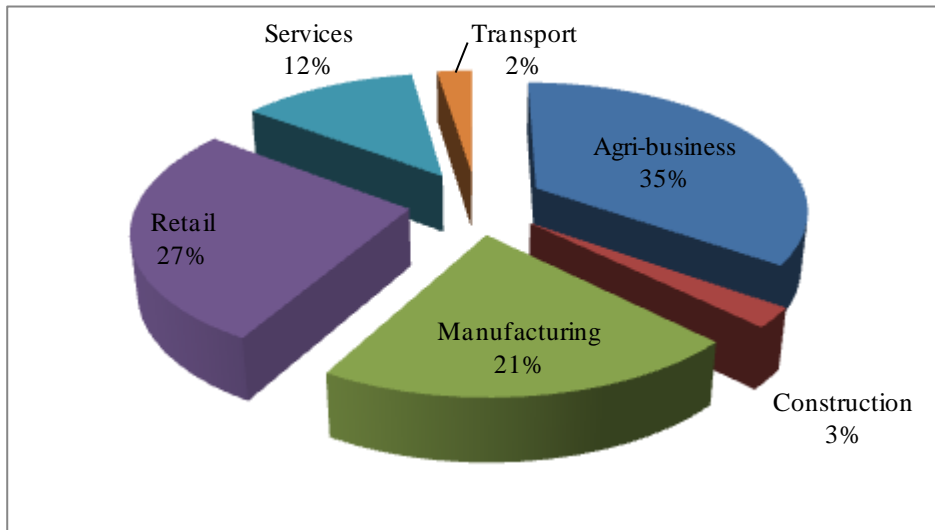
- To determine the age of the informal sector enterprises;
- To establish the ownership structures of informal sector businesses;
- To determine the size of the informal sector businesses;
- To assess the resources generated by the informal sector businesses; and
- To ascertain the current sources of credit and finance for informal sector businesses.

A combination of simple random and purposive sampling was used in selecting respondents in the informal sector for interviews. The study relied on different institutional databases on the activities of informal sector players. For example, eMkambo database was used to draw information on farmers and traders in vegetables and livestock at Mbare Musika, Harare as well as markets in Bulawayo. The farmers and the traders were then selected at random, largely based on convenience, for interviews. Secondly, the Harare Chamber of SMEs as well as the Bulawayo Chamber of SMEs membership databases were used to gain access to their members, who mostly operate in the informal sector. Thirdly, the Women's Bureau membership database was also used to gain access to their members in Bulawayo. These women were also contacted through the Bulawayo office and interviewed based on availability. Through this process, some of the farmers interviewed who were delivering products to Harare came from Murewa, Mutoko, Nyanga, Mhondoro and Domboshawa.

A total of 244 informal sector players were interviewed, for which about 69% were in Harare, 27% in Bulawayo and 4% were from other parts of the country. Among the businesses

interviewed, those in the agri-business sector dominated, constituting about 35% of the respondents, followed by retail (27%) with transport being the last (Figure 2).

Figure 2: Distribution of interviewed businesses by type



2. Relationship between banks and informal sector: Literature review

2.1 Reasons for being informal

Brand (1986), in a survey carried out in Mbare (a high density of Harare) argued that the experience of poverty and the need to support families through the provision of supplementary income was the main reason why people joined the informal sector. The study also cited other reasons as low wages in the formal sector and also termination of previous employment which push individuals to join the informal sector.

Some authors like Lee and Viuvarelli (2004) argued that there is a relationship between Structural Adjustment Policies (SAPs) of the 1980s and 1990s and the growth of the informal sector. These SAPs usually required cutbacks in government spending and public sector downsizing resulting in increased unemployment in the formal sector which forced people to join the informal sector. Ikiara and Ndungu (1999) suggest that the SAPs in Kenya caused the employment rate in the informal sector to increase from about 4% in the 1970s to about 50% by 1994. In Zimbabwe, the Economic Structural and adjustment Programme (ESAP) was implemented during the period 1991 to 1995. According to the Government of Zimbabwe (1996), 94% of targeted posts were abolished in-order to reduce the wage bill. The wage bill was reduced from 16.5% of GDP in 1990/91 to 10.4% in 1994/95 which led to most of the people becoming redundant. The downsizing in both public and private sectors following the inception of ESAP saw a dramatic rise in unemployment and the majority looked to the informal sector for jobs.

Stark (1991) argued that there is a relationship between the migration of labour and the informal sector. He postulated that the decision to migrate to urban areas was directly influenced by family needs for a better economic status. Rural to urban migration has been a common phenomenon which has been exacerbated by declining non-farm activities in rural areas particularly during the hyperinflationary period. Family members who migrated to urban areas would sent remittances to sustain the families in the rural areas usually women and children. Todaro (1969) and Mazumdar (1976) clear connection between the rural to urban

migration and the expectation of employment opportunities in urban areas. Prospects for employment and income differentials between the urban areas and the rural areas have been the main drivers of rural to urban migration.

In addition, the urban development bias has resulted in people who would have migrated to urban centers who failed to secure formal jobs to venture into informal sector activities for survival. Lipton (1977) observed that many African governments pursued developmental policies that had an urban bias. Consequently, more resources were devoted towards urban development, to the detriment at the expense of the rural economy. International agencies have also found it easy to support projects in based urban which area easy to monitor and reinforced political goodwill to the leadership. In this regard improved health, education and employment conditions in urban areas, became a pull factor for rural to urban migration as migrants sought for better standards of living. However, some of the migrants became victims of expectations as they failed to secure the much need employment in urban areas leading to an increase in the urban poor. Engaging the informal sector activities particularly buy and selling became a default survival strategy.

Armstrong and McGee (1987) argued that informal sector activities are posed as antithesis of capitalist economic activities or a drag on economic development, but however the activities of the informal sector are productive endeavours that serve to alleviate poverty when employment opportunities are limited. Sethuraman (1997) suggested that the informal sector is the only holding ground for rural migrants before finding wage employment elsewhere. Mijere (1989) postulated that the informal sector usually emerges due to the inability of the formal sector to create job opportunities for the urban as well as the rural labour force in developing countries.

2.2 Major challenges in financing the informal sector

Limited access to funds is one of the major challenges confronting the players in the informal sector. Facilitating access to formal financing channels could be a major step in facilitating growth of informal sector entrepreneurs and formalization of their businesses. The informal sector also suffers from negative perception. Players in the sector are considered as high risk and some of the activities are perceived as illegal in nature. According to Ncube (2013), associating the informal economy to criminal endeavours or tax evasion is not a good way to formalize the sector in Africa. The notion that informal sector activities are illegal and that the players in the sector have criminal tendencies discourages the banking from advancing loans to the sector as the banking sector is not allowed by law to deal with clients deemed to be involved in criminal activities.

However, the informal sector is a heterogeneous group with diverse players and different levels of development and sophistication of enterprises. Government and bankers in particular need a thorough understanding of the nature and dynamics of the informal sector in terms of product and service offering; funding requirements; risk profiles; level of profitability; accounting practices; varied compliance levels with local authorities' by-laws as well as the size of enterprises. In this regard the funding challenges faced by the diverse players in the informal sector also vary. Thus any strategy intervene to support the players in this sector need take note of this heterogeneity to avoid blanket statements that paint the informal sector with one brush. In depth knowledge may assist in devising funding strategies and intervention measures that adequately respond to the needs of the sector.

The amount of formal external finance available to the informal sector in particular is far less than expected. Despite the sector's strong interest in credit, banks' profit orientation may deter them from supplying credit to them because of the high transaction costs and risks involved. First, informal sector loan requirements are small, so the (more or less fixed) costs of processing the loans tend to be high relative to the loan amounts. Second, it is difficult for financial institutions to obtain the information necessary to assess the risks of new, unproven ventures, especially because the success of small firms often depends heavily on the abilities of the entrepreneur. Third, the probability of failure for new small ventures is considered to be high (Aryeetey, 1993)

It is difficult for the informal sector to obtain credit from the formal financial sector due to the lack of enough recognizable collateral (Adisu, 2006). Kashuliza (1993) maintains that all financial institutions in developing nations share a common characteristic of considerable amount of default rate. Consequently, Adisu (2006), states that informal traders are therefore forced to resort to informal sources of credit such as money lenders (loan sharks) who charge them exorbitant interest rates that they cannot easily repay or cannot afford to repay at all.

