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Full Length Research Paper

An Evaluation of Financial Strategies Used by Companies in the Retail Sector During Recession Period (2000-2010).

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This paper analyses financial strategies for Zimbabwean companies in the retail sector industry in an economy characterized by recession from 2000 to 2010. The paper sought to meet the following objectives among others; to identify the various operating financial strategies available for companies operating in recession; assess the applicability of various short and medium term financial strategies for Zimbabwean companies and; provide a prescription to various stakeholders in the retail sector on evidence based operating financial strategies. Research findings showed that many companies ceased operations voluntarily and in most cases involuntarily. Others adopted a variety of financial strategies ranging from scaling down operations, streamlining business operations, being selective in service delivery to putting plants and machinery under care and maintenance. There was liquidity crunch in the market and as a result, companies failed to get funding; banks failed to attract meaningful deposits to provide companies with funding. Lack of operating finance was the chief cause why companies failed to reach pre-2000 operating levels. The study recommended companies to taking advantage of priority option in making payments as well as adopting a thorough recession management approach. Ignoring the impact of recession and its repercussions with the view that it would go away proved to exacerbate the problem.

Key Words. Recession Management, Capacity Utilization, Depression, Multi-Currency, Working Capital

Introduction

Long and short term finance is crucial for the normal functioning of any organization. Capital structure is the ratio of long term debt to total long term financing (long term debt plus equity) and is a strategic component of financial planning. Operating finance refers to short-term credit used for financing working capital needs of firms usually offered by but not always by banks (Bhole, 2004). Operating finance is needed by any business to cater for its short-term financial needs which range from the need to acquire raw materials, payment of utility bills, payment of wages and salaries as well as for marketing business products offered to the market among other uses. Operating finance is elusive under normal business conditions worse still under periods of recession. A recession is a recurring period of decline in total output, income and employment, usually lasting from 6 months to one year and marked by widespread contractions in many sectors in the economy (Samuelson and Nordhaus, 2005). This usually leads to financial malfunctioning, unemployment and economic depression. The Zimbabwean recession has been extraordinary as the country experienced a recession since the year 2000. The purpose of this paper is to analyse operating financial strategies for companies operating in recession using a sample of Zimbabwean companies drawn from the retail sector. The majority of Zimbabwean companies operated below capacity ranging from 0 to 50% during the period under review (CZI-KMFS Survey, 2008). Firms were facing a number of challenges including insufficient electricity regardless of the huge generating capacity in the country. Energy (electrical) is strategic as it affects all other sectors of the economy but its generation capacity was greatly affected by availability of operating finance. The research sought to evaluate operating financial

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strategies for Zimbabwean companies under recessionary conditions.

Research Questions

The paper sought to provide answers to the following questions:

What operational financial strategies are available for Zimbabwean companies operating under recession?

How has recession affected operating capacity of companies?

How are firms responding to operating finance shortages?

Literature Review

Many countries have experienced serious macro-economic instabilities in recent years. These instabilities included among other things; hyper-inflation, high levels of unemployment, unstable exchange rates as well as shortages of basic commodities. According to Eiterman *et al* (2004), Equador after suffering a severe banking crisis and high levels of inflation adopted the US dollar as its official currency in January 2000. As a result of this, the country became the largest adopter of the US dollar and this brought sanity to its economy and companies concerned. Zimbabwe has been suffering from macro-economic instabilities since the year 2000. In February 2009, the country adopted a multi-currency system as a way of trying to avert macro-economic instabilities. This involved adoption of a number of currencies as official modes of exchange in place of the eroded Zimbabwean dollar. Several benefits were expected to accrue from using hard currencies and these can be summarized as follows; combating of inflation, integration and stability of the financial system as well as reduced transaction costs. Multi-currency system was also expected to lead to foreign currency denominated savings which would then promote the viability of the financial sector. Zimbabwe is a bank based economy hence the great need of the viability of this sector. Savings are important as they can be availed for company utilization if they are efficiently mobilized.

