Drivers and Implications of the Structural Shift of the Private Sector in Zimbabwe

Dr Peter Davis, Barbara Vitoria

Final report

Client: DFID

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Executive Summary

During the first decade of this century, the Zimbabwean economy virtually halved in size, ending in a spiral of hyper-inflation. The policy of dollarization, served to stabilise the economy, and the early years of this decade saw good economic growth. However, this growth has now stalled and the economy is now virtually stagnant: many fear that the situation may yet worsen significantly. This turmoil has had a substantial impact on Zimbabwe's private sector, with many of the country's larger companies going out of business. As a result there has been a huge increase in the number of SMEs, as those made redundant from bigger companies seek ways of earning a living.

This paper examines the dynamics within the Zimbabwean economy over the past decade and a half, in order to understand two key issues. First, why is it that some companies, despite the significant challenges, have managed to survive, and what might be learned from their experience? Second, what variables seem most likely to lead to a resurgence in the Zimbabwean economy, and what might be done (for example, by DFID) to promote and support that process.

The situation in Zimbabwe has been examined in light of the wider, global literature on economic and firm-level growth. How economies grow, and the contribution to macro-economic expansion of firm-level growth are issues of immense importance for all countries, not just developing ones. It is not surprising therefore that the literature on this topic is immense and multi-faceted. This study identified nine key themes in this literature, which have been examined under three key headings. 1) capabilities and learning: referring to the capacity, skills and capability of individuals, firms and government entities is the basis without which economic growth at any level is not possible; 2) proximity: the physical location of firms relative to each other is significant in determining how firms grow. Also a country's location, and how well it collaborates with its neighbours is also significant. However, 'social proximity' is also key, providing the 'human' connection between firms, alongside geographic ones; 3) regulatory environment: Although criticisms of the World Bank's Doing Business (DB) indicators are fair, the reality is that regulation still matters greatly. However, it is not just individual regulations that matter, but also the general environment of rent-seeking, government openness and other such factors which are of importance.

The paper then explores the specific experiences of the Zimbabwean economy over the past decade and a half and explores the particular pathology which has led to the significant economic decline since 1999. The most obvious, and perhaps the most intractable issue, is that of macro-political uncertainty. This is likely to continue until there is confidence about predictability of the policy environment. Secondly, the economy suffers from the policy decisions that have been taken since 1999, specifically in relation to the approach taken to implement the 2007 indigenization policy. Thirdly the cost of doing business in Zimbabwe is high relative to neighbouring countries. This is the result of power, water and other infrastructural problems; and of the country having adopted an uncompetitive position relative to the US dollar. Fourthly there is a lack of capital for investment and to allow companies, and hence the economy to grow. This stems from the economic decline since 1999, and the wiping out of savings at the time of dollarization. Finally, as a result of these factors, Zimbabwe has effectively gone through a process of de-industrialisation. Many, if not most, large companies have gone to the wall, to be replaced by a huge swathe of, mostly-informal, SMEs.

However, despite these challenges, some companies have managed to survive, and even to flourish. This paper finds a number of explanations for this. Firms which have survived have needed to be persistent and resourceful, and have had to spread risk. This has required highly competent management, and robust processes of corporate governance. They have also been highly politically-aware, but yet to have avoided political capture. Finally, resilient companies have worked with each other, and collaborated in order to survive.

It is also clear that, challenging though the economic environment is, there are considerable opportunities for growth in a range of sectors, most obviously in agriculture, which is seen as being central to economic recovery and has the potential to significantly reduce poverty, enhance economic growth and entrench economic stability. Opportunities also exist in mining, manufacturing and tourism. The conclusion of Ricardo Hausmann's 'product space' analysis of Zimbabwe is positive: that the country contains sufficient 'personbytes' (the amount of knowledge held by one person) to produce a much wider range of products, including machinery, office products and footwear.

However, for this potential to be realised, significant changes are needed. Most obviously clarity is needed on the political context. Recently the Government has proved amenable to the introduction of business reforms in a number of areas, but this process needs to go further, particularly in relation to land tenure and indigenization. Further there is a need to unlock the financial sector. At the moment, there are virtually no domestic resources for investment, so re-capitalising the banking sector and stimulating FDI would be extremely valuable in providing the means to further economic growth. There is also a need to address the damage that has been done to the structure of the private sector in recent years, and to encourage the raft of informal SMEs to formalise so that at least some of them might have the potential to expand and create jobs. Moreover inter-company relationships need to be stimulated, to create networks of companies operating in adjacent, related industries which can create growth from improved agglomeration and collaboration.

None of this will be straightforward, but there are clear steps that DFID and others might take to help create a path to economic recovery. The political situation suggests that wholesale change is unlikely, but there are opportunities for 'exemplar' projects to demonstrate, in various areas, how change might be achieved, and the benefits it would bring. There are a number of actions proposed including sector-specific reforms to encourage formalisation; sector growth strategies; use of 'presumptive tax' structures to improve tax take; and implementing measures to improve the environment for exporters. The situation in Zimbabwe also offers the potential for use of development finance tools (perhaps, for example, DFID's Prosperity Fund) to facilitate and encourage investment in Zimbabwe.

Zimbabwe does therefore have a clear path to economic recovery. Despite the damage that has been wrought over the past 15-16 years, many of the bases for firm-level and broader economic growth are still in place. Zimbabwe still has considerable natural and indigenous resources; reasonable levels of skills; and a beneficial geographic location. Moreover, there exist good models of how success does occur, for example in the garment sector, from which lessons can be learned elsewhere. The challenges though are considerable: the policy and regulatory environment is extremely challenging and levels of trust and confidence are very low. However, as this study has shown, there are steps which could be taken to build on the growing willingness in Government for reform, and which both demonstrate the beneficial impacts of change, and provide models of how change might be implemented elsewhere. Effecting such a programme will require considerable political sensitivity, but there is a clear role that DFID and other development partners can play in helping Zimbabwe regain the economic success of which it is eminently capable.

Introduction

1.1 Background to this project

This paper reports on a research project undertaken between July and September 2016, which included both a substantial literature review and a country mission to interview a range of business-people, business groups, government officials and other commentators. The study was supported by DFID's Policy Research Fund and used primarily qualitative techniques.

The central aim of this project has been to explore the dynamics within the Zimbabwean economy over the past decade and a half, with a view to understanding two key things. First, why is it that some companies, despite the significant challenges, have managed to survive, and what might be learned from their experience? Second, what variables seem most likely to lead to a resurgence in the Zimbabwean economy, and what might be done (for example, by DFID) to promote and support that process.

1.1.1 Economic and business context

Zimbabwe experienced a decade of staggering economic decline between 2000 and 2009, averaging a 6% annual fall in GDP, with the result that the economy virtually halved in size. This was followed by the policy of dollarization, in which Zimbabwe addressed the challenge of hyper-inflation by abandoning the Zimbabwean dollar and using instead a range of other currencies, principally the US dollar. The early years of this decade saw strong economic growth, but this has now stalled, largely as the result of political and economic policies, and the economy is now virtually stagnant.

This development has contributed to a significant deterioration in the business and investment climate. Despite a return to positive economic growth post dollarization, the economy remains depressed. There has been a surge in the number of small and medium-sized enterprises (SMEs) (most of which remain in the informal sector) as many larger companies (those with a turnover of more than US$ 5m) are downsizing or closing their businesses.

In principal, SMEs can play a pivotal role in development through generation of employment, increasing export and industrial production. However, there are considerable variables which influence whether and how SMEs are able to make such a positive contribution. However, given the size of the shift from large to small companies in Zimbabwe in recent years, the implications of this for firm-level growth and inclusive economic development are not well understood.

Moreover the growth of SMEs in Zimbabwe is not the result of an upsurge in entrepreneurialism. Rather the growth in the number of MSMEs is the result of survival activity by those who have lost formal-sector jobs as large companies have gone under. A very high proportion of MSME owners would prefer to have a formal sector job.

Previous research by DFID Zimbabwe has begun to develop a picture of the SME landscape in the country[1]. Defined as a business with less than 75 workers, SMEs in Zimbabwe employ 5.7 million people, nearly 45% of the total population. We also know that there has been a significant structural shift in the economy fairly recently - 71% of SMEs have been in operation for 5 years or less, and

[1] Data as provided in the ToR or this study.

only 15% are officially registered. 43% of SMEs are in operation in the agriculture sector, 33% are in wholesale and retail and 9% in manufacturing. Those employed by SMEs typically earn low wages (11% have no monthly income), and thus one could hypothesise that they are currently not driving growth but nonetheless play a vital role in promoting resilience in the Zimbabwe economy.

1.1.2 The role of DFID Zimbabwe

Promoting economic reform and development is a key strategic objective for DFID Zimbabwe for the period 2016-2020. The outlook for the manufacturing sector is bleak, at present the main avenue for inclusive growth is via the SME sector. Previous analysis also identified potential pockets of SME growth in the Zimbabwean economy. DFID Zimbabwe supports access to finance for SMEs, and works towards improving investment climate and business environment reforms. There is a major opportunity to strengthen the evidence base for the above areas which will help to review the validity of DFID Zimbabwe's current approaches and identify those which have the greatest efficacy in promoting economic development. At the same time, a stronger evidence base will serve as a guide to future investment and policies in the field by DFID, other donors and the Government of Zimbabwe.

1.2 Study aims, methodology and structure

1.2.1 Research questions

This study explores the factors of growth in the Zimbabwean economy to both understand in more detail the economic decline of recent years, but also to understand where growth might come from in future. As part of this process, particular focus has been given to the need to take account of the changed structure of the corporate sector in Zimbabwe. The Terms of Reference for this project provide four clear research questions, which are answered in chapter 5:

1. What are the underlying drivers of the structural shift in Zimbabwean firms (from large corporates to SME's) in the past decade?
2. Going forward is transformational and inclusive growth in Zimbabwe likely to be led by SME's or by large corporate firms? What are the implications of firm size for productivity and export potential in Zimbabwe?
3. Identify the attributes of both resilient SMEs and large corporates operating in Zimbabwe's difficult business environment?
4. Consider whether there are sectors that best lend themselves to the development of resilient SMEs as well as sectors that favour the development of resilient corporates.

As an addition to the questions set out in the Terms of Reference, DFID Zimbabwe also asked the research team a further question. Given all of the above, what specific, practical activities might DIFD undertake to help re-generate the private sector and hence assist economic growth. DFID will shortly be beginning a new round of PSD programming: what elements might this usefully contain which respond to the conclusions drawn by this study? This question is answered in chapter 6.

1.2.2 Methodology

This study is based on two main elements of work. The first was a review of relevant literature. The issue of 'where does economic growth come from' is of great interest to academics and policy makers. Accordingly, there are a large number of different analytical frameworks which seek to understand how growth is created. These range from analyses at the level of the firm up to assessments of the implications on growth on macro-level issues such as geographic location and connectedness. This study began with a review of this literature, with a view to developing hypotheses which could then be tested on-the-ground in Zimbabwe.

The second element of this project was therefore a country mission to interview a range of different, relevant groups and individuals. These included businesses, business membership organisations. Government agencies independent commentators and others. These interviews were undertaken during September 2016. A more detailed explanation of the methodology used in this report is contained as Annex 1.

1.2.3 Report structure

The remaining chapters of this report are structured in such a way as to explore relevant issues, and to provide responses to the research questions posed.

Chapter 2 reviews the extensive literature on factors of firm-level and macro-economic growth. As noted earlier, this is a topic of great interest and importance with the result that the literature is both large and diverse. This chapter therefore seeks to pull out issues, questions and lessons which might be the most relevant in better understanding the situation in Zimbabwe.

Chapter 3 examines in detail the course of Zimbabwean economic development over the past decade and a half. Drawing both on literature and on issues raised during the interview process, this chapter seeks to explain in more detail the factors that have underpinned the economic demise during this period. Further it paints a picture of the current structure of the business sector with a view to understanding better how economic revival might occur.

Chapter 4 draws on both of the preceding chapters to answer the 4 specific research questions set out in the Terms of Reference. In particular this chapter examines why it is that some companies have managed to survive and to explain what attributes they exhibit that have enabled them to do this. Secondly this chapter draws on the lessons both from the literature and from interviews to define those factors which could lead to renewed economic growth.

Chapter 5 responds to the additional question set by DFID Zimbabwe for this study: to set out a range of possible areas of activity which might form the basis for the next iteration of PSD programming in the country. Of necessity these issue areas are defined fairly broadly, but seek to proposed actions which would directly address the areas of potential growth identified in chapter 5. These recommendations are, as far as possible, couched in such a way as to be feasible given the political economy realities in Zimbabwe now, and in the foreseeable future.

2 Literature review: what are the sources of firm-level and macro-economic growth?

2.1 Introduction

How economies grow, and the contribution to macro-economic expansion of firm-level growth are issues of immense importance for all countries, not just developing ones. It is not surprising therefore that the literature on this topic is immense and multi-faceted. Analyses range from those focussing at the level of the firm through to those which look at macro-level issues such as the geographic location of counties, and their inter-connectedness. This literature review therefore seeks to draw from this extensive literature on those sources and analyses most likely to provide relevant insights to the situation in Zimbabwe. It has been something of a challenge therefore to form a detailed-enough insight into each of these areas to provide a sufficient basis to inform the in-country research in Zimbabwe, whilst not becoming drawn too far into any one element of the literature.

What has also become clear is that the different analytical frameworks inter-relate to a considerable degree. The literature on 'product space' for example focusses on what additional products a country might be able to produce given additional skills or resources. This self-evidently means that there needs to be a focus on firm-level capabilities. To what extent do individual firms have the capabilities, or can they acquire them, to enable production of more sophisticated goods and services? Equally, the literatures on clusters and agglomeration and on SEZs overlap to a considerable degree.

The literature on why firms grow, or fail to do so, is clearly enormous. Despite this, there does not appear to be agreement even on what the different factors are to consider, much less clear assessments of how all these different factors might be fitted together to provide a clear policy framework for growth. On one hand, this is surprising given the volume of literature available, and how long this discussion has been going on. On the other hand it is not surprising given the ideological and other factors which also inform policy decisions relating to firm-level and wider economic growth.

It is also clear that even were a definitive 'recipe for firm-level and macro-economic growth' available, its implementation would be hugely impacted by the political economy considerations in any given country. The literature on SEZs, for example, makes clear that such zones can be beneficial in promoting economic growth and investment. However, they can also be used by elites as a way of perpetuating rent-seeking behaviour, in which case the wider economic benefits of such zones is negligible. It is clear therefore that this research project needs to take strong account of the particular political economy issues in Zimbabwe in order that any policy and other recommendations made are likely to prove feasible.

The inception report identified nine areas of literature which seemed relevant to this study. As noted above there is a good deal of overlap between these literatures. Taking these overlaps into account, the literature suggests that there are three main headings to consider:

1. **Capabilities and learning:** The capacity, skills and capability of individuals, firms and government entities is the basis without which economic growth at any level is not possible;
2. **Proximity:** The physical location of firms relative to each other is significant in determining how firms grow. Also a country's location, and how well it collaborates with its neighbours is also

significant. However, 'social proximity' is also key: the 'human' connection between firms, not just the geographic ones;
3. **Regulatory environment:** Although criticisms of the World Bank's Doing Business (DB) indicators are fair, the reality is that regulation still matters greatly. However, it is not just individual regulations that matter, but also the general environment of rent-seeking, government openness and other such factors which are of importance.

The following sections highlight some of the key issues in each of these topic areas. These summaries are then followed by a completed version of the chart presented in the inception report.

2.2 Capabilities and learning

2.2.1 Firm-level capabilities

The experience of the Asian Development Bank in Vietnam is that a key challenge to more inclusive economic growth is that individual firms lack both technical and managerial skills to be able to take advantage of opportunities available. Similarly, in Sierra Leone, skill levels within local firms meant that only a few were able to tap into the significant amount of international funding that was available for post-Ebola recovery[2].

A study conducted last year under the Policy Research Fund looking at the role of donors in middle income countries, identified that "companies also face internal challenges and lack capacity in crucial areas."[3] Specifically, the report identified a number of challenges. First is the lack of technical skills: in Zambia for example, most of the skilled workforce in the mining industry has come from outside of the country given the shortage of appropriate local technical skills. Secondly, companies often lack relevant management skills and experience. Companies are often owned and run by individuals with little formal management training, with the result that their capabilities are low. There are also the political and cultural issues that impinge on making sound business decisions, both within the private sector and in the public sector. Thirdly, as a result of this, internal systems of management, oversight and financial control are weak. Whilst they might be just about fit-for-purpose for the current state of the company they do not allow scope for diversification or expansion.

Capabilities need to exist at a number of levels. Firstly a company needs to have the right technical skills to enable it to operate effectively. The establishment of the MozLink project in Mozambique in 1999 was an example of efforts to skill up local supplier firms to have the technical capabilities to be able to service effectively large foreign investors[4]. Challenges that local firms faced included consistency, quality control and timeliness of supply. Such technical skills are therefore the first, key element in companies' ability to compete and grow.