Kirsten, *et al* (2006) holds the view that some informal traders are discouraged from borrowing by the fact that their future earnings are usually less than the value of their assets (collateral). Another simple reason for these small informal businesses not getting financial support is that they are not registered and this makes it very difficult for the willing financial institutions to reach out to them as they do not know where to find them. There is also lack of tools and equipment as well as technical skills for improving productivity due to lack of adequate finance with which to source these resources. Limited finance has made it difficult for the small businesses to advance technologically, hire expert labour, buy inputs in bulk to enjoy scale economies and even grow in size.

Siddiqui and Nyagura (1993) also show that informal business often do not make optimum use of their existing resources and argue that they are unlikely to do better even if they get enough loans. The argument is that they do not have strategic business plans and financial records which may guide the effective and efficient use of any available resources. In a survey of small scale business management deficiencies, it was found that small enterprises fail to keep books of accounts for their business operations, or if they do, they are inadequate (Levitky, 1989). The inadequacies result from the fact that they do not provide data for appraisal to ascertain its profitability and hence loans applicability.

Formal financial institutions require collateral for them to be able to finance activities of the informal sector so that they can recover their resources in case of default. At the moment the Zimbabwean Banking sector is saddled with 18.5% non-performing loans. Collateral security and loan contracts serve to control borrowers risk taking propensity and increases chances of recovery under default. Collateral is one way of mitigating risk of loss since it provides the bank with safety net which provides a cushion against losses in the event of primary repayment fail to perform. Banks need this to offer loans with certainty (Bessis, 2003)

The following are some of the constraints that have been identified to hinder informal sector development.

- riskiness of lending because of poor management and high rate of business failure;
- high administrative cost;
- low productivity;
- under capitalization;

- shortage of skills;
- poor attitudes of the loan applicants;
- aversion to disclosure of information; and
- Lack of collateral.

Another constraint which tends to block the flow of credit to the informal sector 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, based on the suspicion that information about their business may leak through to competitors (Winborg and Landstrom, 2000).

2.3 Creditworthiness of the informal sector

One of the most difficult issues for financial institutions is to assess the extent to which the informal sector players are suitable candidates for loans and other forms of credit. An assessment of whether the informal sector is creditworthy should be based on a deep understanding about the characteristics of the informal sector players, which would also reveal their funding requirements and risks. The informal sector players generally have very small start-up capital requirements, which individually would not create much risk on the financial institution. Rhyne and Otero (1994) report that evidence in several countries show that initial capital requirements ranged from \$49 in Sierra Leone to \$1,104 in Jamaica, even though the requirements for working capital would be slightly higher to cover raw materials and inventory. Thus, the individual loan requirements for the players would not involve large amounts of money.

Some informal sector players are also part of larger family or household unit, with earnings from one enterprises being mingled with that of other household activities, including from other enterprises (Rhyne and Otero, 1994). Thus, while one business unit might be assessed in isolation for creditworthiness, a true picture on the creditworthiness would involve assessing the players at the family level.

In general, then players operating informal sector enterprises lack marketable assets that could be used as a measure of credit worthiness. In addition, some family members operating in the businesses would also be time constrained due to other family roles and responsibilities. This implies that lending requirements would need to factor in substitutes for formal collateral, rapid loan-processing procedures, and convenient locations for financial offices as the businesses require services that are located close to their places of operation (Rhyne and Otero, 1994).

Banks that apply the general templates for loans would also find it difficult to deal with informal sector players as they process loans at a cost that can be covered by interest charges with confidence in the borrower's ability to repay. Banks rely on credit checks to gain information about the client's character, project appraisal to assess the client's business prospects, and formal collateral. Informal sector players however do not keep records and have no established credit ratings with no formal marketable collateral (Rhyne and Otero, 1994). This implies that banks should come up with a template for the informal sector which

takes into account the various characteristics of the players to be able to give out loans while at the same time able to recover the loans.

One of the possible ways of assessing creditworthiness of the players is the amount of savings that they might have with a financial institution. The informal sector players always want a good place to save their money and shunning financial institutions is mostly due to lack of perceived benefits. Mobilising savings for the informal sector players is thus a good strategy to enhance their creditworthiness as the financial institutions would have records about the savings. Lending to the informal sector can thus be financed to a large extent by savings from the same players if the financial institution is able to design services with the informal sector needs in mind. These funding schemes have been found to work well, where borrowers would be required to save a portion of the amount they borrowed, with limited access to their savings until the loan was repaid. The savings would thus function as very liquid collateral (Rhyne and Otero, 1994).

The Grammen Bank model can also be used as the basis for assessing and enhancing creditworthiness of informal sector players. The Grameen Bank in Bangladesh is now widely known for its lending schemes to the poor as a poverty alleviation strategy. The bank's credit program is characterised by small loans to the poor for self-employment activities. Borrowers are required to form groups of five and accept joint responsibility for repayment of loans, with access to credit in future being conditional on all group members repaying their loans (Bernasek, 2003). The organization of borrowers into groups provides incentives for additional peer monitoring, even though the Bank also sequences the granting of loans to some group members in order to monitor their repayment performance before granting loans to the remaining group members. The bank was also able to reduce risk by creating a platform where the bank has good knowledge about the borrowers by requiring bank workers from a branch to travel to the borrowers' businesses once a week rather than requiring the borrowers to travel to the bank branch. Although the loans are designed for the poor women with the average loan size being about US\$160, the interest rate on loans was about 20% in 2000, which was the same as the rate charged by other commercial lenders in Bangladesh (Bernasek, 2003). It therefore follows that the biggest challenge for informal sector access to credit are not the interest rates but absence of marketable assets to serve as collateral.

Some informal sector players in the manufacturing sector are also integrated vertically with formal sector players, especially those that supply raw materials or buy finished products from the informal sector. Thus, flows of trade and supplier credit could also be used as some form of collateral, where the lending would strictly be through paying the suppliers while the payment to the informal sector player from the formal enterprises would pass through the bank to make the necessary deduction for the loan. However, Rhyne and Otero (1994) argue that the linkages with larger businesses are generally weak and account for only a small fraction of the sales from the informal sector enterprises. This would limit resources that could be lent out through this arrangement.

2.4 Tools and models for tapping into the informal sector

The ability of the banking sector and other non-bank financial institutions to tap into the resources in the informal sector is hinged on innovations by the financial sector. These innovations should be both in product and process changes (Tuffour, 2000). According to Tuffour product changes include the linking of savings and credit, building loans into savings cycles, and the adoption of fixed ratio credit-saving schemes.

Process changes involve the use of outreach services and this might include the use of agents or opening branches specifically located where these private players operate. These innovations are intended to;

- Knock down the literacy barriers that deter demand for formal banking services,
- Remove the formality of banking hours and banking premises, and of completing savings and withdrawals forms, while preserving standards of banking practice;
- Make banking more convenient and understandable to the target clients; and in so doing encourage more positive banking habits (Tuffour, 2000).

Another method that can be deployed to access resources from the informal sector is through development and strengthening of linkages among the informal sector players (Conning, 2002). Forging linkages have implications for the mobilization of local savings and their efficient use as well as for the macro economy. Linkages would enhance the flow of savings and credit up and down the system. This involves developing linkages between institutions in which the formal institution hires the less formal institutions to act on its behalf. Under this arrangement funds flow from the clients through the partners, or the other way round, to facilitate remittances, payment of utilities, and mobilization of deposits or even facilitating loans. Typically for these types of linkages, fees are paid by one partner to the other for the service rendered

Under the linkage arrangement, the country and banking sector can benefit if savings of small contributors gathered through the informal sector operators can be re-directed to other productive areas of the economy through the banking channels. Linkages have the potential to make saving safer and more profitable for individual clients, as well as give the formal sector access to a significant, low cost of loanable funds (Conning, 2002)

De Soto (1995) argues that financial institutions could benefit from the informal sector through recognition of property titles as a mechanism to have access to credit. The proposed innovation seeks to simplify the release of a legal property title and to adapt it to prevalent conditions of de facto ownership. This course entails disregarding contractual prerequisites and providing proof of property using alternative means of recognition, such as long-term usufruct, calling on witnesses (preferably neighbours when housing or land are involved) and having boundaries recognized by third parties when there are conflicts of interest. Thus, entitlement responds to a major obstacle to having access to credit, since collateral requirements, which usually involve assets, represent a further hurdle to a sector where 'property' is not formalized (Tokman, 2007).