Working Capital Management

Working capital is crucial as it helps a business to gain vitality and life strength, (Chowhury and Amin, 2007). Working capital management involves choosing the most effective choice of working capital sources and the determination of the appropriate levels of the current assets and their use. At present, rising cost and scarce funds make the importance of working capital needs special. Modern theories on working capital reveal that the profitability of business depends on the manner in which working capital is managed. Kamath *et al* (1995) revealed that almost all large firms invest surplus cash in money market instruments. Popular investment options according to Kamath *et al* (1995) were found to be commercial papers, certificates of deposits, repurchases agreements, treasury securities and bankers` acceptances. Rappaport *et al* (1984) indicated that a number of firms keep a stock of short-term investments for pre-cautionary reasons. Stretching of payables beyond the due date was also considered a source of finance. The amount of discount along with the delay period from the discount date to the due date determines the cost of skipping as a source of finance (Hill *et al*, 1983).

Financial Planning and Performance

Comprehensive financial planning is required to monitor financial capability over time (Gapenski, 1999) in order to profitably operate the organization. Organizations that do not generate a return on assets in excess of their cost of capital are however in danger of financial failure (Kim and Park, 1985). Capital intensity is inversely related to financial performance (Mahler, 1990). Organizations in early stages of development require a greater capital before becoming established and less once they become a mature entity (Modigliani and Miller, 1958). The strategic use of capital structure in overall business strategy is important in particular since the allocation strategy is driven from the strategic plan (Collins, 1990) and debtors of tax exempt organizations remain concerned with firm’s ability to operate as business while implementing their charitable missions. Cost of financing has implications on asset use because optimal capital structure minimizes cost of financing asset (Stowe *et al*, 1980). Rising capital cost and scarce funds place a greater importance on working capital needs. Kamath *et al* (1985) revealed that almost all large firms invest surplus cash in money market. The purpose of this study was to assess whether these sources were available to Zimbabwean firms and evaluated the extent that they reduced the liquidity crunch that engulfed the country during the period under study. Financing decisions are also affected by taxes and contracting costs according to Ferrogher (1986). Rapid organization growth is suggestive of debt financing (Beaver and Ross, 1999) and can create financial troubles for organizations that do not actively attempt to control growth.

Cash Management and Financing

Corporate finance theory assumes perfect information, no taxes, and no risk of bankruptcy (Mahler, 1990) however, information is not perfect, there are taxes and bankruptcy is possible. Tax exempt organisations have different access to owner equity primarily since they are organised for charitable purposes (Shah and Slemrod, 1991). Therefore tax-exempt organisations cannot provide an individual investor a return and as such, they approach capital markets differently than other organisations (Musgrave and Musgrave, 1989). Financing decisions are effected by taxes and contracting costs (Hartman, 1984). The same study reported that earnings are frequently used to support growth of assets, through increased debt at certain times. The study found that organisations tend to use earnings to support asset growth and debt for other uses. Some organisations studied had a preference for the use of internally generated fund (cash savings, operating profits), short and long term debt and equity. Rapid organisation growth is suggestive of debt financing (Horch and Popiel, 1989) and can create financial troubles for organisations that do not actively attempt to control growth.

Fund Raising as a Source of Finance

Increased fund raising can increase an organisation's growth rate (Horch and Popiel, 1989), though donations are often the last source of financing. The reason behind this, lie on the fact that, the firm would have accessed funds cheaply. The source of financing is an important point for decision-making (Ike, 1984). Many managers have target financial measures and most espouse the traditional perspective that generally no relationship exists between a need for funds and the source of funds (Roe, 1990)

Methodology

Descriptive survey design was used to come up with eleven companies drawn from the retail sector. The retail sector was considered as it was viewed to have a great impact on the economy. Two of the companies constituting the sample were in the financial sector. Data was collected using documentary review, questionnaires and interviews. Information and data gathering was done through conducting field research within the retail sector. To increase reliability of the study, a pre-test of the questionnaire was done to check on the ability of the questionnaire to gather the required information. Also a standardized interview guide was sent to interviewees in advance to help them follow easily during the interview session. The researcher used simple random sampling to select companies for the study form the sector as alluded earlier on.