However, management skills and, more broadly, effective corporate governance are also important. Venture capitalists in Vietnam report that in many cases, small and medium size firms have grown as the result of a strong individual or family group, but few proper management and governance structures are in place. As a result, growth is constrained by the limits of these individuals, who also frequently lack the business planning and budgeting skills that allow them to present fundable projects to potential investors.

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[2] Davis P. *Ebola in Sierra Leone: Economic impact and recovery.* SOBA/ DFID 2015

[3] Davis P. *Private Sector Development in Countries Progressing from Poverty*. Ecorys/ DFID 2016.

[4] IFC. *Mozal Linkages Program (IFC PEP Africa).* IFC 2007

It is also clear that 'firm capability' encompasses more than just skills, be those technical or managerial. Many areas of literature point to the importance of a company's attitudes. Firms which are entrepreneurial, whilst arguably more risk-taking, are those which will succeed over time. Dedication, focus and long-term commitment also appear to be important: management teams need to drive their businesses and seek to encourage and motivate their personnel.

A study of manufacturing firms in Brazil[5] sought to understand the link between innovation and firm-level growth, paying particular attention to the capabilities that companies needed to succeed. The study identified two main innovation strategies which firms used: internal development in which companies develop and incubate their own innovations and technologies ("technology make") and external acquisition, in which a company absorbs and adapts innovations developed elsewhere ("technology buy)". The study concluded that firms performed better and grew faster which adopted the 'technology buy' approach – 'the technology buy strategy is significantly related to firm growth.' Essentially companies buy-in innovations, and then learn how best to use these in their own context. Interestingly, however, from the perspective of firm-level skills: 'a large share of workers with secondary education is very important for process innovations. It does not require a tertiary skilled workforce to be a successful process innovator.' Whilst this lesson may not necessarily hold true elsewhere, it is nevertheless interesting that successful innovation and firm growth does not, in the Brazilian case anyway, require very high-level skills.

2.2.2 *How companies learn*

A further important issue is how companies learn. In part this requires a focus on the education system, which needs to ensure that companies have access to high quality technical and managerial staff. However, companies also learn from each other. There is a good deal of evidence, for example, that companies learn a great deal from the process of exporting: the need to meet international standards requires them to improve themselves. As Knight and Cavusgil[6] argue, 'companies that operate internationally from an early stage in their development' grow faster and are more robust than their domestically-focused counterparts. Moreover, this international view, and preparedness to learn means that 'despite the scarce financial, human, and tangible resources…[these] firms leverage innovativeness, knowledge, and capabilities to achieve considerable foreign market success early in their evolution.' In the past, these authors conclude, smaller firms would connect to international markets by working with larger firms. However the emergence of electronic and other 'mechanisms and infrastructures…are facilitating the internationalization of countless smaller, entrepreneurial firms.'

Whilst it may be true that new linkages are being formed, foreign direct investment (FDI) remains an important tool to stimulate both economic growth of the recipient country and expansion of its domestic companies. As World Bank argues: "sustained long-term poverty reduction depends on stimulating economic growth, which in turn depends on trade policy reform. No economy has ever developed without integrating with the world economy."[7] This conclusion is bourne out by a study be the UN University, which found that there is 'a strong causal link from FDI to GDP…FDI appears to be growth enhancing much the same way as domestic investment.'[8]

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5 Goedhuys M & R Veugelers. 'Innovation strategies, process and product innovations and growth: Firm-level evidence from Brazil'. In *Structural Change and Economic Dynamics* 23 (2012), pp516– 529.

6 Knight G A % S T Cavusgil. 'Innovation, organizational capabilities, and the born-global firm.' In *Journal of International Business Studies*, Vol. 35, No. 2 (Mar 2004), pp. 124-141.

7 World Bank. 'Trade Policy for Development.' World Bank *Knowledge in Development* note 2. 2007.

8 Hansen H & J Rand. *On the Causal Links between FDI and Growth in Developing Countries*. Research Paper No 2005/31. UN University. 2005.
Henrik Hansen and John Rand* June 2005.

However, the impacts of FDI are far from linear: international investors are often criticised on the basis that investments in emerging countries fail to bring benefits to the population at large. As a CAFOD paper argued, “some oil, gas and mining operations may bring considerable FDI but create relatively few local jobs.”[9] As Narula and Dunning conclude: foreign investment “does not always result in a proportional increase in development effects, because [different companies] have different potential for externalities.”[10]

Whether or not foreign companies encourage or discourage domestic investment in the economy appears to depend on a number of variables. These include, for example, the strategies of the investing companies and the extent to which they are prepared to share knowledge and expertise with domestic firms.[11] However, the ability of local firms to absorb the technological and practices presented by foreign companies is also seen as important. Foreign investment therefore has greater developmental impacts when domestic firms are larger and the technological gap between them and incoming companies is smaller.[12]

Where investing companies are prepared to work with local providers the effects both on the host economy and companies within it can be profound. For example an INSEAD study of Unilever’s business in South Africa[13] found that every job Unilever creates in its direct operations, a further 22 were created in the value-chain, representing 0.8% of the country’s total employment. A similar study looking at the operations of Coca-Cola and SABMiller in Zambia and El Salvador concluded that the gross value added (GVA) by the value chains of these two companies in 2008 was US$ 21m in Zambia and US$ 83m in El Salvador. Oxfam calculated that this supported and estimated 3,741 jobs in Zambia, and 4,244 in El Salvador[14].

The case of Samsung’s investment in Vietnam demonstrates the obverse of these examples: that when local firms lack adequate capacity, then the knock-on effects of FDI are limited. According to an Asian Development Bank[15] report Samsung has 59 ‘vendors’ (first tier suppliers) in Vietnam. However, only two of these are Vietnamese firms, and these are suppliers of packaging and logistics (non-core electronic businesses). Local firms ‘are not “qualified” due to the fact that they are unable to meet the high technical standards as required to be able to supply to Samsung.’

It is clear therefore that FDI can have very differential effects, and that ‘spill overs from foreign firms substantially depend on the absorptive capacity and productivity levels of individual firms.’[16] How then do countries go about attracting the ‘right sort’ of FDI? Narula and Dunning advocate that host governments use an industrial policy to ensure that they accept foreign investments appropriate to the stage of development of their economy[17]. But what does this look like? Some recent literature has explored the relative impacts of FDI from different countries. As one of these studies makes clear, ‘the origin of external flows matters…[therefore] integration and openness to external flows could lead to policy recommendations that are too generic, without taking into account the

9 CAFOD. *Everyone’s Business: Towards a mature understanding of the role the private sector in development.* CAFOD, London 2011. p8.

10 Narula. R & J H Dunning. ‘Multinational enterprises, development and globalisation: Some clarifications and a research agenda.’ *United Nations University Working Paper Series #2009-023*. United Nations University, Maastricht. 2009 p3.

11 Spencer, J. ‘The Impact of Multinational Enterprise Strategy on Indigenous Enterprises: Horizontal Spillovers and Crowding Out in Developing Countries’. In *The Academy of Management Review*. Vol 33, No2. 2008 pp341-361.

12 ‘Zhang Y, et al. ‘FDI spillovers in an emerging market: the role of foreign firms' country origin diversity and domestic firms' absorptive capacity’. In *Strategic Management Journal*. Vol 9, pp969-989. Sept 2010.

13 Kapstein, E. *Measuring Unilever's Economic Footprint: The Case of South Africa*. 2008.

14 Oxfam America. *Exploring the links between international business and poverty reduction*. Oxfam 2008.

15 Asian Development Bank. *Private Sector Assessment, Vietnam.* ADB Hanoi, 2014.

16 Damijan J *et al. Impact of firm heterogeneity on direct and spillover effects of FDI: Micro-evidence from ten transition countries.* Journal of Comparative Economics 41 (2013) pp895–922.

17 Narula. R & J H Dunning. p13.

potentially different impact of diverse types of external flows.'[18] This paper concludes that importing from Southern countries raises the ability to expand the variety of manufactured exports and to introduce more advanced goods in less diversified economies; and FDI from the South fosters diversification of low-tech industries such as the processing of agricultural products and the textiles-apparel sector. By contrast FDI from the North promote diversification within primary goods industries, and importing from the North improves productive capacities in higher-tech and more capital-intensive sectors.

Given the significant differences in the profile of external flows from North and South it is important then to consider what a country might do differentially to attract interest from Northern and Southern partners. In his paper, Banga concludes that investors from these locations are looking for quite different things in developing countries. He finds that 'FDI from developed countries are attracted to large market size, higher education levels, higher productivity of labour, better transport and communication and lower domestic lending rates, while cost factors play a more significant role in attracting FDI from developing countries.'[19] In policy terms, the implications of this are that tax breaks and other financial inducements are more likely to attract Southern investors who are looking for low-cost manufacturing sites. By contrast, Northern investors will be looking either for large markets to tap into, or unique skills bases. It is clear therefore that recipient countries need to calibrate their FDI offer depending on what attributes they wish to gain from that foreign investment.

If one looks more broadly at the importance of capability beyond the firm level, central to Hausmann's 'product space' analysis is that skills and capabilities are central to a country's ability to develop new products and services, and so to expand economically. He uses the analogy of scrabble: as you acquire more letters, you can create more and more complex words. Thus, the more skills a company or an economy has, so it can produce more, and more sophisticated goods and services.

However, what Hausmann's work also demonstrates is the need for capabilities that interact. Traditional PSD 'value chain' work tends often to focus on a specific product – for example how might the production of maize or sorghum be improved. This neglects Haumann's analysis that as products get more sophisticated, they need, for their further expansion, to draw on other capabilities. This means that countries need also to focus on what might be termed 'cross-cutting' capabilities such as packaging, logistics and business services, to facilitate the further expansion of firms with capabilities in producing specific goods. Focussing on such 'value-webs' might be central to re-generating the Zimbabwean economy.

2.2.3 Issues arising

The discussion above raises a number of issues in relation to the situation in Zimbabwe. Some of the key questions are the following:

- How far does the education system in Zimbabwe provide training in skills and attributes relevant to the private sector?
  - Is technical training adequate and appropriate?
  - Does it engender the kinds of attitudes and values required to run a successful business, such as dedication, focus and long-term commitment
  - How easy is it for companies and their managers to access high quality management training and mentoring?

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[18] Amighini A & M Sanfilippo. *Impact of South-South FDI and trade on the export upgrading of African economies.* EUI Working Paper RSCAS 2013/75. 2013.

[19] Banga R. *Impact of government policies and investment agreements on FDI flows*. Indian Council for Research on International Economic Relations. Working paper 116. November 2003.

- In product/ service areas regarded as having the potential for growth to what extend does the complete 'universe' of skills and capabilities exist? Hausmann, for example sees potential for Zimbabwe in areas such as chemicals, plastics and food products. What 'lateral' capabilities might be missing which hinders this potential?
  - What might be done to foster greater lateral collaboration?
- How resilient are Zimbabwean SMEs in terms of their capabilities?
- Given the levels of capability of different types of firms (SMEs/ larger companies), what are the implications for where economic growth might most readily come from?
- What strategic advantages and disadvantages does Zimbabwe have (in skills, proximity, etc.) and what implications do these have about choices for PSD? Does the relatively high cost-base point to the need for a focus on high value, niche markets?

2.3 Proximity

2.3.1 Clusters and networks

As much of the literature points out, companies operating in the same line of business have long tended to congregate in one location. There are both international examples such as Silicon Valley and the Detroit motor industry; developing country instances include Bollywood, the Indian entertainment centre, and the growing technological hub in Bangalore.

However, as the original ToR for this project observed, the clustering of firms in similar businesses in one area can lead to price competition with the result that some firms go out of business. Whilst this may be healthy from the perspective of economic Darwinism – the weakest firms die off, and the strongest survive – this phenomenon is less desirable from the perspective of employment. However, as a number of studies demonstrate, the reality is rather more complex. As Delgado, Porter and Stern argue, the impact of firms clustering is two-fold. The first is the process of 'convergence' which occurs 'when the potential for growth is declining in the level of economic activity as a result of diminishing returns'[20] The second is 'agglomeration' which leads to increasing economic returns which arise 'from interdependencies across complementary economic activities.' In practice what this means is that if the companies clustered together are in the same industry, then convergence will occur – the least robust will go under. On the other hand if companies in a cluster are in complementary businesses, then the process of agglomeration will see that cluster grow.

Clusters appear to work when they serve to create innovation. The literature identifies a number of factors which serve to make this happen. Geographic proximity serves to bring together people with similar but complementary skills. The interaction between them spurs new ideas and innovations which have higher value-added and therefore higher prices. As an analysis of the Bollywood entertainment cluster in India observes, 'we see growing synergies with related industries like TV, pop music, computer games and advertising. This configuration of connectivity has facilitated the growth of an emerging entertainment complex.'[21] The existence of a group of similar companies in one area also drives the development of a job market: people can move between companies relatively easily. As Delgado *et al* conclude in their study, 'industries located within a strong cluster are associated with higher employment growth… Strong clusters also foster growth in wages, the number of establishments, and patenting.'[22] Thus clusters create 'ecosystems' of companies operating in the same broad field, but including the range of different skills necessary to produce

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20 Delgado. M, M E Porter & S Stern. 'Clusters, Convergence, and Economic Performance' *NBER Working Paper No. 18250* National Bureau of Economic Research, Cambridge MA. July 2012 p2.

21 Lorenzen. M & R Mudambi. 'Clusters, Connectivity and Catch-up: Bollywood and Bangalore in the Global Economy'. In Journal of Economic Geography 13 (2013) pp. 501–534.

22 Delgado *et al. Op cit.*

sophisticated and innovative goods and services. The City of London, for example specialises in finance, but within that umbrella are included many different specialisms. However, as well as the financiers themselves, the City also includes specialist marketing agencies, lawyers and other 'lateral' skills which are not themselves finance-focussed, but which are highly important to the overall success of the 'cluster'. Similarly, in different parts of Germany, 'Mittelstand' companies have long been at the heart of German manufacturing industry. This group of companies contributes almost 52% of Germany's total economic output, with a combined overall turnover in 2011 of around € 2 trillion. By comparison, the turnover of German's 30 largest companies in the DAX30 turned over € 1.19 trillion[23]. These companies are also significant in creating employment. About 61.3% of Germany's industrial workforce is employed by Mittelstand companies, a figure that rose 1.6% during the economic crisis. By comparison, larger German firms reduced their employment levels by 2.4% between 2008 and 2011.

Once again these companies are part of an ecosystem, with training and financing institutions existing locally which are a key element of the companies' success. According to the German Economics Ministry, as much as 54% of investment in these companies comes from equity, with a further 29% coming from bank loans. Of the latter, a high proportion of debt finance is from local banks, whose representatives often sit on company boards and so understand the companies well. The result is a very stable funding base, which encourages investment over time. Similarly the companies are well tied into local training institutions, and provide 85% of Germany's apprenticeships. The importance of this juxtaposition of companies with other support mechanisms in Germany is reflected in broader studies of clusters which emphasise 'central role of specialized local institutions (from training facilities to infrastructure investments) in allowing potential complementarities to be realized.'[24]

From a policy perspective however, there are some challenges: it is hard for donor interventions directly to create strong business clusters. The rationale for this criticism is three-fold. The first is that donor interventions are too-often supply-, rather than demand-side focussed. For example, a 2011 report by ODI for UNECA studying SME networks in sub-Saharan Africa criticised donor actors' activities for focussing on building firms' capabilities, rather than identifying markets for them. 'Business needs markets and the traditional supply-side menu of support for training and access to finance does not necessarily result in market access.'[25]

More successful in creating access to markets, the report concluded, are 'vertical networks' which respond to the needs of a small number of key, larger businesses. SMEs are thus provided with a market as suppliers to these larger firms. It is hard for donors to create such structures, as their viability is reliant on commercial drivers of the firms involved. 'This suggests that public policy makers should focus upon improving the broad enabling environment for business and only seek to support vertical networks which have a sufficiently strong commercial logic to incentivise the lead buyers without government support.'[26]

Secondly, donor interventions are criticised for focussing on relatively-narrow value chains, and so miss the importance of the connections to industries in complementary areas which are so important for firm-level and economic growth driven by the process of agglomeration. Once again, linkages to larger companies can therefore be important. A good example of this is the development of MozLink in Mozambique. This programme exists to up-skill SMEs in Mozambique to international standards so that they can become suppliers to some of the main global companies

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[23] German Ministry of Economics and Technology. *German Mittelstand: Engine of the German Economy.* 2012.
[24] Sölvell, O, G Lindqvist, & C Ketels, *Cluster Initiatives in Developing and Transition Economies*." Ivory Tower AB, Stockholm 2006.
[25] Davis P, Loehr C & Lemma A. *Promotion of SMEs: SME networks and business linkages in Africa*. ODI, London 2011.
[26] Ibid.

operating in the country, including Coca-Cola, Sasol and MozAl. Established in 2002, the project has worked with nearly 200 SMEs which provide a range of support services to the companies, including transportation, steel fabrication and mining services. As Delgado *et al* make clear, 'the presence of complementary activity via clusters is a strong driver of growth through allowing firms ready access to key inputs, better interactions with customers, and facilitating experimentation and innovation.'[27]

However, the third criticism relates to a further factor that appears to be important for clusters to work: that it is not just geographic proximity which is important, but also 'social proximity'. Innovation and growth does not just occur because companies and their people are physically close together, but because they get along and want to work together. Innovation and new ideas are driven by people rather than structures – 'the impact of human capital on inventive activity and innovative production is stronger than formal R&D expenditures.'[28] Therefore the degree to which like minds can be brought together is crucial to the success or otherwise of a cluster. As Lorenzen and Mudambi's study of Bollywood makes clear, central to the cluster's success has been 'decentralized personal relationships [which] have remained the dominant linkage type in value creation…value is created through flexible linkages between persons rather than rigid linkages between organizations'[29]. A study of industrial clusters in Europe reached similar conclusions, that 'regions with high levels of social capital tend to perform better in terms of creating new knowledge.'[30]

Recent literature argues that geographic proximity is irrelevant in the absence of social proximity. A 2013 article argued that 'open innovation is a social phenomenon that requires a social proximity between firms and entrepreneurs.'[31] Without this social proximity, it does not matter how geographically proximate firms are: 'even in close contexts of cognitive, organizational and institutional proximities, social distance can be an impediment to collaboration.' Moreover, to a degree at least, geographic clustering is less relevant in a more interconnected world: if people want to collaborate and work with others, they are willing to travel in order to do so. From a policy perspective therefore, according to these authors, it is largely irrelevant how much effort is put into creating geographic proximity between companies if the social proximity is not created. The success of the former is dependent on the latter. 'Public policies for clusters should particularly target the enhancement of social proximity between local entrepreneurs instead of relying on geographic and cognitive proximities.' This implies that the focus of government and donor efforts should be to support clusters where social proximity may already exist to some degree. Clusters, it appears, work best if they emerge spontaneously, rather than as the result of governmental action.