Another innovative mechanism that banks can employ to tap into the resources of the informal sector is through the process of factoring. Factoring is a type of supplier financing in which firms sell their credit-worthy accounts receivable at a discount and receive immediate cash. Factoring is not a loan and there are no additional liabilities on the firm's balance sheet, although it provides working capital financing. Like traditional forms of commercial lending, factoring provides SMEs with working capital financing. However, unlike traditional forms of working capital financing, factoring involves the outright purchase of the accounts receivable by the factor, rather than the collateralization of a loan. Under this arrangement, both the bank (the factor) and the firm benefit from the transaction.

Dube, Abel and Mugocho (2013) also suggest that banks can benefit if they venture into order financing. Banks would ensure that manufacturing firms get credit while at the same time banks have something to hold on to. Although the firm might not be in a healthy position, if they have secured orders and the buyers confirm that they are willing to buy, such confirmations can be used as collateral. Such order financing can involve payments made directly to the bank to eliminate any risk while the firms get the necessary take off into competitive production.

Banks can harness resources from the informal sector if they manage to bring together members involved in almost similar trade into groups. These groups would then be encouraged to pool together their savings. Opening an account with a bank has advantages to the group since the account allows individual small savers to pool their savings in a single larger account and leaves much of the account handling costs up to the group rather than the bank. Since small savers are much more interested in the safekeeping of their funds and easy access to them, they are also often willing to pay more for that service. Banks can then onward lend these resources to the group members holding the savings as collateral.

2.5 Policy constraints for financing the informal sector

Policy constraints can be looked at from both the demand side and supply side. On the demand side, policy should be able to instil confidence of the public with the banking system. Policies aimed at promoting a vibrant savings culture can encourage banks to develop programs and products to boost savings mobilization from informal sector players. The policies should make it easier for the informal sector players to bank with financial institutions by relaxing the requirement to open bank accounts while at the same time creating incentives for those who save with financial institutions. The policies should also make it easy for banks to craft tailor made products and services for the informal sector.

However, most policies governing the financial sector are not friendly to the informal sector players. To open bank accounts, banks require too much documentation which informal sector players may fail to produce, even if they might have the money to bank. The requirements are mostly a result of policy pronouncements, which makes policy a hindrance to access to bank services by the informal sector players.

Although banks could be willing to develop tailor made products for the informal sector, prudential regulation policies by the central bank might only allow some limited flexibility for the banks. Access to bank services for the informal sector thus could require changes on bank regulations and standards governing loan collateral, approval and documentation (Rhyne and Otero, 1994) especially when the central bank might not allow too much flexibility.

Policies that also try to formalise the informal sector by collecting taxes or forcing them to register have also been found to have a negative impact on access of financial services for the informal sector. Many policies that have attempted to formalise the informal sector have failed due to failure to recognise that informalisation is part of the economic development process (Blunch, Canagarajah and Raju, 2001).

Taxation systems also serve as a policy constraint for mobilising resources from the informal sector as the taxation systems in many countries are multi-step, complex and put a lot of discretionary powers on tax authorities (Eggenberger-Argote, 2005). The fear of taxation is mostly a result of lack of knowledge about the tax process, given that the low levels of

income that the majority of informal sector players enjoy would not earn prohibitive levels of tax. Policy should thus target awareness about the tax systems by the informal sector more than targeting compliance with the system.

Policies that are designed to facilitate access to finance for the informal sector should therefore make deliberate efforts to recognise the features of the informal sector which disqualify them from having access to banks. Proof of income for opening bank accounts could be difficult to obtain given that there are either no records or there exists just simple records which do not qualify from the normal regulatory template as proof of income. In addition, the time required to fulfil the general conditions should be minimal, as it is not in the interest of the informal sector business for the owners to spend the whole day in queues. Policy flexibility is therefore necessary to accommodate the informal sector players.

3. Overview of the informal sector in Zimbabwe

The informal economy in Zimbabwe has been growing fast on the back of declining formal economic activities and has become the largest employer as the economy is failing to absorb many job seekers into formal employment. According to the 2011 Labour Force Survey, 84% of the currently employed population aged 15 years and above are in informal employment. In both urban and rural areas, small to medium enterprises operations are dominated by female entrepreneurs who account for 50.3% of the those currently employed in the informal sector, dominating the wholesale and retail trade and primarily operate from homes and streets (Labour Force Survey, 2012). Men tend to dominate the relatively complex and larger activities such as construction, transport, welding and carpentry. Like any other country in Africa, the informal sector in Zimbabwe is dominated by trade-related activities accounting for 51.9%, whilst manufacturing and construction accounts for 16.7% with other services accounting for only a small percentage of this sector.

Most of these workers in the informal sector are self-employed and the activities are carried out in the three broad activities namely; small-scale production enterprises, petty trading and distribution activities, and the non tradable service sector. The 2012 FinScope SMEs Survey, also supported the results of the 2011 Labour Force Survey, noting that the majority of SMEs surveyed are engaged in small-scale production, with the agriculture sector accounting for 43%, driven by growing produces for the fruit and vegetable market. About 9% were into manufacturing, mainly tailoring, carpentry, welding and brick making. The FinScope Survey noted that 33 % of SMEs were in the non-tradable service sector and petty trading activities and these related to the vending and selling of clothes, food and also include in this category newspaper vendors and airtime vendors.

Upon attaining independence in 1980, the informal economy was relatively small, accounting for less than 10% of the labour force. With the deregulation policies after independence and economic stagnation and decline, the informal sector share of employment grew to 20% by 1986-1987, 27% by 1991 due to government policy interventions in post independent Zimbabwe (Munhande *et.al*: 2008). During the first decade of independence 1980-1990, the government encouraged and promoted the establishment of growth points in the rural areas and home industries in urban areas to encourage entrepreneurship. To promote the growth of the SMEs sector, the government established more vocational and technical training facilities. These offered skills training to school dropouts, retrenched workers and other school leavers.

In the 1990s Zimbabwe introduced ESAP, which also demanded the relaxation of labour market regulations in order to achieve labour market flexibility and employment flexibility.

Thus, labour market regulation entailed the repealing of the 1985 Labour Relations Act making it easy for firms to hire and fire workers. Thus, a number of companies started to restructure their work processes, resulting in massive retrenchments with the highest casualties being unskilled workers who were given severance packages. The retrenched workers, including those laid off by the civil service, were meant to benefit from the Social Dimension Fund (SDF), but because of the sheer numbers involved and the limited funds available, not all of the retrenched workers were assisted in starting income generating projects.

Faced with dwindling prospects for formal employment, and increasing urban poverty the majority of Zimbabwean households turned to the informal sector, selling a wide range of goods from vegetables to backyard manufacturing supporting of thousands of households. In response the government showed its desire to promote the informal economy through Statutory Instrument 216 of 1994 which amended the Regional Town and Country Planning Act {Regional, Town and Country Planning Act (Chapter 29:12)}, thus allowing for the development of non-residential activities in residential areas commonly known as of home industries. This saw the flourishing of informal activities such as hairdressing, tailoring, book-binding, wood or stone carving as well as welding and carpentry in urban areas. Before the enactment of the statutory instrument, the establishment of small to medium enterprises activities in residential areas was subjected to local government authorities' planning permissions. Because of this, ESAP became synonymous with the growth of the informal sector in Zimbabwe in period 1990 to 2000 as market liberalisation and deregulation created individual entrepreneurship.

