The impact of hyperinflation on Small to Medium Enterprises in Harare, Zimbabwe. The case of the formal and informal market at Avondale Shopping Centre.

BY

TAWANDA MAKUSHA

Submitted in partial fulfilment of the requirements for the degree of Masters of Development Studies, Faculty of Humanities, Development and Social Sciences, University of KwaZulu-Natal
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Declaration of Originality

This dissertation represents original work by the author and has not been submitted in any other form to another university. Where use has been made of the work of others it has been duly acknowledged and referenced in the text.

The research for this dissertation was performed in the School of Development Studies at the University of KwaZulu-Natal, Durban. Research was undertaken under the supervision of Professor Vishnu Padayachee during the period from February 2007 to November 2007.

The financial assistance of The Ford Foundation is hereby acknowledged. Opinions expressed and conclusions arrived at are those of the author and should not necessarily to be attributed to the Ford Foundation and the University of KwaZulu Natal.

Signed,

TAWANDA MAKUSHA	DATE

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Abstract

The pattern of a classical hyperinflation is an acute acceleration of inflation to levels above 1000% generally associated with printing money to finance large fiscal deficits due to wars, revolutions, and the end of empires or the establishment of new states (Coorey et al, 2007: 3). After World War I, a handful of European economies succumbed to hyperinflation. Austria, Germany, Hungary, Poland, and Russia all racked up enormous price increases, with Germany recording an astronomical 3.25 million percent in a single month in 1923 (Reinhart and Savastano, 2003: 1). Since the 1950s, hyperinflation has been confined to the developing world and the transition economies. Zimbabwe currently has the highest rate of inflation in the world with an annual rate of 7982.1% in September 2007 (RBZ Website, 1/11/07). This paper examines the impact of hyperinflation on Small to Medium Enterprises (SMEs) in Harare, Zimbabwe with aims of revealing how SMEs were affected by hyperinflation and other factors linked to the phenomenon.

Acronyms and Abbreviations

AIDS	Acquired Immune Deficiency Syndrome
CIA	Central Intelligence Agency
CZI	Confederation of Zimbabwe Industries
DRC	Democratic Republic of Congo
ESAP	Economic Structural Adjustment Programmes
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
HIV	Human Immunodeficiency Virus
IDI	In depth interviews
IMF	International Monetary Fund
MPR	Monetary Policy Review
SAP	Structural Adjustment Programmes
SME	Small to Medium Enterprises
RBZ	Reserve Bank of Zimbabwe
UDI	Unilateral Declaration of Independence
USA	United States of America
USAID	United States Agency for International Development
ZANU-PF	Zimbabwe African National Union-Patriotic Front
ZCTU	Zimbabwe Congress of Trade Unions

Table of Contents

Declaration..........ii

Acknowledgements..........iii

Abstract..........iv

Acronyms and abbreviations..........v

Tables and Figures..........viii

Chapter 1: Introduction..........1

1.2: Summary of findings..........4

1.3: Organization of dissertation..........5

Chapter 2: Literature review..........6

2.1: Definitions of hyperinflation..........6

2.2: Hyperinflation in other countries..........6

2.3: Hyperinflation's impact on SMEs in Zimbabwe: A review of the literature..10

2.4: Theoretical framework..........14

Chapter 3: Methodology..........17

3.1: Introduction..........17

3.2: Methodology and justification..........18

3.3: Ethical considerations..........20

3.4: Data analysis..........20

3.5: Significance of study..........21

3.6: Limitations of study..........21

Chapter 4: Background to the Zimbabwean crisis..........23

4.1: Introduction..........23

4.2: Zimbabwe from 1980-1990 (Period of socialism)..........23

4.3: Zimbabwe's economic policy from 1990-2000..........25

4.4: The period after 2000..........29

Chapter 5: Research findings..........34

5.1: Introduction..........34

5.2: Impact of hyperinflation on SMEs before price controls..........34

5.2.1: SMEs' views on the impact of hyperinflation in Zimbabwe..........34

5.2.2: Adjusting prices....38

5.2.3: Adjusting wages....41

5.3: Implementation of price controls and their impact on SMEs in Zimbabwe...44

5.3.1: SMEs' definitions and understanding of price controls....44

5.4: The impact of fuel shortages on businesses in Zimbabwe....57

5.5: Impact of electricity power cuts on SMEs in Zimbabwe....59

5.6: Reliance on the banking system in the country....61

Chapter 6: Summary of findings, recommendations and conclusion....63

6.1: Summary of findings....63

6.2: Recommendations....64

6.3: Conclusions....67

References....71

APPENDIX 1: List of interviewees....76

APPENDIX 2: Questionnaire:....77

APPENDIX 3: Interview guidelines....79

Tables and Figures

Table 1: Inflation rates 2000-2007……………………………...………………………2

Figure 1: Inflation rate from December 2000 to September 2007………………………....3

Figure 2: Map of Zimbabwe……………………………………………...………...16

Figure 3: Zimbabwe-GDP in Billions of dollars……...………………...………………...31

Chapter 1

1.1. Introduction

Zimbabwe became independent in April 1980 after the Lancaster House agreement with Britain brought an end to fifteen years of Unilaterally Declared Independence (UDI) by the former white-minority Government of Southern Rhodesia. Independent Zimbabwe inherited an economy that was more industrialized than most in Africa, with a diversified productive base, well-developed infrastructure, and a relatively sophisticated financial sector. Zimbabwe witnessed relative economic growth during its first five years of independence. However from 1985 to date the country witnessed many economic crises due to a variety of social, economic and political policies implemented by the government.

Since the late 1990s Zimbabwe has been grappling with the resolution of fiscal problems; the inequities in land distribution, poverty, and unemployment; population pressures; and unfavourable rainfall patterns. It also faces a growing HIV and AIDS epidemic, exacerbated by increasing poverty and reduced access to basic social services following the introduction of Structural Adjustment Programmes (SAPS) in the early 1990s (Basset, 1997). The implementation of Economic Structural Adjustment Programmes (ESAP) in the country led to the closure of some business sectors while others were down sized. Economic deterioration has coincided and been worsened by the uncertainties surrounding the land reform program and, consequently, decreased agricultural production and tourism revenues. It has also been argued that the intervention of Zimbabwe in the civil war in the Democratic Republic of Congo in 1998 aggravated the economic crisis in the country after ESAP had already taken a heavy toll on the economy (Moore, 2003). This action by the government led to high government expenditure on the military at the expense of social development.

The twenty-first century to date has witnessed a hyperinflationary environment in Zimbabwe. It is argued that this situation has adversely and seriously affected both the formal and informal sectors. Hyperinflation in the country led to sharp increases in prices of basic commodities not only for the consumers but also for the business people. This

hyperinflationary environment led the government to control prices of all commodities to June 18, 2007 levels (*The Herald*, 2007: 1). These price controls led to panic purchasing of basic commodities, property and clothes leaving the shelves of almost all the stores virtually empty. It is therefore important and useful to find out how business of all kinds have been and are coping with the hyperinflationary environment before and after the June 2007 price controls.

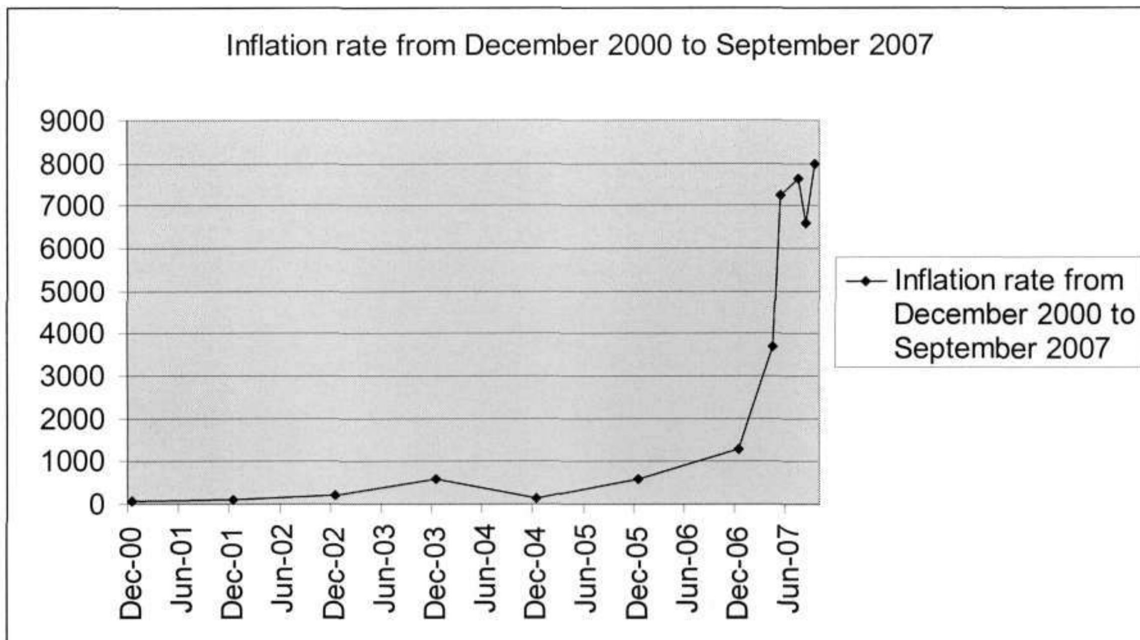
A fiscal deficit has led to sharp growth of money supply, fueling inflation. While year-on-year inflation declined from its peak of 623% in January 2004 to 130% at the end of 2004 it should be noted that it picked up sharply in mid-2005 (Munoz, 2006:3). According to the latest statistics, year-on-year inflation reached 914% in March 2006, 3713, 9% per cent in April 2007, 7251% in May 2007, 7634.8% in July 2007, 6592.8% in August 2007 and 7982.1% in September 2007 (Muleya, 2007: 1, RBZ website, 01/11/07). A recent International Monetary Fund (IMF) forecast stated that annual inflation could reach 100,000% by the end of 2007, compared with the central bank's latest declining figure of 6592.8% in August 2007 (Hawkins, 2007:4). The Consumer Council of Zimbabwe put the current year-on-year inflation at 18,000% (Hawkins, 2007:4). On the other hand, Zimbabwe's Central Statistical Office stated that it could no longer calculate the rate of inflation because there were not enough goods left in the shops to allow price comparisons (*Business Times*, 2007: 28).

Table 1

Central Bank Inflation rate figures from 2000-2007.

Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004	Dec 2005	Dec 2006	Apr 2007	May 2007	Jul 2007	Aug 2007	Sep 2007
55.22	112.1	198.93	598.75	132.75	585.84	1281.11	3713.9	7251	7634.8	6592.8	7982.1

Figure 1: Inflation rate from December 2000 to September 2007



Source: Reserve Bank of Zimbabwe website (www.rbz.co.zw accessed 26 November 2007)

Hyperinflation in Zimbabwe is therefore a fairly recent phenomenon and there has been insufficient research on its impact on the economy. It is against this background that this research was conducted on the impact of hyperinflation on Small to Medium Enterprises (SMEs) in Harare, Zimbabwe focusing on both the formal and informal businesses. Since there is no standard definition of Small to Medium Enterprises, for the purpose of this research SME will refer to businesses comprising between one employee and a hundred employees.

This study was conducted at Avondale Shopping Centre, a middle class market place, which is about two kilometres out of the Harare city centre. The centre accommodates both formal and informal traders who fall in the category of being SMEs. The study was conducted to:

- Elucidate changes in economic activities such as diversification and discontinuity and reasons for the observed changes where and when they occur in the formal and informal business sectors due to hyperinflation in the country.

- Find out how hyperinflation affected SMEs' profit and turnovers and their income and expenditure, which include such expenses as wages and transport allowances for their employees.
- Find out how SMEs were pricing their commodities in the hyperinflationary context and the impact of the July 2007 government implemented price controls on the SMEs.
- Find out the various effects of hyperinflation on the reliance of the SMEs on the banking systems.
- Find out how the various businesses have been affected by fuel shortages in the country due to hyperinflation and high foreign currency exchange rates on the parallel market due to lack of foreign currency in registered banks.
- Investigate the impact of electricity power cuts was also taken into consideration while conducting the research to find out if these power cuts had any impact on the profits and losses of SMEs at Avondale shopping centre.
- Investigate the adjustment and coping mechanisms and the circumstances under which these occur and to understand if either formal or the informal traders have been profiteering from the hyperinflationary environment and in what ways.

1.2. Summary of findings

While it would appear that hyperinflations in Argentina (1943-1955) and Germany in 1924 offered businesses opportunities for unfair profiteering, this research has generally found that Small to Medium Enterprises (SMEs) have, in the main, been affected negatively by hyperinflation both before and after the imposition of a 50% price control on June 26, 2007 by the government.[1] In Argentina, radical politicians complained that high prices threatened the pueblo and the Socialists offered forceful critiques of merchant profiteering (Eduardo, 2007). In Germany, there were violent attacks against allegedly profiteering Jews, Poles and assorted foreign merchants in cities across the country during 1923 (Feldman, 1993: 690).

[1] There might have been some SMEs that were profiteering unfairly due to hyperinflation but this research did not expose this. SMEs were unlikely to reveal their illegal profiteering to someone they do not know.

Contrary to the hypothesis that SMEs in Zimbabwe were adequately coping in the current hyperinflationary environment, there was a general consensus among businesses, which took part in the research, that hyperinflation led to more losses than to increased profits. Hyperinflation led to increases in prices of commodities on the market while the average Zimbabwean employees' real income is very low leading to low sales because most people could not afford to purchase the commodities on the market. The businesses also suffered losses after the price controls by the government because they were forced to sell their commodities at prices lower than the market price. The businesses stated that they were sustaining themselves rather than coping in the hope that the future holds better business prospective for them.

1.3. Organization of the Dissertation

The remainder of the dissertation will take the following structure: Chapter two will review literature and theoretical framework that is significant to this study. It will provide a definition of hyperinflation, review the impact of hyperinflation in other countries and examine the impact of hyperinflation on SMEs in Zimbabwe as reported by the media. Chapter Three will describe the methodology undertaken for this study. It will explain how the study was conducted and the reasons for conducting it in this way. Chapter four will provide a background to the Zimbabwean economic crisis dating back to 1980. Chapter five will provide a presentation of the findings of the study respectively. Chapter six will offer recommendations and conclusion of the paper by providing a summary of the keys issues brought forth in the study.

Chapter 2

2. Literature Review

2.1 Definition of Hyperinflation

According to the Encarta Concise English Dictionary (2001: 709), "hyperinflation is very high and rapid price increase that is so great as to threaten a nation's economic stability". Hyperinflations are largely a modern and rare phenomenon generally associated with printing money to finance large fiscal deficits due to wars, revolutions, and the end of empires or the establishment of new states (Coorey et al, 2007: 3). Hyperinflation has also been defined as an acute acceleration of the inflation rate until it reaches extremely high levels. Cagan cited in Friedman (1956: 25) defines hyperinflation as "episodes of rates in excess of 50%". One can also use a 12- month inflation rate of 1000% or above as a threshold of defining hyperinflation (Coorey et al, 2007: 3). Another characteristic of a classical hyperinflation is that the acute acceleration of the inflation level is accompanied by rapid substitution away from the domestic currency.