Results

The researcher sought to find the utilization of the following financing options; accruals, trade credit, working capital advances, public deposits, inter-corporate deposits, short-term deposits, rights debentures for working capital, commercial paper, debt factoring as well as any other form of financing Zimbabwean firms could utilise. The most popular source of operating finance was short-term loan as eight out of the eleven respondents indicated having used it. This was followed by accruals with six companies. Trade credit was also moderately used as four of the eleven sampled companies indicated having used it. There were however some forms of credit which were not popular namely; public deposits, right debentures, commercial papers and debt factoring. Five companies indicated that they were willing to utilize more days if offered by suppliers. All the sampled companies indicated the need for Reserve Bank of Zimbabwe (RBZ) or the government to intervene to lower interest rates. The central bank had ceased to operate the lender of last resort when the country adopted the multi-currency system in February 2009. Banks were paying meager interests on deposits as low as 2% per annum whilst at the same time charging very high bank charges as high as 30% per annum for borrowed funds and a result, both depositors and borrowers were left worse off.

Views on Effective Operating Financial Strategies

The respondents indicated a number of factors which could be pursued to enable the available financial strategies to operate effectively. Eight companies revealed the need for suppliers to offer more days on their payment periods. As seven firms indicated the necessity for a reduction of the cost of capital as the companies were finding the rates which prevailed prohibitive. Ten out of the eleven companies highlighted the presence of a liquidity crunch which prevailed when the economy adopted the multi-currency system. The need for the companies to negotiate friendly terms with the providers of finance was a view supported by six companies. Two firms indicated that they did not use the common financial options like the lines of credit offered in banks or the use of commercial paper. These companies cited scarcity of the lines of credit as the chief reason why they did not utilize the facilities. One company indicated fear of the possibility of failing to service the loan as the reason why it could not even think of sourcing the lines of credit. It is a common phenomenon to find companies being forced into forced liquidation as a result of failing to meet creditors` obligations. Two large and established firms utilized most of the financial options as compared to their smaller counterparts. Nine companies revealed the need to review interest rates to lower levels to enable the companies afford and utilize them. The overall strategy pursued by the sampled companies is more or less of a combination of two or more strategies as evidenced by Figure 1 below.

With regards to the other forms of sourcing finance, two companies reflected borrowing from mother companies or sister companies as an option at their disposal which they utilised. One company sourced low interest bearing loans from some Non Governmental Organizations

