Observing Corporate Governance Principles: Growth Strategy for Small Traders in Zimbabwe

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Abstract

Illegal activities were rampant throughout the Zimbabwean economy during the economic crisis experienced by the country from the year 2000 to 2008. To ensure their survival, companies were involved in illegal activities which included sourcing for foreign currency from the black market. Under these hardships, some large companies had to stop operation due to the high costs they were incurring. In the absence of large companies, small traders sustained the economy. However, when the economy started to recover the majority of these small traders folded up as they were operating illegally and some of them did not observe corporate governance principles. The paper discusses the reasons for the collapse of many small traders when the economy started to recover by analyzing their conduct in relation to corporate governance principles. The researchers adopt a multiple case study approach to arrive at the reasons for the collapse of some of the small traders. The paper demonstrates that some small traders collapsed when the economy started to recover as a result of the absence of checks and balance systems in the way their businesses were operated, lack of separation of ownership and control on the part of business financiers and absence of a growth strategy.

Keywords: Small Traders, Collapse, Corporate Governance, Economic Recovery

Background

Many SMEs consider that corporate governance is only relevant to large companies. This perception could be due to the fact that some authors have defined the term with reference to large companies. For example, Cochran and Wartick (1988) cite the Commonwealth Treasury as defining the term as the "rules and practices put in place within a company to manage information and economic incentive problems inherent in the separation of ownership from control in large enterprises…" However, the Cadbury Report (1992) defines corporate governance as the "system by which companies are directed and controlled." The definition by the Cadbury Report (1992) is broad as it does not limit the practice of corporate

governance to a particular group of companies; implying corporate governance also has to be practiced by SMEs. Furthermore, Johnson and Greening (1999) associate corporate governance with the defense of shareholders' interests by the use of governance systems.

Corporate governance is therefore, a conscious, deliberate and sustained effort on the part of organizations and institutions to strike a judicious balance between their own interests and the interest of various constituents on the environment in which they operate. The interest of the various constituents encompass those of shareholders, creditors, employees, customers, suppliers, competitors, local community, natural environment and the legal and regulatory environment (Jenkins, 2006). However, shareholders, management and board of directors are cited as the three key actors in the implementation of corporate governance since they are directly responsible for organizational outcomes (Zahra et al, 2007 and Crauford, 2007). Brunninge et al (2007) reveal that much of the research in corporate governance has mainly focused on investigation of one type of governance mechanism, mostly the board, while excluding others. This paper explores how the interaction between a firm's ownership, board and top management, in their effort to observe corporate governance principles promotes growth of small traders.

With respect to the importance of shareholders, management and board of directors, Singh (2005) cites the Report of SEBI Committee (India) as defining corporate governance as the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. Corporate governance is therefore about commitment to values, ethical business conduct and being able to make a distinction between personal and corporate funds in the management of a company. A number of researchers on corporate governance seem to agree that a Board of Directors should be in place and should observe the following basic ingredients of corporate governance: transparency, independence, accountability, integrity and implementation of a system of checks and balances (Sweeney, 2007; Abor and Biekpe, 2007; Mardjono,2005). Research on the ingredients of corporate governance has tended to concentrate on state owned enterprises (Rabelo and Vasconcelos, 2002; Zhou, 2002) and large corporations (Tam, 2002), despite the fact that there has been growth on studies in corporate governance and small to medium enterprises (SMEs). However corporate governance research focusing on SMEs does not take into account the importance of corporate governance principles in reducing their collapse and promoting their growth. Additionally, Schulze et al (2003) acknowledge that a particular serious shortcoming of small traders is the

fact that they are closely held and governance issues are more entwined than in large publicly held firms where the separation of ownership and management is clear-cut. In small to medium enterprises, ownership and top management often overlap with the same people from the same family involved at all levels (Brunninge et al, 2007). This makes the exploration of failure to observe corporate governance principles by small traders more important.

The contribution of the small traders to the economy of a nation is well recognized (The World Bank Review of Small Business Activities, 2001). In developing countries, Mponji, (2010) says it is believed, the contribution of SME's towards employment generation is significant because small traders:

- tend to use more labor intensive production processes than large enterprises, boosting employment and leading to more equitable income distribution
- provide livelihood opportunities through simple, value adding processing activities e.g.in agriculturally based economies;
- nurture entrepreneurship; and
- support the building up of systematic productive capacities and the creation of resilient economic through linkages between small and large enterprises.