Clusters therefore can be a powerful tool in driving innovation and growth, which in turn can lead to job creation and economic growth. However, clusters in which companies are too similar are likely to lead to a process of convergence, which leads weaker companies to go to the wall with consequent losses in jobs. Clusters therefore need to include companies engaged in a range of related and complementary activities. Whilst there may be benefits in cost-savings – 'firms benefit from their location in such "industrial districts" by sharing the fixed costs of common resources'[32] – this is not the principal reason for the importance of clusters. Clusters drive innovation and new

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27 Delgado *et al. Op cit.*

28 USai S, E Marrocu & R Paci. 'Local Clusters and Global Networks'. In Hilpert U. *The Routledge Handbook of Politics and Technology.* Routledge, London 2016 p115.

29 Lorenzen & Mudambi. *Op cit.*

30 De Dominicis, et al. *Regional Clusters of Innovative Activity in Europe: Are Social Capital and Geographical Proximity the Key Determinants?* Tinbergen Institute Discussion Paper. Amsterdam 2011.

31 Letaifa SB & Y Rabeau. 'Too close to collaborate? How geographic proximity could impede entrepreneurship and innovation.' In *Journal of Business Research.* 2013.

32 Desrochers P. 'Geographical Proximity and the Transmission of Tacit Knowledge'. In *The Review of Austrian Economics* 14:1 2001 pp 25-46.

product development which allows new markets to be created and growth to occur. However for this to happen more is needed than simply geographic proximity. It is the social interactions between people which is important. What is needed therefore are conduits by which enable ‘creative and entrepreneurial individuals to absorb thinking processes, ways of talking and ways of doing things by interacting closely with other knowledgeable people.’ Geographic proximity can enable social proximity, but it is not sufficient on its own.

2.3.2 ‘Special economic zones’ and similar structures

‘Special economic zones’, export zones and other similar structures also receive a lot of attention in the literature. The evidence on their impact is mixed. As the World Bank argues, ‘SEZs have been successful in attracting FDI and generating jobs and exports and demonstrate marginally positive cost-benefit effect…However, many scholars [argue that their] success is confined to specific conditions over a limited time horizon and there are some concerns that zones may become “enclaves”’[33] In Zeng’s view ‘Sub-Sahara Africa’s experience with traditional economic zones has been relatively poor…The key challenges include the poor regulatory and institutional framework, lack of effective strategic planning, weak governance and implementation capacity, and inadequate infrastructure…’

The Asian Development Bank also holds that economic zones can stimulate the economy. When these structures work effectively they ‘have paid high dividends in job creation, increased exports, and larger FDI.’[34]. A study of Special Economic Zones in China reached a similar conclusion, that: SEZ policy ‘1) increases FDI by 58%...2) does not crowd out domeostic investment…and 3) increases total factor productivity…’[35] However experience elsewhere suggests that the benefits of SEZs are less clear-cut. Though they can be successful, they often fail to deliver much additional benefit to surrounding firms: situations “where investors gladly took tax breaks without producing substantial employment or export earnings.”[36] Companies within these zones can benefit from improved infrastructure, tax breaks and so on, but the benefits for potential supplier companies are minimal. Furthermore, it is not always clear that SEZs provide economic benefits for the host country with tax breaks on offer sometimes – for example in the case of Samsung’s investments in Vietnam – mean that the tax yield from such sites is very low.

The main criticism made of them is that they often fail to spur wider economic growth. As Kulkarni and Sanyal conclude ‘the high growth sectors often push the development-related activities to the brink thereby resulting in the uneven growth of the different aspects of the geographical area under consideration.’[37]

The broader policy environment of the country in which an SEZ is established is also seen as being highly significant. In their study, Davies and Mazhikeyev concluded that ‘SEZ firms in open economies are 25% more likely to export than their non-SEZ counterparts, with a large negative effect in closed economies. Thus, the estimated effect of introducing an SEZ can be meaningful, but is heavily contingent on the local economic environment.’[38]

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[33] Zeng DZ. *Global Experiences with Special Economic Zones Focus on China and Africa.* World Bank 2015. Douglas Zhihua Zeng.

[34] ADB, *How can SEZ catalyse economic development*, Asian Integration Report 2015.

[35] Wang J. *The Economic Impact of Special Economic Zones: Evidence from Chinese Municipalities.* LSE Job Market Paper. Nov 2009

[36] The Economist. “Special economic zones: Political priority, economic gamble. 4th April 2015.

[37] Kulkarni N & Sanyal AJ. ‘Impact of Special Economic Zones – A critical review of recent literature’. In *International Education and Research Jorunal.* Vol 2, Issue 8. Aubust 2016.

[38] Davies RB & A Mazhikeyev. *The Impact of Special Economic Zones on Exporting Behaviour.* Centre for Economic Research Working Paper Series. WP15/28. University College, Dublin. November 2015.

Why SEZs are set up is also seen as being very important. If they are intended as the first step in a wider process of economic liberalisation, then they can be extremely effective. However, the literature notes that in many cases such zones are used by elites to perpetuate rent-seeking behaviours. Moberg argues that 'SEZs can be both and economic stimulus and a cause for rent misallocation. They can promote economic reform on the one hand, and allow governments to increase their rent-seeking on the other'[39]. She argues that in some circumstances, in China for example, SEZs were used as a tool to gradually phase in reform – trying new approaches in relatively small areas before rolling out reform more broadly. Conversely, she argues, in other locations SEZs have been used by governments (or people within government) to perpetuate the potential for rent-seeking when reforms (for example such as might be promoted by Doing Business reviews) are limiting the possibility for rent-seeking in the economy as a whole. Thus 'which role SEZs play will depend on whether the right institutions and policies are in place.'

The development of agricultural growth corridors demonstrates that special economic zones do not have to be limited to a small geographic area. The African Union and Economic Commission for Africa concluded in 2009 that, "developing regional value chains for strategic agricultural commodities … is essential for African countries to enhance their agricultural transformation and global competitiveness"[40] As Arvis, Smith and Carruthers[41] make clear, the successful operation of trade corridors requires a mixture of upgrading the physical infrastructure and changes to the regulatory environment, for example in terms of customs reforms, non-physical barriers to improved trade. Such a project requires a strongly joined-up approach involving host governments, donors and the private sector.

Geographic proximity is not just relevant domestically, but also at an international level. Countries which are better positioned geographically – close to suppliers and customers, access to the sea, and on good trade routes – generally perform better than those which lack these advantages. The literature also makes much of the importance of regional trading blocs as a tool for stimulating trade, exports and economic growth.

2.3.3 Issues arising

The discussion above raises a number of issues in relation to the situation in Zimbabwe. Some of the key questions are the following:

- Where are the agglomerations that could build cluster growth?
- How connected are Zimbabwean financial and training services to these agglomerations?
- Where have SMEs successfully developed business linkages with larger firms? What has precipitated the success?
- What role might SADC and COMESA play in stimulating economic opportunities for Zimbabwe by providing a strong regional trading bloc?
- What has been Zimbabwe's previous experience with SEZs and other similar structures?
  - What has been the rationale for their establishment, and to what extent has this been delivered upon?
- How can we develop higher levels of trust?
- What have been the economic drivers in the past at firm, sector and national level?
  - What has sustained things in the past, and why/ how has this changed?
  - What could be done to improve things in this regard?

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39 Moberg L. *The Political Economy of Special Economic Zones.* PhD thesis. George Mason University. 2015

40 Economic Commission for Africa. *Developing African Agriculture Through Regional Value Chains* UNECA, Addis Ababa 2009 p143.

41 Arvis, J-F et al. *Connecting Land-locked Developing Countries to Markets: Trade Corridors in the 21st Century*. World Bank, Washington DC. 2011.

2.4 Regulatory environment

A key aspect of donor economic development activity over the last decade or two has been that of business environment reform. Programmes like GEMS3 in Nigeria and PEPE in Ethiopia have focussed on various aspects of the enabling environment as a basis for encouraging a thriving private sector. Key aspects of these programmes have been on reform and harmonisation of taxation; land reform, with a particular focus on land titling; and investment promotion. The World Bank *Doing Business Indicators* have provided a basis for comparing progress in different countries.

However this focus has been criticised, for example by Page[42] who advised donors to 'stop *Doing* (monkey) *Business.* He is not alone in criticising the DB indicators. In 2015 *The Economist* criticised the rankings for being too prone to political gamesmanship – 'Countries might seek to improve their ranking on the Doing Business index by amending regulations in ways that have little substance.'[43] The report pointed to a number of countries, Rwanda for instance, which have significantly improved their DB ranking but yet remain very poor. To some extent the World Bank has responded to these criticisms and is beginning to focus more on 'sub-national' DB analyses, and pushing harder on the implementation of reforms, as well as their legal introduction.

However, it is clear from most of the literature that the state of the regulatory environment is still of considerable importance in allowing firms to endure and grow, and in enabling durable economic growth. Good regulation provides the framework which enables the private sector to act most effectively. According to Paul Wolfowitz, then-President of the World Bank, "The private sector is the most important engine of development, but it's also clear that the private sector can't do it on its own. There are critical things that have to be done by the public sector…"[44]

Investors prefer a predictable policy environment in which to operate. This was borne out by a study of foreign investment in 100 countries since 1970 which concluded that investors prefer countries that are stable and where democratic institutions and legal safeguards are in place: "for profit-maximising enterprises…[countries with] democratic institutions would be the preferred institutional structure for their investments."[45]

The development of renewable energy has been cited as an example of the role of government in creating a regulatory framework and structure of incentives to encourage private sector activity. A Chatham House paper coined the term 'investment grade energy policy' as "a critical factor for unlocking significantly scaled-up capital flows into renewable energy and energy efficiency."[46] This term is used to define policy regimes which provide investors with clarity, stability, predictability and long-term visibility for investors.

Brown and Jacobs argue that the government role needs to go beyond passive setting of a policy framework, and include the development of incentives. "National and sub-national governments, therefore, have a crucial role to play in creating the policy and institutional environment what will incentivise private sector investments..."[47] This bears out the argument put in the 2010 report by the UN Secretary-General's Advisory Group on Climate Change Financing. This group made the case

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42 Page J *Reversing Africa's Industrial Decline: Some Ideas from Learning to Compete*. Presentation to ODI 14th Jan 2016.

43 The Economist. *Pulling rank: The shortcomings of the World Bank's business-climate index*. 26th Sept 2015.

44 Wolfowitz. P. Remarks at the Corporate Council on Africa, June 23, 2005.

45 Jensen, Nathan M (2006) *Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment.* Princeton University Press, p148.

46 Hamilton. K. 'Unlocking Finance for Clean Energy: The Need for 'Investment Grade' Policy'. *Chatham House Briefing Paper EERG BP 2009/06*. RIIA. 2009. p1.

47 *Ibid*.

for using relatively limited public capital to leverage private investment. Such an approach, they argued would 'crowd in' private capital by compensating these investors for lower rates of return.[48]

Companies therefore need straightforward and transparent processes in areas such as registration, tax payment, and land titling. These areas form the basis of the DB analyses because where these processes are overly-complicated it wastes the time of key managers and staff and diverts them from the job of running their company. Opaque regulations also serve to distort the playing field because some firms will pay bribes or use their contacts to expedite necessary paperwork. This means that the system tends to benefit the wealthy or well-connected, rather than those with the relevant skills to succeed.

However the nature of the business environment at the regulatory level is not the only issue of concern. The broader context within which business operates is also highly material. The experience of many countries has been that even when changes are made to business regulation, these changes are not, for various reasons, properly implemented. As a result the real situation facing companies does not change, even if the regulations do. The willingness and capability needs to exist to implement more pro-business regulations on the ground. Furthermore issues such as corruption can greatly affect the business environment. As has been noted elsewhere the creation of SEZs, beneficial in some circumstances, can also be used as the basis for rent-seeking by politicians and officials.

More broadly, the concept of regulatory environment for business can also be interpreted to include the wider political context which companies face. Specific legal issues are frequently the result of a country's governance structures being challenging. The political situation in Zimbabwe is well known: it is noteworthy that in an interview with the Financial Times, Ricardo Hausmann identified Zimbabwe's main obstacle to strong economic growth as being the presence of the current President and his coterie.

Also relevant in relation to the environment for business is the physical environment. Access to services such as power, water, roads and other key elements of infrastructure are fundamental to companies' ability to make and distribute their goods and services. As the literature makes clear, access to physical infrastructure has a significant impact on the ability of firms to grow.

2.4.1 Issues arising

The discussion above raises a number of issues in relation to the situation in Zimbabwe. Some of the key questions are the following:

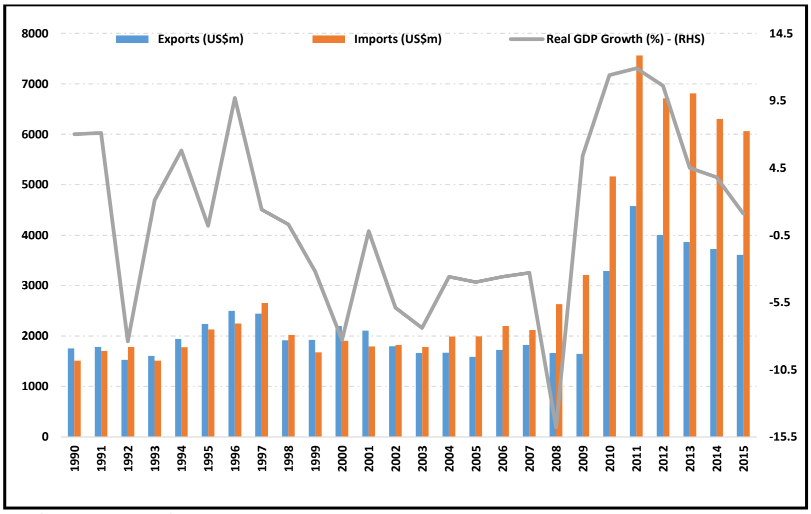
- What are Zimbabwe's strategic advantages as a country?
- What areas of the general business environment still require attention?
- Where good regulations exist which are not properly implemented, why is this the case, and what might be done to improve the situation?
- What issues of graft and corruption exist, and how to these manifest themselves?
  - How can these constraints be avoided or circumvented?
- What challenges are there with the physical infrastructure which impedes firm and economic growth?

[48] AGF. *The Report by the UN Secretary-General's High-level Advisory Group on Climate Change Financing.* 2010.

3 The Challenges for the Zimbabwean Economy

The Zimbabwean economy has performed very poorly for much of the past two decades. In the first decade of the century Zimbabwe averaged an annual drop in GDP of nearly 6%[49]. Although things seemed to improve in the period between 2009 and 2012 when the economy grew at an average annual growth rate of around 11% this proved to be an illusion. In reality this period of growth was the result primarily of dollarization of the economy from 2009, and masked real challenges for the country in general and the private sector in particular. Indeed, as the beneficial effects of the multiple currency arrangements and the Government of National Unity unwound, growth slowed to 4.5% in 2013 from 10.6% a year earlier, slowing further to 3.8% in 2014 and to only 1.5% in 2015[50]. So bad has the economic situation become that the Government is discussing openly the possibility of issuing bond notes.