However with the deteriorating economic activities, deepening poverty and rising unemployment in the late 1990s and early 2000, the informal economy effectively became the mainstay for the majority of Zimbabweans, much to the dismay of the government who in 2003 enacted the Hawkers Act, which mandated the police to clear all unlicensed street vendors operating in urban areas. Thus, in the year 2005 in line with the Hawkers Act of 2003, the government of Zimbabwe launched Operation Murambatsvina/Restore Order, a countrywide clean up exercise which resulted in a crackdown on the informal market activities. Vendors were chased off the streets and flea markets were closed down, with bulldozers razing down market stalls.

However, in the year 2010 the government of Zimbabwe enacted the Indigenization and Economic Empowerment Act (Chapter 14:33), which among other things promoted the growth indigenous entrepreneurs/ small to medium enterprises reserving certain sectors of the economy to indigenous people, especially the retail sector which is mainly dominated by the informal sector. According to the FinScope 2012 survey on Small to Medium Enterprises, there are over 2 million individual entrepreneurs and 800,000 SMEs with employees and these are estimated to be employing over 2.9 million people.

The discussion with the informal sector players also revealed a lot about the manner in which they are organised as well as their potential. The traders in Mbare indicated that collectively that can realise about \$1500 per day in revenue. Many of them however do not have bank accounts, as the procedure is very cumbersome with banks requiring so many documents such as proof of residence and letters of employer which traders some of whom are tenants/lodgers ordinarily do not have. The players are also failing to access loans from banks since banks want a guarantor (with payslips) which automatically excludes self-employed traders, small-scale manufactures and service providers some of whom do not earn regular

monthly income. Most of the traders hardly keep any records in a format accepted by banks as proof on the capacity/potential and profitability of the business.

Many of the informal sector players who rely on self-financing from personal savings, close funding/working capital gaps by borrowing from expensive sources of money such as microfinance institutions and other informal sources that factor in higher risk premiums on the interest rate. Examples, include dealers of apples who get informal credit at Road Port bus station at costly terms payable on a daily basis. Some microfinance institutions have also realised the potential from informal sector players and lend amounts of between \$100 and \$500, which are repayable on a daily basis once the loan matures. Despite these unfavourable and costly terms, the players have been able to generally repay the loans, revealing that banks, which offer more favourable terms, could do better in getting more players to borrow. The only challenge is the lack of information about the operation of the players, which imbeds a lot of risk. The key issue therefore is to find means of enhancing transparency and collaboration between banks, the intermediaries (microfinance institutions/high net-worth individuals) and the players in the informal sector to establish the true and diverse potential of players in the informal sector.

4. Financing the informal sector in Zimbabwe

There are various factors militating against the growth of informal business operations in Zimbabwe, with access to finance being the largest obstacle to their success. According to LEDRIZ (2012), the financial system in Zimbabwe has been excluding people in the informal sector particularly those in rural areas. The banks avoided lending to the SMEs sector as they considered them risky as the majority of them do not have acceptable collateral security and a traceable banking history. The government has made attempts to cater for this sector through the support provided by the Ministry of Small and Medium Enterprises and institutions such as Small Enterprises Development Corporation (SEDCO).

Section 2G of the SMEs Act provides for the establishment of a Micro, Small to Medium Enterprises Fund which will be funded by government and other advances made to it in line with government borrowing. The fund is administered by the Small Enterprises Development Corporation (SEDCO), established in 1983 through section 3 of the SMEs Act. The presence of a statutory body to provide funding to SMEs highlights government commitments to ensuring that the informal sector is contributing to economic growth. Thus, all applications for funding are directed to SEDCO and for loans of \$500 and less (also known as microloans), SEDCO requires some movable property as collateral. The loans granted bear an interest rate of 15% per annum and has loan tenure of 4 months. For loans within the threshold of \$501- \$5 000, SEDCO requires collateral security as well as a comprehensive business plan or proposal.

As can be noted SEDCO's funding requirements already excludes most borrowers from the informal sector who may not have elaborate business plans and collateral security. Whilst the government have realized the importance of the informal sector and put in place measures to avail funds, many entrepreneurs in the informal sector have no access to financial services in the banking facilities. According to a 2009 report by the Parliamentary Portfolio Committee on Small and Medium Enterprise Cooperative Development, interest rates being charged by SEDCO on loans advanced to SMEs are considered too high beyond the reach of SMEs, whilst on the other hand SEDCO indicated that it has not been receiving budgetary allocation from the government leaving it with no funds to extend to SMEs.

Following the adoption of ESAP, the government established a social safety net, the Social Dimension Fund (SDF) to provide concessional loans to retrenches in both the public and private sector so as to alleviate the impact of poverty arising from job loss. The fund provided funding to high risk enterprises, the majority of whom did not have collateral security. According to a study by Moorsom et.al (1997) there were serious problems associated with the Social Dimensions Fund as a small proportion of the target population was reached due to the sheer numbers involved against the limited funds available in the SDF. The study noted that the sectoral distribution of SDF loans had a strong bias towards the service sectors with two-thirds of the distributed loans being allocated to the service sectors (services got 25%, retail 2%, transport 30%) with 17% in manufacturing and 13% in agriculture. The loan approval process was noted to be less satisfactory, as about 24% of loan applicants were informed of the success of their applications. The challenges in financing SMEs from the SDF Loan scheme were that it restricted the use of the loans to capital costs and did not cater for the borrower's working capital needs which were crucial at the initial stages of operation. Whilst having caps on the maximum loan size that one could borrow from the SDF, beneficiaries were discouraged from seeking alternative co-financing avenues, hence the entrepreneurs could not borrow elsewhere to cater for additional working capital needs (Moorson; 1997)

The decade long economic crisis (1997-2008) in the country meant that the majority of SMEs couldn't access affordable loans, high inflation rates meant high nominal lending rates, thus increasing the cost of borrowing beyond the reach of many SMEs. Thus, in 2006, the Reserve Bank of Zimbabwe established an SMEs Revolving fund and other interventions with a view of improving access to finance by SMEs and other small scale farmers. The funds were mainly focused on funding SMEs in primary production and value addition. However, only formally registered SMEs were eligible to access the loans. The loans had a maximum tenure of 12 months and 24 months for working capital and capital expenditure respectively. However, the majority of SMEs did not have collateral security to secure these loans whilst the majority of small scale farmers were not formally registered. For those SMEs that managed to receive the subsidised financial and non financial assistance from the central bank, some entrepreneurs diverted the resources to other non-business use, whilst some farmers abused the central bank agricultural facility by selling subsidised fuel and inputs on the black market for quick returns creating a reputation of high financial indiscipline among the informal businesses¹.

The Reserve Bank of Zimbabwe (2006), noted the challenges being faced by SMEs in Zimbabwe. These included the perceived high risk profile of SMEs and the history of not repaying loans due to an entitlement culture that emanated from receiving free funds from government. This has resulted in financial institutions charging higher interest rates on funds borrowed by SMEs compared to larger firms². On the other hand the majority of SMEs lack management skills in handling finances and other technical requirements hence they often submit substandard business proposals when seeking financial assistance from financial institutions. These proposals usually do not have sufficient/credible information to convince financial institutions to extend credit.

¹ RBZ Fiscal operations breed corruption, The Standard, 26 March 2009; <http://www.thestandard.co.zw>

² Culture of Entitlement Perilous, Financial Gazette, 20 June 2013, <http://www.financialgazette.co.zw/culture-of-entitlement-perilous/>

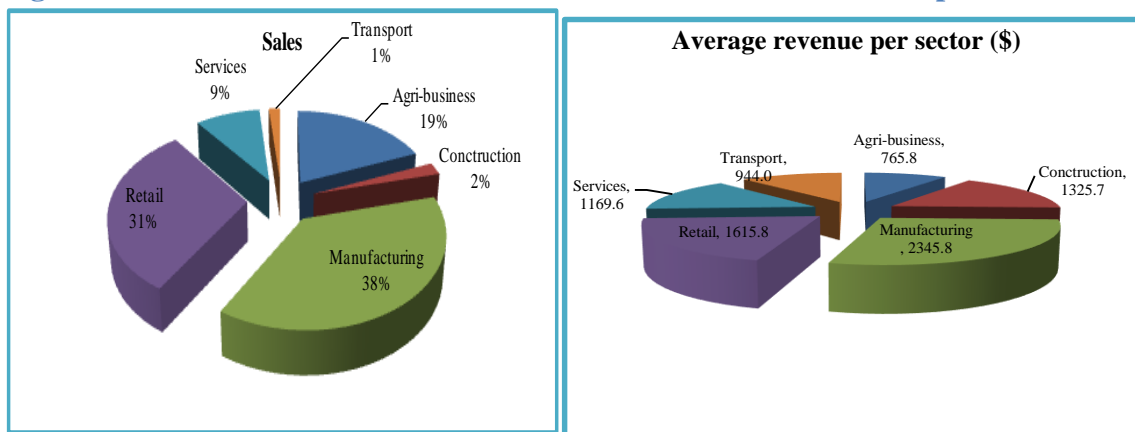
5. Findings from primary data collection