Small traders are defined in different ways in different parts of the world. Some define them in terms of assets, while others use employment, shareholder funds or sales as criteria. Some would use a combination of revenue and employment to define small traders (Ayyagari et al, 2007). In developing countries they have been defined as including sellers at a local market (Mponji, 2010).

There are characteristics which distinguish small traders from larger firms. Large firms often have direct access to international and local capital markets because they have an established structure that is, governance, while small traders often do not. Small traders cannot afford the high fixed costs of complying with regulations (Rabelo and Vasconcelos, 2002). Another distinguishing feature of small traders is that they start off as family businesses and are usually one-man owned. It has also been suggested that because of this distinguishing feature, many entrepreneurs come from a traditional business family background (Zahra, Neubaum and Naldi, 2007; Abhor and Biekpe, 2007 and Mardjono, 2005). Business family relations are also noted as important for new start up businesses, particularly in developing countries in which there is very little, if any, institutional support for small entrepreneurs. As such the family has a dominant role in business continuity and survival, providing the financing (instead of banks) and the moral support (Kim, 2002; Jaque and Hadassin, 2010; Zahra et al 2007).

Amongst the corporate governance issues arising from family ownership are: unfettered powers, conflict of interest, lack of transparency, accountability, creativity and innovation, growth and control measures (Sweeney, 2007; Abor and Biekpe, 2007; Mardjono, 2005). The dominance of family members in SMEs has resulted in their collapse as there is lack of independence in decision making. Crauford (2007), Zahra et al (2007), Bhatia, (2002) and Singh, (2005), Jaque and Haddassin (2010) and Mponji (2010) suggest the appointment of a Board of Directors in order to induce independence in decision making; promote growth, transparency, accountability, creativity and innovation, reduce conflict of interest and introduce checks and balances. The viability of introducing a board for small trader that possesses the same characteristics as those of a seller at a local market in a developing country was not explored by these researchers.

In a research conducted by Barca and Trento (1997) in Italy and Rabelo and Vasconcelos (2002) in Brazil, it was observed that absence of corporate governance structures incapacitated individually owned and family owned businesses to access capital for their growth. The problem does not only affect small traders. In Brazil, large companies that do not observe corporate governance principles have failed to develop a consistent multinational strategy (Rabelo and Vasconcelos, 2002). In light of this some researchers have gone to propose that governments must provide capital to support growth of small traders. Kim (2002), whilst analyzing if corporate governance contributes to a firm's market value, concludes that it is evident that the state policy to aid and concentrate capital to small traders in Korea was not able to generate a competitive global firm. This is an indication that something more than capital is needed to promote small trader growth.

Crauford (2007) argues that the conception of shareholders for large companies must be extended to SMEs. The author states that shareholders invest but do not want to run or are incapable of running the company, they provide the capital and the risk appetite but they want people with specialized knowledge to manage the business, so they appoint an agent- the board of directors to oversee their investment on their behalf. The board is the agent of all shareholders and stakeholders. Likewise, the author advises family owned businesses and SMEs to imitate their counterparts of large companies and appoint a board to oversee their investment. Zahra et al (2007) postulate that outside directors can add value to SMEs by sharing their wealth of experience with their top management team members, thus as the ratio of outside directors increases, their diverse experiences, skills and capabilities will augment those of SME management.

Lack of support from the owners and top management is cited as the greatest impediment of corporate governance implementation and growth of the organization (Mordjono, et al 2007). The owners and top management take a short term view of success, which is profitability, as a measure of success. They should realize that corporate governance is a long term project which typically results in a decline in profitability in the short run with the promise of greater financial rewards in the long run. In the short run, costs may rise as management out sources funds from financial institutions in order to attract skilled directors, but a return on the investment will be realized in the long run. In a study conducted by Sweeney (2007) in Ireland on the implementation of corporate governance, the findings revealed that those SMEs that had implemented corporate governance experienced a growth of about 5%.

The study focuses on the relationship between corporate governance and the folding up of cross border traders in Zimbabwe's grocery retail sector. The research further explores the possibility of observing corporate governance principles by small traders and the likelihood of it promoting growth of small traders in Zimbabwe. Findings are presented not only from a theoretical perspective but there is a deliberate practical emphasis.