Fig 3.1: Performance of the Zimbabwean economy[51]



Source: RBZ & Zimstat

This chapter explores some of the reasons for Zimbabwe's economic woes, and why a once-thriving economy finds itself in such dire straits. The aim of this paper as a whole is to understand where economic growth might come from in the future: to do this effectively, it is important to assess why growth has not occurred for most of the recent past.

3.1 Macro-political uncertainty

A key factor – many of those interviewed saw it as the key factor – in explaining Zimbabwe's economic malaise is its political uncertainty. The timing of President Mugabe's departure, and what happens thereafter are both matters of considerable discussion in Zimbabwe, and very unclear.

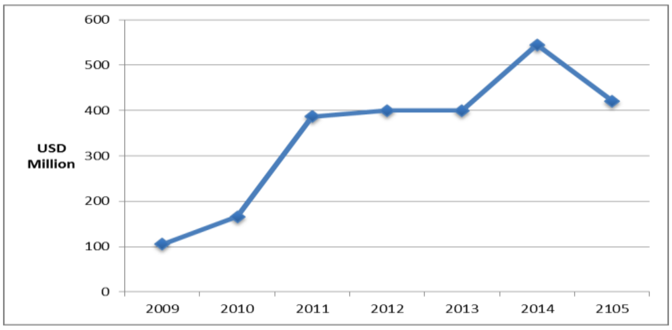
49 World Bank. *World Development Indicators.*

50 African Development Bank. *Zimbabwe Economic Outlook.*

51 http://www.financialgazette.co.zw/zimbabwes-gdp-to-grow-by-16-percent-in-2016-afdb/

As things stand at the moment, the macro-political environment, and associated policy volatility is a huge obstacle to economic recovery. The lack of visibility of who will be in power next, and what the next President will do when in power are significant drags on economic confidence. This is reflected for example in levels of Foreign Direct Investment, which dropped 23% in 2015 to $421m[52]. Local reporting of these figures suggested that 'lack of policy consistency, disregard for property rights and the unwillingness of authorities to deal with corruption' were behind this fall.[53] FDI inflows increased during 2009-2014, but uncertainty about the future have contributed to a significant decline in 2015. The decline is likely to continue in 2016.

Fig 3.2: FDI to Zimbabwe[54]



3.2 Policy legacy

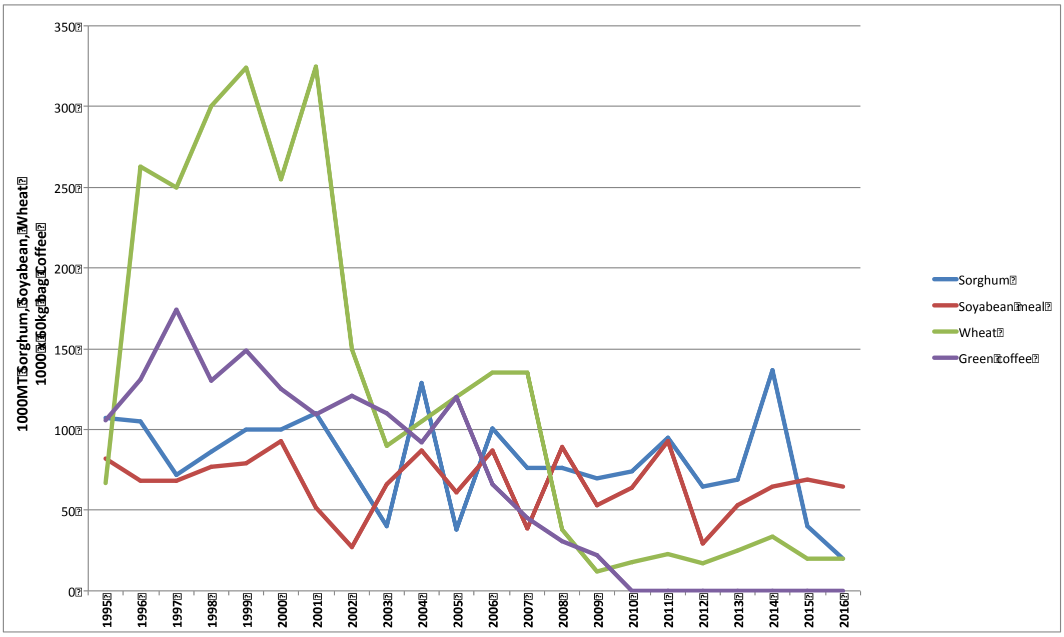
However it is not just the current political uncertainty which is de-stabilising the economy, but also the legacy and impact of political decisions taken over the past 2 decades, during which time the Zimbabwean economy has been subject to a number of shocks, mostly as the result of official government policy. There are two elements of this legacy which are especially problematic: land tenure and the policy of indigenisation.

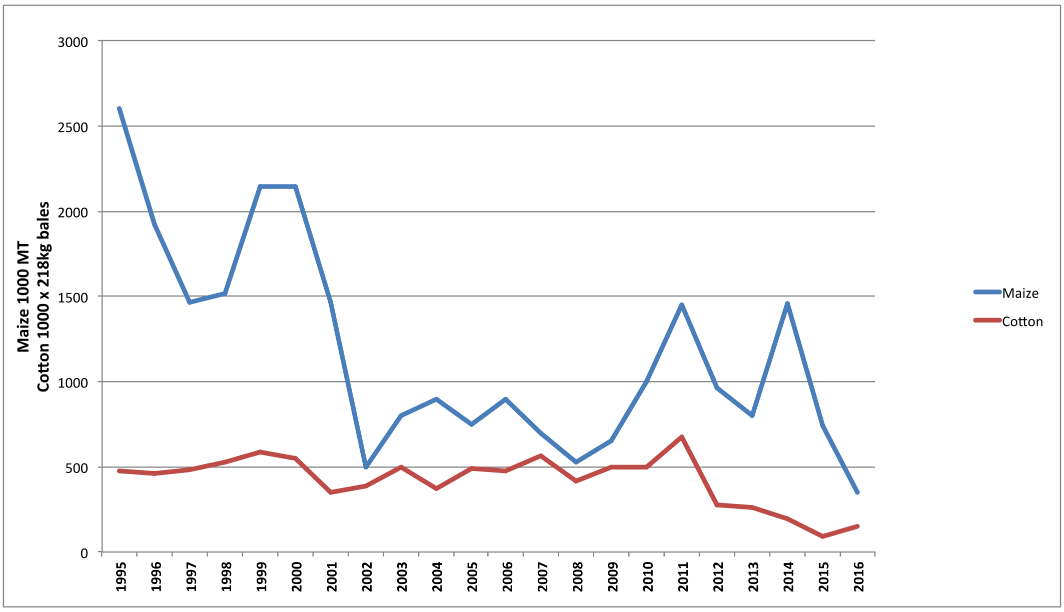
From around 1999 the Government enacted a process of forcible seizure of commercial farms, which were handed over to those perceived to have been disadvantaged in the colonial period. It is estimated that by 2006 only around 500 of the original 6,000 commercial farms were still operational, with the result that Zimbabwe went from being one of the main agricultural exporters of the region to a net importer of food. As well as this most obvious impact, it is clear from our interview data that the farm seizure process had a number of other, economically-detrimental impacts. First, the decline in commercial agriculture led to the demise of other local firms whose revenues depended on the large-scale farms. Secondly a great deal of Zimbabwe's industry relied on agricultural inputs, which dried up as the farming sector declined. Thus the land reform programme had the unintended consequence of also undermining a large part of the manufacturing sector. Thirdly, as a result both of the land re-allocation and the consequent impact on manufacturing, Zimbabwe lost a good deal of expertise as commercial farmers and experienced business people left the country. However, probably the most significant impact of the farm seizure process was the impact it had on confidence in the wider business environment. Security of land tenure is widely seen as a key element in promoting business confidence and investment. By removing the certainty of land ownership, the willingness of actors in a wide range of sectors to invest in Zimbabwe and to seek to grow businesses has been undermined. Zimbabwe's agricultural

52 UNCTAD. *2016 World Investment Report*. UN, New York. 2016.
53 The Source. *FDI to Zimbabwe falls 23 percent to $421mln*. 13th July 2016.
54 UNCTAD. *Op cit*

production declined since 2000, and whilst some crops, e.g. tobacco have revived, agricultural outputs to the manufacturing sector remain constrained, as illustrated Fig 3.4:

Fig 3.4: Agricultural output in Zimbabwe (1995-2016)[55]





More recently, laws introduced in 2007 to 'indigenise' the private sector more broadly have been blamed for further undermining confidence in Zimbabwe. The Indigenization and Economic Empowerment Bill required companies to hand majority ownership (51%) to indigenous Zimbabweans, who were defined in the Law as being 'any person who before the 18th of April 1980 was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person.' As many of those interviewed made clear, potential investors were therefore apparently expected to hand effective control, and 51% of their capital investment, at a cost to be determined sometime in the future, over to a company owned by the Zimbabwean Government: a

55 Indexmundi

considerable disincentive to both foreign and local investors. However, the situation was further complicated not just by what the Law said, but what it did not say. As an Economist article observed at the time 'the law contains a lot of ambiguity, and gives a lot of loosely-defined discretion to the government. It is unclear whether the transfer would apply only to future mergers, demergers, restructurings and transfers, or to all existing companies.'[56] This lack of clarity, and the competing interpretations from different ministries as to exactly how the policy was to be implemented have further damaged investor confidence and willingness to invest.

There is good evidence that the Government is seeking ways to address both of these problematic policy legacies. On land reform discussions are underway about the potential for granting farmers 99-year leases on land. It is thought that this would preserve the idea of state-ownership of land while allowing profitable use of it. Current discussions are centring around whether such a legal structure would be acceptable to banks as collateral for loans, but at the time of writing it remains unclear what the outcome will be. In addition, the Constitution of Zimbabwe provides for Government to give 30 days' notice to acquire land without compensation. These issues remain obstacles for releasing finance to farmland. On indigenisation, a statement by the President in April overrode many of the statements of Indigenisation Minister, and clarified the situation. Most importantly it made clear that companies would not be expected to hand over 51% of their stock if they were actively taking other steps to train, employ or in other ways support indigenous Zimbabweans.

Nevertheless, levels of trust in the Zimbabwean government are not high and whilst these recent developments are widely welcomed, there is still a high level of uncertainty. There is also wariness as to whether the current attempts to rectify previous policy challenges might themselves be reversed. Until the issues of security of land tenure, and clarity around business ownership are properly clarified, uncertainty will remain.

3.2.1 The cash crisis and bond notes

Over the past 3 years, the underlying economic tensions have been growing into what, in 2016, has turned into a cash crisis. The cumulative fiscal deficit has grown significantly between 2013 and 2016 and has been funded mainly by Treasury Bills. This is on top of in the significant foreign debt under discussion with the IMF. The realisation amongst potential investors that Zimbabwean Government debt is highly risky has meant that, since the beginning of 2016, Zimbabwe has had problems finding additional sources of finance.

This culminated in the announcement in early November of the introduction of 'bond notes' – effectively a re-introduction of the Zimbabwean dollar – to improve domestic cash flow. These bond notes are guaranteed by a US$200m loan facility from the African Export Import Bank, and will be issued at par with the US dollar. The first phase of this process will see $75m disbursed by the end of December.[57]

Opinion was divided on its desirability. Some felt it was a welcome move and would provide liquidity in the economy and facilitate economic activity. The analogy was cited of the process of quantitative easing which has been used in Europe in the past few years to stimulate economic activity. Others, on the other hand, fear that printing money could be a precursor to a further descent into hyper-inflation.

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56 The Economist. *Blackening the economy.* 13th Sept 2007.

57 Nemukuyu D. *Bond notes law promulgated.* The Herald. 1st November 2016

3.3 Cost of doing business

Even when these wider issues are resolved the private sector in Zimbabwe faces significant other challenges, the first of which is the high cost of doing business. Part of this relates to the process of dollarization, a step which was taken in 2009 to address the hyperinflation that had plagued the country for much of the previous decade. Essentially Zimbabwe pegged itself to the US dollar at the wrong rate, with the result that key business costs, in particular wages, are too high relative to neighbouring countries. According to the Zimbabwe Bankers' Association[58], during the period of 2009-12 this incorrect gearing did not matter greatly as the economy was performing reasonably well, and the dollar was relatively weak. The high commodity prices which partly drove stronger economic performance would have in any case led to the strengthening of a local Zimbabwean currency. However since then, as the economy has weakened sharply Zimbabwe is – like Greece with the Euro – saddled with an uncompetitive currency. As a result, Zimbabwe's cost of finance[59], taxation[60], wages[61], redundancies[62], electricity[63], import and export time and costs[64] are often higher than regional neighbours and labour productivity[65] and logistics performance[66] lower. Moreover because the country lacks its own currency, it is not able to devalue to retain competitiveness, and therefore struggles to compete especially on low value-added products.

However it is not just the dollar gearing which makes doing business in Zimbabwe expensive, the regulatory environment is also overly-complicated and adds financial and time costs. The country is ranked 155th out of 189 in the World Bank *Doing Business Indicators,* putting it in the company of places such as Iraq, Burundi and Sudan[67]. Zimbabwe fares particularly badly on administrative issues. For example the country is ranked 182nd on 'starting a business', which takes 90 days by contrast with an average of around 27 days in sub-Saharan Africa. Feedback from interviewees suggests that this amount of time is needed because of the degree of centralisation in Zimbabwe: much corporate certification requires the applicant to come to Harare on repeated occasions. The time spent so doing is therefore not time spent managing and growing the business. As a result of these inefficiencies, starting a business in Zimbabwe costs 112% of national income per capita, by comparison with an average for sub-Saharan Africa of 53%. Zimbabwe also fares particularly badly in securing construction permissions, a process which takes 448 days in Zimbabwe and costs 25% of the building value. This compares with averages for sub-Saharan Africa of 162 days and 6.6% of value.

Table 3.5: Labour Productivity rates[68]

Country	GDP/available worker	GDP /employed person
Zimbabwe	2 010	3 262
South Africa	16 927.28	44 422
Zambia	4 749.12	8 937
Mauritius	2 124.58	42 229

58 Interview with Zimbabwe Bankers' Association. Sept 2016.
59 Central Banks of Botswana, Mauritius, Kenya, Rwanda, South Africa, Zambia and Zimbabwe (2016)
60 World Bank Doing Business (2015)
61 World Bank Doing Business (2016)
62 Ibid
63 Infrastructure Country Diagnostic Power Tariff Database (2015), Zimbabwe Energy Regulatory Authority (ZERA), 2016
64 World Bank Doing Business (2014)
65 ILO Key Indicators of Labour Market (KILM) (2015)
66 World Bank (2016)
67 World Bank. *Doing Business Indicators 2015, Ease of doing business in Zimbabwe* http://www.doingbusiness.org/data/exploreeconomies/zimbabwe/.
68 ILO *Key Indicators of Labour Market* .2015

Kenya	3 654.57	6 515

The cost of doing business is further exacerbated by pervasive corruption. Zimbabwe ranks 150= (with Burundi and Cambodia, out of 167) in the Transparency International *Corruption Perceptions Index*[69]. A recent report published by TI's Zimbabwean chapter concluded that corruption had become so endemic as to become 'commercialised', and has 'become a means for securing more resources for the state from an increasingly impoverished population that considers the Police, the City Council, the Vehicle Inspection Department, and Education as the most corrupt institutions in Zimbabwe:…where individual state agents collect revenue on their own behalf.'[70] This picture was borne out by those interviewed for this study: corruption is a significant challenge for business, both in terms of increasing costs and rendering doing business more complex and less predictable.

Finally business costs are also increased by unreliable and deteriorating infrastructure. Power and water cuts are frequent, the rail network has been so neglected it is virtually useless, and many roads are pot-holed. Whilst in this regard Zimbabwe is not dissimilar from many of its neighbours, these infrastructural challenges, the losses in production to which they lead, and the costs of finding alternative sources of power and water nevertheless all add to the costs to and uncertainty for businesses in Zimbabwe.

3.4 Lack of capital

Zimbabwean businesses are starved of capital and funds available for investment are in short supply. In part, the problem stems from when the country dollarized in 2009 when all companies and banks lost their assets without corresponding debts also being erased. In addition, just before dollarization, the Reserve Bank expropriated corporate foreign currency accounts. These amounts have not yet been repaid and it is not clear if they will ever be repaid. This, together with the mismanagement that caused the hyperinflation, had an enormous negative impact on confidence in the financial sector. Mistrust of the financial sector remains and is one of the main reasons why investors remain sceptical of the Zimbabwean market.

In addition, the banks have historically served a few large corporates or large scale commercial farmers and they have struggled to create a working business model to serve SMEs, which now comprise the bulk of business, or small-scale farmers, who now comprise the bulk of the farming sector. Their conservative lending practices have also undermined the financial sector's ability to provide finance. The lack of innovation has also meant that billions of dollars of untapped collateral opportunities, e.g. an estimated $20 billion of properties are owned outright but owners are largely unable to use these to leverage borrowings for SME businesses.