5.1 Availability of money in the informal sector

The availability of money in the informal sector can be assessed from three perspectives; the revenue (sales) that the players realise, the expenditure that is sunk into the business and the value of equipment that the players have invested into the business. This subsection discusses the first two while the latter would be discussed in section 5.6. The average revenue for all the players who were willing to disclose their earnings was about \$1,413.3 per month, ranging from a minimum of \$120 and a maximum of \$24,000 per month. The maximum value shows that there is indeed a significant amount of resources that are being generated in the informal sector. Out of this revenue, an average of about \$894.5 is used to purchase raw materials (for manufacturers) and materials for resale (for retailers), which implies that the average profit is about \$518.8 per month, with the maximum monthly profit being about \$21,000. However, taking into account the owners and workers' salaries and other overheads, the players generally break even, as on average they make a loss of about \$5, after spending an average of about \$1,418.3 as total expenditure. Since this includes their salaries, this generally implies that the profits are mostly taken wholly out of the business for investment into different aspects of livelihoods. The monthly average of \$1,418.3 total expenditure incurred by the informal sector players ranges from a minimum of \$200 to a maximum of \$20,000 per month.

A look at the sectoral breakdown of the revenue (Figure 3), reveals that revenue from the manufacturing sector constitute the bulk, constituting about 38% of the revenue, followed by the retail sector (31%) while the transport sector constituted about 1% of the revenues from the respondents. The average revenue per sector (Figure 3) also confirms the same trend where the manufacturing sector generally generates more resources (\$2,348 per player) through sales than the retail sector and other sectors.

Figure 3: Sectoral distribution of the total sales revenue from the respondents



The total expenditure trends (including both raw materials and salaries, electricity etc) also mirrors the revenue picture, with manufacturing and retail dominating while the transport sector is the least (Table 1). Thus, strategies to harness resources from the informal sector could initially target these two sectors, even though manufacturing has a fairly longer payback period.

Table 1: Sectoral distribution of total expenditure

	% of total expenditure	Averagetotal expenditure
Agri-business	18.2739	742.5
Construction	2.9766	1790
Manufacturing	35.9026	2248.958
Retail	31.3395	1653.158
Services	10.1605	1328.261
Transport	1.3470	810

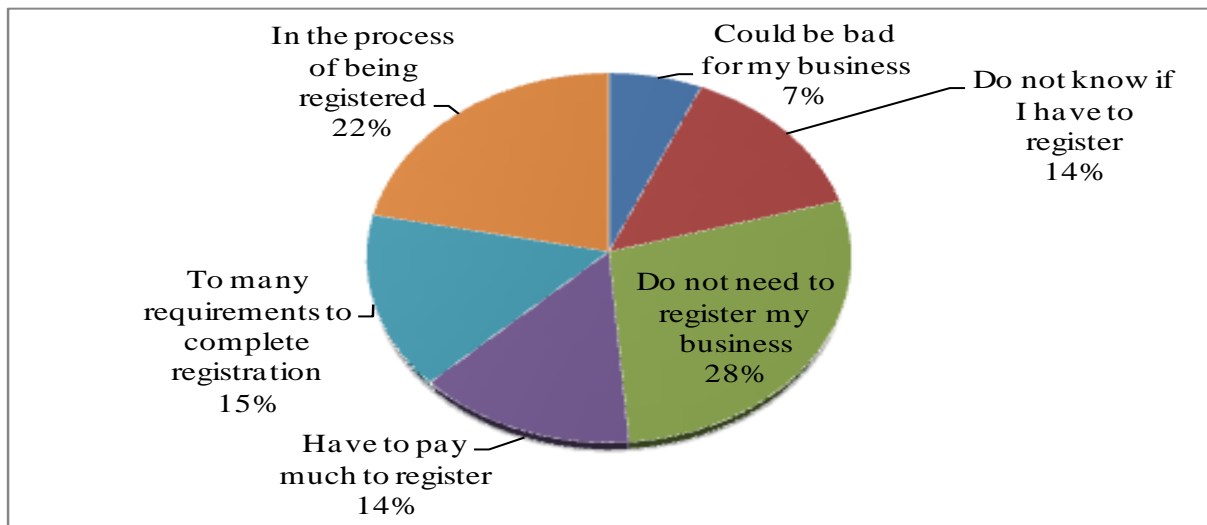
5.2 Traceability of the players

The extent to which the players can be traced is key to unlocking resources from financial institution, as this also plays a role in reducing the risk of default. Thus, it is important to understand whether the players' business has a fixed place or they are just mobile. Out of the total interviewees who responded on places of operation, about 73% indicated that they operated in designated places with professional premises whilst the remaining 27% indicated that they operated without professional premises. For those who indicated that they operated with professional premises, 72% operated in council designated places, whilst 23% operated in workshops, shop and restaurant. Only two indicated that they operated in farms with one operating in a plot whilst the remainder did not indicate the type of professional premises they were operating from.

For those without professional premises, 15% indicated that they operated at home without special installation whilst 8% indicated that they used an improvised post in a market. The majority of the respondents did not indicate how they conducted business without professional premises. It can be assumed that these people are more likely to be those who do not need a permanent post to conduct their day to day activities for example those involved in consultancy services and hawkers.

Of the total people who noted that they operated with professional premises, 50% indicated that they were registered with either the city council or company registry. The remaining half indicated that they were not even registered with 28% stating that they did not need to register their business (Figure 4). About 22% noted that they were in the process of being registered, with only 7% indicating that it could be bad for their businesses.

Figure 4: Reasons for not registering business for respondents who operated with professional premises



The remaining 75% of respondents who indicated that they operated without professional premises said they did not register their business with the majority stating that they did not need to register their businesses.

About 81% of the respondents indicated their places of operation. Of those who indicated their places of operation, 76% stated that they do rent, with long-term contracts with 17% respondents indicating that they own their places of operation, and 3% specifying that they do rent-free with permission. Of those who did not indicate their places of operation, it might be because some individuals move from one place to another, with no fixed place of operation especially in the case of consultancy services and also hawkers. The fact that some have their own places of operation could be leveraged upon to enhance their collateral capacity.

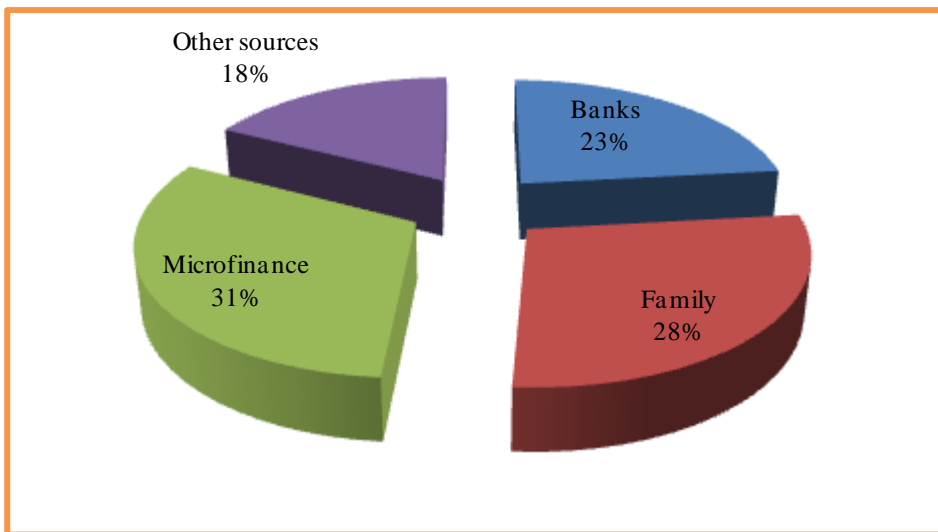
5.4 Availability of bank accounts

Only about 23.8% of the respondents had bank accounts, which generally reflects attitude and difficulties for opening bank accounts. The players pointed out the complicated procedures which take most of their time when trying to open bank accounts as well as the documentation required as proof of residence, which are difficult to get. Business bank accounts are also difficult to obtain for unregistered businesses. Although the majority of the respondents do not have business bank accounts, about 44.6% of the respondents have personal bank accounts. About 72.3% of those with personal bank accounts but without business bank accounts use them for business purposes. Thus, some who failed to open business bank accounts resorted to opening personal bank accounts for the same purpose, as personal bank accounts are easier to open compared to business bank accounts.