2.2 Hyperinflation in other Countries

Hyperinflation was made infamous by pictures of Germans pushing wheelbarrows full of banknotes to buy pints of milk in the 1930s. Inflation was so high that the value of their money fell hour by hour, so the nation went out and bought everything it could in the hope that material goods might retain their value (Laidler and Stadler, 1998). Laidler and Stadler (1998: 817) and (Feldman, 1993: 690) state that the German inflation, which culminated in hyperinflation in 1921-23, generated four contentious stylized facts namely, a phenomenal increase in prices due to the business opportunities which were opened up for unfair profiteering by the Jews, Poles and other assorted foreigners.

The second feature of hyperinflation in Germany was a well in excess of the increase in the money supply from mid-1921 onward, the third was a more rapid rise in the exchange rate than in domestic prices, a widely perceived "shortage of money", and lastly an extremely large increase in real balances in the wake of the stabilization which brought inflation to an end (Laidler and Stadler, 1998).. These facts were seen as incompatible

with the quantity theory of money, but consistent with a widely accepted alternative explanation of inflation cast in terms of a balance of payment problem.

Feldman (1993) and Kindleberger (1994) on the other hand provide abundant evidence that the hyperinflation was at least as much a socio-political as an economic phenomenon. In Zimbabwe, the government stated that hyperinflation was being fuelled by businesses with a political agenda of tarnishing the image of the government by increasing prices of commodities in the market. This view was stated by the Minister of Trade and Industries in Zimbabwe, O. Mpofu who argued that "Government is aware that these escalating price increases are a political ploy engineered by our detractors to effect an illegal regime change against the ruling party, ZANU-PF and the Government following the failure of illegal economic sanctions....The taskforce recently constituted by the government is going to immediately take appropriate action against unscrupulous and insensitive economic players" (*The Herald, 26 June 2007:1*). On the other hand the dislocation of Germany's export capacity was associated with the World War I and its aftermath, not to mention the prospective burden of meeting punitive reparations obligations imposed at Versailles, put important economic and political limits on the Weimar Government's room for manoeuvre in economic policy (Laidler and Stadler, 1998: 820).

China also experienced a severe inflation following the end of World War II, from September 1945 to May 1949, which also qualifies as hyperinflation. According to Chang (1958) cited in Teh (1970: 453) hyperinflation puts great upward pressure on market interest rates. Chou (1959: 426) states that official interest rates were quite unrealistic under such circumstances thus the black market interest rates were chosen to represent the nominal cost of borrowing money in China during the inflation period.

In another instance, hyperinflation in Bolivia during 1984 and 1985 was the most rapid in Latin American history, and one of the highest in world history. During the twelve-month period, August 1984 to August 1985, prices rose by 20,000 %, and during the final months of the hyperinflation, from May 1985 to August 1985, the inflation surged to an

annualized rate of 60,000% (Sachs, 1987: 279). The Bolivian inflation may be unique in the annals of hyperinflation as one of the cases that did not arise in the aftermath of a foreign war, a civil war, or a political revolution but rather, the hyperinflation emerged as the result of several less-dramatic shocks hitting the country during a period of intense political instability (Sachs, 1987: 280). This situation in Bolivia may also be linked to the Zimbabwean situation whereby war did not take place but hyperinflation took its toll due to political and economic instability in the country.

Beckerman (1995: 664) focused his research on the impact of hyperinflation on the public sector in Argentina. Beckerman (1995) states that between 1989 and 1990, Argentina underwent a series of hyperinflationary episodes mainly due to military dictatorship. He further states that during this period the Menem government undertook a programme of reforms to liberalize the economy and reduce the scope of the public sector. In early March 1990, the Government of Argentina announced a strong fiscal programme. The exchange rate, which had been floating since the previous December 1989, stabilized and inflation moderated somewhat, although consumer prices continued to rise at monthly rates of 5-15 % over the remainder of 1990 (Beckerman, 1995: 664). This study in Argentina shows how the government managed to control hyperinflation through its stabilization programmes.

Schiendorfer (2007:1) stated that a kilogram of bacon was priced at 20 trillion Serbian dollars in Serbia in 1993, in 1946; Hungary released a bank note with twenty zeros and in 1923, an egg in Germany cost up to 150 billion marks in 1923. While the German hyperinflation is better known, a much larger hyperinflation occurred in Hungary after World War II. In Hungary, between August 1945 and July 1946 the general level of prices rose at the astounding rate of over 19,000% per month, or 19% per day (Salemi, 2003:1). According to The Concise Encyclopedia of Economics (1946), Hungarian prices more than tripled everyday during this period. Between 1989 and 1994 Serbia suffered greatly under hyperinflation. In 1993 alone, inflation came to more than a billion percent and in December 1993, the cost of living was 2,839 times more than the month before and more than six billion times higher at the start of the year (Schiendorfer, 2007:2).

These examples show that hyperinflation leads to a condition in which prices increase rapidly as currency loses its value.

In Angola between 1991 and 1998, the local currency, the kwanza lost almost all of its value due to hyperinflation which caused the currency to spiral downward out of control mainly due to the civil war. As a result of the loss of value of kwanzas, a large amount of money could only purchase small amounts of good, and as a result there were bills in the denomination of 5 billion kwanzas in circulation in the local market. The kwanza like the Zimbabwean bearer's cheques cannot be used as a medium of exchange outside Angola as it is not considered hard currency (www.foreignmoney.com).

In the Democratic Republic of Congo hyperinflation began in the early 1990s, reaching nearly 24 000% in 1994, and recorded Gross Domestic Product (GDP) shrunk still further, until by the end of the decade it was just one third of what it is was in the mid 1950s (www.iss.co.za/af/profiles/**DR**Congo/Economy.html). It is argued that this was due to the fact that Laurent Kabila's economic management was as poor as that of Mobutu's, and led to further uncontrolled monetary growth, inflation, and a widening gap between the official and parallel exchange rates (www.iss.co.za/af/profiles/**DR**Congo/Economy.html). The civil war, corruption and the plundering of resources by some neighbouring countries also worsened the hyperinflationary situations. There were very few business operations that were taking place in DRC during the time.

Hyperinflation continued to rise due to war and other external factors and this negatively affected the local businesses in the country who had to cope with war, high inflation and the plundering of their resources by neighbouring countries who were acting in the 'pretence of assistance' to achieve peace. Access to food continued to become more difficult for the population in Kinshasa during the hyperinflationary period (OCHA, 1999). This was so because hyperinflation and the war had severely affected household food security as these led to an inadequate flow of foodstuffs into the market as some businesses had closed down due to these factors. The United States embassy in Kinshasa

estimated a 41% increase in food prices in the food market between June and July 1999 due to the two factors (OCHA, 1999).

In the study of the impact of hyperinflation in Yugoslavia, Watkins (1996: 2) argues that between October 1, 1993 and January 24, 1995 prices increased by 5 quadrillion percent and the average daily rate of inflation was nearly 100%. This meant that prices of all commodities almost doubled on a daily basis. This situation led the government to increase the money supply. However, despite the government's desperate printing of money it still did not have the funds to keep the infrastructure in operation. Potholes developed in the streets, construction projects were closed down and the unemployment rate exceeded 30%. Watkins (1996:2) also explains that the government tried to counter the inflation by imposing price controls.

However, the price controls implemented by the government in Yugoslavia did not curb inflation but actually witnessed its further rising. The government price controls led producers to get ridiculously low profits from the sales because their production costs were higher than the cost of their products. This situation led the producers to simply stop producing. In October of 1993 the bakers stopped making bread and Belgrade was without bread for a week (Watkins, 1996). The slaughter houses refused to sell meat to the state stores and this meant meat became unavailable for many sectors of the population. In the same month the government also printed a new currency of which it had removed six zeros from the old currency but this did not stop inflation (Watkins, 1996: 3). Hyperinflation in Yugoslavia led to stoppage of production by many manufacturers of basic commodities and as a result this led to numerous shortages of the basic commodities (Watkins, 1996). The Yugoslavian case study presents an almost similar situation as the one expressed in Zimbabwe in the current hyperinflationary environment.

2.3. Hyperinflation's impact on SMEs in Zimbabwe: A review of the literature

Zimbabwe has currently by far the highest rate of inflation in the world. In recent years there has been increasing concerns about the effects of hyperinflation on the vulnerable

and poverty-prone groups in Zimbabwe. However not much literature exists on how hyperinflation has affected Small to Medium Enterprises, as it is a fairly recent phenomenon in the country. In relation to the Zimbabwean case, Hanke (2007: 1) supports the month on month definition of hyperinflation by Cagan when he argues, "Zimbabwe has entered the hell of hyperinflation. Indeed, inflation in March rose by well over the 50% monthly threshold for qualifying as hyperinflation. The reporting of Zimbabwe's travails invariably includes the standard reference to Weimar Germany's 1922-23 hyperinflations, in which the monthly inflation rate peaked at 32,400%".

In the twenty-first century to date Zimbabwe has witnessed rapid increase of inflation and loss of value of its currency. The Central Bank of Zimbabwe introduced bearer cheques as legal tender for the first time in September 2003 in Z$5,000, Z$10,000 and Z$20,000 denominations in order to deal with the economic crisis. A Z$50,000 bearer cheque was introduced on the 1st of February 2006 (Africa Research Bulletin, 2006: 17082). The introduction of the bearer's cheques, however, did not address the economic crisis. This led the Central Bank to introduce a batch of new bearer cheques after removing three zeros from the old bearer cheques. Economists however argued that this would be a short-term gain in convenience but inflation could continue to increase adding back the zeros. "It will take more than just lopping off zeros to fix the economy, corruption must stop, agricultural and industrial production must be revived", stated Makumbe, of the University of Zimbabwe (Africa Research Bulletin, 2006: 17082).

Munoz (2006: 2) explores explanations for the substantial decrease in velocity and increasing levels of real money balances that led to a divergence between inflation and monetary expansion since late 2003 in Zimbabwe. Coorey et al (2007: 3) on the other hand state that Zimbabwe has currently the highest rate of inflation in the world and that the high rates of inflation have contributed to the contraction of the economy, which has declined by about 30% since 1999. They go on to examine the stabilization experience of countries that experienced similar rates of inflation during 1980-2005 and draw different lessons for Zimbabwe. However, since the beginning of 2007 the pace of economic

decline in Zimbabwe has accelerated and inflation has increased rapidly, while industrial unrest in the public sector over wages has reached unprecedented levels.

In April 2007, the International Monetary Fund (IMF) stated that the Reserve Bank of Zimbabwe (RBZ) was not capable of managing the levers of Zimbabwe's financial industry and would need to be recapitalized to regain the confidence of the banking sector. According to the IMF, "The RBZ is making losses because of the costs involved in supporting government policy through quasi-fiscal activities and keeping the currency overvalued" (Africa Research Bulletin, 2007: 17374). The losses have arisen from a range of activities, including monetary operations to mop up liquidity; subsidized credit; foreign exchange losses through subsidized exchange rates for selected government purchases and multiple currency practices; and financial sector restructuring (Africa Research Bulletin, 2007: 17374).

The IMF stated that the dual exchange rate has worked to the disadvantage of the Central Bank, which has had to rely on the illegal foreign exchange market for hard cash for onward selling to parastatals and other key sectors at a loss (Africa Research Bulletin, 2007: 17374). The quasi-fiscal losses of the central bank have been financed through money creation or issuance of Central Bank securities, pushing up inflation (Africa Research Bulletin, 2007: 17374). In support of this view, the Central bank of Zimbabwe argues that the combined effects of supply side rigidities, fiscal overspending, excessive credit expansion, indexation of prices to the parallel foreign exchange rates, and speculative behaviours have sustained the inflationary build-up in the economy (Monetary Policy Review, 2007: 20).

However, most literature on hyperinflation in Zimbabwe exists only in the electronic and print media due to the fact that it is a recent phenomenon. Hyperinflation in Zimbabwe had witnessed major price increases of basic commodities and other essential services. As the price increases were making it difficult for the majority of Zimbabweans to afford to purchase basic commodities on both the formal and informal markets, the government set up an eight member ministerial government taskforce to ensure that all price increases are

justified with scientific pricing models. The taskforce was also put in place to make sure that the diversion of scarce goods from the formal market to the parallel market ceases and that speculative price increases are reversed (*The Herald, 21 June 2007*). The government also stated that it would achieve this goal by the enactment of policies to remove distortions in the market.

The Herald (*13 July 2007: 1*) stated that the government ordered price controls of all commodities to June 18, 2007 levels as a way of attaining policies to remove market distortions. However, it should be noted that it was going to be difficult to hold the price of all commodities below their market clearing without inviting an expansion in the demand of those commodities as more people can now afford to purchase the commodities. On the other hand as more people buy more, the accumulated supply is quickly taken from the shelves of the merchants but unfortunately the merchants will not be able to replace the commodities as their capacity is curtailed through the resulting loss emanating from the forced sale of goods below cost price.

Price controls, which refer to the fixing of prices below the market levels, have been tried in Ancient Rome, in the French Revolution, in Soviet Union, in Yugoslavia. In every age, and every culture the price controls have not worked but ended up being disastrous to the respective economies. The worst cases have occurred in China in the 1920s during the term of Chiang-kai-Sheik who rounded up merchants and shot them in a public square to enforce price controls and deter other merchants from hiking prices (Kingdom Financial Holdings, 2007: 2). In Zimbabwe a number of retailers were arrested as to deter other retailers from increasing the prices of their commodities (*Mail and Guardian, 13 July 2007*).

Cox (1997: chapter 7) however states that "…the legal price is merely a misstatement of actual conditions and is comparable to plugging a thermometer so that it can never read more than 50 degrees even if the actual temperature might be higher. The law of supply and demand cannot therefore be repealed". It is further argued that although consumers call for price controls as a way of making the available commodities cheaper, the end

result of those controls would be shortages if those products as quantities demanded will outstrip quantities in supply. Price controls may also lead to hoarding of commodities and cause artificial shortages of the commodities. This leads the goods to be sold at a more expensive price because the commodities will now only be found on the parallel market at higher prices.

2.4. Theoretical Framework

This study drew in a broad and impressionist way on various approaches to understand how hyperinflation affects businesses. Earlier research on hyperinflation can be classified into three main strands of theory. The first one follows the quantity theory of money and is associated mainly with the works of Cagan (cited in Friedman 1956: 26). The quantity theory of money states that there is a direct relationship between the quantity of money in an economy and the level of prices of goods and services sold. According to the quantity theory of money, if the amount of money in an economy doubles, price levels also double, causing inflation.

The theory of inflation as an increase in the money supply, causing prices to go up, is consistent with basic supply and demand analysis. When there is an increase in the supply of a good, the value of each unit has got to go down, is also consistent with the law of diminishing marginal utility and consistent with the fact that in most cases inflation increases at the same time money supply is increased (Cox, 1997: chapter 21). The government of Zimbabwe's reliance on the domestic bank finance to bridge the country's internal resource gap led to broad money supply growth which continued on an upward trend, escalating from 1 638.4% in January 2007, to 17 073.1% in July 2007 (RBZ, Monetary Policy Statement, 2007: 17). The increase in quantity of money in Zimbabwe is one of the factors that have led to an increase in inflation.

The second strand of theory focuses on the exchange rate and is mainly associated with the works of Frenkel (1976). The exchange rate is the relative price of two currencies, which is determined by the relative supplies of, and demands for, the two moneys. The exchange rate approach states that high volatility of floating exchange rates have adverse

and serious impact on inflation, employment, investment and economic growth. Bilson (1978: 392) states that an increase in the money supply will result in a proportional depreciation of the exchange rate, an increase in real income will appreciate the exchange rate and that an increase in the nominal rate of interest will depreciate the exchange rate. In Zimbabwe, the increase in money supply led to the depreciation of the exchange rates on the parallel market while the Central Bank exchange rate is overvalued.