Methodology

Participants and setting

This paper is based on case studies of small traders (popularly known as cross border traders) specializing in selling of grocery products in Zimbabwe that have since stopped trading ever since the introduction of the multiple currency regime in the country. Small traders in this research are defined as the traders (trading individually or in partnership) that imported grocery products from neighboring countries like Botswana, South Africa and Mozambique during the economic crisis in Zimbabwe. These traders sold their imported products from small shops referred to as tuck shops. Some of these cross borders actually supplied large supermarkets with the imported grocery products.

Sample

Twenty cross border traders make up the case portfolio. The twenty cases consist of small traders of comparable size, that is, they were individually owned, and all of them stopped trading within a defined period of approximately eight months after the introduction of the multi-currency. The study was carried out mainly during the last three quarters of year 2010.

Sampling procedure

Judgmental sampling was initially used in selecting the cases. The criterion for selection was the small traders must have stopped trading and were no longer operating their tuck shops as from March to December 2009. This technique was preferred because more than twenty informal traders were considered in the initial pool. However, some of the traders were unwilling to participate in the research, so convenient sampling had to be used to finally select participants for the study. Participants that were easily accessible and willing to participate in the study finally constituted the research sample.

Instrumentation

This paper is based on qualitative data, derived from in-depth, semi-structured interviews with 20 small traders. The study used a collective case study approach, which investigated, through detailed discussion with small traders, how small trader businesses were run during the economic crisis in the country and how their failure to observe good governance led to their collapse. The case study approach enabled the research to retain the characteristics of real life events (Yin, 1984) such as the good governance principles studied here.

Informal interviews were, therefore, used to collect the data for the research. Participants were interviewed at their homes. The setting proved conducive to the participants as they were willing to divulge data on how they ran their small businesses and what they thought contributed to their failure to thrive when the economy started to recover. Participants were uncomfortable to have the conversation recorded, so responses were written down in a notebook.

Data analysis procedure

Content analysis was used to analyze data from the interviews. Interviews were analyzed by drawing a number of key themes drawn from the interviews and comparison of interviewee responses was made. The data was analyzed based on the following corporate governance attributes in the context of small trader collapse in the grocery retail sector in Zimbabwe:

- integrity;
- separation of ownership and control;
- system of checks and balances;
- conflict of interest;

- growth strategy

Quotes are used to illustrate key research findings.

Aims of the study

The aims of the study are to ensure that small traders are assisted and encouraged to grow through the implementation of corporate governance principles in their small businesses.

Objectives

- To investigate the extent to which lack of corporate governance practice has contributed to the collapse of grocery products informal traders.
- To evaluate if implementation of corporate governance principles can promote growth of small traders.

Key findings

Below is a summary of findings covering the twenty cases in the study:

Integrity

Of the twenty small traders profiled, all of them lacked integrity in the way they conducted their businesses. For example when it came to recruiting employees for their tuck shops, this is what some of the respondents said;

> *"I sought the assistance of relatives to assist in selling merchandise from the tuck shop."*
>
> *"My son (daughter, or nephew, in some cases) assisted in running the tuck shop… and sometimes they would go to buy goods from South Africa, Botswana or Mozambique"*

The research results reveal that all the informal traders did not have transparent procedures in the way they recruited their employees. Failure to implement transparent recruitment procedures resulted in the recruitment of relatives to man the tuck shops and even to supply large supermarkets with the imported grocery

products. In most cases these relatives lacked the skills and qualifications for the posts for which they were appointed. The relatives lacked inventory management skills, basic bookkeeping and product pricing skills which are very relevant to a grocery retail outlet. The large supermarkets somehow defrauded the informal traders' employees as they did not have Tax Certificates. Products were being sold on a credit basis since consumers did not have ready cash due to the cash crunch in the economy. Additionally, due to the dishonesty of the relatives some inventory sold on accredit basis would not be accounted for such that the introduction of the multi- currency found the traders with no foreign currency in hand to replenish their stocks. Failure to control credit and debt led to the collapse of the informal traders as they did not have liquid cash to replenish the stocks. Nepotism is one factor that contributed to the collapse of these informal traders.