5.3 History of borrowing

About 35.5% of the respondents have borrowed from friends, relatives, banks and microfinance institutions within the past four years. The main source of borrowing was microfinance institution (31.4%) while those who borrowed from other sources (NGOs, Government, usurers, producer associations etc) constituted about 17.4% (Figure 5).

Figure 5: Sources of borrowing by informal sector players



The average amount borrowed by the players from all these various sources is about \$1,536 which was used mostly for raw materials by manufacturers and purchase of stock by retailers. The ability to borrow also appears to be related to the levels of income; even though borrowers constitute the minority at only 35.5% of the respondents, their revenue as a percentage of the total revenue for all the respondents is about 51.7%. This could reflect that those who borrowed were able to enhance their sales potential.

About 27.3% of the respondents have applied for bank loans over the course of their businesses' lifespan, while about the same number (27%) have also applied for loans from microfinance institutions. Out of these applications, the success rate was about 51.5% for banks and 70.5% for microfinance institutions. This therefore implies that chances are very high that informal sector businesses can get a loan from microfinance institutions, while the probability of success for bank loans is about half.

Although the players gave different reasons for failure to get loans, an assessment of some of the characteristics of those who succeeded might be useful to try and reveal their statuses. Among those who succeeded in getting bank loans, only 29.4% kept detailed records (simplified for tax purposes or detailed formal accounts) while about 14.7% kept no records at all. Thus, the ability to keep records does not appear to deter the informal sector from accessing bank loans. However, about 85.3% of those who were successful in bank loan application keep at least some form of records (including some informal records for personal use).

About 50% of the successful bank loan applications had their businesses registered with either the company registry or the town council in which they operate. Business registration thus does not influence possibilities of successful loan applications, given that the same proportion of successful applications were not registered. This is also evident from the fact that about 56% of those bank loan applications that were rejected had registered businesses. Registration status of the applicant does not appear to be a criterion which banks used in deciding among loan applicants.

The availability of a bank account does also not appear to have much effect on the likelihood of success in getting a bank loan. About 46.9% of the unsuccessful bank loan applicants had

bank accounts. Among those who indicated that they have managed to get bank loans some time before, only 47.1% have bank accounts at the moment. This could however imply that they have since closed the accounts after they have been able to get loans, as it does not appear likely that banks would give out loans to players who do not have bank accounts.

The businesses which have accessed bank loans over the course of their period in operation have an average revenue of about \$3,076 while those that had their applications rejected have an average revenue of about \$1,379. While this is not conclusive on its own, it generally shows that banks have dealt with applications with greater potential to generate revenue. This could also weakly imply that the bank loans have been used to help differentiate the businesses from those that failed.

5.5 Order financing possibilities

As already described in section 2, one possible strategy for banks to support the informal sector is through order financing. This works well for the manufacturing sector, especially when it comes to financing the purchase of raw materials by the financial institution while ring fencing sales which would be conducted through the bank. Informal sector manufacturers with secured orders, which the buyers can easily confirm, can have such confirmations used as collateral. Narrowing down the focus on the manufacturing sector, about 58.8% of the respondents have confirmed orders. However, only 16.7% of these orders are from other formal sector enterprises and public institutions, with the rest being orders from households and other SMEs. Given that order financing would require the transactions to be conducted through the financing bank, only orders with formal sector players would be possible. Thus, there is scope for order finance on a very small scale, as there are limited vertical integration opportunities between informal sector players and formal enterprises. However, the information also reflects that about 16.7% of the manufacturing informal sector players are possible candidates for order financing, which banks could try to leverage on.

5.6 Value of equipment used in the business

The average estimated value of capital by the informal sector businesses is about \$2,852, ranging from a minimum of \$100 to a maximum of about \$50,000. It is mostly manufacturing and transport sectors that have high value equipment (Table 2). In the agri-business sector the average value of equipment/assets used is about US\$951.30 and this exclude the value of land as the majority operated from communal lands which has no known value placed on it. On the low side are small scale farmers whose equipment encompasses farm implements like hoes and ploughs and some fresh produce retailers operating on local government owned markets with low capital requirements. However, the value of equipment used in the retail sector averaged US\$1485.71.

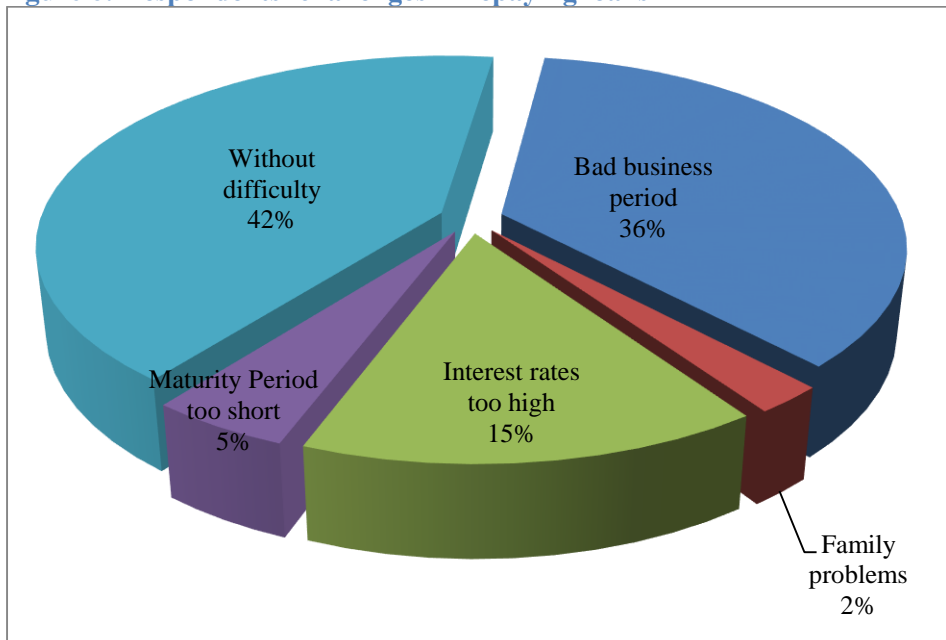
Table 2: Average value of Business Capital by Sector

Sector	Average Value of business capital
Agri-business	US\$ 951.30
Manufacturing	US\$ 6542.16
Retail	US\$ 1485.71
Services	US\$ 2939.66
Transport	US\$ 4750.00

5.7 Current attitudes towards banks

Like any other borrowers, entrepreneurs face a number of challenges when it comes to servicing their loans and these challenges emanate from different sources, some of which are foreign to the loan that has to do with the business operating environment, whilst others relate to the terms of the loan such as interest rates and maturity period. The study found that overall, about 42% of the respondents who borrowed money (from banks, microfinance institutions, NGOs, government, relatives, usurers etc) managed to pay back the loans without facing any difficulties, whilst the remaining highlighted that they faced different challenges in repaying their loans (Figure 6). About 36% the respondents indicated that bad business period affected their ability to repay the loan, 2% indicated that family problems affected their operations and consequently their ability to pay back. Loan terms were highlighted to have negatively affected the entrepreneurs' ability to pay back borrowed money by about 20% of the respondents, where 15% highlighted that the interest rates were too high and 5% indicated that the maturity period of the loan was too short.