The third one is related to the theory of rational expectations and its main contributors are Sargent and Wallace (1973). This approach is based on the assumptions that conditions are such that adaptive expectations of inflation are rational. The concept of rational expectations asserts that outcomes do not differ systematically, regularly or predictably from what people expected them to be. Economists who believe in rational expectations base their belief on the standard economic assumption that people behave in ways that maximize their utility or profits. Economists have used the concept of rational expectations to understand a variety of situations in which speculation about the future is a crucial factor in determining current action (Sargent, 2002: 1).

These approaches best approximate the new orientation to be taken on the study of the impact of hyperinflation on the Small to Medium Enterprises in Harare, Zimbabwe with focus on how both the formal and informal traders have been affected by the quantity and velocity of money, the foreign currency exchange rates, price controls by the government, panic buying by the consumers and the rational expectations of the traders in this hyperinflationary environment.

In relation to the quantity theory of money, it is important for the research to link the relationship between the amount of money in circulation to the rate of inflation. The rational expectations theory will focus on how SMEs operate in a hyperinflationary environment. It is therefore important for the research to point out if SMEs are driven by selfish desires to profiteer in the hyperinflationary environment through price increases due to their speculations of possible producer price increases in future and what implications these actions have on hyperinflation. In relation to the exchange rate theory,

the research will link impact of domestic money supply to the price and demand of foreign currency in Zimbabwe in this hyperinflationary period.

Chapter 3: Methodology

3.1. Introduction

This chapter presents the methodology that was used in conducting this study. The researcher used an exploratory research design aimed at gaining insight into the impact of hyperinflation on SMEs in Harare, Zimbabwe. The study was conducted at Avondale Shopping Centre in Harare, Zimbabwe. Zimbabwe has 8 provinces which are Manicaland, Mashonaland Central, Mashonaland East, Mashonaland West, Masvingo, Matabeleland North, Matabeleland South, Midlands and 2 cities with provincial status namely Harare and Bulawayo. Harare is the capital and largest city in the country. Zimbabwe is a landlocked country in the southern part of the continent of Africa, between the Zambezi and Limpopo rivers. It borders South Africa to the south, Botswana to the southwest, Zambia to the northwest, and Mozambique to the east. The total area of the country is 390,580 km². A July 2007 estimate of the population stated that there were about 12 311 143 people living in the country (CIA, The World Factbook, 2007).

Figure 2: MAP OF ZIMBABWE

Source: CIA, The World Factbook, 2007 (http://geography.about.com/library/cia/blczimbabwe.htm, accessed 25/10/07)

3.2. Methodology and Justification

This study draws on qualitative research methods. Qualitative research has been defined as a type of research involving the interpretation of non-numerical data (Welman and Kruger, 2003). According to Babbie and Mouton (2001) qualitative research gives a more in-depth description and understanding of events or actions and this helps the researcher to gain insight into why and how these events or actions take place rather than just presenting a phenomenon. Qualitative research also allows respondents to express feelings and opinions in their own words. Although qualitative research methods have great advantages in many respects, they also have a disadvantage of being time consuming in both data collection and analysis.

A case study approach was utilized in this research and the case used was Avondale Shopping Centre representing Small to Medium Enterprises in Harare, Zimbabwe. The researcher chose this approach because it facilitates intensive study of the subject in question focusing on the real implications of hyperinflation on both formal and informal businesses. Yin (2003:7) in support of the justification of the case study approach states that the approach is an empirical inquiry that investigates a phenomenon within a real-life context.

Avondale Shopping Centre in Harare, Zimbabwe was chosen as the case study because both formal and informal businesses are conducted there hence an important site in finding out how hyperinflation has affected both sectors. Situated within the centre are wide ranges of supermarkets, banks, retail stores, food outlets and alongside an informal market selling clothes, artifacts and food outlets. This study had an opportunity to bring out the different trends of business in both the informal and formal sector, which fall in the category of SMEs.

Profile of businesses at Avondale Shopping Centre

- Avondale Pharmacy is a member of a group of pharmaceutical companies, which employs five employees. It sells pharmaceuticals and other toiletry products.

- Smart Collections is privately owned and employs one worker. It sells clothes and prices are determined by the current rates of the US Dollar at the parallel market because the company imports its clothes from Dubai and Malaysia.
- Itech is a computer and accessories sales shop, which is privately owned and employs three workers.
- Celians Florist is a privately owned company, which specializes in selling fresh flowers. It has three employees stationed at the centre.
- Mark and Manolios is a privately owned sports shop, which specializes in selling sports attire and employs one worker.
- Bon Marche supermarket is part of the OK Group of Companies. It has about thirty employees working at the Avondale branch. It sells groceries and basic commodities.
- T.M Supermarkets is a subsidiary of Miekles Group of Companies. It sells groceries and other basic commodities and has about twenty employees on the Avondale branch.
- Edgars Stores sells clothes and cosmetics. It is a subsidiary company of Edgars stores in South Africa. It employs five workers at the Avondale branch.
- Zeon Clothing Shop is a privately owned shop, which sells clothes and employs one worker.
- Nandos, Wimpy and St Elmo's Pizza are subsidiaries of South African companies, which sell fast foods.
- Also situated at the centre are Intermarket Bank, Standard Chartered Bank, the Central African Building Society (CABS), Z.B Holdings and Barclays Bank.
- In the informal market, operations of most of the businesses take place from open stands. Most of the businesses have a single employee and they are all privately owned. Most traders in the informal market sell clothes and artifacts. They stated that their prices and wages are usually determined by the foreign currency rates at the parallel market.

Purposive sampling was used to identify SMEs for the study. This is because the researcher had in mind a specific target population and approached only those who fit the

purpose of the study. A questionnaire consisting of closed and open-ended questions was administered for each business to get a broad understanding of the impact of hyperinflation on SMEs. To get an in-depth understanding of the impact of hyperinflation on SMEs, the researcher interviewed a fraction of traders in both the formal and informal businesses using a tape recorder. The researcher also utilized secondary data relevant to his area of study. This enabled the researcher to understand and critically assess the different impact of hyperinflation on SMEs in Zimbabwe while also comparing with studies that were conducted in other countries to figure out if theories on hyperinflation apply to all countries that have been affected by hyperinflation. Participant observations were also used as a tool of collecting data for the research to maximize validity and reliability of findings from other data collection instruments.

3.3. Ethical Considerations

Informed consent forms were given to all the respondents as part of the requirements for ethical research. The SMEs were informed about a range of matters relating to the study namely: the purpose of the study, how respondents were selected, identity of the researcher, and how the information obtained would be made available to them. According to Scheyvens et al (2003, 142) informed consent is essential as it ensures people's freedom not to participate in the research if they are not comfortable with it. The researcher ensured that confidentiality; anonymity and privacy were strictly observed. All the first hand information that was collected from the respondents was not revealed to anyone in a form that can allow the identification of the respondent.

3.4. Data analysis

Thematic analysis was used to analyze the data collected in the research. According to Aronson (1994:1) the conversations that take place in a researching process, ideas emerge that can be better understood under the control of a thematic analysis. Thematic analysis focuses on identifiable themes and patterns of living and or behaviour. It also involves the identification of all data that relates to the classified patterns. Thematic analysis also involved combining and making a catalogue of related patterns into sub-themes. These themes that emerged from the informants' stories were pieced together to form a

comprehensive picture of their collective experience (Leininger, 1985:60). Thematic analysis was therefore a necessary tool to analyze and comprehend all information that emerged from the different data tools used to draw up a conclusion from the findings.

3.5. Significance of study: - A case study approach was utilized in this research to ensure that a thorough research was conducted, as the population studied was relatively small. The researcher was able to relate to the traders since he knows the local languages and general customs of communication in Zimbabwe. Research was also conducted at a time the RBZ was presenting its Monetary Policy Review (MPR) for 2007 enabling the researcher to get recent information on issues pertaining to inflation. Descriptive, analytical and theoretical validity and reliability were maximized by the observation strategy as this tool was meant to cement the information from the secondary data analysis, interviews and questionnaires. The research was conducted for three weeks, a time period, which enabled the researcher to gather as much information as possible on the impact of hyperinflation before and after the June 26 50% price controls by the government. The researcher therefore managed to collect as much data from the informants as possible and also managed to observe the business trends and get secondary sources to support and analyze his findings.

3.6. Limitations of study: -The research findings might not be representative of the impact of hyperinflation on the formal and informal sectors in Zimbabwe since the research was focusing only on the operations of the formal and informal markets at Avondale shopping centre, Harare. Some traders might not have divulged some important information on their activities to the researcher because they did not know him and also because of the fact that their rules of trade might not have allowed them to give business information to anyone. Some traders were not willing to participate in the research due to their fear of the state.

In some instances the researcher had to get clearance from companies' head offices not situated at the centre to conduct interviews at their branches at the Avondale centre. This was time consuming for the researcher; however, the researcher had success in getting the

required clearances to conduct the research from the head offices. The researcher realized that some of the businesses did not want to either fill in the provided questionnaire or to be recorded but accepted that the researcher take down notes during the interviews. The researcher did not get as much help as he anticipated from the Central Bank of Zimbabwe. This is so because the RBZ librarian, who is in charge of all the published and unpublished material on monetary issues in the country stated that the Bank did not have any hard copies of the annual reports. The researcher was advised by the librarian that he could access the information on the RBZ website but the latest annual report that was online was that of 2004!

CHAPTER 4: Background to the Zimbabwean Crisis

4.1. Introduction

The Zimbabwean crisis has generated a great deal of academic and political debate. According to Power (2007) "the country's economy in 1997 was the fastest growing in all of Africa, now it is the fastest shrinking". She further asks how the breadbasket of Africa could have deteriorated so quickly into the continent's basket case. The US State Department's leading Africa official (2001) cited in Bond (2007: 150) stated that, "the current crisis in Zimbabwe has its roots in many areas. Broadly speaking, poor fiscal policies and rampant government spending, including the cost of Zimbabwe's military involvement in the Congo set the stage for the present economic meltdown.

Due in large part to an illegal and chaotic ''fast track'' land reform program pursued by the government, the agricultural sector has been badly disrupted". Davies cited in Bond (2007:150) puts the beginning of crisis at 1997 and turns immediately to blame wealth accumulation due to a peculiarly rampant form of absolute extraction by the ruling party. This is because it is argued that most of the government officials in Zimbabwe were accumulating wealth for private enrichment through unfair and corrupt means. Others simply blame Robert Mugabe for his socialist orientation while the United States Agency for International Development (USAID), states that the country's deep economic crisis is the result of the government's flawed economic and public management policies.

4.2. Zimbabwe from 1980-1990 (The period of Socialism)

Independent Zimbabwe inherited an economy that was more industrialized than most in Africa, with a diversified productive base, well-developed infrastructure, and a relatively sophisticated financial sector. The government at independence adopted a Marxist-Leninist approach, which promotes state led industrialization coupled with a drive for a one-party state. On the other hand, the new government introduced a welfare system, which subsidized public services, farming inputs and basic commodities. The leftist thinking that emerged from this period was influenced by official Sino-Soviet ideologies given that China and the Soviet Union supported Zimbabwe's independent government. Brickhill (1999: 35) notes that while relationships with the Soviet-aligned socialist

regimes had their strategic and even opportunistic aspects, there is no doubt that direct exposure to socialist regimes and parties of various types, including for the first time political training in socialist ideas, had a profound and meaningful impact on political debate within the ranks of the liberation movement.

The new government adopted a policy of Growth with Equity in 1981 which stated that more rapid growth would protect minority livelihoods and increase the resources available for redistribution which would occur as the economy was reoriented in a socialist direction (Jenkins, C. 1997: 587). The strategy of Growth with Equity was meant to reduce the economic inequalities among racial groups by redistributing some of society's assets and incomes, non-material assets to Africans who were previously disadvantaged during the colonial period. These were in the form of improved education, health facilities through the government's increased expenditure by 10% (Sylvester, C. 1985: 31). However, these social welfare policies also contributed to the excessive increases in government spending.

Socialism acted as a fairly effective blocking ideology against the introduction of pro-growth reforms during the 1980s. However, protection of local industries sustained existing high cost companies but discouraged exports by raising costs of inputs to exporters, leading to a critical shortage of foreign currency needed to acquire imported technology. Foreign companies were not allowed to remit dividends and new foreign technology was actively discouraged and this led to loss of investor confidence in the country. These overall constraints favoured existing capital-intensive producers who were largely white. This suppressed the emergence of a genuinely entrepreneurial African business class, which also increased unemployment. Investment levels fell in real terms from 15.5 per cent of the GDP to 10.7 in 1989 (Herbst. 1992: 58). Zimbabwe also faced many impediments to export led growth due to shortage of skilled labour, low productivity, potentially impenetrable markets and high management costs.

Loose fiscal policy and balance of payments deficits, both of which necessitated tight monetary policy also meant that there would be very little new investment. The

disinclination of foreign investors to inject capital into the economy meant aid had to be sought to provide foreign exchange for external debt service as the need to run current account surpluses was reducing growth potential (Jenkins, 1997: 597). This led the government to implement serious cutbacks in public spending as most ministries providing services for Africans were told to cut their budgets by 5% to cater for the low investments (Chidzero, 1984). In its endeavour to reverse the trend of declining growth rate the government accommodated private producer interests. The government did this by the relaxation of market control, as well as its adoption of macroeconomic policies designed to liberalize trade, narrowed the rift between the public sector and the private sectors, generated local investment optimism, attracted a significant amount of foreign capital and led to a period of economic upturn during the 1986 to 1990 period (Logan and Tevera, 2001: 102).

The introduction of the first Five Year National Development Plan in 1986 was mainly due to the fact that the government borrowed large sums of money at commercial rates on foreign markets partly in expectation of receipts of aid from forty-five donor countries that had promised aid to Zimbabwe at the Lancaster House Agreement (Jenkins, 1997:597). When the promised flows did not materialize, the country was left in a serious debt-servicing problem, which finally pushed the government towards the Economic Structural Adjustment Programme (ESAP). The inefficiency of the economy was also made worse by corrupt tendencies of public officers who used their political offices for private benefit and public administration became a system of patronage (Jenkins, 1997: 594). Internal pressures for liberalization from both the private sector and the technocrats in government also led to the adoption of ESAP. International Financial Institutions, particularly the World Bank also played a pivotal role with regards to the decision taken to adopt Economic Structural Adjustment Programme in 1990.

4.3. Zimbabwe's economic policy from 1990-2000

In 1991 Zimbabwe introduced Economic Structural Adjustment Programme (ESAP). The World Bank prepared the key documents in 1987. ESAP promised that by the end of 1995 there would be a 25% cut in the civil service, along with the demise of all labour

restrictions, price controls, exchange controls, interest rate controls, investment regulations, and import restrictions, as well as many government subsidies. Privatization of parastatals was practically the only major ingredient in the typical adjustment recipe that Zimbabwe declined, but even so, parastatal commercialization was pursued with vigour. However, ESAP failed miserably in relation to its promises.