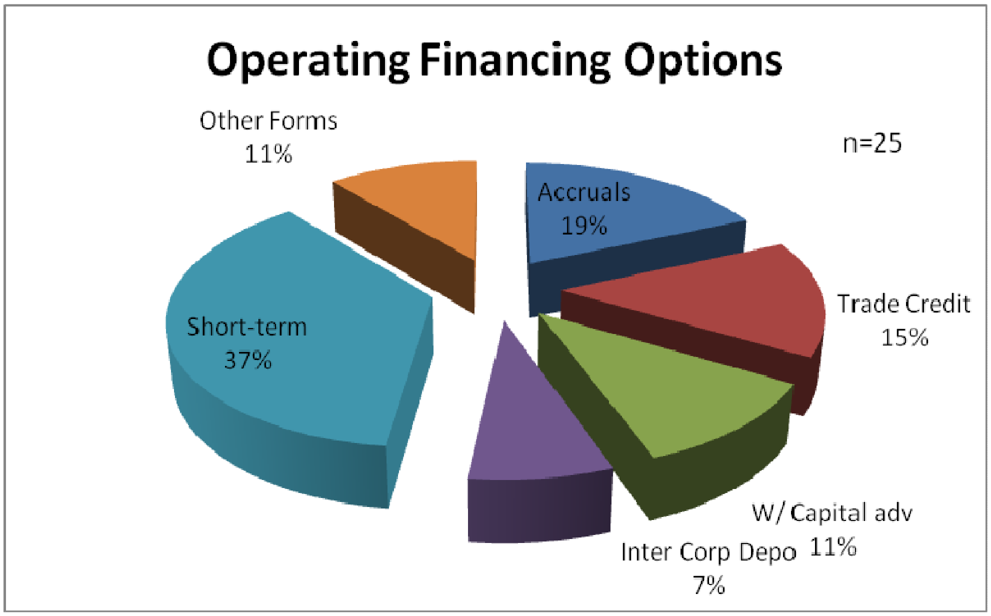

Figure 1. Operating Financing Options

**N.B The total number of respondents is more than eleven companies all of the companies used more than one financial strategy.*

(NGOs). NGOs are tax exempt organizations hence can afford to lend at low interest rates as compared to financial institutions. All the sampled companies highlighted how their activities contributed to the growth of Zimbabwe's Growth Domestic Product (GDP). All the sampled companies revealed that they were negatively affected by the recession which affected the Zimbabwean economy since the year 2000.

Capacity Utilisation

In as far as operating capacities were concerned, all companies were operating below capacity though at varying levels. This can be depicted clearly by the table below;

One company was operating at zero capacity. The company indicated that it had placed its assets under care and maintenance to preserve the integrity of its assets. Another company operated within the zero to 10% capacity utilization level cited lack of operating finance as the reason why it could not operate beyond that range. In the range 10% to 20% capacity range was also one company. Most of the companies operated within the range 20% to 40% and these were five in total. Three companies operated within the 40% to 60% range. There was no company which operated beyond the 60% capacity utilization level. There was one common feature highlighted by the companies concerning their operating levels. All the companies indicated their desire to increase their operating capacities.

Measures Taken to Cope with Recession

All companies revealed that they took various measures to respond to the recession as follows;
One company operating at zero capacity highlighted that it had put its operation under care and maintenance to cut cost and preserve the integrity of the company's assets. The company ceased operations at the height of economic downturn in the beginning of 2009. The company demonstrated its desire to increase its operating capacity by seeking finance from various sources.

All the companies had put forward measures to cut expenses in order to curb negative effects of the macro-economic environment. Operating expenses other than labour were drastically reduced. Cutting down on labour was taken with caution as it was viewed to have social implications.

Seven companies said that they had scaled down operations. This also largely explains the operating levels alluded earlier on.

Two firms which provided an after service to their customers revealed that they were being selective in their service delivery to survive the adverse macro-economic environment.

All the companies had previously restructured one way or another in order to limit the negative impact of the harsh operating environment.

Companies revealed a number of factors to make available financial strategies more effective. Eight companies indicated the need for more days to be

Table 1. Capacity Utilisation

Operating Level	No. of Firms	%
0.00%	1	9.1
0.00% > 10%	1	9.1
10% > 20%	1	9.1
20% > 40%	5	45.5
40% > 60%	3	27.3
> 60%	0	0
Total	11	100

offered by suppliers to enable the debtors time to pay the credits. Seven companies (64%) indicated that the cost of borrowing was prohibitive hence were with the view that the costs should be reduced. The study revealed that the liquidity crunch that was prevailing required the concerted effort of the RBZ and the private sector to lessen the negative impact of the crisis. There was also need to negotiate friendly terms with suppliers of finance and these were sentiments from six companies.

Impact of The stock Exchange

Two listed companies which were part of the sample indicated that the stock exchange is necessary for economic development. This concurred with the findings of the study which viewed the stock exchanges a necessary avenue to market the companies' images. This image is believed to go a long way in helping the listed company raise short and long term finance easily. The companies revealed that financial stability was enhanced due to their listing on the Zimbabwe stock Exchange (ZSE). All the eleven companies sampled responded to operating financial shortages. Their strategies to lessen the negative effects of the financial crisis differed. Six companies revealed that they were making priority on payment of creditors, utility bills and other expenses. Creation of investor partnerships was another option considered by four companies. All companies indicated that they streamlined their operations to reduce the negative effects of financial shortages.