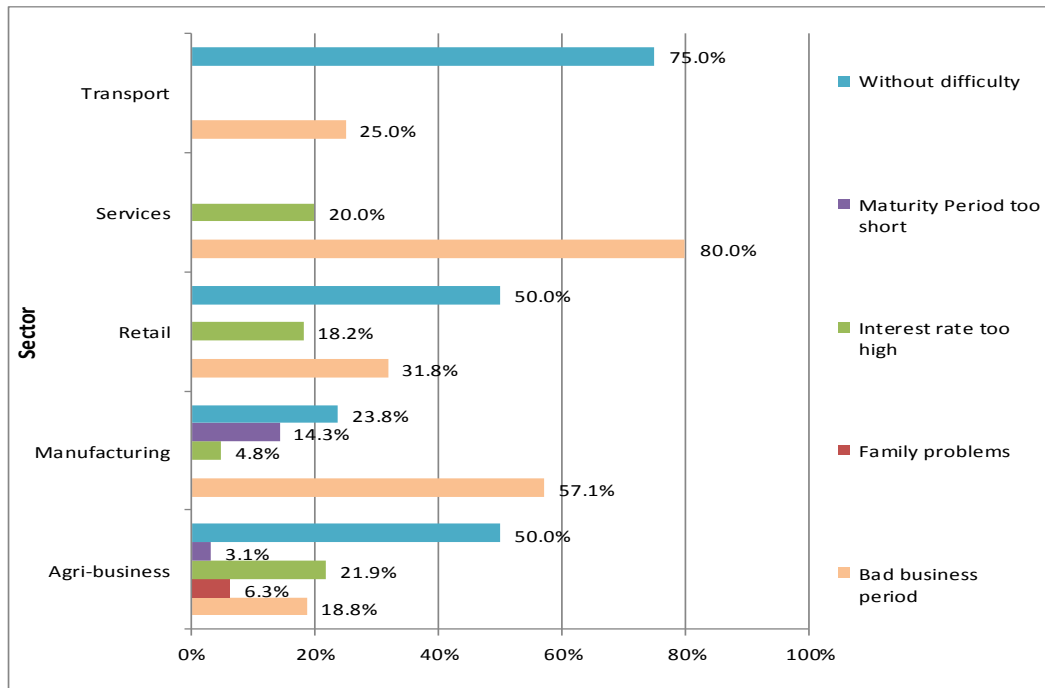
Figure 6: Respondents' challenges in repaying loans



A sectoral breakdown of the challenges faced in repaying loans (Figure 7) shows that 75% of respondents in the transport sector repaid their loan without any difficulties whilst the remaining 25% faced a bad business period which affected their ability to repay. In the services sector, all the respondents highlighted that they faced challenges in repaying their loans with 20% of the respondents attributing the difficulties to high interest rates whilst 80% of the respondents attributed them to bad business period/environment. Half of the respondents in the retail sector indicated that they did not face any challenge in repaying their loans, whilst the other half indicated that they faced challenges with high interest rates (18.18%) and experienced bad business period (31.82%). In the manufacturing sector, only 23.81% of respondents highlighted that they repaid their loans without any difficulties whilst the rest faced challenges emanating from bad business period (57.14%), short loan maturity period (14.29%) and high interest rates (4.76%). In the agribusiness sector, 50% highlighted that they did not face any difficulties in repaying the loans whilst the other half attributed

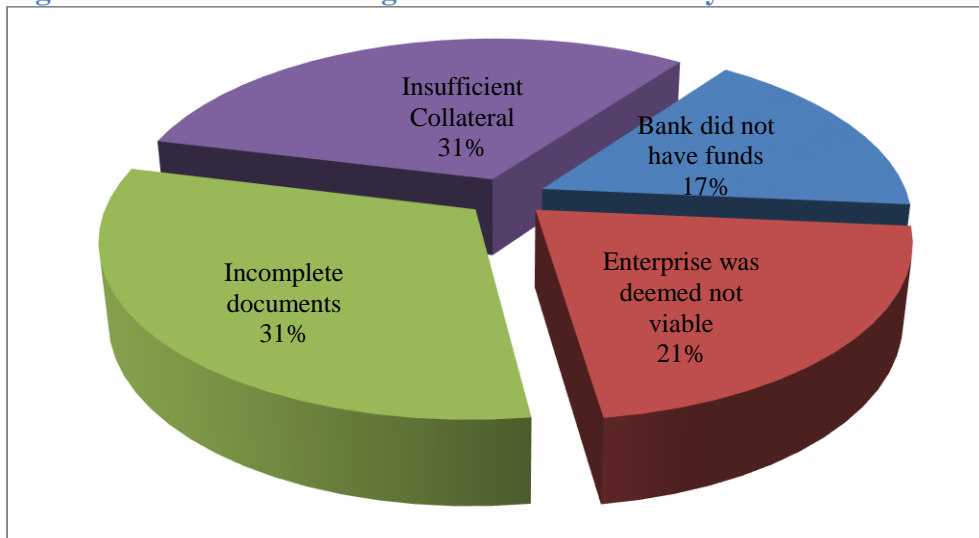
their difficulties to high interest rates (21.9%), bad business period (18.75%), family problems (6.26%) and short loan maturity period (3.13%).

Figure 7: Sectoral breakdown of challenges faced in repaying the loans



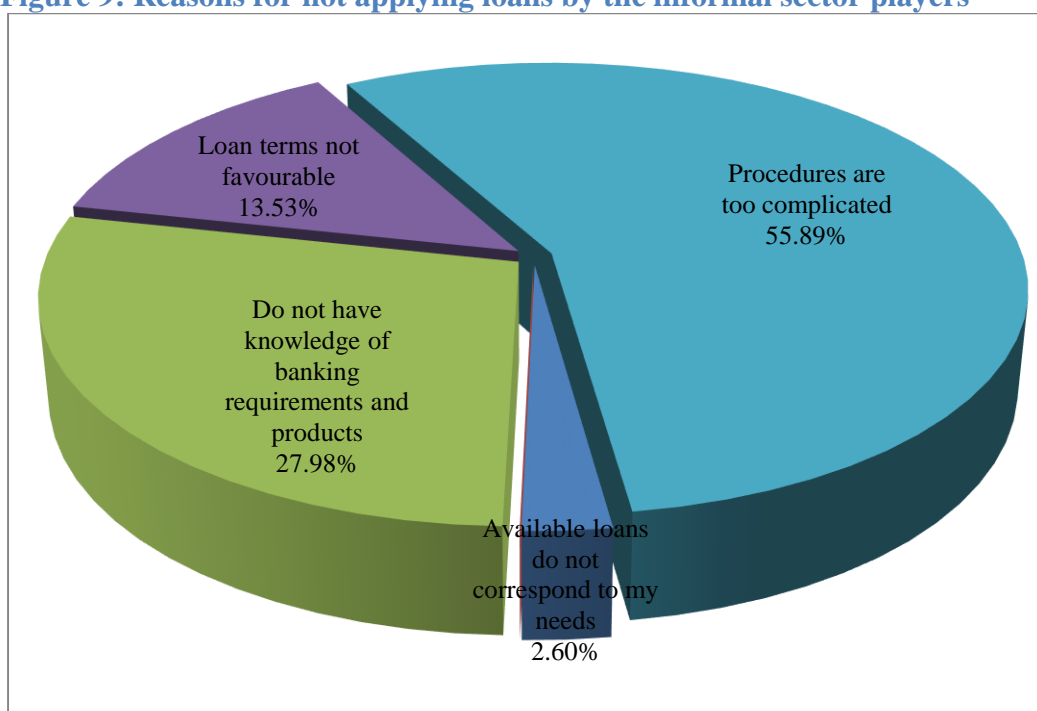
About 31% of the respondents whose loan application were rejected by banks highlighted that their applications was turn down due to incomplete documents, whilst 31% of rejected applications did not have sufficient collateral and 21% had enterprises that were deemed not viable. About 17% of the respondents highlighted that the banks indicated to them that they do not have sufficient funds to extend as loans (Figure 8). Thus, the key in unlocking funds to the informal sector would depend on their ability to get around the problems of collateral, proper documentation and viability of enterprises.