Gross Domestic Product (GDP) growth reached only 5% during one year, which was in 1994, and averaged just 1.2% from 1991 to 1995. Inflation averaged more than 30% during the period, and never dropped anywhere near the 10% goal, which had been set up by the government. The budget deficit was more than 10% of GDP during the ESAP era. Zimbabwe also faced a trade deficit during the early 1990s due to the increase in imports which was roughly double that anticipated. This is supported by Mendis (2002: 155) who states "negative trends in terms of trade during 1990-1993 also put severe pressure on the pressure on the balance of payments situation and exchange rates".

The democratic government of South Africa also cancelled its trade agreement with Zimbabwe and subjected its exports to punitive tariffs just as Zimbabwe reduced its own, leading significantly to deindustrialization of Zimbabwe (Stoneman, 1998: 100-1). The Zimbabwe Congress of Trade Unions (ZCTU) argued that trade liberalization tended to turn manufacturers into traders as firms have tended to stop manufacturing products locally, preferring to import them directly and then sell them to local consumers thus leading to the fall of exports.

It is argued that the failures of liberalization were also due to the fact that there were difficulties associated with the attempt to impose over-rapid liberalization on a relatively weak and highly protected economy. The need to eliminate uncompetitive industries and reduce over manning was bound to reduce output in the first instance and with it, government revenue. It is argued that these tendencies were seriously underestimated by policy-makers, leading to serious inconsistencies and failures. Financial liberalization undermined the stabilization effort as the increase in the government interest bill offset fiscal retrenchment. This fiscal problem led to the uncertainty about future economic

policies, as agents were unsure how compatibility would eventually be restored. The resulting risk premium contributed to the very high interest rates in the early years of the programme. In any event, manufacturing investment was too low to generate the economic growth that was hoped for by the introduction of ESAP (Gunning and Oostendorp, 2002: 15).

The period between 1991 and 1997 during which ESAP was implemented can thus be considered a failure in many crucial respects. These failures can be attributed to noncompliance with key elements in the programs and unsustainability of corporatist alternatives. ESAP was also undermined by extremely unfavourable conditions. Drought reduced agricultural output, exports, public revenue and demand for local manufacturing increasing foreign borrowing which expanded both indebtedness and aid dependence, reducing the government's ability to determine economic policy independently. These failures have been reflected in the 1993 bread riots that broke out in the high-density suburbs of Harare, and in the city centre, in 1995. Public workers went on strike in 1996, and other private employees including plantation workers followed at an unprecedented rate in 1997 (Bond, 2007: 169).

These failures led the government at the time to conclude that ESAP was their most important policy error and its introduction was the starting point of the economic crisis taking place in Zimbabwe to date. In support of this view one former cabinet minister of Zimbabwe stated that he was glad that ESAP failed because he saw it as a capitalist project. The Zimbabwe government blamed the economic crisis after ESAP upon Western states and institutions angry about land reform that took place in the country after 2000 (*The Daily News: 2001*) cited in (Bond, 2007: 151).

Since the late 1990s Zimbabwe has been grappling with the resolution of fiscal problems; the inequities in land distribution, poverty, and unemployment problems; population pressures; and unfavourable rainfall patterns. Economic deterioration has further been exacerbated by the uncertainties surrounding the land reform program and, consequently, decreased agricultural production and tourism revenues. One sign of impending

economic collapse was the crash of the massively overvalued Zimbabwe Stock Exchange beginning in September 1997.

The economic crisis was made worse by the awarding of pension fund payouts to veterans in a bid to placate the War Veterans Association. According to Bond (2007) the main objective of the government's unbudgeted 1997 gratuities to the war veterans was to buy off their protest movement. The government agreed to compensate war veterans with a lump sum of Z $ 50 000 each and a lifetime pension of $ 2 000 subject to increase as and when the living standards increase. In order to make sure that all the listed war veterans received their compensation funds, the government printed more money and this increased the inflation rate and also the loss of value of the local currency. It should be noted that these compensations were characterized by a lot of corruption, as there were a lot of prowling of veterans' health and compensation funds. The government did not learn from its first mistake of excessive printing of money in 1997 and went on to print money excessively again in 2005 to pay off its International Monetary Fund (IMF) debt. This printing of money led to an excessive year on year increase of the country's inflation rate from 238 % in 2005 to 1017 % in 2006 (Reserve Bank: 2007).

However, the Governor of the Reserve Bank of Zimbabwe defends the excessive printing of money to pay the IMF debt. He argues that:

> Zimbabwe, under very difficult circumstances, cleared its US$210 million arrears to the IMF in 2005 after being assured that such clearance was going to lead to the restoration of our IMF voting rights, access to technical assistance and international finance. These funds were diverted from the fertilizer needs of agriculture, the raw material needs of industry, fuel, maize and medical drugs needed for our hospitals, as an act of sacrifice, and as a goodwill gesture (Monetary Policy Review, 2007: 41).

The Governor of the Reserve Bank of Zimbabwe however stated that events did not turn out as the IMF promised them. This was because even after the payment of the debt, Zimbabwe still lost its voting rights and did not get any international technical and

financial assistance (Monetary Policy Review, 2007:41). This led the Governor of the Reserve Bank of Zimbabwe to argue that one could not isolate economics from politics as Zimbabwe was being isolated more because of its political decisions than economic failures. The Central Bank of Zimbabwe Governor in support of this argument stated that:

> There is consensus among some IMF, World Bank, Africa Development Bank economists in their private discussions with us that if other developing countries were assessed through the same criterion and treated in the same manner that Zimbabwe is assessed and treated today, these multilateral institutions would not be working or lending support to half of the countries that they are currently working in and supporting (Monetary Policy Review, 2007: 41).

This proves that the situation in Zimbabwe is not only about economic and monetary policies but also about politics, which according to the Governor of the Reserve Bank of Zimbabwe "is a factor outside the parameters of Central Bank Governors" (Monetary Policy Review, 2007).

The intervention of Zimbabwe in the civil war in the Democratic Republic of Congo in 1998 aggravated the economic crisis in the country further as this action by the government led to high government expenditure on the military force. The government expenditure, which was not complemented with an increase in government revenue, led to inflation and an increase in the prices of basic commodities accompanied by the retrenchment of civil servants as a way of cutting down government expenditure. This situation led to an increase in the rate of unemployment and the removal of government subsidies for basic staples also had negative impact on the food security of the poor.

4.4. The period after 2000

In order to conciliate the mass discontent over the slow pace of land redistribution, in late 1997, the government unveiled a plan to secure millions of hectares of commercial lands to be redistributed to communal farmers. The 2000 land reform led to many white farmers losing their farms without compensation from the government for the land but only for the developments they had made during the period of ownership of the farms. The land reforms led to many foreign disinvestments in the agriculture sector as most

investors stated that it was no longer safe for them to invest in Zimbabwe. Most of the white farmers who had their farms taken from them either went back to their country of origin or were given contracts in other countries in the region to invest and carry out their agricultural activities. The government of Zimbabwe on the other hand received a lot of criticism on the way it implemented the land reform. It was argued that the land reform was carried out on political grounds and this had a huge impact on the agro-economy and the food security of the country.

The government has been criticized for its land reform program because even though it empowered the poor people with land, it did not give them the necessary capital needed for subsistence and commercial farming. Most of the people who were allocated the farms did not have adequate farming equipment, capital, farming knowledge and skills and this led to low produce in agricultural sector. This situation resulted in most of the land laying fallow and unused because of a lack of adequate resources. This led to serious food insecurity for the country and resulting in government reliance on food aid as a supplement of the limited food reserved in the country.

Zimbabwe faced sanctions from Britain and the European Union after the implementation of the land reform program. These sanctions exacerbated the economic crisis in the country as they cancelled most of the international trade agreements with Zimbabwe. This made it difficult for the country to export its commodities such as beef and tobacco to the Western countries. The 2000 parliamentary and 2002 presidential elections were characterized by a lot of violence and this led the other Western countries to sanction Zimbabwe. This further isolated Zimbabwe from international trade and communications making it almost impossible for Western countries to invest in Zimbabwe thus having an adverse effect on the economy of the country. The period from 2000 to date has witnessed a high reliance of Zimbabwe on international aid due to the failure of the economy. Most companies' production levels have fallen to rates far less than their expected levels of production leading to a lot of job shedding and low revenue for both the companies and the country at large.

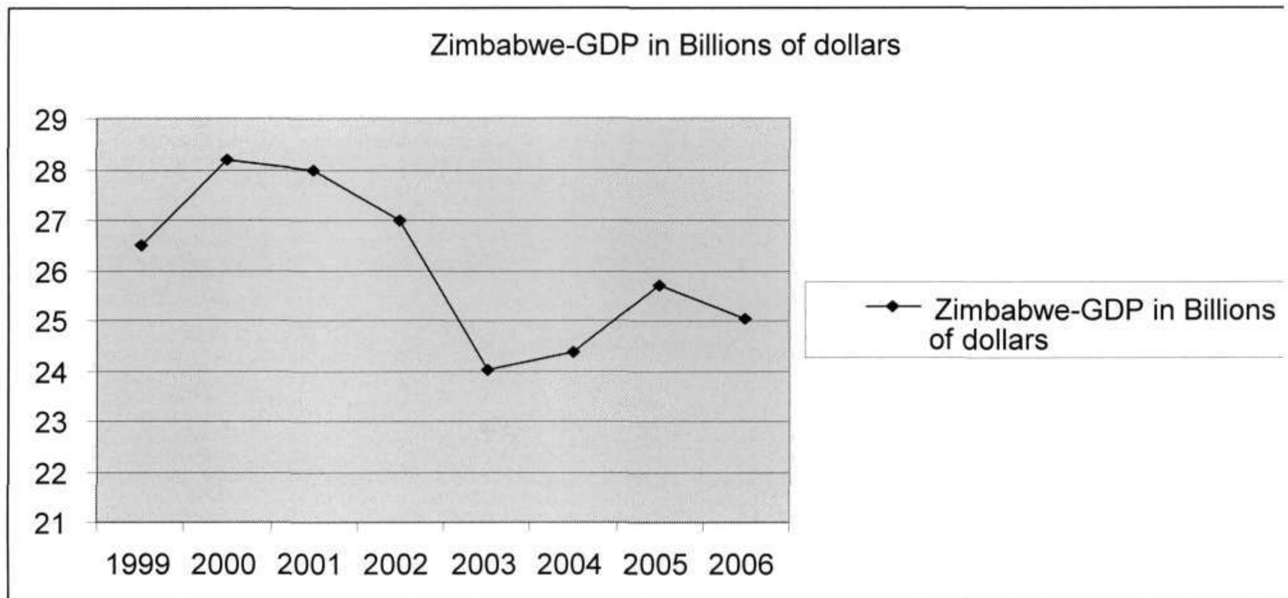
The implementation of Operation Restore Order (*Murambatsvina*) in May 2005 aggravated the economic crisis in the country as this program was characterized by lack of economic planning and poor decision making on the part of the government. Operation Restore Order's unplanned expenditure was due to the price of conducting the whole operation and the reallocation of resources to the displaced people. The destruction of the informal economy by Operation Restore Order also negatively affected the economy as this led to the decrease of the country's GDP. This was because the informal economy was a large contributor to the whole economy of the country through employment of a large number of people in the urban areas and also through its revenue. The implementation of Operation Restore Order also decreased the chances of a creation of new foreign investments in the country as foreigners feel it would not be safe for them to invest in Zimbabwe after they saw the destruction of other businesses.

The recent economic crisis in Zimbabwe has also been attributed to the brain drain of educated and skilled middle-aged people to other countries in the region such as South Africa, Namibia and Botswana to mention a few and other countries in the world at large. This is because most of the companies in Zimbabwe are not offering lucrative benefits for the skills of the people in the country thus the skilled people prefer to sell their labour to countries, which offer greener purchases thus negatively affecting the human resources of the country. The recent unstable political environment also makes it unsafe for investors to want to invest in the country. The shortages of fuel and electricity due to lack of foreign currency has also had a negative impact on businesses and the economy of the country at large. It has become expensive to transport goods due to fuel shortages thus making production costs increase. The shortages of electricity have slowed down operations and adversely affected manufacturing business, which heavily rely on electricity. This in turn has affected output and revenue thus worsening the economic crisis.

Other factors that have exacerbated the Zimbabwean economic crisis are expansionary macroeconomic policies, a breakdown in law and order, and the virtual collapse of the agricultural sector as a result of the fast-track land reforms, reducing the potential for

growth. Lenneiye (2006) states that real Gross Domestic Product (GDP) declined by 6.5% in 2005, which was the seventh consecutive year of negative GDP growth since 1997. Lenneiye (2006) further argues that over the period 1997-2005, GDP declined by more than 30%. This is because Zimbabwe is a landlocked country which has an agricultural base and during this period it was not producing as much agricultural products as it used to in the past leading to the decline in GDP. (See figure 3 for Zimbabwe's GDP from 2000 to 2006).

Figure 3: Zimbabwe-GDP in Billions of dollars



Source: CIA World Factbook, accessed 25/10/07

The decline in GDP can be attributed among other factors to the bad land reform process that took place, which witnessed productive commercial farmers having their farms taken up by new farmers, many of whom did not have farming knowledge, capital, or even the will to farm. Most of the land that was taken by the government is argued to be laying idle for most of the farming seasons leading to huge losses for the agriculture based economy.

According to the analysis by the IMF, the fiscal deficit in 2005 was close to 60% of GDP (Munoz, 2006: 2). These fiscal deficits are mainly because the government is spending a

lot yet it is receiving very little income returns from the various sectors it is supporting. In recent years it has been argued that the composition of public expenditure is highly distorted, with the public services wage bill said to be absorbing more than a third of total expenditure and fewer resources available for poverty-reducing activities. Zimbabwe is also facing a hyperinflation, which usually comes packaged with many other policy mistakes, the accumulation of which contributes to a poor and often disastrous economic performance.

Chapter 5: Research Findings

5.1 Introduction

This chapter details findings from a qualitative study of the impact and effects of hyperinflation on SMEs in Harare, Zimbabwe in 2007. The chapter describes perceptions of the negative impact of hyperinflation on SMEs in Zimbabwe. A total of 15 questionnaires were administered and 18 in-depth interviews (IDI) were conducted over a period of two weeks in June and July 2007 and three weeks in September and October 2007 at Avondale Shopping Centre in Harare, Zimbabwe. The sample was selected purposively. The sample consisted of business owners and workers in the SMEs.

The period from March 2007 to November 2007 marks the period of hyperinflation in Zimbabwe under discussion in this paper. June 26, 2007 marks the introduction of price controls by the government and the impact of both hyperinflation and the price controls on SMEs in Zimbabwe. During the period March 2007 and June 2007, before the price controls were implemented, both the formal and informal traders adjusted their prices according to the rate of hyperinflation, increases in production costs, fuel costs and increases in wages among other factors.

5.2. Impact of hyperinflation on SMEs before price controls

5.2.1. SMEs' views on the impact of hyperinflation in Zimbabwe

The majority of the SMEs, both business owners and workers, defined hyperinflation as a situation where too much money chases too few goods. In support of this view most SMEs associated hyperinflation with the loss of monetary value to purchase commodities in the market. According to the branch manager of Edgars, "hyperinflation is when money does not have the high value it had before to enable one to purchase as many goods as they did in the past when the value of money was higher than the value of goods" (Interview, The Branch manager, Edgars: 22/06/07). The branch manager of Edgars also stated that the price of new stock was rapidly increasing, almost on a daily basis and this made it difficult for them to purchase as much stock as they wanted. The branch manager of T.M supermarket also acknowledged the negative impact of hyperinflation on their business operations when he stated that:

> Hyperinflation has witnessed a situation whereby our revenue from the sales cannot afford us to purchase new stock. It has also brought about a situation whereby our employees cannot afford to purchase the commodities they sell because their real income is far much lower than the ever-increasing prices. (Interview, The Branch manager, T.M supermarket: 21/06/07).