Discussion

The findings revealed that working capital is crucial for business survival. Lack of it can cause collapse of a firm. According to (Fry, 1978), the problem of working capital has been recognized as noticeable in many companies. Companies use several strategies to overcome the problem of working capital shortages. The study showed that short-term loans, accruals, trade credit, working capital advance, intercorporate deposits were chief forms of operating financial strategies being utilized by Zimbabwean companies. This concurs with the discoveries of Kamath *et al* (1985) who asserts that the most popular investments were; commercial papers, certificate of deposits, repurchases agreements, treasury securities and bankers acceptances. Almost all large firms invest surplus cash in money market instruments (Kamath *et al,* 1985). Large and well established firms in Zimbabwe have indicated having used commercial papers and public deposits however. These forms of financing in addition to rights debentures for working capital as well as factoring were not popular especially with small firms. The point to note is that Zimbabwe was in recession under the period under study and this fact account for the better part why some otherwise common financing options not used.

A commercial paper as a debt instrument is issued by a corporation and is not tied to any specific collateral but is secured only by the general earning power of the issuing corporation (Inanga, 1990). The findings showed that all companies were not operating at or near full capacity. Research findings show that not any single firm operated beyond 60% capacity utilization. This then goes to mean that borrowing using earning power as the yardstick became difficult. This is however easy in normal economies.

Stretching Accounts Payable

Trade credit is an important form of finance as evidenced by the four companies which advocated for its use. Hill *et al* (1983) revealed that the vast majority of firms generally take discount over stretching accounts payable. The use of trade credit is not as popular in Zimbabwe due to lack of suppliers of such facility. The companies which advocated for the use stressed the need for more days to be offered by the suppliers. Stretching of accounts payables beyond the due date considered three important factors namely; the effects on relationships with suppliers, value of using the funds and the impact on the firm`s credit rating (Hill *et al,* 1983). The surveyed firms revealed the importance of relationships when they stressed the need to negotiate more friendly terms with the providers of such facilities.

Smaller firms used fewer sources as compared to their larger counterparts. This was attributed to their smaller names. This concurs with the findings of (Leite and Makonnen, 1986) who highlighted that small firms have fewer available sources of funds, a higher cost of capital and an increased transaction costs. There is a positive relationship between sources of sources of finance and the size of the firm. Findings demonstrated the important relationship between small firms financing and operating difficulties, financial distress and bankruptcy. Firms are failing to maximize return to shareholders due to lack of debt financing. Debt financing enhances shareholders due to the benefits derived from tax exemptions. Surveyed firms revealed their desire to take credit provided it was offered and was on favourable terms. Under perfect market conditions, the firm`s optimal capital structure put into perspective equilibrium risk and return to the extent that capital cost are kept minimum. (Stowe *et al,* 1980) in the study of large corporations discovered a direct relationship between the two sides of a financial position of a firm.

Conclusion

The study sought to; seek operational strategies for companies in Zimbabwean recessionary environment, evaluate how the recession affected operating financial strategies for companies as well as highlight how companies had responded to operating finance strategies. With regard to the first aim, there were several techniques which companies used to source finance chief among them being short-term loans from financial institutions. Other options used were; accruals, trade credit, working capital advance, inter-corporate deposits as well as sourcing from mother and sister companies. Rights debentures for working capital, commercial papers were not popular ways of raising finance in the period under review. All companies were negatively affected by the recession. This was evidenced by the firms` operating below full capacity levels. Surveyed firms highlighted that funds were scarce in the market. Companies' responses to operating financial shortages varied. Some companies borrowed from mother and sister companies. Others sought low interest loans from Non Governmental Organisations (NGOs and the government. One company put its operations under care and maintenance to preserve the integrity of the company`s assets. Other measures taken under the period under review included; scaling down operations, being selective in service delivery as well as restructuring operations. In short several strategies were taken to lessen the impact of recession on the operations of the firm and what became clear was that, operating in recession was really challenging. A thorough recession management approach was to be adopted as the recession stayed for longer than normal period.

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