Figure 8: Reasons for failing to access bank loans by the informal sector



Many players in the informal sector have never attempted to get bank loans and a number of reasons were given for this (Figure 9). About 55.89% of the respondents who have never applied for a loan, highlighted that the procedures to apply for a loan are too complicated (the banks' due diligence process is considered too complicated, especially paper work), while about 27.98% highlighted that they do not have knowledge of loan application requirements and other bank products. Unfavourable loan terms were highlighted by 13.53% of the respondents as an obstacle in applying for loans as they fear losing their assets and risk being taken to court for failure to satisfy the terms and conditions of the loan. About 2.6% of the respondents have never attempted to apply for a loan because the available loans do not correspond to their needs. Thus, the players also have their own negative attitude towards banks and their probability of success, which need to be addressed through engagement processes for them to change.

Figure 9: Reasons for not applying loans by the informal sector players



5.8 Sources of capital

The estimated average value of capital (value of equipment and assets being used) for all the respondents is about \$2,852, which could also reflect the value of the amount that can be used as collateral. This capital was mainly sourced through personal savings by about 77.2% of the respondents, while 15.8% got the capital through support from friends and relatives and 6.9% got loans from banks and financial institutions. The average value of capital that was sourced through loans is about \$17,286, while capital sourced through friends and relatives is about \$1,513. On average, about \$1,832 was raised through personal savings. This generally reflects that businesses that have high value equipment generally needed to obtain loans from financial institutions. Thus, the majority of the businesses were established through personal savings mainly because they did not require much capital. There is still room for the financial institutions to target the players that are aiming to operate on a larger scale.

6. Conclusion: Possible strategies of harnessing resources from the informal sector

The study has generally established that although the informal sector players could have few resources in isolation, they could become a formidable source of resources when combined. Banks should thus engage the informal sector players and embrace the idea of fostering partnerships and clusters. Under this arrangement informal sector players, through the assistance of banks, pool their resources by bringing their capital and expertise together to make a meaningful investment. This also allows them to gain knowledge, further their skills through knowledge transfer from their partners than when operating as individuals. If the small traders come together to work as a group, they can register their associations to assist in easily identifying their location, assessing their challenges and also make banks aware of their existence.

Currently, informal sector traders are able to generate resources that surpass income of those in formal sector employment. The average revenue for the informal sector players is about \$1,413, with the maximum being about \$24,000 per month which is way ahead of the salaries for formal sector players who are getting bank loans. Since banks are more willing to take aboard as clients those in formal employment compared to those in the informal sector with more resources, banks could be depriving themselves potential sources of revenue if they properly manage the risks. It is important that the banks should review their current know-your-customer (KYC) information and simplify the information that is required for opening accounts so that it can attract some of the informal sector players into the banking fold. The success of electronic and mobile banking platforms (EcoCash, One wallet, TeleCash etc.) in attracting the resources from the same customers that are considered risky by banks also point to the need by banks to review the KYC requirements so that they can access the resources that are in the informal sector.

As revealed in section 2, one of the principles of the Grameen Bank is easy facilitation of the opening up of bank accounts by the informal sector players by locating closer to the informal sector businesses. Most informal sector traders in Zimbabwe indicated that banking services are not accessible to them. The majority of the traders have time constraints to go to the banking halls as their trade is too competitive and time sensitive. It is therefore important that the banks come closer to the players rather than the players looking for the banks. There is need for the banks to be innovative through establishing branches in proximity to the informal traders; introducing agent banking and leveraging on the cellphone capabilities to gather information on potential clients. The other advantage of establishing bank branches is that bank staff can become acquainted with the trades of the informal players hence processing applications for opening accounts and loans in situ becomes easier.

Currently the informal sector is characterized by savings and lending groups (SACCOs) both registered and unregistered. Banks can also target these groups and bring their resources into the banking fold. Banks can open accounts for the group which is easier to manage than for individuals. Creatively banks can start lending to members against the security of the resources they will have deposited as a group. In this case the bank is now acting as the agent of the group hence earning their interest from the loans and at the same time able to lend out excess resources from the group. Another trend that was experienced is that some bank clients are taking out loans from the banks and lending it out to the informal sectors traders at exorbitant rates (*chimbadzo*). Banks can destroy the system by being actively involved in

bridging the information gap and investing harvesting data on the characteristics and requirements of informal sector players as a way of reducing the perceived risks and the associate risk premiums.

Banks should also try to exploit the relationship between the formal sector and the informal sector. Given that one way or the other, the informal sector buys its raw materials from the formal sector or sells its finished wares to the formal sector, banks can use the linkages formed to get resources. For example, in well-established linkages banks are able to lend money to the formal sector establishment who then onward lend the resources to the counterpart informal sector player. The formal player, because of the well-established relationship with the informal sector, can easily collect the repayments. Alternatively the bank can finance raw materials purchase of the informal sector player and agree with the formal sector player to deduct the repayment once the informal sector player sells his ware to him. As revealed in section 5, about 16.7% of the manufacturing informal sector players have linkages with formal sector players, which is a good starting point.

One of the challenges that banks have realized is that there is lack of general information about the borrower and the predictability of the surrounding transactions. Because of the adverse selection and moral hazard challenges, there is unwillingness to deal with the informal sector. During the study it was established that informal sector players have their own way of relating and these usually involve committees (chairpersons, secretary and treasurer). These officials have in-depth knowledge of their members hence the banks could utilize these structures/officials to understand the informal sector players and can easily make decisions based on information provided. Most of these committees keep records and usually are involved in similar trade.

During the interviews it was also established that the internal organization of most banks is such that SMEs applying for loans deal with branch staff that have little say in the final decision, whereas major decisions are taken at the head office by officials who know very little about the enterprise on the ground. 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 projects are turned down because distant credit officers lack enough undocumented information to form an opinion on the projects and especially on entrepreneurs. It is therefore important that credit officers be acquainted with the dynamics and diversity informal sector players and their operational settings to understand in order for them to access the true potential the various projects requiring funding from their institutions.

Most SMEs are finding it difficult in maintaining a good cash flow position to meet their operational needs. In order to circumvent this challenge banks should establish factoring services. Factoring helps SMEs breathing space when it comes to the management of their accounts receivable. One advantage that will accrue to the bank is that factoring is the only source of business financing that grows with sales. As sales increase, more money becomes immediately available. Unlike the transitional bank financing, factoring has no maximum limit to restrict growth.

Banks can also consolidate on their previous relations with some of the players in the informal sector, as about 6.9% got loans from banks and financial institutions over the course of their business life. The average value of capital that was sourced through such loans is about \$17,286, demonstrating the extent to which the informal sector could be willing to

borrow. Thus, strategies that get around the lack of information on the players, which would help solve the issue of collateral, proper documentation and viability of enterprises could be beneficial to the banks.

As described in section 2, successfully mobilising savings from the informal sector can be useful in enhancing creditworthiness. Some informal sector players indicated that despite the service charges, they would still be willing to open bank accounts as it would enable them to plan ahead with their savings. Banks can thus develop products involving flexibility on bank accounts by informal sector players which can be used to guarantee loans. Lending would be financed to a large extent by savings, which could also include groups of the players to reduce risk. The group savings would only be accessible to the players after the loan is repaid in full. The relaxing of minimum requirements of opening bank accounts could include business information, such as statements given to traders by the city councils as proof of residence. The traders operate at designated places with addresses yet these are not considered as good enough by banks.

Banks can also leverage on data bases of institutions that have interacted more with informal sector players and develop win-win partnerships. For example, a bank that is interested in funding successful farmers in a particular farming areas can benefit from the knowledge accumulated by the extension officers; GMB records on the trend of maize delivery and agro-dealers. Similarly major wholesalers do capture information on traders purchasing goods for resale.

7. Areas for Further Research

This study was exploratory in nature, funds permitting the study needs to be extended by drilling down on key sub-sectors that have shown to have capacity to generate huge returns. They may also be scope to explore the concept of supporting value chains and the nature of structure and synergies that can be built between the formal and informal sector players participating in this value chain. For example, the timber and metal fabrication industry has both large players and small informal sector players. The question could be what structure can be put in place to nurture and develop vibrant value chains that benefit all players including informal sector players in the value chain while creating value for banks.

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