The stabilization of the exchange rate and the use of multi currency meant the parallel market was no longer profitable since it had been their source of cheap foreign currency. The huge profits enjoyed by these small traders which sustained them during the economic crisis were due to the exorbitant prices charged for the grocery products. Consumers had no choice of where to get the basic products as these were nowhere to be found in the large supermarkets. Indiscipline was observed during the economy meltdown experienced in the black market and prices being altered on a daily basis. Now with the economy recovering, a number of small traders stopped trading, as if shunning the sanity that was returning to the economy. Failure by management to adhere to the behavior that is expected of them results in business insolvency. Lack of transparency and honesty inadvertently creates an epicenter for small trader failures.

Separation of ownership and control

Sixteen out of the twenty small traders had been financed by relatives as such the relatives automatically became shareholders to the businesses. These shareholders were entitled to some of the imported groceries that were meant for resale. This resulted in the eating up into part of the circulating capital. In all the instances, the relatives (financiers of the businesses) dictated what had to be bought by the capital and most of the time the products requested were not for resale but for personal consumption. These findings imply that there was no separation of ownership from control suggesting that there was no distinction between the shareholder/ director and the manager. The other four small traders' businesses had been self financed. However, the small traders had reached a point in development where the main shareholder was no longer able to fulfill the roles of shareholder, executive

director and manager simultaneously. With this group of small traders, their collapse after the economy started to recover was mainly due to their failure to delegate authority to employees. Delegated authorities should be reviewed periodically to ensure that they remain appropriate given the structure, size, scope and complexity of a company. These results are in agreement with the argument put forward by Sweeney, (2007); Abor and Biekpe, (2007); Mardjono, (2005) who say lack of separation and control is a very strong source of small trader failure.

System of checks and balances

A common feature with the informal traders understudy was the absence of checks and balance systems in the way they operated their businesses. In the entire cases understudy, systems inadequacy exposed the informal traders to unethical and criminal conduct as they engaged in parallel market activities and operated with no operational and import licenses. Some of the grocery products sold were actually being smuggled into the country as the traders were not in possession of import licenses. Systems inadequacies in all instances appear to point to inadequacies in management and corporate governance leading to the collapse of the small traders. When asked why they did not make an effort to apply for operational and import licenses, some traders responded;

> *"At the time it was not necessary, regulatory authorities at the borders allowed us to import the large quantities of products that we brought into the country."*

> *"Grocery products could only be obtained from neighboring countries at the time, so I was trying to assist those that could not go outside the country to get the products. I never thought of applying for a license since importing without a license at the time was acceptable."*

The economic crisis in the country could have contributed to the illegal operation of these small traders.

Conflict of interest

Eighty percent of the cross border traders were running their businesses as sole proprietors despite the fact that the businesses had been financed by relatives. The financiers can be referred to as 'shareholders' since they had invested in the business. This is very common with small traders in developing countries as acknowledged

by Kim, (2002); Jaque and Hadassin, (2010) and Zahra et al (2007) who concur that financing of small traders usually comes from family members. The other twenty percent were partnership businesses. Unlimited liability is a common feature in such types of businesses. This feature implied that there were no boundaries between the interests of the business and those of the owner(s). In all the cases the owners' interests surpassed business interests. The owners gave themselves personal loans from business funds which they did not repay since there was no one to enforce their repayment. These loans were disproportionate to the resources of their businesses.

Some participants highlighted that, "…sometimes I would take cash from the business to solve family problems with the intention of returning, but with the rate of inflation in the country at the time, it was impossible to repay…."

"I would give goods bought for the tuck shop to relatives and friends. Things were difficult at the time and sometimes circumstances forced you to be humane…"

Eighty percent of the cases had at some point, before the collapse of their businesses asked for funds from relatives to recapitalize their businesses. The disproportionate loans depict lack of management skills on the part of the owners and absence of knowledge of how businesses are run.

Discussion

- This study examined the reasons for the collapse of SMEs soon after the Zimbabwean economy started to recover. The study demonstrates that failure to observe corporate governance principles by the small traders during the economic crisis led to their collapse when the economy started to recover. One of the main sources of SME collapse observed in this study appears to be lack of integrity on the part of both owners and employees. The small traders were exploited by large traders, whom they sourced supplies for from neighboring countries, because they did not have Tax Certificates. Failure to control credit and debt by the employees resulted in the insolvency of the small traders.