The manager of Bon Marche stated that during the hyperinflationary period the prices of commodities increased rapidly as compared to their real income and sometimes on a daily basis. The manager of Bon Marche also stated that:

> Hyperinflation has made it difficult for our consumers to purchase commodities as much as they would have liked so as to satisfy their basic needs because our customers do not earn as much to enable them to spend as they used to do in the past (Interview, Branch manager, Bon Marche: 21/06/07).

To support this view the manager of Celians Florists stated that:

> Hyperinflation has led to a rapid increase in prices of our commodities, sometimes thrice a week so as to make at least a break-even in our business. This has however reduced the number of customers we get on a daily basis since most people cannot afford to buy commodities at such high prices. (Interview, The Manager, Celians Florists: 20/06/07).

The manager of Edgars also stated that hyperinflation led to numerous shortages of commodities in the market. These shortages led the volumes of sales to decrease due to lack of variety for consumers to choose from. The managers of T.M and Bon Marche supermarkets argued that hyperinflation led to reduced production by many manufacturers of basic commodities. The reduction of production by manufacturers resulted in an increase in shortages of basic commodities in the market. There was a general consensus among participant that due to shortages of stock in their businesses, they had to sell the little stock available at high prices so that they could maintain profit margins and make enough revenue to purchase new stock.

All the traders interviewed in the informal sector stated that hyperinflation affected them mainly through increases in price of foreign currency on the parallel market, which was ever-rising and made it difficult for the SMEs to purchase foreign currency to enable them to import commodities from neighbouring countries for resale in Zimbabwe. The informal traders stated that the exchange rate was highly volatile. The volatility of the exchange rate had an adverse impact on inflation, employment, investment and economic growth. One informal trader, who sold designer clothes, stated that:

> The current economic crisis in Zimbabwe has made it impossible for businesses in the informal economy to purchase foreign currency from the Reserve Bank of Zimbabwe leading most informal traders to purchase foreign currency on the parallel market. Hyperinflation has led to a rise in the rates of foreign currency on the parallel market making it expensive for the businesses to purchase it. This situation led to the rapid increase of prices of commodities on sale because we have to retain our capital, also need profit and enough money to purchase foreign currency at the rate it would be sold for in future. (Interview, Informal businesswoman: 21/06/07)

The research findings showed that hyperinflation in Zimbabwe led to a creation of an unfortunate chain of burdens. This was echoed by the branch manager of T.M supermarket who stated that:

> Hyperinflation in Zimbabwe has created vicious circle of high prices; the manufacturers purchase their primary goods from the producers of raw materials at exorbitant prices. Manufacturers need to make profit so they charge the businesses who buy stock from them higher prices for their commodities. This will in turn lead the traders to sell the commodities to the consumers at higher prices to meet their profit margins. In the end the consumers are the ones who are most affected by the situation as they have to purchase these goods at exorbitant prices. However, since most consumers cannot afford to buy commodities at such high prices, this means a reduction in sales on our part. This slows down our business and will lead us to reduce the volume of our new stock which will also

> affect the manufacturers' revenue in the end (Interview, The Branch manager, T.M supermarket: 21/06/07).

This view highlights that hyperinflation in Zimbabwe made it difficult for traders to sell their products at market prices because most of the people in the country could not afford them. This led to low sales, which resulted in low revenue for the businesses. The non-purchase of commodities by the consumers due to high prices led commodities to stay on the shelves longer than anticipated and sometimes fragile commodities went bad and some expired and this led to losses for the businesses.

The owner of Itech computer sales made an interesting comment on the impact of hyperinflation on the spending patterns of consumers in Zimbabwe when he stated that their sales had hugely declined. He believed that this was due to the change in spending patterns of the people in Zimbabwe (Interview: 20/06/07). He stated that:

> People have definitely shifted their spending patterns from purchasing other commodities such as the computers and computer accessories that we sell and luxury goods to only purchasing basic commodities as and when they find them in the supermarkets since they are scarce. This is because most people in the country are not earning as much to be able to afford both basic and luxury commodities. (Interview, The owner of Itech Computer sales: 20/06/07).

This view was also supported by an employee of Mark and Manolios among other SMEs who stated that they sometimes spent up to three working days with no sales of the sporting products they sell. According to the employee, this was because "hyperinflation has made many people focus on acquiring basic needs such as food and shelter. Sporting products and clothes are not people's priorities right now..." (Interview: 20/06/07). The pharmacist of Avondale Pharmacy argued that most people only purchase drugs from the pharmacy because they are a necessity if one is sick but their sales in luxury commodities such as perfumes, deodorants and other luxury products they sold drastically declined during the hyperinflationary period.

In summary, SME traders identified several issues as impacting their businesses arising out of hyperinflation namely:

- Increases in producer prices which led them to increase their consumer prices.
- The revenue which SMEs received from their sales was not enough to purchase required new stock to maintain their profit margins.
- Consumers' low real income led to a decline in the SMEs' sales as most customers reduced their consumer baskets due to hyperinflation.
- The reduction in production and in some cases the cessation of production by manufacturers led to shortages of commodities in the market. This affected the SMEs' sales and revenue.
- The overvaluing of the exchange rate made the demand for foreign currency from the Central Bank higher than the supply thereby creating scarcity of the commodity. This led to parallel market foreign currency traders to dictate the prices of foreign currency available in the market.
- Hyperinflation led to a shift in the spending patterns of consumers as most people shifted from their luxury spending patterns to purchasing basic commodities due to low real income.
- Hyperinflation led SMEs to experience increased expenditure patterns at the expense of low revenue and this led to losses for most SMEs.

5.2.2. Adjusting prices

Most SMEs stated that they increased the prices of the commodities they sold as and when the input costs were also increased. A pharmacist at Avondale Pharmacy stated that they were increasing the prices of their commodities as and when they had new stock in the Pharmacy. This was because the producers would have increased their producer prices, therefore for the pharmacy to stay in business it had to also adjust its prices to ensure that it sustained its profit margins (Interview: 20/06.07). The Pharmacist also stated that the pharmacy increased the wages of its employees at least twice a month to enable its employees to meet up with the escalating living expenses in the country. She stated that the increases in wages of employees had an effect on adjusting prices of their

commodities. This was because when they increased their expenditure, they also had to increase their revenue so that the business could maintain profitability.

The manager of Bon Marche stated that before the price controls by the government, they used to increase prices of their commodities as and when their producers increased the producer prices. The manager argued that when the producers increased the price of the new stock they also had to increase the consumer prices of both the old stock and the new stock regardless of the fact that they bought the old stock at a lower price. Their argument in increasing the price of the old stock was that if they sold the old stock at the old price they would not be able to purchase the average quantity of new stock they usually purchased at the increased producer prices while they maintained their profit margins (Interview, Branch manager, Bon Marche: 21/06/07).

The manager of T. M supermarket stated that they increased the prices of their commodities as and when the price of production increased. He also argued that they adjusted their prices according to how other businesses were adjusting the prices of the same brands of commodities they sold on the market (Interview, Branch manager, T.M supermarket: 21/06/07). It is therefore clear that the producer price was not the only determinant in the adjustments of prices by businesses as the general operations of the market also played an important role in the setting up of prices.

An employee of Smart Collections stated that the prices of the clothes they sold were determined by the rate of the US dollar or the rand at the parallel market (Interview: 22/06/07). She also stated that they had eradicated the lay-bye system. This was because their lay-byes were valid for three months and if a customer paid half of the price of a commodity he or she wanted to purchase, by the time they finished their installment, the currency would have lost its monetary value due to hyperinflation. The owner of Itech computer sales stated that prices of its products were adjusted once a week depending on the prices of the new stock received (Interview: 20/06/07). Celians Florists adjusted the prices of their flowers on a daily basis. The manager however stated that they still failed to maintain the profit margins because of the ever-increasing prices of commodities they

needed to sustain their business (Interview, The Manager, Celians Florists: 20/06/07). The employee of Mark and Manolios sport shop stated that the prices of commodities were adjusted four or five times a month during the period in discussion (Interview: 20/06/07).

The branch manager of Edgars stores stated that the prices of their clothes and other commodities increased as and when the producer prices were increased. She acknowledged that they adjusted the price of the old stock to the same price as the new stock so as to retain their profits (Interview, The Branch manager, Edgars: 22/06/07). On the other hand prices of clothes sold by Zeon clothing company were adjusted every week while the salaries of the employees were adjusted monthly (Interview, Employee, Zeon Clothing Company: 22/06/07). The researcher observed that Nandos, Wimpy and St Elmo's adjusted the prices of their fast foods on an average of three times per week (Observation: 19-25/06/07). The employees of the three fast foods companies stated that this was because most of the producer prices of necessary ingredients were increased three times per week.

All the informal traders interviewed stated that they adjusted their prices according to the parallel market rates of the rand or the US dollar. They stated that if the prices of the rand or US dollar increased on the parallel market, the traders would also increase the consumer prices of their commodities. One trader's argument in this regard was that she purchased most of her business products in South Africa and Dubai so she had to sell the commodities at the equivalent prices of the respective foreign currencies so that she could be able to purchase new stock (Interview: 29/09/07). The researcher however found out that the prices of commodities were not reduced when the price of foreign currency on the parallel market decreased (Observation: 25/09/07-05/10/07).

Even though businesses adjusted their prices at different rates, most stated that they adjusted their prices according to increases in production costs. Zeon Clothing Company, Mark and Manolios sport shop and Celians Florists stated that they sometimes increased the prices of their commodities by 100% or more if the producer prices were also

increased by such margins (4/10/07). These increases in consumer prices however contributed to the rise of hyperinflation in Zimbabwe. On the other hand hyperinflation affected the SMEs negatively because most consumers could no longer afford to purchase commodities on the market at the high prices they were being sold for. This followed the rational expectations theory, which states that outcomes do not differ systematically, regularly or predictably from what people expected them to be.

In summary, all SME traders interviewed stated that they increased their consumer prices so that they could maximize their utility and profits. The informal traders in general determined the prices of their commodities by the rate of the foreign currency exchange rate at the time. Most formal businesses determined the prices of their commodities by the producer prices of their commodities. Most SMEs also stated that they increased their prices in speculation of increases in producer prices in the future. These increases in prices to maintain profits by SMEs on the other hand led workers to negotiate for increases in their income so as to afford to purchase commodities on the market. This cycle led to a need for more money in circulation to meet demand, leading to an increase in money supply and this increase in money supply led to a rise in inflation.

5.2.3 Adjusting wages

The manager of T.M supermarket stated that they increased their workers' wages once a month. He also stated that they increased the transport allowances twice a month to cushion employees from increases in transport fares due to the increases in fuel prices (Interview, The Branch manager, T.M supermarket: 21/06/07). The manager of Bon Marche stated that they sometimes reviewed the salaries of their employees according to the monthly inflation rates but usually according to company policy, which stated that salary reviews would be conducted quarterly. They also adjusted transport allowances for their employees as and when fuel prices were increased to make it possible for employees to commute to work. The manager of Bon Marche also argued that adjusting wages and transport allowances for employees without following company policies and following the inflation rates might result in huge losses for the business (Interview, Branch manager, Bon Marche: 21/06/07). However, both supermarkets' company policies stated

that it was illegal to decrease the wages of employees even when the revenue was lower than the expenditure.

The branch manager of MICA hardware stated that they increased the wages of their employees according to the rate of inflation (The manager, MICA Hardware: 28/09/07). An employee of Smart Collections on the other hand stated that wages were adjusted once a month. She however argued that the wage would lose its monetary value before the end of the same month due to hyperinflation (Interview: 22/06/07). This meant that the real income was not adequate to maintain the employee for a month due to hyperinflation and the ever-rising prices of basic commodities and transport fares to commute to and from work in the country. The owner of Itech stated that the wages of employees were adjusted as and when prices of general basic commodities were increased so as to increase the real income of the employees (Interview: 20/06/07). Mark and Manolios' employee stated that her wages were adjusted once in three months though she received transport allowance every week to provide for the increases in transport costs (Interview: 20/06/07).

The branch manager of Edgars stated that salaries of employees were adjusted according to company policy but the employees' transport allowances were adjusted twice a month to cushion employees from increases in the transport fares (Interview, The Branch manager, Edgars: 21/06/07). Employees of Nandos, Wimpy and St Elmo's stated that employees' transport allowances were adjusted twice a month to enable workers to cope with the rising transport fares to and from work; however, their wages were adjusted quarterly. The employees stated that the transport allowances they got from the fast foods outlets were not enough to enable them to commute to and from work, moreover, their wages were too low to enable them to attain basic living conditions in the hyperinflationary environment.

The informal traders interviewed stated that they all had different contracts. They also stated that most of the contracts were 'open contracts' and their wages and transport allowances were reviewed according to individual agreements with owners of the

businesses. Some of the informal traders were owners of the businesses they were operating at the market and they stated that they reviewed their wages as and when they realize profit in the business. The employees stated that their sales had been affected negatively by hyperinflation in the sense that even though they had so much stock to sell to consumers, most of the consumers could not afford them. This was due to the consumers' low real income and the fact that the consumers had shifted from purchasing commodities such as clothes and artifacts regularly to purchasing basic commodities, which were not sold by the informal traders.

The change in spending patterns by consumers negatively affected some informal traders who spent about six months without ordering new stock since their old stock had not yet sold out. This loss of revenue by traders meant that the wages of employees in the sector were also affected negatively. Most employees stated that at the end of every financial month their employers paid them a standard wage, which was not adequate to sustain them for the rest of the month at the time. The employees stated that the employers paid their other allowances as commission of the sales they would have made for the month thus if one did not have any sales that month, their commission would be very low. This scenario was elaborated by one informal trader who stated that:

> One can go for a week without having had any sale of the commodities on display. As an employee, my wage depends on my sales. If I do not make any sales it would mean I will not have any commission added to my wage. This will leave me with just an insufficient basic salary unable to sustain me for the whole month (Informal trader, 20/06/07).

The findings above reflect that hyperinflation negatively affected SMEs even before the government implemented price controls end of June 2007. Hyperinflation during the discussed period affected both the SMEs and the employees working for the SMEs. This was evidenced by the sentiments of an employee at OK who stated that, "For us it is even worse because we sell commodities that we cannot afford to buy with our paltry salaries" (*The Herald, 25 June 2007*).

In summary, businesses however responded differently in adjusting wages in the hyperinflationary context. These included:

- Some SMEs adjusted the wages of their employees once a month, while others adjusted them twice a month.
- Wages adjustments for other employees in the formal sector were adjusted quarterly.
- Other SMEs adjusted the wages of their employees according to their companies' policies while other SMEs adjusted the wages according to the rise in monthly consumer price index (CPI). SMEs who adjusted the wages of their employees according to respective company policies were largely formal businesses.
- The informal traders had individual contracts and their wage adjustments depended on their respective contracts.
- Most SMEs provided transport allowances for their employees to cushion them from the increases in transport fares caused by the increases in fuel prices. However, the intervals at which the SMEs provided transport allowances for their employees differed depending on company policies.