This has a number of impacts. First both companies and banks are struggling to service debts that were taken out in a time of hyperinflation and a weak currency. Secondly, it means that banks only have short-term deposits available which constrains their ability to make loans on medium- to long-term lengths which would be required by companies. In normal circumstances, funding for longer term loans would come from funds made available by international institutions such as the African Development Bank and the IFC. However, because of the multilateral debt owed by the state of Zimbabwe, these funds are not being made available. Therefore the ability of banks to lend to business on reasonable maturities and acceptable interest rates will be constrained until the

69 Transparency International. *Corruption Perceptions Index 2015.* http://www.transparency.org/cpi2015#results-table.

70 Mutondoro F *et al. 2015 Annual State of Corruption.* TI Zimbabwe 2016. p9.

Government puts in place a set of macro-economic policies which are seen as credible by international financial institutions.

With bank lending so constrained then companies have to rely for investment capital on their own savings and retained income. Here too there are challenges. The loss of their reserves through inflationand the significant decline in the economy over the past decade and a half has meant that many companies have completely ceased to trade at all, and those that have stayed in business are operating far below capacity. One engineering firm interviewed for this study, for example, estimated that it was operating at about 35% of maximum capacity. Companies are therefore, in many cases, struggling to stay afloat and resources are in short supply for new investments. As Professor Tony Hawkins of the University of Zimbabwe observed, domestic savings were wiped out by hyperinflation and dollarization[71]. Therefore not only are companies not profitable enough to retain earnings to plough back into the business, they do not have other savings to fall back on. Indeed so bad is the situation that Zimbabwe records a negative figure for gross domestic savings (-12% in 2014[72]) meaning that the economy as a whole is spending more income than it produces.

Zimbabwe is therefore reliant on foreign revenues, be that through FDI or export earnings. Unfortunately, as noted elsewhere, FDI declined by 23% in 2015 and the current political uncertainty seems likely to constrain foreign investment for some time to come. In the longer term Zimbabwe has much to attract foreign investors, but unlocking that potential will be a challenge until the political situation has resolved itself and the policy environment is more secure.

A significant impact of the absence of capital is that companies are not able to renew or upgrade their equipment, meaning that many of those firms which have survived are using antiquated kit that further reduces their ability to compete with more modern firms elsewhere. The reliance on older equipment also compounds the issue of relatively-high wage costs since less modern equipment generally requires more human labour to operate it. The problem of availability of investment capital therefore further worsens Zimbabwe's competitive position.

3.5 De-industrialisation

The past decade and a half has seen a significant process of de-industrialisation in Zimbabwe, as the economy almost halved in size in the first decade of this century. Issues such as those discussed above, in particular poor policy climate has significantly undermined confidence within the private sector with the result that many larger companies went out of business. A number of factors have contributed to this situation.

In the first place policies such as land re-allocation and more recently on indigenisation have undermined some of the legal fundamentals that might normally be expected to provide confidence to the private sector. Secondly, re-allocation of commercial farms led to the decline in one of Zimbabwe's strongest sectors – agriculture. This in turn undermined those industrial and manufacturing firms that relied on the agriculture sector for their inputs. For example, a garment company said that in the 1990s, 97% of their raw materials (cotton and fabric) were sourced domestically. Today almost all raw materials have to be imported which leads to a huge increase in input costs as well as the cost of financing capital to pay for the inputs. Thirdly, when the period of hyperinflation was ended by dollarization, this had the effect of wiping out companies' reserves (and indeed the savings of individuals). Thus companies have not been able to invest. This, combined with the high cost-base of the country has greatly reduced the country's competitive position.

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71 The Standard. *Dollarization wipes out domestic savings.* 21st July 2013.

72 World Bank. *Gross domestic savings (% of GDP)* http://data.worldbank.org/indicator/NY.GDS.TOTL.ZS.

The combined effect of all these factors has been to push many companies out of business and has led, in effect to a process of de-industrialisation. Therefore although in the 1980s Zimbabwe had a flourishing manufacturing sector, this has now largely disappeared. Some companies have managed to survive (the reasons for which will be examined in more detail in chapter 5), but they are few in number and are operating at well below their potential capacity. As those companies have disappeared, so a large number of technical and other staff previously employed by those companies are now forced entrepreneurs. Whether or not they want to, they have to operate as ‘jobbing’ specialists. The pattern of work in Zimbabwe has therefore changed dramatically, with many fewer formal-sector jobs, and many more ‘forced entrepreneurs’. Whilst some of these have the potential to develop durable small businesses, most are likely to want a stable job.

However, problematic though the current situation is, Zimbabwe is far from being without hope. Although significant challenges exist, they are not insurmountable and, though much damage has been wrought on the economy over the past two decades, many of the fundamentals which might give rise to renewed growth remain in place, and some companies have demonstrated remarkable resilience. Where growth might come from, and how companies have been able to be resilient will be explored in the next chapter.

4 Resilience and recovery

The Terms of Reference for this study identified a number of questions to be explored. These are as follows:

1. What are the underlying drivers of the structural shift in Zimbabwean firms (from large corporates to SMEs in the past decade)?
2. Going forward is transformational and is inclusive growth in Zimbabwe likely to be led by SMEs or by large corporate firms? What are the implications of firm size for productivity and export potential in Zimbabwe?
3. Identify the attributes of both resilient SMEs and large corporates operating in Zimbabwe's difficult business environment;
4. Consider whether there are sectors that best lend themselves to the development of resilient SME's as well as sectors that favour the development of resilient corporates.

The first of these questions has been answered in the previous chapter which explored the issues that led to economic decline. This chapter considers the remaining 3 questions, and seeks to answer them within the wider context of defining what wider-scale economic re-development might look like in Zimbabwe, and what changes would be needed to bring this about. In answering these questions, this chapter draws on learnings from the literature review, and from the interview process in Zimbabwe.

4.1 Resilience

A key goal of this study has been to understand why it is that some companies have been able to survive the economic turmoil of the past decade and a half: to 'identify the attributes of both resilient SMEs and large corporates operating in Zimbabwe's difficult business environment.' It is important to note at this point the presence of 'zombie companies' in Zimbabwe: many of the medium and larger-sized companies which have survived are those which have been politically-co-opted – they are in effect owned and controlled by politicians.

The pattern is widely repeated of politicians putting pressure on banks to keep funding companies they own. These companies cannot therefore properly be considered to have demonstrated resilience, since they are not properly functioning and will go to the wall when the situation means that their owners are no longer in positions of political influence. There are however companies which have been able genuinely to survive and to stay in business. Defining how companies have managed to do this must necessarily be qualitative: however a number of key themes emerged from interviews with companies, business associations and those organisations such as MFIs which work with companies[73].

4.1.1 Political awareness

A key attribute of resilient companies is that they have learned to navigate their way around the political jungle. 'We've learned that if one avenue gets closed down we need to use our knowledge and contacts to find another way of achieving what we want', was how one company interviewee explained it. At the same time these companies realise the need to avoid too-close connections to

73 All quotes taken from interviews in Harare Sept 2016.

particular politicians or senior officials. 'It would be easy sometimes to accept a 'favour' or give a 'gift' to get something done. But we know that would come back to haunt us.' This ability to be able to navigate the political situation effectively, without being pulled too-close into it is a key capability of resilient companies.

4.1.2 Persistence and flexibility

Resilient companies are those which choose to be persistent and to find ways of getting things done, even when the situation is extremely difficult. The need and ability to navigate the political situation is an illustration of this, but this persistence needs to apply to all areas of business. Companies which are not able to innovate and find ways of dealing with problems are those which have gone under.

One medium-sized foreign investor explained that getting the necessary approvals for their business had taken many months of work and persistence. 'You usually can't send one of your staff, they want to see the boss – the main man – and that ends up taking a lot of your time. Often you have to work with officials to help them understand what their job is and how to do it.'

However being persistent also means being flexible, and always being prepared to look for new ways to do things and overcoming obstacles. 'There's always something going wrong and you've got to be incredibly entrepreneurial to find ways round the challenges. You've almost got to relish and enjoy overcoming obstacles.'

4.1.3 Risk management

Because of the lack of transparency and predictability of the market resilient companies are those which have a diversified range of activities to spread their risk. This means that if one area of their operations is stalled for some reason they have other business activities which can sustain the company while problems are being addressed. 'SI 64[74] has cost me a lot of money – a whole line of business was stopped overnight. However, I've got interests in other areas that keep us going until we sort this mess out', explained one company which imports from South Africa.

Some of those companies interviewed said that they had gone as far as to diversify into businesses in other parts of Africa in order to spread their risk. A company in the agriculture sector explained that this achieves a number of things: 'we get access to other markets which may be growing more than Zimbabwe, but we also get access to finance in other places too.'

However management of risk also involves taking timely decisions in response to changing circumstances. An engineering firm explained that it has re-scaled its operations to respond to the new market situation. 'We are working at something like 35% of full capacity, which means we've had to mothball a lot of equipment and let people go. That's hard, but needed to be done to mean the business could survive.' Another company interviewed was about to suspend an area of their business, which would lead to a considerable number of redundancies.

4.1.4 Corporate governance

All those companies interviewed stressed the importance to their survival of good corporate governance. A key element of this is the need to have robust financial systems and controls so that the management team has a clear understanding of the business. 'Things are so unpredictable that

[74] 'Statutory Instrument 64' was introduced in June 2016 and limits the import of a number of goods into Zimbabwe.

you need a good handle on where your business is, where you're making money, and where you are not', commented one trading company.

More broadly, however, in a situation where governance from state institutions is weak, companies believe that they need to have their own robust processes to ensure that they are able to operate properly. This is particularly the case for those companies which work, or wish to work internationally, where they will need to be able to demonstrate that they operate to global standards on issues such as environmental protection and labour conditions, even if these standards are not properly enforced by the Zimbabwean government.

Moreover, robust corporate governance appears to support companies in resisting corruption and political predation. It provides the company and its staff with clear guidance on how to go about doing things, and about which behaviours are, and are not, acceptable. For a company to be resilient it needs more than a strong leader. It needs to have a team of the right people who are willing and able to work within the ethos set by their company's corporate governance structures.

4.1.5 Collaboration

Interviews with certain business membership organisations suggested that despite the challenges of the past few years, there are sectors where collaboration between companies – formal and informal remains strong. Indeed, as the situation has changed, the web of relationships has flexed and changed, but remained in place. This study identified cases in the light engineering and garment sectors where surviving formal-sector companies were working both with smaller formal firms, and with informal-sector craftspeople. This has a number of beneficial impacts. First it allows the formal firms to be able to respond to periodic surges in demand without having to take on the risk of expanding their own core operations. Second it ensures that those who have lost jobs in the formal sector still have a way of earning a living. Third, it ensures that skills levels can be maintained, which provide the basis for greater expansion in the future.

In the engineering sector for example the trade body EISAZ (Engineering Iron & Steel Association of Zimbabwe) is working to improve collaboration between its members. Since May, under the Association's auspices, member companies have been sharing the cost of transport of goods imported from South Africa, thereby reducing the unit cost of those imports for each firm. Future plans include working with their counterpart trade body in South Africa to explore opportunities for marketing South African goods in the region from Zimbabwe. This collaboration seems also to happen in the garment sector where the larger companies work with smaller ones to add capacity to deal with surges in demand.

4.2 Sector selection

A further question which this study was asked to explore is whether there are particular sectors from which growth is most likely stem: To 'consider whether there are sectors that best lend themselves to the development of resilient SMEs as well as sectors that favour the development of resilient corporates.'

The strong view expressed by many of those interviewed was that a focus on particular sectors would, at this stage, be to miss the central point. At present there are key issues in the business environment which, if addressed, would open up all sectors. Some expressed concern that some form of industrial policy addressing a few privileged sectors would be misguided. Policy-makers could only develop approaches for sectors they themselves could perceive and understand –

agriculture, manufacturing and so on. But they might miss innovative sectors – bespoke computer programming, off-shoring of back-office functions, for example – which might actually be those which will drive Zimbabwe's future recovery.

However, even if there is a need to focus on the macro-economic situation it is still relevant to explore which known sectors might be the most important to recovery, and what might need to be done in each to prompt revival.

4.2.1 Agriculture

Almost universally, agriculture is seen as being central to economic recovery and has the potential to significantly reduce poverty, enhance economic growth and entrench economic stability. The sector provides employment and income for about 70% of the population, supplies 60% of the raw materials required by the industrial sector and contributes 28 % of total export earnings. Strong performance of the sector translates into overall improvement of the country's GDP and poverty reduction. The sector is estimated to contribute around 13% of the country's GDP.

The sector, however, underperformed in the 2014/15 agriculture due to the El-Nino induced drought. Despite the recurrence of natural disasters, the country continues to have a comparative advantage in agricultural production compared to many African countries due to its diverse and favourable climatic conditions and good soils suitable for a variety of crops and livestock production. The competitive edge of the agriculture sector can therefore, be propelled by improving investment in mechanization and irrigation development, research and development, agriculture funding, market access and value addition.

However, the challenges are clear, most obviously the on-going uncertainty about land tenure. However it is also clear that a good deal of agricultural infrastructure has disappeared in recent years; for example the new owners of the former commercial farms sold off a good deal of the moveable equipment such as tractors and irrigation pumps and pipes. The seizure of commercial farms has also meant the loss of a good deal of expertise. However, although farm land is presently being under-utilised there is a strong view that productivity could be improved relatively easily and agricultural exports increased markedly in a fairly short time-frame.

Regenerating agriculture would also have wider effects since it could then be used as the basis for recovery in other sectors, food processing for example, which rely on agricultural inputs for their production. This would allow greater value-addition in Zimbabwe for companies which currently rely on imported raw materials.

4.2.2 Tourism

As with agriculture, tourism is seen by many as making good use of one of Zimbabwe's natural resources. Game parks and most notably the Victoria Falls are world-class attractions, rivalling what countries like Kenya, South Africa and Tanzania have to offer. However, according to the Zimbabwe Council for Tourism (ZCT), the country also has potential as a conference and convention destination. The tourist industry currently accounts for 11.7% of GDP[75] but ZCT believe that this could be expanded to be as much as 15% of GDP – a US$5bn business.

However, there are a number of constraints to be addressed. The first is the perception of the country as being risky – tourists may prefer to go to places seen as being more stable. The high

[75] Figures given by ZCT.

costs of doing business mean also that Zimbabwe is a relatively-costly destination by comparison with some of its rivals. ZCT argues that taxes on the tourism sector are too high, and removing 15% VAT on tourism would enable the business to be more competitive. There are other practical challenges, for example the current cash shortage dissuades potential tourists. There is also a need properly to fund wildlife parks to ensure that the land and animals are properly maintained.

4.2.3 Manufacturing

During its peak in 1999, the sector contributed about 24% to the country's GDP (Ministry of Finance and Economic Development, 2015). However, the contribution of the manufacturing sector has declined over the years, to 13.1% of GDP. The sector has been heavily affected by high cost of borrowing, tight liquidity conditions, outdated technology, continued use of antiquated plant and machinery, declining agriculture output, low aggregate demand, electrical power outages and competition from cheap imports, among other factors. Lack of long term financing has precluded the sector from accessing additional capital injections needed for retooling. These factors have eroded the viability and competitiveness of the manufacturing sector that has potential to generate employment and exports[76].

However, it is not sensible to recreate the past, in part because Zimbabwe's self-reliance was to a large extent forced on it by the international situation, and because the world has moved on since then. However, there are sectors where Zimbabwe is still able to be competitive and so focussing on such sectors could be a key plank in a process of economic recovery. This study did not undertake a systematic assessment of which manufacturing and industrial sectors might be viable, but it did identify two examples of sectors that do have potential, and the model of which may provide clues as to other sectors that might also be viable.

Engineering

The small-scale engineering sector appears to have manage to 'right-size' for the new realities of the Zimbabwean economy. Companies have calibrated their production to the demand that exists and so have a number of them have been able to survive. There is collaboration between the companies to reduce costs and the formal firms have developed a process for working well with the smaller, informal firms that have emerged as technicians have been made redundant as larger firms have collapsed. Furthermore companies have focussed on making products that are relevant for the Zimbabwean market, and are seeking to leverage the relatively-beneficial geographic position of the country to become and entrepot between South Africa and the wider region.

Garment manufacture

Like the engineering sector, the garment sector is significantly smaller and less diverse than in the past. However companies are still operating and are focusing on value-added garments (such as health and safety clothing) where Zimbabwe's relatively-high cost base is less of a problem. The sector has worked to create an international profile and one company interviewed, for example, sells its garments into Europe. As with the engineering firms, companies in this sector are able to leverage the fact that Zimbabwe is well-located geographically. There is also a degree of collaboration between firms in the sector, with smaller companies being used as sub-contractors or to deal with surges in demand. The sector is also one for which a clear sector strategy has been developed.

[76] Data in the following sectoral sub-sections is taken from NECF. *Zimbabwe National Competititveness Report 2015* National Economic Consultative Forum, Harare. 2015.