- The study also shows that in all instances where the small traders failed to distinguish between shareholder/director and management resulted in there being no separation between ownership and control. In situations where there was no separation between ownership and control, governance

inadequacies tend to show through financiers of the businesses (who in this case are relatives) dictating how the businesses will be run. Most small trader businesses are run as sole proprietors or partnership businesses. Such businesses have unlimited liability and as a result there are no boundaries between the interests of the business and those of the owner(s). Usually, the owners are the employees of their businesses. Due to the above assertion, Teksten et al (2005:50) assert that "for SMEs and privately owned companies a Board of Directors (BODs) is not always viewed as a successful part of the corporate structure". A Board of Directors is a necessity in every organization irrespective of the type of the organization because it ensures that there is a balance between the interests of the owner(s), business and other stakeholders. In as much as it could be true that BODs are a necessity in every organization, sometimes the argument may not apply to the small traders in developing countries such as the cross border trades in this case. Considering the small profit they earn, it may not be enough to sustain a board.

- Results also show that systems inadequacy exposed the small traders to unethical and criminal conduct as they engaged in illegal activities in order to maximize profits. This was attributable to the prevailing environment in the country at the time. Anyway, Jaque and Hadassin, (2010) argue that good governance is not primarily concerned with compliance with formal rules and regulations. Rather it is about establishing a framework of company processes and attitudes that add value to the business; help build its reputation and ensure its long term continuity and success. The results from the research could imply that the small traders lacked an attitude that could add value to their businesses.

- The study also shows failure by small traders to adapt to the demands of a changing competitive environment. Most small traders could not keep up with competition in their line of business as the large supermarkets started to restock their shops. This resulted in them collapsing.

- Finally the study shows that the small traders had no growth strategy in place, success was only measured in terms of profitability. Lack of a strategic plan is failure by the owners to have a long term view of their businesses (i.e. failure to observe the principle of going concern in a business)

Conclusion

The collapse of small traders that occurred in Zimbabwe when the economy started to recover was mainly due to failure to observe corporate governance principles. However, the economic situation that prevailed at the time also contributed to their collapse since systems inadequacies in the economy promoted to their illegal operation.

Recommendations to Small Traders

- Small traders may not afford to have a fully constituted board of directors, but it is important for them to get expert advice from those that are knowledgeable in the running of their type of businesses.
- Small traders must make an effort to observe corporate governance principles right from the moment they think of starting a business. This will ensure their continued existence and growth in the future. Just like Barca and Trento (1997) and Rabelo and Vasconcelos (2002) say, absence of corporate governance structures incapacitates individually owned and family owned businesses to access capital for their growth. Financiers are more willing to assist small traders that observe corporate governance principles. Although a cost at the initial stage of implementation, corporate governance results in improved profitability in the long run. Mensah et al (2003); CIMA (2010) and Ogbor (2009) acknowledge that there is strong evidence that companies with good corporate governance are more likely to be profitable and sustainable than others without it. If profitability improves due to good corporate governance practices, there is no way SMEs can collapse, if the concept is well implemented.
- A well governed business is reputable with all stakeholders. This implies that small traders must strive to be disciplined, fair in their dealings. This is likely to improve their reputation such that when faced with problems, stakeholders will be willing to offer assistance, thus avoiding their collapse.
- It is necessary to introduce outside directors (non-executive directors, NED) once small traders start to grow. This leads to better management decisions and helps small traders to attract better resources. NEDs may have knowledge or useful information on financial facilities available to SMEs (Abor and Biekpe, 2007). Small traders fail due to lack of resources, ignorance of the owners and their lack of information on the sources of funds available to them. Sources of finance do not want to put their money where they know it will not be put into effective use. Searching for funds requires small traders to come up with attractive business plans and not

window dressed financial statements. NEDs are placed in a better position to win the funds of the finance providers for the SMEs thus saving them from collapse. Abor and Biekpe (2007:292) assert that a Board of Directors is able to achieve this "through their social networks and professional networks through interlocking directorates."

- The vision of every small trader is to graduate into a large corporation and be listed on the local bourse. However, small traders often find that they have a lot of ground work to do before going to the market. A consistent track record of good corporate governance will greatly assist when that point comes. Good corporate governance, therefore, aids a firm in the smooth transition from a small trader to a large company.

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