5.3. Implementation of price controls and their impact on SMEs in Zimbabwe

5.3.1. SMEs' definitions and understanding of price controls

The majority of the SMEs defined price controls as regulations set by the government to reduce the prices of commodities on the market below their cost prices. Some SMEs defined price controls as restrictions on maximum prices that are established and maintained by the government in its quest to curb inflation. The majority of businesses also stated that price controls led most businesses to operate at a loss. This was because in most cases price controls inevitably made their selling price lower than their purchasing price. It was also stated that price controls led to bulk buying by the consumers. This left most stores with empty shelves and without enough capital to reinvest in the purchase of new stock. This view was supported by the manager of Bon Marche who stated that:

> Price controls have led us to suffer huge losses as we were made to sell all our commodities at prices 50% lower than the market price. Our storerooms were

> emptied and all our products put on the shelves. Our stores are empty because a lot of people bought most commodities in bulk. The government-gazetted price is not even half of the producers' prices we paid to purchase the commodities from our producers. This has led us to operate at a loss. We do not know where we will get the capital to reinvest in the business and operate on a normal scale as we did before the price controls. Business operations were difficult before due to hyperinflation but the implementation of price controls has just made it more difficult for us to sustain our businesses (The branch manager, Bon Marche, 29/09/07).

In regard to price controls, the manager of Edgars stated that they were selling every product in their range below cost. She stated that they were heading for bankruptcy and did not know what to do next (Interview, The Branch manager, Edgars: 05/10/07). Other businesses stated that they were not able to replace their stocks of spares and purchase essential inputs. The manager of T.M supermarket stated that, "when we run our stocks down to zero, we would go onto a hand and mouth basis, asking our clients to source the required spares and raw materials before we could start work because there is nothing else we will be able to do in this situation" (Interview: 4/10/07).

According to the *Mail and Guardian* (2007: 12) the June 2007 price controls are projected to halve the state's income in the short term and will further cripple the economy. Signs of this happening were emphasized by the branch manager of Edgars who stated that:

> We are operating at a loss because our expenditures have been higher than our revenue for a larger part of the year especially beginning in March 2007 because of the high producer prices, high wages being demanded by the employees for them to cope with hyperinflation, high transport allowances, high rental, electricity and water bills, not being allowed to lay-off staff by the government to reduce our expenditure and forced to reduce our prices lower than the market rates. The government would not even assist by subsidizing our expenditure to keep us in business (The Branch manager, Edgars Stores, 05/10/07).

Although the intervention by the Zimbabwean government on prices was done in good faith for the benefit of the public, it is doubtful whether the price controls were a viable mechanism to increase consumer welfare in the context of a hyperinflationary environment without also focusing at the cost side of the production chain. Some traders have therefore argued that the government used its political muscle to reduce prices in the market to try and cover up for its bad economic decisions.

In support of the view that price controls were implemented with political motives, the Chairman of the Cabinet Taskforce on Price Monitoring and Stabilization, O. Mpofu stated at a press conference on 25 June 2007 that:

> Government is aware that these escalating price increases are a political ploy engineered by our detractors to effect an illegal regime change against the ruling party, ZANU-PF and the Government following the failure of illegal economic sanctions....The taskforce recently constituted by the government is going to immediately take appropriate action against unscrupulous and insensitive economic players (*The Herald, 26 June 2007:1*).

To emphasize the political side of hyperinflation in Zimbabwe, the Central Bank Governor stated that economic challenges and policies, monetary or fiscal, including any shortcomings thereof, can not and should not be read and viewed in isolation of the political challenges Zimbabwe is facing as a country (RBZ, Monetary Policy Review, 2007: 38).

On the other hand, the Central Bank Governor stated that; "in the controlling of prices the government needed to realise that apart from attending to consumers' plight, there is need to attend to the production plight, what we call the supply side, to avoid the emptying of shops without replacements the next day" (*Mail and Guardian, 14 July 2007*). In the 2007 Monetary Policy Review, the Central Bank Governor maintained his stance against hyperinflation and price controls when he stated that:

> No Central Bank likes high inflation; let alone hyperinflation; no Central Bank likes Government budget deficits or overspendings; no Central Bank likes

> subsidized credit or any form of generalized subsidies to the economy except those properly targeted to cushion the vulnerable poor. That is, if your situation is normal. No Central Bank likes pricing distortions in its backyard be they for grain, electricity, fuel or foreign currency. We do not and have never hidden our view on this matter. No Central Bank likes price controls of any nature and no Central Bank likes to engage in quasi-fiscal operations when general fiscal budgeting and the market is there to take care of these aspects (RBZ, Monetary Policy Review, 2007: 38).

In June 2007, a week after the government had requested the reduction of prices of basic commodities on the market, supermarkets continued to increase prices of their commodities. On the 25th of June 2007, standard loaf bread was pegged at Z$ 44 000. 00 while super white bread was pegged at Z$ 59 000.00. A loaf of bread cost Z$ 22 000.00 the last week and barely seven days later it had gone up by 100 %. The managers of T.M and Bon Marche stated that they had to sell the bread at high prices because the prices of flour and other raw materials needed to make bread were also expensive. During the same week Nandos increased its prices by about 300% stating that they had to so that they could at least breakeven (Observation: 25/06/07). *The Standard, Business Digest* (23-29/11/07) stated that 90% of the country's bakeries have closed shop since the beginning of the year after they failed to get consistent fuel and wheat supplies from the government.

Both managers of T.M and Bon Marche argued that it was only rational for them to charge such prices so that they could maintain profit margins otherwise if not so it would be better for them to stop producing standard bread and produce an alternative not price controlled by the government such as meat pies. Due to government persistence to make supermarkets sell bread at half the market price, both T.M and Bon Marche supermarkets reduced the quantity of bread produced. These sentiments were also echoed by Eddie Cross, a businessman in Zimbabwe who stated that:

> In my own business we passed a milestone today-by our calculations inflation in our business now exceeds 10 000 % per annum. I was told by my supplier today

> that flour for the bakery would now cost me Z$ 250 000.00 for a 50 kilogram bag and I have to collect it at my own cost from Harare... The last time I bought flour from the same supplier it was Z$ 30 000.00 for a 50 kilogram bag delivered to Bulawayo (Cross, May 2007:1).

On the 26th of June 2007, all supermarkets were requested by the government to reduce the prices of 2 litres of Mazoe Orange crush, Colgate toothpaste and Geisha soap. Most supermarkets cut the prices of 2 litres of Mazoe Orange crush but did not reduce the price of 1 litre of the same drink. Supermarkets were selling 2 litres of Mazoe Orange crush at Z$ 120 000.00 from between Z$ 400 000.00 and Z$ 550 000.00 the previous week while 1 litre of the same drink was still being sold at Z$ 225 000.00. When the researcher asked the manager of T. M supermarkets why they were selling 1 litre of Mazoe orange crush at a higher price than a 2 litre bottle of the same drink, the manager stated that:

> This was because the government only requested us to reduce the price of 2 litres of Orange crush and not 1 litre ones so we maintained the prices of the 1 litre but reduced the prices of the 2 litres so that we could at least get a profit from the one litre ones when the 2 litre ones are out of stock (Interview: 21/06/07).

The bread price which had been increased in that week to between Z$ 40 000.00 and Z$ 60 000.00 was reduced to Z$ 22 000.00. This situation led T.M and Bon Marche to stop producing bread. This in turn led to shortages of bread for the consumers who bought their bread at the centre. The government insisted on the price controls of many other commodities the same week and this scenario witnessed many basic commodities disappearing from the shelves. Most clothing and furniture shops were also forced to freeze the prices of their commodities to June 18, 2007 levels (*The Herald, 13 July 2007*). By controlling prices the government meant to give the workers a significant disposable income since their real incomes were eroded by hyperinflation. However, this situation just witnessed the transference of burden from the consumers to the business operators in the short run and in the long run both the consumers and the producers were affected, as the consumer could not purchase commodities from the producer because the producer could not produce at low rates.

As a result of the price controls, most manufacturers were forced to produce commodities and sell them at lower rates than the market prices. Many of these manufacturers then had to stop most of their production or even to completely close down all operations. The Confederation of Zimbabwe Industries (CZI), an independent, self-financed, legally constituted organization that represents and serves interests of member industries in a wide array of matters affecting their viability and competitiveness in Zimbabwe stated that:

> Most manufacturing companies had reduced their productions and some had closed down operations because they could not meet their profit targets at such low prices being gazetted by the government. The reduction of production by the manufacturing industries has witnessed the reduction of commodities in the market thus leading to scarcity of commodities. The scarcity of commodities has experienced unfair profiteering by businesses that end up selling their commodities at exorbitant prices to 'willing buyers' or 'affording buyers'. The government is exacerbating the pricing problem rather than solving it (The Marketing manager, CZI: 28/09/07).

Supermarkets in the country initially responded to these price controls by removing most of their commodities from the shelves to their storerooms. The disappearance of basic commodities led the government to employ a police taskforce to go into most supermarkets and search for hidden basic commodities of which if found were confiscated and sold at rates stipulated by the government (*The Herald, 13 July 2007*). This situation led to many supermarket, clothing and furniture shops to sell all their products at the rate stated by the government. The manager of T.M supermarket argued that:

> Since most of the police officers that were tasked to make sure that businesses reduced the prices of their commodities by 50% did not know the initial prices of all the commodities before the price controls, some of the police officer decided the prices they wanted the commodities to be sold at (The branch manager, T.M Supermarket: 4/10/07).

This situation led to bulk purchasing by the consumers, as the prices of commodities were low and real income had increased due to the reduced prices of commodities in the market.

Bulk purchasing by the consumers left many stores with empty shelves by the beginning of July 2007. Although most stores had their shelves empty by the beginning of July 2007, the manager of MICA hardware stated that:

> Even though consumers were buying our commodities in bulk, we had so much stock that we still refilled the shelves. This was because it was better for us to sell all our products than have the police come and confiscate the commodities. Confiscation of our products would mean that we would suffer greater losses than we stand to suffer by selling our products at the government gazetted price (Interview, The manager, MICA Hardware: 28/09/07).

The informal traders and some small formal business people at Avondale Centre stated that they were not as negatively affected by the price controls instituted by the government as the big registered formal businesses. The informal traders and some small business people were still pegging the prices of the commodities they were selling at the exchange rate value of the Rand and/or the US dollar at the parallel market rate. This was because most of their commodities had no fixed price and they were not forced by the government to put price tags on their commodities so a consumer would only be told the price of the commodity after asking for the price. An employee of Smart Collections stated that they had not been approached by the government to reduce prices that is why they had not reduced them (Interview: 3/10/07). The owner of Itech also stated that they were still selling most of their products at market rates determined by the producer prices (Interview: 28/09/07).

When some informal traders were asked by the researcher why they were not reducing the prices of their commodities and still pegging them using foreign currency, some of the traders stated that they had bought the commodities in foreign countries and for them to maintain their mark up they needed to peg their prices equivalent to the foreign

currency they used in purchasing the commodities. On the other hand, informal traders stated that even though they did not reduce the prices of their commodities, they were still affected by the price controls by the government. This was because their sales dropped substantially and this led to huge losses when prices of commodities being sold in the formal businesses were controlled. This was due to the fact that many consumers preferred to buy their commodities in the formal market where they were cheaper as government had reduced their prices rather than purchasing commodities from the informal traders.

The formal stores, which did not reduce their prices, were also affected as they did not manage to have as many sales as they would have if they had reduced their prices due to the government implemented price controls. An employee of Smart Collections stated that they spent six months without purchasing new stock and without selling much of the old stock they had due to the high prices of their commodities (Interview: 3/10/07). An employee of Zeon clothing store stated that most stores have not been able to sell most of their stock and this has led them to suffer to huge deficits (Interview: 1/10/07). When the researcher asked the SMEs how they were coping with hyperinflation in country, the majority of the SMEs stated that they have not managed to cope very well during the period under discussion but were just sustaining their businesses hoping that better opportunities in the near future.

On the other hand the decrease in stock, sales, price controls and low profit margins led some SMEs to threaten that they would lay off some of their staff to maintain their profit margins. The low profit margins were a result of high expenditures due to high wage, electricity, rental, water and for some SMEs production bills while their incomes were very low. The government however responded to threats by SMEs to lay off some of their staff by not allowing companies to lay off staff or reduce their salaries as a result of the economic crisis *(The Herald, 13 July 2007)*. President Mugabe responded to the SMEs' threats by stating that all manufacturers and producers were supposed to continue producing commodities for the market or the government would take over all the firms, which would not be productive (*Sunday Times, 8 July 2007*).

President Mugabe further echoed that "the nonsense of price escalation must come to an end immediately and if not then it will be a rough game between the government and the business operators" (*The Herald, 28 June 2007: 1*). Vice President, Joseph Msika reiterated the President's words stating that the government was not going back on its decision on price controls and if anything the government would want further price reductions. He further stated that "those companies who do not want to comply with the government price controls should close or the government would force them to close down" (Kingdom Financial Holdings, 2007). However, when the Vice President advocated for closure of these companies, he did not take into consideration the number of people these companies were employing, as their closure would lead to mass unemployment.

The negative impact of price controls was also noted by Eddie Cross, a Zimbabwean businessman who stated that, "Since we were forced to reduce our prices by 50%, we have been swamped by demand. Virtually all butcheries and filling stations are closed, more than half of the bakeries are closed and maize is virtually unattainable" (*Pretoria News*, 2007: 1). This is because farmers stopped selling their farm produce at low prices, which the government of Zimbabwe had gazetted. *The Mail and Guardian* (2007: 1) states that the Governor of the Reserve Bank of Zimbabwe slammed the Government for not taking his advice to do away with price controls. The Governor of the Reserve Bank of Zimbabwe had written a report to the government arguing that it was the Central Bank's strongest conviction that only through a holistic framework could Zimbabwe stabilize prices, without inducing shortages in the market.

Not only were supermarkets and other commodity shops fast running out of stock but also the quality of commodities which were being produced such as bread were severely compromised. Price controls made it difficult for retailers to get the required orders from producers as they had either stopped producing or reduced production significantly (Kingdom Financial Holdings, 2007: 3). Raw materials destined for the manufacturing sector were reduced significantly and some SMEs closed some of their branches after running out of stock.

Hyperinflation and the price controls led the closure of some smaller branches of stores such as Edgars and Express clothing stores. The manager of Edgars stated that:

> We were forced to close down some of our smaller branches in smaller towns and in places where stock in the stores had run out to cut on losses emanating from rentals of the buildings, electricity and water bills. However, we did not lay-off any employees as a direct response to the closure of these branches but transferred those who still wanted to work for Edgars to other branches. Express stores have also had some of their branches closing down due to the price controls and inadequate capital to purchase new stock (Interview, the branch manager, Edgars: 05/10/07).

This was because when the price controls were implemented many consumers purchased available commodities on the market in bulk leaving most stores empty. A number of SMEs traders argued that they sold most of their commodities at a loss. This was because they had purchased their stocks from their producers at prices that were higher than the prices gazetted by the government. Those branches, which were closed down, had their employees transferred to other branches, which were still operating. Employees from branches that were closed down were transferred to other branches because the government did not allow SMEs to lay off staff as a result of the economic crisis. However, some employees resigned because their real income was too low in search of greener pastures. For some employees who were transferred from closed branches to other branches where they had to take two taxis to get to work or were transferred to other branches outside their town of residence it was reasonable for them to resign and receive their packages. The manager of Edgars stores argued that:

> Some employees who were transferred to branches outside their residential towns or to branches where they took more than one taxi to get to work resigned. Some of the employees who resigned cited reduction of their real income as a result of either taking more than one taxi to work or as a result of separating from their families citing economies of scale (Interview: 5/10/07).