4.2.4 Mining

The mining and quarrying sector accounts for 6.9% of GDP. Lack of long term funding, intermittent power outages and rising labour costs continue to weigh down on mining output. Given Zimbabwe's significant and diverse mineral deposits the mining sector has considerable potential over time. Despite the challenges of the country, mining is still one of the larger sectors for foreign investors, though the total inflows are modest by comparison with the potential; and as Hausmann's chart demonstrates, more than half of Zimbabwe's current exports are mining-related.

However mining is possibly the sector most affected by the macro-political challenges. The issues of land tenure are particularly challenging when commercial mines may cost billions of dollars to build and take decades to make a profit. Equally the high levels of investment make interpretation of the indigenisation rules particularly important as foreign investors would not wish to see, in effect, 51% of that investment to go straight to the Government.

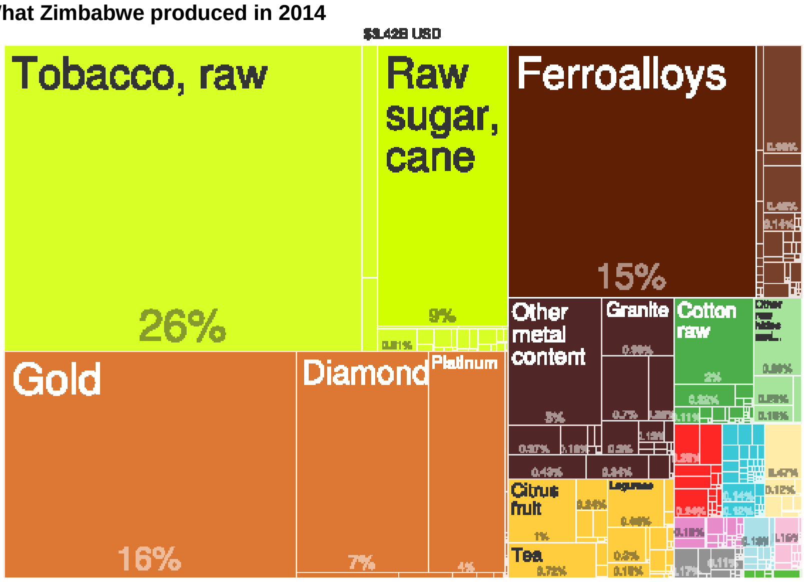
4.2.5 Other sectors: Hausmann's 'product space' assessment for Zimbabwe

A number of those interviewed warned against being too rigidly focused on particular sectors – observing that if the business environment were more conducive then companies might emerge in sectors as yet unknown in the country.

In understanding what these newer sectors might be the Hausmann 'product space' analysis is interesting focusing as it does on identifying those sectors which are feasible for a country to enter given the skills, raw materials, infrastructure and other capabilities which the country currently possesses. Hausmann uses the analogy of the board-game, Scrabble. 'In this analogy, each product is represented by a word, and each capability, or module of embedded knowledge, is represented by a letter. We assume that each player has plenty of copies of the letters they have. Our measure of economic complexity corresponds to estimating what fraction of the alphabet a player possesses, knowing only how many words he or she can make.'[77]

To use his analysis according to Hausmann's 'product space' analysis, Zimbabwe's exports are currently structured as follows:

Figure 4.1 What Zimbabwe produced in 2014

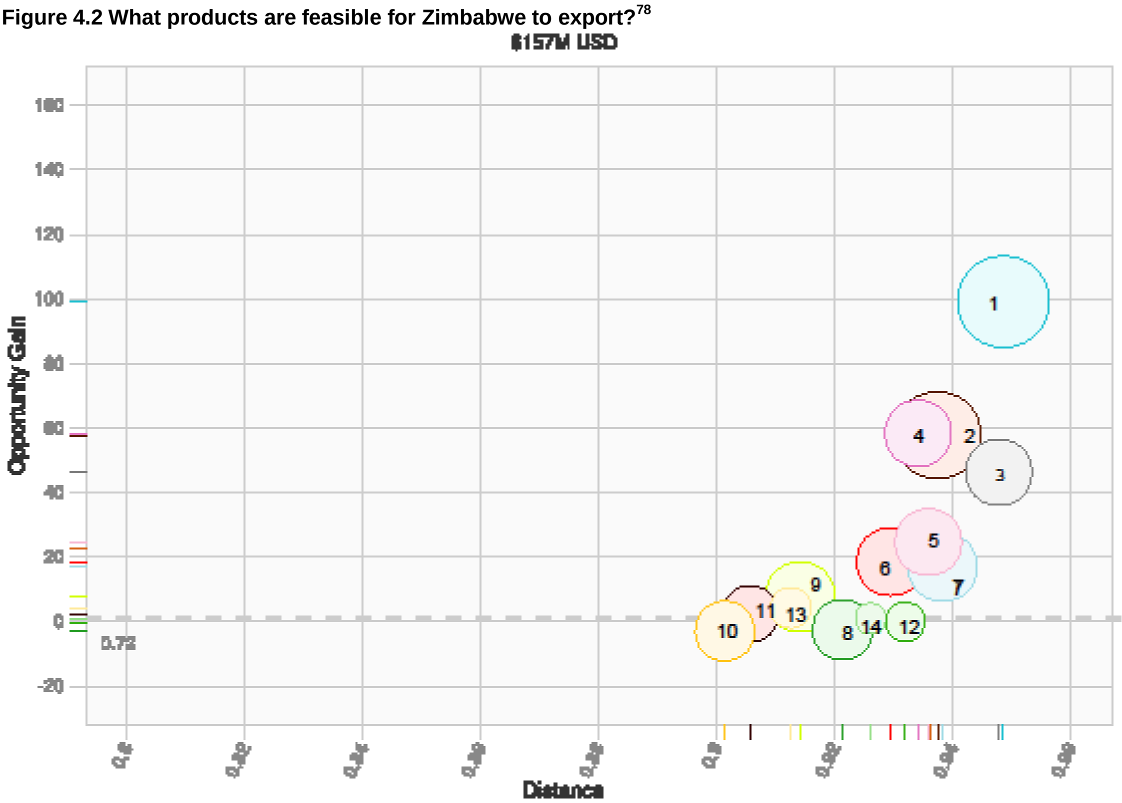


[77] Hausmann R *et al. The Atlas of Economic Complexity: Mapping paths to prosperity.* Harvard University 2013.

As noted above, Hausmann is optimistic about Zimbabwe, and his analysis concludes that the country has the potential to diversify its basket of exports quite readily. Central to his analysis is that a country's ability to grow is driven by knowledge shared within society as a whole, and the ability of that country to use that knowledge as the basis for innovation and the creation of new products. His assessment is that Zimbabwe contains sufficient 'personbytes' (the amount of knowledge held by one person) to produce a much wider range of products. His analysis identifies a number of areas of potential 'opportunity gain' for Zimbabwe. These are product areas which are sufficiently close to Zimbabwe's current products in terms of the resources and skills needed to manufacture them, but which are more complex (and hence of higher value-added) and so promote firm-level and macro-economic growth. He identifies the following product areas:

1. Machinery and electrical equipment;
2. Metals;
3. Miscellaneous office goods;
4. Chemicals and allied industries;
5. Plastics/ rubbers;
6. Wood and wood products;
7. Transportation;
8. Textiles;
9. Foodstuffs;
10. Vegetable products;
11. Mineral products.
12. Footwear/ headgear
13. Animals and animal products
14. Raw hides, skins, leather, fur

Figure 4.2 What products are feasible for Zimbabwe to export?[78]



In this figure the terms are defined as follows:

[78] Hausmann R. *Ibid* http://atlas.cid.harvard.edu/explore/pie_scatter/export/zwe/all/show/2014/ (retrieved 9th Oct 2016).

- Opportunity gain: 'the potential benefit to a country if it were to move to a particular new product…[this] quantifies the contribution of a new product in terms of opening up the doors to more and more complex products'.
- Distance: refers to the gap in complexity of the products a country currently makes, and those which it plausibly could make.
- Size of the bubbles: refers to the potential international size of the potential markets .

4.3 What might recovery look like?

What then might a recovery in Zimbabwe look like, and where might some entry points be to promote that recovery. The following assessment builds both on the literature review of chapter 3 as well as on the data and insights gathered from the interview process.

4.3.1 Credible macro-economic policy and a transparent business environment

Although benchmarks such as the Doing Business Indicators have been criticised, it is clear from the literature review that a country's business enabling environment is of crucial importance: as Jensen puts it: 'for profit-maximising enterprises…[countries with]. democratic institutions' are preferable[79]. At present, therefore, possibly the biggest challenge for Zimbabwe's economy is the absence of a credible macro-economic policy and of clarity in the business environment.. Whilst it is true also that 'downstream' there are myriad complexities to be dealt with in simplifying regulation and so on, these are relatively minor by comparison with the need for clear direction at a policy level. As the Bankers' Association of Zimbabwe makes clear, the presentation of a credible economic policy would help unlock international financial support for Zimbabwe and so ease the extremely tight credit situation. If banks were able to lend at reasonable rates and maturities then companies would be able to start investing again.

Two other key macro-level issues also need to be addressed: those of land reform and indigenisation. As things stand at the moment, even were investment capital to be available the lack of certainty about land title, and the risk that 51% of any investment would be taken by the Government are powerful disincentives. The Government has demonstrated an awareness of the need to address these issues, with the exploration of 99-year land leases as a solution to land tenure, and the President's remarks in April 2015 clarifying the policy on indigenisation. Nevertheless, considerable doubts and mistrust remain, and so it is not yet clear whether banks would be prepared to accept a 99-year lease as collateral for a loan. Issues round land reform and indigenisation need to be made more clear, and potential investors would still want to have faith that solutions would not be reversed. This is not likely to happen until after a new President is in place and seen to have plausible security of tenure.

There are also many practical issues which also need to be addressed, not least the situation with customs and exports. Zimbabwe has the potential to be a regional hub, and urgently needs to improve its exports if it is to improve the current cash crisis. However much needs to be done to address delays at customs. As the figures below demonstrate, customs procedures are more onerous in Zimbabwe than in neighbouring countries and costs higher:

Table 4.1: Costs and Time to Import and Export[80]

[79] Jensen N. op cit
[80] World Bank. *Doing business indicators.* 2014

	Cost to export (US$ per container)	Cost to import (US$ per container)	Import to Export Costs Ratio*	Time to export (days)	Time to import (days)	Cost to Export as a % Freight Value*	Cost to Import as a % of Freight Value*
Botswana	3,045	3,610	1.19	27	35	15.2%	18.1%
South Africa	1,705	1,980	1.16	16	21	8.5%	9.9%
Zambia	2,765	3,560	1.29	44	49	13.8%	17.8%
Zimbabwe	**3,765**	**5,660**	**1.50**	**53**	**71**	**18.8%**	**28.3%**
Sub-Saharan Africa	2,108	2,793	1.32	31	38	10.5%	14.0%

NB: The costs measure the charges for ocean transport levied on a *20-foot container* in U.S. dollars weighing 10 tons, valued at $20,000

Table 4.2: Customs Clearance, Selected Indicators[81]

	ZIMBABWE	S. AFRICA	ZAMBIA
Number of agencies - exports	10	2	5
Number of agencies - imports	10	2	5
Physical inspection (% of import shipments)	13.69%	8.64%	8.89%
Multiple inspection (% of import shipments)	41.83%	2.10%	1%
Solicitation of Informal Payments (% of responses saying nearly always or often)	50%	7.14%	0%
Transparency of Customs Clearance (% of responses answering nearly always or often)	0%	42.90%	66.70%

Table 3.7 shows that 14% of imports shipments are subject to physical inspections and about 42% to multiple physical inspections whereas in South Africa and Zambia they have to deal with only 2 to 5 agencies and only 8% of their shipments are subject to physical inspection. Beyond transport, importing and exporting in Zimbabwe are issues to do with red tape, excessive and opaque processes, frequent solicitation of informal payments (bribes), and other self-inflicted non-tariff barriers like numerous road blocks on the same route. These issues need to be addressed if Zimbabwe is to maximise its potential role in the region.

4.3.2 Unlocking of the banking and financial situation

At present the credit situation is extremely tight. In part this is a function the political risks that exist, and therefore the lack of macro-economic predictability. Until the government has a credible economic strategy in place it is unlikely that international financial flows will open which would allow banks to lend. However, even were this to be delayed other steps might help loosen the financial situation at least to some degree. Were companies more easily able to export, this would have the effect of bringing in capital to be used by those companies to invest and, through payment of taxes, to ease the government's fiscal situation. However, this latter aspect would also require something to be done to improve levels of formalisation so that companies exporting would pay their share of taxes.

Improving levels of FDI would also be extremely valuable, although here again lack of confidence in the political and macro-economic situation remains a drag on FDI. Approaches that might reduce these risks to potential investors – the use of investment risk guarantee insurance, or first-loss co-financing of private sector investments from public funds would serve to defray those risks and so encourage otherwise reluctant investors.

4.3.3 Not small or large, but small and large – need for networks

Another of the questions posed by the Terms of Reference for this study was to assess where growth might come from in terms of firm size: 'going forward is transformational and is inclusive growth in Zimbabwe likely to be led by SMEs or by large corporate firms? What are the implications of firm size for productivity and export potential in Zimbabwe?'

What seems clear both from the literature review and the evidence from the interview process is that the answer is not 'either/ or', but rather 'both'.. As Delgado, Porter and Stern make clear, if companies which are clustered together are too close in their activities, then 'convergence' leads to diminishing returns, and the demise of the weakest firms. When firms collaborate in clusters, and those firms are in related but not identical businesses, then the process of 'agglomeration' can lead

[81] World Bank Logistics Performance Index. 2016

to strong growth at both the level of the firm and of the economy – 'industries located within a strong cluster are associated with higher employment growth…growth in wages, the number of establishments, and patenting.'[82]

Interviews in Harare have borne out these global conclusions: it seems that where firms have been able to survive the economic woes of recent years, their ability to collaborate with others has been an important factor in that survival. The examples of the engineering and garment sectors suggest strongly that renewed economic growth will benefit strongly from leveraging these and other clusters. However, these examples also appear to highlight another issue to have emerged from the literature review, that it is not just geographic proximity which is important, but also 'social proximity'. As Lorenzen and Mudambi conclude about the success of Bollywood, 'personal relationships have remained the dominant linkages type in value creation'[83]. Given the huge institutional shift that has taken place in Zimbabwe in the past 15 years, such personal links have had to be paramount. Moving forward, reconstruction of the economy is likely to be most readily built on pre-existing social linkages.

Drawing on the evidence for the ODI/ UNECA study of clusters in sub-Saharan Africa, clusters work best when they include both small and large firms as they have 'a sufficiently strong commercial logic o incentivise the lead buyers without government support'[84]. This too is a lesson of Hausmann's analysis is the importance of a network of companies: a 'web' of companies in overlapping businesses, rather than just a chain in one. The examples of the garment and engineering sectors suggest that web-networks connecting smaller and larger firms are working and are one explanation of how some firms have been able to survive the economic turbulence of recent years. Given the importance, as demonstrated in the literature, of social proximity between firms as well as geographic, it would make sense to focus on those sectors where this social capital already exists, rather than on seeking to develop areas that are new and un-linked in this way.

4.3.4 *Replacing the 'missing middle'*

If the intention is to grow the Zimbabwean economy, then there is a need to recreate an economy with a graduation of firms from large-scale to small-scale. At present there are a small number of larger firms, and a huge number of (mostly informal) companies. The economic problems of recent years have led many firms to go under, with many of their former employees now working as jobbing craftsmen in the informal sector. Evidence, for example from the engineering sector, suggests that at least some of these people are able to make a basic living working as sub-contractors to larger firms. This has proven to be a workable interim solution, but needs to be changed, not least because the high level of informal firms means that revenues to an already cash-strapped government are further reduced.

However, more importantly such arrangements are not conducive for economic growth in the longer term, in large part because, as the literature observes, smaller, relatively-unskilled firms are less likely to be able to benefit from FDI and other larger-scale investment. As the Asian Development Bank observed, of Samsung's 59 vendors in Vietnam, only two are indigenous firms. For FDI to have positive impacts on the recipient country's private sector, then local firms need to be in a position to absorb the technology and practices of foreign companies.[85]

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[82] Delgado, Porter & Stern. *Op cit*

[83] Lorenzen & Mudambi. *Op cit*

[84] Davis, Loehr & Lemma. *Op cit*

[85] Zhang *et al. Op cit*

As things stand at the moment, the barriers to formalisation are considerable. Informal businesses see formalisation as expensive, time consuming and bureaucratic and, with the depressed business environment, there are many disincentives to formalise[86]. Government bureaucracy is slow and unwieldy, as well (in many cases) as being corrupt. Simplification of the process of formalisation , reducing its costs and incentivising formalisation through better access to markets and finance and freedom from harassment from rent-seeking authorities might encourage those small-scale operators who see themselves as entrepreneurs to be able to set themselves up as a company. Those who are forced entrepreneurs may then be able to get jobs with newly-established small, formal companies.