Some property owners removed their properties from the property market to evade the government crackdown on prices. This was stated by the managing partner of one of the

leading property owners who acknowledged that landlords had resorted to withdrawing properties form the market due to government's rent freeze (*The Sunday Times, 8 July 2007*). The withdrawal of property on the market created uncertainty for the business people who were renting business places from property owners. This was because if the property owners withdrew their property from the market, in worst cases could force businesses to close down. The withdrawal of property from the market would also promote precarious contracts between the SMEs and the property owners with the owners having to dictate their terms unconditionally.

South African companies who had invested in Zimbabwe such as Makro supermarkets were questioning whether investments were safe in Zimbabwe. It is argued that images of the 2000 land invasions had flickered darkly in their minds. The price controls were argued to be a possible turn away to all prospective investors in the country (*The Herald Business, 13 July 2007*). The effects of the price controls by the government led many renowned companies not to reinvest in Zimbabwe. The lack of investment in the country adversely affected the growth of the economy in a huge way. One informal trader argued that:

> The government is destroying the economy on its own because of its habit of chasing away foreign investors by its introduction of policies, which do not promote economic growth such as these price controls and the fast track land reform programme. The fast track land reform programme led many farmers who had invested in Zimbabwe taking most of their investments to neighbouring African countries who support economic growth. Zimbabwe was reduced from being a breadbasket of the SADC region to a nation that survives on food handouts due to some irrational policies by the government (Interview: 29/09/07).

SME traders argued that hyperinflation negatively affected the diversification and expansion of old businesses. The branch manager of Edgars stated that instead of Edgars stores opening up new branches across the country, they had been forced to close some of their smaller branches to maintain profit margins. One informal trader argued that it was difficult for their business to expand because they were already operating at a loss. When

the researcher asked SME traders if there were other people who joined the business sector during this period of hyperinflation most of the SMEs stated that it was difficult for people to join the business sector because of the shocks associated with hyperinflation. It was however noted that many SMEs had diversified their business ideas. This was demonstrated by Nandos and Wimpy food outlets, which did not sell sadza as part of their main dishes before the country experienced food shortages but sold it during the hyperinflationary period[2] (Observation: 25/09/07- 5/10/07). It is argued that they could not find most of the products they needed to make their meals due to food shortages so they opted for alternatives, which were available in the market.

Given these negative results of the price controls, there was need for the government to address the cost side of the production chain through the introduction of subsidies so that producers could access such imports as fuel, foreign currency and farming produce at a lower price. This is because although subsidies, just like price controls cause price distortions, subsidies guarantee the availability of commodities at a lower price. Kingdom Financial Holdings (2007: 4) argued that, "unfortunately the government's capacity to subsidize producers is limited due to the financial constraints emanating from a plethora of national requirements such as the importation of food and agricultural sector inputs and machinery".

Even though the government invested greatly in the agricultural sector inputs and machinery, the farm produces were low because of the bad rainfall patterns in recent years. Most of the resettled farmers also lacked the capital and expertise to produce as much as the displaced farmers. These factors coupled with high input costs in farming and low profit margins due to price controls led to low supply of farm products to producers. The manager of Bon Marche stated that the supermarket was receiving very little of farm products such as meat, vegetables, milk, mealie-meal and this situation had left them without any of the farm products to sell to the consumers. When these products were found in the supermarket, they would be of limited quantity, most likely to be sold off in an hour and being sold at a price out of reach for most consumers to recover the

[2] Sadza is Zimbabwe's staple food cooked with boiled water and mealie-meal.

supermarket's purchase price from the producers (Interview: 29/09/07). The manager of T.M supermarket stated that the reason why they were not getting a lot of farm produces from the dairy company or from the grain marketing company was because most farmers argued that they would not sell their produce at such low prices (Interview: 04/10/07).

Although most SMEs were restocking the commodities they sold by the end of September 2007, *The Sunday Mail* (30 September 2007: 1) stated that most of the products that were being sold by the SMEs were not classified as basic commodities but consumers expressed concern over the high prices of the commodities stating that most of the goods were essential. The researcher observed that most of the products that were on the shelves of T.M and Bon Marche were not locally produced and when he asked the managers of the stores, he was told that they imported the commodities from South Africa. The managers of T.M and Bon Marche also stated that they sold the commodities at high prices to recover their buying price and maintain their profit margins. In the first week of October 2007, a standard loaf of bread was pegged by the government at Z$ 30 000.00 while it was being sold on the parallel market at as much as Z$ 300 000.00, a figure which is ten times the gazetted price (Observation: 1/10/07- 5/10/07).

In summary, although the government might have implemented price controls in good faith as they were meant to increase the real income of consumers in the country, the results of these price controls were largely negative. The majority of SMEs were adversely affected by the implementation of price controls in the hyperinflationary period under discussion. Some SME traders argued that they were operating at losses due to the implementation of price controls as they sold their products at half the market price.

Other SMEs who did not implement price controls were also affected negatively as their sales declined because the number of consumers purchasing their commodities had also declined as consumers preferred to purchase their commodities from businesses that had reduced the prices of their commodities. Some SMEs closed some of their smaller branches to reduce operation expenses. Hyperinflation coupled with the price controls made it difficult for SMEs to expand their businesses. However, most SMEs had to

diversify their business operations so as to remain profitable. Generally, hyperinflation and the implementation of price controls led to serious shortages of commodities in the market and huge losses for SMEs and businesses in general.

5.4. The impact of fuel shortages on businesses in Zimbabwe

Zimbabwe has been suffering from fuel shortages for a large part of the Twenty-first Century. This has been mainly attributed to the shortages in foreign currency to purchase fuel and the high foreign currency exchange rate. This fuel shortage situation led the government to introduce private purchase of fuel in foreign currency but the government withdrew from this policy in July 2007 by banning all private purchase of fuel in foreign currency. The *Mail and Guardian* (2007: 1) stated that this move was severely criticized by the Governor of the Reserve Bank of Zimbabwe who stated that, "the scrapping of the fuel scheme, which removes one of the few remaining ways for people to acquire scarce petrol, appeared ill-thought".

The banning of private fuel purchases increased the price of the commodity being sold at the parallel market by more than 400% (*The Sunday Times, 8 July 2007*). This led to an increase in transport costs for both the producers and the employees who needed transport to go to work. Most of the business traders stated that they had to increase the transport allowances for their employees so as to cushion them. This was however negatively affecting the businesses' revenue, which was already suffering from losses due to low revenue from sales and high expenditures from rentals, water and electricity bills. The fuel expense also led to an increase of the transportation costs of the products from the producers to the stores.

The managers of Bon Marche and T.M argued that they had to incur more transportation costs due to fuel price increases. The managers stated that they were affected by the fuel shortages, which led to the increases in fuel prices. The increases in fuel prices led to high transport costs for their products from the producers to their branches. T.M and Bon Marche supermarkets had to increase their consumer prices so as to recover the money they spent on transport costs. An employee of Zeon clothing stated that she spent most of

her wage on transport costs to and from work and this reduced her real income with a substantial amount (Interview: 1/10/07).

Informal traders stated that they spent most of their income on transport costs. One informal trader stated that incurred a lot of transport expenses as she bought her commodities in South Africa. She stated that she paid for her transport costs in rands as transport companies argued that they bought their fuel in South Africa (Interview: 29/09/07). An employee at Nandos stated that transport costs played an important role in determining the price of the fast foods they were selling (4/10/07). The fuel shortages in the country created a chain of burdens from traders who had the scarce commodity in stock to transportation businesses, to the businesses who wanted their products to be transported from one place to the other and lastly to the consumers.

After having realized the problems being faced in the transport business the government authorized all fuel dealers to sell fuel at Z$ 60 000.00 per litre from Z$ 150 000.00 at the filling station and Z$ 320 000.00 at the parallel markets and promised that National Oil Company of Zimbabwe (NOCZIM) will ensure that all gasoline stations acquire cheap fuel (*The Herald Business, 13 July 2007*). However, this did not transpire as the government had promised since NOCZIM failed to provide fuel for the gasoline stations thus leading to a further punishment by the parallel market increases in prices of the scarce commodity in the country.

This situation made commuter operators to park their vehicles as they argued that they could not reduce the commuter fares while affordable fuel was not available. This situation has also witnessed most long distance bus operators parking most of their buses due to unavailability of affordable pump priced fuel while government is insisting on the reduction of their fares. This has seen most people willing to travel long distances being stranded in bus terminuses. From the research none of the SMEs stated that they had problems with employees not reporting for duty due to transport problems. However, there was a general consensus among the traders interviewed on the high costs of transport fares due to fuel shortages. The traders argued that commuter operators were

taking advantage of the fuel shortages in the country to overcharge employees during peak hours to and from work.

The *Mail and Guardian* (2007: 1) stated that the Reserve Bank commented against the banning of private fuel purchases in foreign currency when it stated that, "...we must avoid good intentions having negative results. Everything needs to be properly dissected, looking at the pros and the cons so that we do not make rushed decisions..." Referring to the actions taken by the government in this hyperinflationary period, Gono went on to state that, "...the last thing we want is legitimate fuel that runs mines failing because we have done what we have done ... we have hindered people from going about their normal business..." The banning of private fuel purchases in foreign currency has led to most of the transport operators parking their vehicles and has affected SMEs in various ways.

In summary, fuel shortages in the country made business operations in the country more expensive than they were before the shortages. Fuel shortages in the country affected supermarkets and food outlets more than other SMEs because these sectors required constant supplies of basic commodities for their consumers. Due to the scarcity of fuel and the high demand of the commodity on the other hand, people who had the commodity tended to maximize profits at the expense of desperate consumers. Fuel shortage led to increases in transport costs, increasing the expenditure of businesses that had their products transported to their branches, businesses that had to increase the transport allowances of their employees on regular basis. For the employees, the fuel shortages led to a decline in their real income and their vulnerability to exploitation and manipulation by commuter operators who maximized their profits on the desperation of employees to travel to and from work.

5.5. Impact of electricity power cuts on SMEs in Zimbabwe

Supermarkets stated that they were hugely affected negatively by the electricity power cuts taking place in the country. Electricity power cuts were mainly due to the fact that the government does not have adequate foreign currency to pay for its electricity debts. Zimbabwe largely imports its electricity and this requires huge amounts of foreign

currency of which was in short supply during the period under discussion. This situation led the government to introduce load shedding of electricity in all parts of the country.

The electricity power cuts adversely affected supermarkets because most of their fragile goods that needed to be kept refrigerated went bad due to the inconsistency of electricity supply in the supermarkets. The manager of T.M stated that they suffered huge losses due to the electricity power cuts. He argued that before the price controls the prices of fragile foods were expensive because the producer prices were also expensive so most of the food went bad because very few people could afford. After the price controls the fragile foods went bad mostly because of the frequent electricity power cuts. This led the T.M supermarket to suffer huge losses as it could neither sue the Zimbabwe Electricity Supply Authority for its losses nor could it return the goods to the producers (Interview: 4/10/07).

These views were reiterated by the manger of Bon Marche who argued that they seriously considered stopping fragile food orders from their producers due to the losses they had incurred when the food went bad due to inconsistent electricity supply (Interview: 29/09/07). Nandos and Wimpy employees also stated that they had suffered losses due to electricity power cuts (Interview: 4/10/07). This was because they needed electricity to preserve and prepare most of the food they were selling which the electricity power cuts did not make possible.

It was however noted that stores, which did not sell fragile foods, were not affected by the electricity power cuts in a great way except that they could not operate their computers and electronic cash registers. Electricity has however indirectly affected most stores at Avondale shopping centre due to fact that even those stores trading in clothes only were affected by low outputs from their manufacturers who were suffering from electricity power cuts which slowed down their production costs.

5.6. Reliance on the banking system in the country

Most of the formal SMEs stated that they relied on the country's banking system while all the informal traders stated that they did not rely on the country's banking system. Most traders in the formal market stated that they deposited their money from their sales on a daily basis and had no problems withdrawing their money from the banks since they had corporate accounts thus they could withdraw very large quantities of money as long as they notified the bank a day before the transaction had to be made. The manager of Edgars stated that, "they deposited all the money they get from their sales to their bank on the following business day" (Interview: 5/10/07). This was the situation in most formal companies.

On the other hand the informal traders and some privately owned formal businesses stated that they do not deposit any money from their sales to the banks because it is difficult for them to withdraw it in bulk when they want to purchase their products to sell. According to Sekete, a managing director of Kingdom Financial Holdings' subsidiary MicroKing Finance, "more than 90% of entrepreneurs in the informal sector have no access to banking facilities at all. In cases where the operators have access to financial institutions, most have no collateral and therefore are unable to open accounts and secure loans from the banks" (Interview: 5/10/07). Some informal traders stated that they kept their money in their houses while some stated that they changed them into rands or US dollars so that they will not lose value. Some informal traders stated that they invested their money in properties. They argued that when they make a lot of profit in their businesses they buy properties because unlike the domestic currency, property in the country does not depreciate. The informal traders stated that they could sell the properties when they want liquid cash at higher price since properties appreciate value on a daily basis.

On July 31, 2006 the Reserve Bank of Zimbabwe announced that it had removed three zeros from the currency. The removal of zeros by the Reserve Bank of Zimbabwe is not the first of its kind in world history. All SMEs interviewed however, stated that the removal of three zeros by the Reserve of Zimbabwe on 31 July 2006 only benefited them

in that they did not need to carry large sums of money with very little value around while doing their business. Edgars stated that the removal of zeros did not improve the value of the currency nor did it reduce the rate of inflation. The manager of T.M supermarket stated that the removal of three zeros did not have any substantial effect on the prices of its commodities as it just made them also remove three zeros from their price lists but with no change in value. One informal trader stated that:

> Zimbabwe has defied all economic logic, as a nation we do not even have a real currency; our money is not used as a medium of exchange anywhere else in the world except Zimbabwe. Even if I were to open a foreign currency account, I would have to collect my foreign currency in the form of traveller's cheques and go to Botswana or South Africa to change my traveller's cheques into either pulas or rands. This is because I cannot change my foreign currency in any Zimbabwean bank because the exchange rate is very low (Interview: 2/10/07).

A year after the removal of three zeros from the Zimbabwean currency, on 31 July 2007, the Reserve Bank of Zimbabwe introduced a 200 000.00 Zimbabwean dollar note because hyperinflation had led to the loss of value of the currency again. The 200 000.00 Zimbabwean dollar bill which was introduced would be equivalent to 200 000 000.00 Zimbabwean dollars if the Reserve Bank had not removed the three zeros. However, critics of the removal of three zeros from the currency argued that this was a short term gain in convenience but inflation was not stabilized. Makumbe, a political analyst from the University of Zimbabwe argued that it will take more than just lopping off zeros to fix the economy; corruption must stop, agricultural and industrial production must be revived (Africa Research Bulletin, 2006: 17082).

Chapter 6: Summary of findings, recommendations and conclusion

6.1. Summary of findings

The research has demonstrated that generally the SMEs have been negatively affected by hyperinflation in Zimbabwe. It was realized that most of the businesses were failing to cope with hyperinflation and the price controls implemented by the government in June 2007 as the two factors led SMEs to operate at large deficits. Most SMEs stated that they were just sustaining their businesses because the government did not allow them to close down or lay off their employees to maintain profit margins and keep them in business. The research also found out that most SMEs were sustaining their businesses with the hope that the economy would recover in future. Huge losses were reported by the SMEs and the traders stated that revenue from sales was lower than their expenditures which included employees' wages, rent, water and electricity bills that were high and rising.

The research findings also brought out that most SMEs had failed to expand their businesses, some of them closed down their smaller branches due to hyperinflation, price controls and restriction to retrench some of their employees by the government. The research findings are consistent with evidence, which states that hyperinflation leads to the printing of new currencies and removal of zeros from the currency. The present findings from the research show that Zimbabwe printed new currency and removed three zeros from its domestic currency as a way to curb the effects of inflation in July 2006.

On the other hand the both the primary and secondary components of the research also show that hyperinflation was as much a political issue as it was an economic issue in Zimbabwe during the period under discussion. This view was emphasized by the Governor of the Reserve Bank of Zimbabwe who acknowledged hyperinflation in Zimbabwe was as much a political issue as it was an economic one when he stated that:

> The question to answer is whether our situation is a normal one, and the answer, a no, and certainly not after the advent of the country's land reform programme, not after the imposition of sanctions against our country... Our economic landscape has had to play second fiddle to the local and international political life of this country in terms of economic policy formulation, degree of flexibility, rationality

of some policies, their consistency and predictability (Monetary Policy Review, 2007: 38).

The findings elaborated the effects of the land reform programme on the reduction of farm produces to various SMEs and shortages of foreign currency due to the isolation of Zimbabwe from world trade, the current economic sanctions the country is facing and the withdrawal of funding from the IMF and World Bank. On the other hand, although the quantity theory of money, exchange rate theory and rational expectations theory have been presented in this paper in a broad and impressionist way, the research findings revealed that the three theories have some relevance and salience in the context of the current hyperinflation in Zimbabwe, and the findings of this study, in so far as its impact on SMEs are concerned, are largely consistent with the overall thrust, if not the specificities of the major theories set out in Chapter 2.

6.2. Recommendations

Zimbabwe currently has the highest rate of inflation in the world with an annual rate of 7982.1% in September 2007 (RBZ Website, 1/11/07) and its impact on SMEs has been largely negative. The recommendations proposed therefore specifically focus on what policies should be implemented to reduce the negative impact of hyperinflation on SMEs in Zimbabwe. Zimbabwe needs to set up a stabilization package and comprehensive structural reforms to reduce the country's hyperinflation. It is therefore important to recommend for adjustments of policies that have worked in other countries that experienced similar rates of inflation above 1 000 % and other policy recommendations from the research findings. Zimbabwe can reduce its current hyperinflation rapidly if it makes appropriate stabilization policies as noticed in Bolivia where hyperinflation ended abruptly and led to the reduction of prices in the stores while stores maintained their profit margins. This was due to a comprehensive stabilization program introduced by the new government, which came to power in early August 1985.

Tightening fiscal and monetary policies are important for a successful stabilization program. In creating this comprehensive stabilization program it is important for the

government to consult with all SMEs for their views and comments. This will create a stabilization program, which is inclusive of the needs of the SMEs in the country. It is important for the government to seek international policy advice, technical and financial support during the early stages of stabilization. The government is also encouraged to view SMEs as partners in the development of Zimbabwe and not as enemies so that the two stakeholders can work together for the benefit of the economy at large.

Hyperinflation in Zimbabwe has been fueled by high rates of money growth reflecting rising fiscal and quasi-fiscal deficits. These deficits reflect large foreign exchange subsidies to public enterprises, government and price supports to exporters to partially compensate them for the highly overvalued exchange rate. In order to finance these activities, the RBZ increased money supply, giving rise to accelerating rates of inflation. The government therefore needs a comprehensive, strong fiscal consolidation, including elimination of quasi-fiscal activities for successful stabilization program to be in place.

The government needs to liberalize the foreign currency exchange rates and remove restrictions on current international payments and transfers. There is also need to liberalize the exchange regime by unifying the exchange rate. The interbank exchange rate would need to be substantially devalued promptly and all multiple exchange rates eliminated. The interbank rate should then be depreciated steadily toward the parallel market rate to promote foreign investments and create an incentive for domestic investors to sell their foreign currency to commercial banks.

Given this extraordinary context of macroeconomic and monetary imbalances the government needs to let the market operate with minimum intervention. This will promote price liberalization, which will restore confidence and establish credibility on investing in Zimbabwe among SMEs and other stakeholders. Although liberalization may contribute to a one-time increase in the price level, it helps allocate resources more efficiently and stops the government from providing subsidies that have previously fueled inflation. If the government promotes price liberalization, the market will determine the prices. If the prices of commodities in the market are too high, consumers will not buy

and this will force SMEs and other businesses to reduce their prices leading to a natural control of prices. Price liberalization also enhances the confidence of domestic and external investors.

The international experience suggests that private capital flows tend to follow successful stabilization, thus better policies and good governance attract private capital. As reforms progress, foreign direct investment (FDI) tend to increase gradually from negligible levels. For Zimbabwe, strengthening relations with local businesses and mobilizing external financing would lead to a reduction in inflation. The government should create a partnership with the SMEs rather than considering them enemies of the state. This will create trust between both stakeholders and encourage cooperation for the development of the economy.

The government is encouraged to draw the line between political issues and economic issues in relation to the causes of hyperinflation. In this sense the government is encouraged not to discourage SMEs and pass public statements that present it as having intentions to see SMEs crumbling. The government should acknowledge that though it may be possible that SMEs among other factors fueled hyperinflation because of their rapid and continuous increases in prices, they definitely were not the cause of it. There are other factors, including the current political exclusion from participation in important activities that bring revenue into the country, and the investors leaving the country due to political instability. The government therefore should acknowledge that when the SMEs were increasing the prices of their commodities they were acting 'rationally' because they wanted to stay in business and make their profits.

The current Zimbabwean situation would require a lot of government financial support to the SMEs. This is because hyperinflation and the price controls have left many SMEs on the verge of their collapse thus without government financial assistance to reinvest in their businesses they would not resurrect. The upcoming 2010 soccer World Cup in South Africa will benefit Zimbabwe if the government assists in the revival of SMEs, other businesses and sectors to give tourists some sense of security to visit Zimbabwe. If

businesses are revived in the country before the soccer world cup in South Africa most tourists are bound to visit the country and by so doing, boosting the country's economy.

The revival of businesses in Zimbabwe will require government to seek international funding in reconstructing the economy. This calls for the government to reconcile its political relationships with the international community and create solidarity. If this is not possible with the current government in power, then there is need for regime change in the country. There is need to elect a government which will establish good international relations for the development of the country. At present, the country is almost completely isolated from international activities because of the current government's political activities. However, good international relations are necessary for growth and development of the country.

There is an important need for the monetary policy committee to educate and empower SMEs on how inflation works and what they should do if they are to reduce it. This will assist SMEs in making decisions as to whether they should increase prices of their commodities or increase the wages of their employees. The Reserve Bank of Zimbabwe should also reduce the rate at which it creates money as a way of reducing inflation and reducing the price of foreign currency.

This study has explored the impact of hyperinflation on SMEs in Avondale, Harare, Zimbabwe. By shedding light on the various factors surrounding the impact of hyperinflation on SMEs and by suggesting some policy recommendations, it is hoped that this study will help to reduce the hyperinflation and its impact on SMEs in Zimbabwe.

6.3 Conclusion

The international experience suggests that periods of hyperinflation can last for a considerable time and there is little to prevent inflation from escalating higher if no reforms are undertaken. Hyperinflation episodes have typically been characterized by widespread economic distortions, including very loose fiscal and quasi-fiscal policies, relative price distortions, segmented foreign exchange markets, declining domestic

financial intermediation, and poor governance. They have also been associated with a sharp and sustained decline in economic activity. The research concluded that all the above characteristics of hyperinflation could be linked to Zimbabwe during this period. Stabilizing hyperinflation will call for more than the government pointing fingers at other stakeholders and denying responsibility of the causes of hyperinflation in Zimbabwe.

The aim of this study was to provide insight into the impact of hyperinflation on SMEs in Harare, Zimbabwe. Overall, the findings indicated that SMEs were negatively and deeply affected by hyperinflation in Zimbabwe. Prior to the price controls were set by the government, most SMEs adjusted the prices of their commodities and the wages of their employees according to the operation of the market. The research found that due to price increases in the market; most consumers could not afford to purchase the goods in the market. In addition, electricity power cuts led to further losses for supermarkets as many of their commodities, especially the fragile one, either expired or went bad before being sold.

The research also concluded that though hyperinflation affected both the formal and informal traders negatively, the effects were different. Most formal traders were targeted by the government to reduce the price of their commodities while the informal traders were not targeted to reduce the prices of their commodities. This created a situation where most consumers swamped the supermarkets and clothing stores to purchase groceries and clothes at 50% lower prices than before. This bulk purchasing by the consumers left most supermarkets and clothing shops almost empty. Since the supermarkets and clothing stores were selling below the market price it was difficult for them to order the same quantity of new stock as before thus to date stores that have been affected by price controls are still almost empty. Some SMEs had their smaller branches closed down because they did not have any more stock to sell.

The informal traders and some privately owned formal SMEs were not targeted by the government to reduce the prices of their commodities but were still negatively affected by the price controls. The sales of both the informal traders and the formal traders who

were not targeted reduced substantially during this period. The research concluded that this was due to the fact that most consumers preferred to buy their commodities in formal shops, which sold cheaper commodities. This led to some traders not selling any of their commodities for longer periods than before. The research found out that this made it difficult for the traders to pay their employees and maintain their profit margins at the same time.

The research concluded that most SMEs were rather sustaining their businesses and not coping hoping for positive change in the future. The revenue of SMEs was far lower than their expenditure in terms of wages, electricity and water bills and rentals. The expenditure of SMEs increased due to hyperinflation even before the price controls because wages and other bills went up almost on a monthly basis while their sales were also declining on a monthly basis due to the consumers' low real income. Price controls not only added on the economic problems of SMEs but also made it difficult for SMEs to stay in business profitably.

With earlier studies elsewhere clearly showing that there is no country where price controls were successful in reducing hyperinflation, the government of Zimbabwe still implemented them. The government implemented these price controls even after advice and warning by the Governor of the Reserve Bank of Zimbabwe that the price controls will have a negative impact on the economy at large. The introduction of price controls was a blow that destroyed some SMEs fortunes. Research found out that it would be difficult for SMEs to revive their businesses to the position they were before hyperinflation without any support from the government. However, the government was not accused by most participants for causing the economic crisis due to fear of political victimization although some clearly blamed the current government for all economic woes and were advocating for them to step down from power.

The exchange rate regime plays a very important role in analyzing the effects of hyperinflation on SMEs in Zimbabwe. This is based on the premise that most of the informal traders and some privately owned SMEs purchased most of the commodities

they sold outside Zimbabwe thus requiring foreign currency. The research concluded that most traders sold their commodities at prices equivalent to the amount of foreign currency they would want to earn from the respective sales. In light of the foreign currency exchange rate regime, the research also concluded that most entrepreneurs and some consumers were traveling to neighbouring countries to purchase groceries and other basic commodities in foreign currency. This led to a high demand of foreign currency on the parallel market therefore escalating its price.

The study also indicated that all the SMEs were in business to make profit and would have gone to great lengths to keep their profit margins high. The research concluded that creation of money also fueled hyperinflation since it is argued that when there is more money in circulation, its value decreases. This explains the reasons why SMEs were increasing the prices of their commodities on regular basis. However, the research found out that most SMEs did not know that their actions of increasing prices and wages were also fueling inflation.

In light of the above-mentioned views on the impact of hyperinflation on SMEs in Zimbabwe and the unprecedented economic crises, it is evident that hyperinflation among other economic crises has negatively affected SMEs. It is therefore absolutely critical that interventions aimed at promoting the stabilization of hyperinflation and revival of SMEs have a contextual approach. It is therefore important for the government to form a partnership with SMEs and other stakeholders to come up with stabilization policies that would revive the economy of the country.

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Appendix 1

List of Interviewees

The Pharmacist, Avondale Pharmacy, Avondale: 20/06/07 & 27/09/07

The Branch Manager, Edgars Stores, Avondale: 22/06/07 & 05/10/07

The Branch Manager, Bon Marche supermarket, Avondale: 21/06/07 & 29/09/07

The Branch Manager, T.M supermarket, Avondale: 21/06/07 & 04/10/07

The Manager, Celians Florists, Avondale: 20/06/07 & 4/10/07

The Marketing Manager, Confederation of Zimbabwe Industries, Baines Avenue: 28/09/07

The owner, Itech Computer Sales, Avondale: 20/06/07 & 28/09/07

An employee of Zeon Clothing Company, Avondale: 22/06/07 & 01/10/07

An employee of Smart Collections, Avondale: 22/06/07 & 3/10/07

An employee of Mark and Manolios, Avondale: 20/06/07 & 4/10/07

An employee of St Elmo's Pizza, Avondale: 19/06/07

An employee of Nando's, Avondale: 23/06/07 & 4/10/07

An employee of Wimpy, Avondale: 23/06/07 & 4/10/07

The branch manager, MICA hardware, Avondale: 28/09/07

Five informal traders: 21/06/07 & 29/09/07

Mr. Sekete, Managing Director of Kingdom Financial Holdings' subsidiary MicroKing Finance: 05/10/07

Appendix 2

Questionnaire:

1. What is your definition of hyperinflation?
2. What is the impact of hyperinflation on your business?
3. How has hyperinflation changed your business operations from before the hyperinflation period?
4. How has hyperinflation affected your monthly sales?
5. How has hyperinflation affected the spending patterns of people (Have people shifted from purchasing luxury goods to basic commodities)?
6. How has hyperinflation affected the income and expenditure of your business?
7. How are you adjusting wages of employees in relation to hyperinflation?
8. How has hyperinflation affected the purchasing of new stock in your business?
9. What is the impact of hyperinflation on your reliance on the country's banking system?
10. How has foreign exchange fluctuations on the parallel market affected your business?
11. What is the impact of the July 26, 50 % price slashes by the government on your business?
12. Did any of the formal retailers retrench or lay-off staff directly or indirectly as a result of hyperinflation?
13. What is the impact of the banning of private fuel purchases in foreign currency by the government on your business?
14. What are the effects of electricity shortages in the hyperinflationary environment on your business?

15. What are the various coping mechanisms you have implemented in the hyperinflationary environment?

16. How has hyperinflation affected the joining, diversification or discontinuity of other traders?

17. Do you know if some firms or businesses have closed down because of Hyperinflation?

18. What recommendations do you have for policy makers to stabilize the negative effects of hyperinflation on Small to Medium Enterprises in Zimbabwe?

Appendix 3

Interview Guidelines

What is your definition of hyperinflation?

What is the general impact of hyperinflation on your business?

What are the various coping mechanisms you have implemented to keep the business operations running?

How effective have these coping mechanisms been in the operations of your business?

How have the price slashes implemented by the government affected the operations of your business?

What are your general views of the impact of hyperinflation on Small to Medium Enterprises (SMEs) in Zimbabwe?

What recommendations do you have for other traders to keep their businesses in operation in this hyperinflationary environment?

What recommendations do you have for policy makers to stabilize the negative effects of hyperinflation on SMEs?