Creating pathways to enable informal companies to formalise seem valuable for two main reasons. Firstly it would encourage a gradation of firms of different sizes which could collaborate more effectively. Whilst formalisation in no way guarantees that a company will grow, it does offer a conduit by which growth could happen. Second, formalisation would also improve the Government's tax revenues and therefore its capacity to do more than merely pay its staff and provide tangible benefits to tax-payers. Creating and demonstrating win-win scenarios would be important.

4.3.5 Build on Zimbabwe's comparative advantages

It is very easy to look at what is wrong with the situation in Zimbabwe – a high cost base, poorly-maintained infrastructure, low levels of investment and so on. However the country also has much going for it and a lesson from the interview process is to build on these. Firstly Zimbabwe is well-situated geographically. It is more cost-effective to supply goods into the SADC region from there than from South Africa, and whilst the country's infrastructure needs attention, it is serviceable.

Moreover, the country also has immense indigenous resources. Zimbabwe has some of the world's largest mineral deposits, many of which remain untapped, and highly-productive farmland. Changes in the policy environment, and greater confidence in the political situation would quickly allow these resources to be used productively. Moreover, wildlife resources, and areas of natural beauty such as Victoria Falls means that Zimbabwe also has the basis of a thriving tourism industry.

Zimbabwe also has a reasonably well-educated workforce. Certainly some key skills have been lost as people have left the country. Also the lack of investment means that workers do not have experience working with the most recent technologies. However interviews suggest that workers retain good levels of capability. One company head believed that his workers would be capable of making the jump from working on their current equipment to more state of the art machines. These higher skills levels mean that it is possible for Zimbabwe to produce good with more value-addition – specialist garment manufacture, for example – which offsets the disadvantage of the country's relatively-high wage base.

There appear to be skills challenges in certain areas. Technical skills seem to be generally good, even though they may be slightly out-dated because of the inability of companies to invest in new equipment. Higher-level management skills are less prevalent, however which is one factor preventing forced entrepreneurs from establishing proper businesses. However these skills gaps could be filled with targeted support.

Moreover, greater international trade and investment would also serve to address the skills issues. Much of the literature argues that firms learn from international collaboration. As Knight and

[86] Formalisation Strategy Research, Ministry of Small and Medium Enterprises and Cooperative Development, Zimbabwe, 2016

Cavusgil[87] argue, ‘companies that operate internationally from an early stage in their development’ grow faster and are more robust than their domestically-focussed counterparts. However, what is also clear from the literature is that domestic firms can only respond effectively to the demands of international counterparts if the skills and technology gap between them is not too large.[88]This has implications relating to the inward investment and trade links which Zimbabwe seeks. If it is the case that Zimbabwe has skills levels which are proximate to those of potential international investors, then there is great potential for foreign investment that would provide the impetus for broader-based economic growth.

However, this begs a significant question about which might be the most relevant international collaborators for Zimbabwe. Investors from Northern and Southern countries are looking for different things from the countries in which they invest – investors from Northern countries are generally looking for specific skills; while those from the South are more likely to be looking for large markets to exploit.[89] As Amighini and Sanfilippo succinctly put it: ‘the origin of external flows matters’[90] Zimbabwe therefore needs to think carefully about where FDI and other trade flows might best come from if it is to get the most from international collaboration.

The country also needs to consider the potential for using Special Economic Zones, or similar structures. Moberg argues that such structures can be double-edged swords – they can ‘promote economic reform on the one hand, and allow governments to increase rent-seeking on the other.’[91] Given the rent-seeking behaviour that has been seen in Zimbabwe, there is self-evidently a risk that SEZs in the country could be used by those in power to further enrich themselves. On the other hand, recently there has been growing openness to reform, as demonstrated by the Government’s response to the *Doing Business* assessment. This suggests that there may well be a role for special zones to ‘trial run’ broader reforms: a model that was instrumental in China’s economic growth in the past 30 years[92]. Working with specific sectors to create simplified regulatory structures, or facilitating particular export chains could be a valuable way of experimenting with options for a more liberal business environment which could then be rolled out more broadly if successful.

It is clear therefore that the situation in Zimbabwe is far from hopeless. Certainly the prospects for the economy in the short term are not good. Political uncertainty and the combined impact of a decade and a half of policy disruptions and consequent economic turmoil have had a huge effect, which is reflected in the current statistics. However, many of the underlying fundamentals remain encouraging – the country’s native resources, a reasonably well-educated English-speaking population, and a beneficial geographic position all give cause for optimism. If the current trend towards more liberal and market-friendly policy changes continues – in particular in relation to land reform and indigenization – and if greater political certainty were to emerge, then Zimbabwe’s economy could quickly take off. How that process might be assisted is addressed in the next chapter.

87 Knight & Cavusgil. *Op cit*
88 Narula & Dunning. *Op cit*
89 Banga. *Op cit*
90 Amighini & Sanfilippo. *Op cit*
91 Moberg. *Op cit*
92 Wang. *Op cit*

5 Potential activities for DFID Zimbabwe

The research team have been asked by DFID to draw from their study some ideas about what DFID might usefully do to help improve the situation and to address the issues covered in this report. This chapter outlines an overarching strategy for a set of PSD programming and then proposes what areas some projects within such a programme might focus on.

5.1 Strategic framework

5.1.1 Political economy context

The macro-political situation makes things difficult, and is a variable which defies external control or influence. Moreover, the general view seems to be that even after the departure of President Mugabe, the main axes of political power will remain the same. In the short term at least wholesale change is seen as unlikely.

That said, it is clear that there has been a softening in the Government's position in relation to key economic issues. Changes have been made in the business environment; discussions are underway about a new structure for land title; and the President's comments earlier this year even suggest that a more moderate position is being taken in relation to indigenisation.

A PSD programme cannot therefore presume that there will be a wholesale change in the government's position, as this seems unlikely to occur. However it does seem fair to assume that the current situation, in which the Government is open to incremental reforms will continue. There will be willingness to make changes which can be justified as sensible for the economy, as has been the case with the business environment reform changes that have been made in response to the DB Indicators.

Any PSD programming therefore needs to provide clear 'wins' for the Government, for example in increased levels of taxation or more interest from foreign investors. It will also be important to bear in mind current policy priorities, for example as articulated in the Zimbabwe Agenda for Sustainable Socio-Economic Transformation (ZimAsset) policy[93], as well as the self-interest of key government ministers and officials. They will need to see the advantage to themselves of any changes proposed. Opposition from well-placed individuals would stop or at least delay any reform, no matter how beneficial it might be to the country as a whole.

5.1.2 'Exemplar' projects

This backdrop does not therefore suggest that there is great scope for large-scale reforms. It does not seem likely that Zimbabwe might imminently face a 'fall of the Berlin Wall' moment which would make wholesale reform doable. However, incremental reforms do seem feasible, and a sensible way forward. The ideas set out in this section therefore identify areas of reform where change might be achievable and feasible even in a generally-unchanged political situation. Each would seek to demonstrate that change is possible, and so act as an exemplar that could be expanded and rolled-out. As far as possible the proposed reforms will:

[93] Zim Asset is a cluster based Plan, focusing on : Food Security and Nutrition; Social Services and Poverty Eradication; Infrastructure and Utilities; and Value Addition and Beneficiation

- have clear benefits for government as well as the private sector, therefore demonstrating to government in its own terms (increased revenues or levels of taxation, for example) that change is desirable; and
- as far as possible not undermine the position of elites who might otherwise seek to stymie reform.

The aim therefore is to identify activities which are both useful reforms in their own right, but which also illustrate how wider reform might also happen. The point was also made by a number of those interviewed that DFID needs to put together a 'joined-up' approach with activities in different areas that link up as a coherent whole. Given the scale of the challenge and the current rather piecemeal approach to reform, a co-ordinated set of activities by DFID would be valuable. Reforms related to the business enabling environment might not require additional project structures, but be the basis for an extension and expansion of the Zimbisa project.

5.1.3 'Value webs', rather than 'value chains'

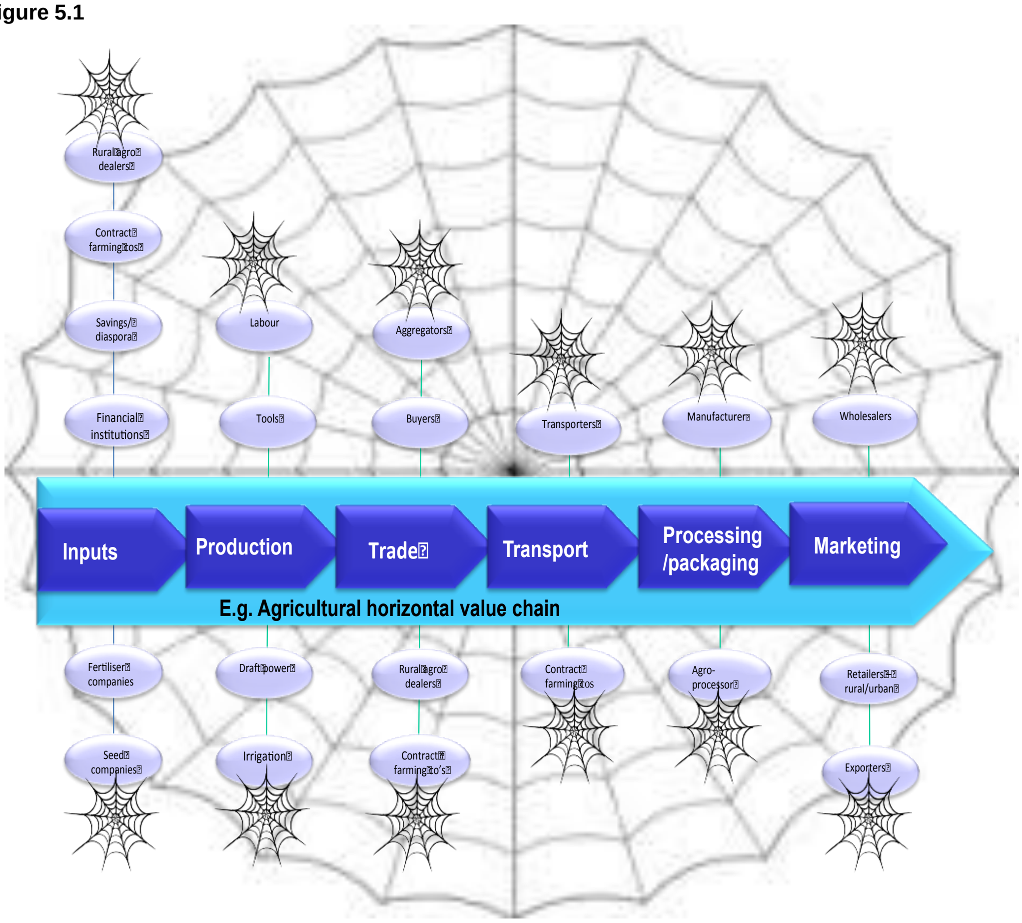
PSD programming often focusses on value chains – seeking to upgrade capabilities and value-addition in the production of particular goods. However, as the literature review demonstrated, economic development happens most powerfully when clusters draw in companies in related but different business sectors. To begin with, the literature suggests that co-location of companies with overly-similar skills leads to a process of 'convergence' in which price competition leads to the weakest companies going under. The aim therefore needs to be to create a process of 'agglomeration'. Bollywood, for example is not just home to companies of one type in the film industry, but a diversity of them, as well as those in related areas such as film finance, marketing and so on. These clusters are therefore more like webs of inter-connected sectors, rather than a linear 'chain' between companies in the same sector.

In the context of Zimbabwe, how might a cluster approach be used to foster formation of this sort of 3-dimensional web of companies? In the case of the agriculture sector (see Fig 5.1), the 'value web' would need to include not just the companies included in the core business of agriculture – providers of seeds, fertilisers and other inputs; farmers themselves; processors; and distributors – but also the other businesses that could develop on the back of a successful farming hub. These companies might include shops of different types, schools and training facilities, leisure facilities and so on.

However, as the literature makes clear, such structures are hard to create proactively, and the most successful ones self-create. However, there are clear lessons which could be applied in Zimbabwe, most obviously the need identify where markets are. As the ODI's study of SME networks in SSA made clear, 'business needs markets and the traditional supply-side menu of support for training and access to finance does not necessarily result in market access.'[94] Examples like Mozlink, in which development partners (in the Mozlink case, IFC) have focussed on supporting key companies to develop their 'web' of suppliers, may provide valuable lessons in Zimbabwe. Where might there be larger companies which could form the centre of a web of other companies and facilitate the growth of all of them?

[94] Davis, Loehr & Lemma. *Op cit*

Figure 5.1



5.2 Specific programme concepts

At present, the concepts presented in this section reflect a mixture of needs expressed by various interviewees and initial responses to the issues that emerged from the research process as a whole. Several of these overlap to some degree.

5.2.1 Sector-specific reforms to encourage formalisation

One of the effects of the economic downturn Zimbabwe has seen in recent years is an upsurge of formal sector unemployment. With the population estimated to be 15.76 million in 2016[95], and approximately 54% of these between the ages of 15-64 years, this suggests a potential labour force of 8.5 million people. The ZIMSTAT *2014 Labour Force Survey Report* cited an unemployment rate of just 11.3%. Assuming the percentages have changed little since 2014, this suggests that currently about 7.14 million people are employed in the informal sector.

Formal sector retrenchments have soared in 2015-16 due to company closures, which saw 229 companies close in the first half of 2016[96]. The collapse of large businesses over the past few years has led to a surge in the number of micro-level informal businesses that at the moment neither provide any significant financial benefit to the state, nor have the potential for growth.

95 http://countrymeters.info/en/Zimbabwe

96 The Zimbabwe Independent, 1 July 2016, https://www.theindependent.co.zw/2016/07/01/150-companies-shut-shop-2016-second-quarter/.

Government revenue relies heavily on individual and corporate taxes, as well as VAT and the slow-down in the economy exposes the fiscus to revenue shocks, mainly as a result of the general slowdown in economic activity, job losses and the resultant reduced disposable incomes. Formalising informal businesses seeks to enhance economic growth through harnessing the enormous entrepreneurial spirit and capabilities of informal sector businesses and increasing government tax revenue.

At present, as a number of interviewees made clear, there is little incentive for companies to formalise. 'Government does not even ask the question about how to help companies like ours grow' was the comment from one business group. Informal companies make it clear that, in their view, 'things feel one-sided in favour of the government.'

Nevertheless, evidence suggests that those operating in the informal sector see benefits from formalising by registering their business, namely, freedom from harassment, improved market access, easier access to loans[97]. However, the same document outlines some perceived disadvantages to formalising through registering businesses, namely, increased costs (taxes and operating costs, the process of registering is expensive, time consuming and bureaucratic).

However, at the same time, a number of those interviewed believe that it would be possible to develop relatively straight-forward reforms to the regulatory environment in different sectors which would encourage formalisation. The Zimbabwe Cross Border Traders Association (Zimcross), for example is working with CZI to develop a set of policies to encourage formalisation in their sector. This project builds on the fact that these small-scale traders form a key role in the economy, largely because they are able to source items at short notice. For example, one company interviewed faced a wait of 5 weeks for the import of a spare part for a key piece of equipment. An informal cross-border trader was able to source the item in 3 days. At present the traders are constrained by access to capital and the Zimcross trial project allows small traders to access small amounts of trade finance, guaranteed by the Association. Zimcross is working with MFIs to develop a programme which would allow traders to access higher levels of trade finance if they formalise.

This sort of initiative seems to offer the basis for an approach which would be both constructive, and which could be used in other sectors. Zimcross said that there are perhaps 20-25 small-scale sectors which would benefit from specific strategies to help improve them and encourage formalisation. Whilst this would need to be tested, there do seem to be sector-level associations like Zimcross which are competent and have a clear idea about the particular regulatory changes in their sector which would encourage formalisation.

5.2.2 Sector growth strategies

Growth strategies have been created for a small number of sectors in Zimbabwe, including the cotton and clothing sector, and for leather production. Even if the actual long-term development of these sectors were to take a different turn than the strategies anticipate, the process of developing these plans seems to have been regarded by those involved as being of great value.

Other sector studies are underway or planned by the Ministry of Industry and Commerce. However there does seem to be a need for these processes not just to provide a final document but also to identify potential linkages, and how 'social capital' might best be developed in each sector.

[97] Formalisation Strategy Research,2016, Ministry of Small and Medium Enterprises and Cooperative Development, Zimbabwe.

5.2.3 *Improving Government revenue and benefits to business though presumptive tax*

Presumptive tax is a process "to help the tax authorities deal effectively with the taxable persons who have historically failed to comply with the tax laws."[98] Even when a policy on presumptive tax may be national, its implementation is typically at local/ municipal level, as is demonstrated by the roll out of this process in several states in Nigeria. In Kawa LGA[99] (local government authority) in Jigawa state a presumptive tax approach has been used to encourage (mainly informal sector) market traders to pay tax. About 20% of the tax revenues are used on improvements to the market. Since the process began in November 2015 sheds have been installed to provide protection from the sun; the cattle market has been fenced; drainage has been improved; and running water has been provided. The impact both for the traders and the local authority revenues are significant. Because they can see tangible benefits from tax payment, traders are more likely to attend the market and to pay fees. According to the LGA, the market used to yield income of around 50,000 Naira per week, a figure which has now increased to N350,000 per week. Traders have also seen a significant up-tick in their business, reporting around a 60% increase in trade because buyers are more willing to come to the market because the improvements make it a better place to transact business.

This type of intervention might also be relevant in Zimbabwe, and would complement well efforts to encourage formalisation, as set out in 5.2.1. At present there is something of an impasse. Small, informal companies do not see the benefits of formalising or of paying tax. Most small business-people we interviewed made it clear that taxation is not seen as providing any advantage to them, so why pay it. As a result potential revenues are lost to national and local governments. A structure that provided tangible benefits to companies may encourage higher levels of tax collection. By improving the environment for the companies involved, the process may also serve to stimulate those companies and allow them to grow.

5.2.4 *Enhancing agricultural production*

The importance accorded by many people to the agriculture sector is made clear in 5.2.2 above. However, in addition to potentially considering the development of a sector plan for agriculture, there are other, more hands-on interventions that DFID might undertake. The challenge is to identify the point of entry which would be most useful, and which would have the best chance of making a meaningful impact on economic growth. This means looking at agriculture as a commercial venture not just from a livelihoods perspective. Small-scale farmers (i.e. those on less than 5 hectares of land) are not, in this case, a relevant target audience.

There is a need to get Zimbabwean agriculture moving again, and to improve levels of productivity. Doing so may not create much employment – the aim would be to create efficient rather than labour-intensive agriculture – but regenerating the business will drive exports, and so generate investment income; and improve tax take for the Government.

The point of entry for such a project would, according to those interviewed, most usefully mainly focus on the sub-units of what were the large-scale commercial farms before the reforms of the 1990s. It was reported to us that many of these have been sub-let to a number of medium-sized resettled farmers who have endeavoured to make at least some use of the land. These farms, we are told, are around 5-10 hectares, but in most cases lack proper equipment and investment. It may be that DFID is not able think DFID is not able to focus on the farm land taken from commercial farmers under the land reform programme. Nevertheless, there are other farmers, old resettled and old small scale commercial, that could be a target group for a DFID project.

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98 Akintola Williams Deloitte. *Presumptive Taxation: A promise or a threat?.* Deloitte, Abuja 2015.

99 Based on an interview with the Kawa market traders' association during the GEMS Annual Review, June 2016.

MFIs interviewed believed that many of these farms could quite readily become productive again given investment in new equipment and, in many cases management training and coaching. Moreover, if a number of such farms could be revived in a reasonably contained geographic area, then other businesses might be able to develop on the back of this. This would include both agricultural service companies, but also those providing services – shops and so on – to rural communities that had more disposable income.

The approach taken by some of the MFIs and other financial institutions to agriculture may be one relevant to DFID. Firms like Quest Financial Services see their core role as being to fund their agricultural clients, but realise that to do so effectively requires also ensuring that those clients have the relevant management skills to be able to invest that money wisely. Some form of loan structure, combined with access to technical advice would be able to provide for these needs.

5.2.5 Creating mid-size industries

As with agriculture, there is a need also to work on the development of middle sized-businesses, and linkages within existing industries. A few words on the benefits of doing this would be useful. Although Zimbabwe's industrial base is much diminished, some of it persists. Even where company structures have disappeared, some key skills have been maintained. Some of those interviewed yearn for the days of the 1980s 'when everything we needed was produced locally'. In the modern economy turning the clock back is unlikely to be efficient. However, it is apparent that in some sectors Zimbabwe enjoys comparative advantages which could be developed upon.

The garment sector, for example has managed to identify a niche in speciality clothing, manufacturing specialist fabrics and safety-related garments. The value-added of such products means that the country's relatively-high cost base is less problematic. Companies in the sector have maintained markets in Europe and elsewhere overseas and therefore form the basis of what could still be a strong industry. The country's clothing sector strategy believes that there is scope for expanding this sector, with existing players passing on orders to others when they reach capacity limitations. One interviewee in this sector explained how a growing industry might lead to the regrowth of other specialist sub-sectors and greater import substitution.

The small-scale engineering sector too seems to be a potential basis for growth. The surviving companies in the sector have adjusted their capacity to the market available, but from time-to-time sub-contract to smaller suppliers when a larger order comes in. In many cases these sub-contractors are those who have lost jobs in larger companies. However EISAZ, the trade body believes there is potential for further expansion of the sector, in a number of ways. For example, there are discussions underway with their South African counterpart organisation to market SA-made goods, and to distribute their goods from Zimbabwe. EISAZ also have considerable hopes were the agriculture sector to be regenerated as 60% of their membership are firms originally set-up to service agriculture.

In both of these cases, and possibly others, there is a need for support to help expansion. This might include provision of loan funding to help companies expand or helping support training infrastructure to ensure that the key technical and managerial skills are available. The key is to work with those sectors which have a clear market: starting with demand, rather than the supply side.

5.2.6 *Increasing exports*

In the absence of domestic funding it is of great importance that the country seeks to develop it exports as fast as possible. However, it is apparent that aside from all the other challenges, the bureaucratic process of making exports is overly complex, involved and expensive. The licensing process is complicated and in some cases requires those wishing to export to travel to Harare to apply for and collect documentation.

For example a company wishing to export mangetout needs to be a registered company in the first place, itself an involved process. The company needs then to register with the Agricultural Marketing Agency, which costs $500. The company then needs to obtain a specific export licence at the cost of $30 per licence. There is then little coordination between the export authorities and the customs. There are reports of companies with apparently properly-prepared export licences being prevented from exporting by customs officials.

It is clear that something needs to be done to simplify the export process. However, wholesale change in these systems is likely to be extremely challenging. What might be aimed at, however, is to work to simplify the export process for a small group of, maybe related, products. Some countries have made use of export zones to stimulate exports; providing simplified export processes for companies in a defined geographic area. In the case of Zimbabwe, there is an urgent need to stimulate existing businesses, rather than seek to attract new ones to an export zone. With Zimtrade, the idea was explored of creating a 'virtual' export zone which would provide simplified export procedures to companies in defined product areas – maybe horticultural products – rather than a geographical area.

Zimbabwe has previous experience with such zones – known as Export Processing Zones (EPZ) – between 1996 and 2006. The EPZ was mainly an export oriented regime, requiring firms to export at least 80% of their production and retain 20% for the domestic market. The entire EPZ programme resulted in 205 companies established, generating an estimated US$172 million worth of investment creating 32,512 jobs and a cumulative US$1.15 billion in export earnings. Moreover, about 21.6% of the approved projects were attributable to FDI. However, EPZs suffered some challenges which included:

- Weak coordination due to multiplicity of legislation which were administered by various government agencies;
- Complicated customs administration due to the fact that EPZ companies were scattered across the country;
- Limited technology transfer; and
- Proliferation of tax incentives outside the zones, hence resulting in preference erosion.

Any new attempt to create 'virtual' export zones can therefore build on the lessons of this experience. Zimtrade has clear ideas about what is needed, which sectors might be used as pilots, and the type of regulatory and process changes that would be needed to stimulate exports in those different sectors. Thus any development of this concept should be undertaken in collaboration and discussion with Zimtrade.

5.2.7 *Funding and ancillary support*

Investment capital is a significant challenge for businesses of all sizes. Without it economic growth will be hard to generate, and other activities to kick-start the economy risk being starved at birth because of the absence of adequate capital.

In the past 3-4 years, DFID has begun to experiment with what it calls 'development capital'[100], which DFID defines as being 'public investment made in the private sector to achieve development objectives. It is a tool used by DFID to catalyse investment that benefits poor people. Development capital follows a double bottom line approach: we seek modest financial return alongside significant development impact.'[101] These therefore are funds that can be used as 'patient' or first loss capital to stimulate investments that may not otherwise occur.

In the context of Zimbabwe, where political risks mean that private investors remain wary, the provision of a tranche of this type of funding could be transformative in pump-priming some of the agricultural and industrial sectors, and so encouraging other investors. The fund could work both proactively and reactively. On the one hand it could search for potential investments, and on the other it could also respond to ideas proposed to it. The diaspora Zimbabwean community may be a useful constituency to canvas: many of those interviewed believed that a significant number of such people would be interested in investing in their home country. Such a fund as is suggested co-investing would reduce the risks to such investors and may therefore encourage them to take that step. Technical assistance could be provided to locals establishing firms using Diaspora funds.

A focus on the diaspora community would also help address skills deficits. However where skills and capabilities were still lacking in a potential investee company, then the fund would also be able provide relevant technical assistance. This may be on functional issues, or on high-end management skills, as may be required by the company. Such TA would be short-term in nature and could be provided either on a concessional or non-concessional basis.

In terms of sector selection, such a fund as is proposed ought not necessarily to have pre-defined sectors of interest. The generally-expressed view was that to pre-select sectors would limit innovation in sectors that those making a sector selection may not even be aware of. Investment decisions should be taken on the basis of their potential, rather than their sector. However, in order to assure the developmental impact, loans would be made conditional on delivering employment, training or other benefits.

[100] Norfund has a model for this sort of approach, based in South Africa, but with a small presence in Zimbabwe.
[101] DFID. *Development Capital Catalysing investments to benefit poor people*. DFID London July 2015

6 Annex 1: Methodological approach

6.1 Introduction

The aim of this study has been to identify different analyses of how and why countries grow, and to apply these to the situation in Zimbabwe, with a view to understanding where growth is most likely to come from there. To that end, the research for this paper consisted of two phases. The first, conducted between June and August 2016 consisted of a review of relevant literature. The second, conducted in September 2016, consisted of a field trip to Zimbabwe in which a number of interviews were undertaken with a range of relevant stakeholders. This brief annex outlines the approach to each of these phases of research.

6.2 Secondary literature review

The ToR for this study referenced a number of academic and practitioner reports looking at factors of economic growth, and other references were provided by the DFID team during the initial phase of the project. This first set of documents were reviewed by the team, and then the bibliographies and references in these papers used to identify further relevant papers in both the academic and practitioner fields. The team then used JSTOR to search relevant academic journals for articles relating to factors of economic growth. In order to focus the relevance of documents surveyed (and to provide a limit to the amount of documents), a cut off was used of articles published since 2012. The team also used contacts in DFID, IFC, Sida, OECD, ODI and other relevant organisations to identify relevant practitioner papers and studies. This process identified nine topics identified as relevant in understanding economic growth:

1. Firm-level capabilities
   Technical and managerial skills within firms
2. Growth from large firms or SMEs
   Does growth most readily come from expansion of a small number of large businesses, or from a large number of small ones?
3. The missing middle
   Where structure of a country's private sector lacks mid-size firms, what are the implications for economic growth?
4. Clusters and agglomeration
   What are the impacts on firms, competition and the possibilities for firm and sectoral growth from co-location of companies?
5. Special economic zones
   To what extent do special economic zones and other similar structures assist growth of the companies located within them; and what is the wider impact on the host economy?
6. Business environment reform
   The regulatory and legal frameworks governing the economy and business, and the effectiveness of implementation of these.
7. Small firm/ large firm linkages
   How best can relationships between firms of different sizes be managed to ensure growth of those firms, and the wider economy?
8. Product space
   Ricardo Hausmann's analysis of how countries can best develop into new, more sophisticated products.
9. Geographic proximity
   What are the impacts on a country of its geographic location, for example on trade routes; and how important are the respective strengths and weaknesses of neighbouring countries?

Further work allowed this set of nine areas of analysis to be grouped into three broad areas, which formed the basis for the in-country analysis. These areas are as follows:

1. **Capabilities and learning:** The capacity, skills and capability of individuals, firms and government entities is the basis without which economic growth at any level is not possible.
2. **Geographic proximity:** The physical location of firms relative to each other is significant in determining how firms grow. Also a country's location, and how well it collaborates with its neighbours is also significant. However, 'social proximity' is also key.
3. **Regulatory environment:** Although criticisms of the DB indicators are fair, the reality is that regulation still matters greatly. However, it is not just individual regulations that matter, but also the general environment of rent-seeking, government openness and other such factors which are of importance.

6.3 Primary research

The in-country phase of the research was designed to understand how these analyses of how economic growth occur applied in the context of Zimbabwe. What could this globally-derived literature tell us about why it is that some companies have managed to be resilient despite the country's economic troubles, and about where growth might come from in future?

This study used primarily one-on-one interviews with relevant individuals and organisations in Zimbabwe. This study made use of so-called 'focussed interview' approach. On the face of it, it is a straight-forward matter to define what an 'interview' is. However, as many social science methodologists make clear, there are a great many ways of conducting interviews, and the approach selected is vital if the right information is to be obtained[102]. Most scholarly analyses of interview methods cite three broad types: structured, semi-structured, and focussed approaches. The structured interview is associated with survey research, and often relies on a questionnaire as a data collection instrument. In conducting a structured interview, the questions and their wording are clearly defined in advance, and the interviewer is permitted very little leeway in how those questions are posed – "little or no variability should be apparent in order not to influence the answers." This approach is claimed to permit greater comparability between interviews because each has been conducted to precisely the same rubric.

Within the second form of interview structure – the semi-structured interview – the different ways in which respondents express themselves is positively embraced since it is perceived to allow more complete responses from interviewees: respondents are encouraged to reply more in their own terms that those stipulated by the research designer[103]. An interviewer is permitted to seek clarification and elaboration from interviewees on the questions asked, which "enables the interviewer to have more latitude to probe beyond the answers…in a way that would be perceived as prejudicial to the aims of standardisation and comparability" in the context of a structured interview.

The third interview type is referred to variously as the 'informal', 'un-standardised', or 'un-structured' interview. However, the use of the title 'focussed interview' seems most appropriate since this approach is not a random conversation between interviewer and respondent, but rather seeks to explore key topics in a systematic and focussed way. May[104] argues that this approach provides greater qualitative insight than the other two approaches. In a focussed interview, interviewees are able to talk about the subject at hand in their own terms thereby providing the researcher with a greater understanding of the subject's point of view, and its genesis: not just what people think, but why. Focussed interviews also provide access to a higher degree of nuance and subtlety than more formalised interview processes. This study will therefore made use of the 'focussed interview' approach, in order that we could explore key topics in a systematic and focussed way, but also allowed respondents to raise issues they see as being important.

It is evident that the interview structure was of paramount importance. On the one hand, it needed to be sufficiently focussed to collect relevant data and not to become merely an unstructured conversation. At the same time, it needed to be able to permit the interviewees to pursue avenues which they perceive to be important which may or may not have occurred to the researcher

[102] Moser, C & G Kalton. *Survey methods in Social Investigation.* Heinemann, London. 1971,

[103] Ornstein, M. 'Survey Research'. In *Current Sociology* Vol 46 (4) 1998

[104] May, T. *Social Research: Issues, methods and processes.* Open University Press, Maidenhead. 2001

previously. Thirdly, interviews needed to be structured in such a way as to ensure both that the respondent is giving their authentic opinion or insight, and that the interviewer was properly understanding the points that the respondent is seeking to make. The participant's perspective on the phenomenon of interest should unfold as the participant sees it, not as we the researchers view it.

The question structure for focussed interviews was therefore of considerable importance: questions were divided into three types. Firstly, there were a set of main questions- the scaffolding of the interview, in effect – which are designed to encourage the respondent to talk about the issues that are central to answering the research questions. Secondly, follow up questions were used to explore the particular themes and concepts, and the ideas introduced by the respondent. These questions were necessarily interview-specific and derive from careful attention to the points an interviewee is making. Finally, we used 'probes', which are techniques which both seek clarification about points that have been made and at the same time keep a discussion going. Sometimes, the best way of keeping a conversation going may be silence, however!

In selecting interviewees, it was crucial that we avoided interviewing "convenience samples" - particular individuals and groups that may be readily accessible, but who might not in any way have been representative of any wider group. To avoid the risk of bias, it was important to ensure that our interview process reached as broad a cross-section of relevant stakeholders as possible. At the beginning of planning the in-country interview process we identified a number of categories of interviewee whom we wished to reach:

- Government officials
- Government entities and
- Representatives of international organisations
- Business owners and managers
- Business membership organisations
- Representatives of informal companies/ entities
- Commentators and other expert observers of the situation in Zimbabwe

Using the knowledge and experience of the research team, and in consultation with DFID and others, an initial set of interviewees was identified. We then used a process of 'snowball samples', by which we asked our initial interviewees to recommend others.

6.3.1 Core interview questions

Our core questions, which we sought to cover in all interviews, was as follows:

- At a firm level, what are the main challenges facing companies in terms of their internal capacities? This might include both technical, and non-technical skills.
- What sectors might Zimbabwe best focus on as it seeks to re-build the economy?
    - Are there new sectors which might have been neglected in the past?
- What has been the experience in Zimbabwe of 'special economic zones' or different types? Might these provide a useful tool to help the country moving forward?
- What challenges and issues are there in terms of business regulation, either in terms of adverse regulation, or poor implementation?
- How good are the links between larger and smaller companies, and how might these be improved?

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