

# Implications of Foreign Direct Investment on SME Growth in Zimbabwe: A Case Study of Bulawayo Province

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## ABSTRACT

SMEs in Zimbabwe have withstood the test of time amidst economic decay experienced by the Zimbabwean economy for the past two decades. Since the adoption of progrowth policies in Zimbabwe FDI inflows have significantly increased overtime towards SMEs due because of their nurture to drive growth and economic competitiveness as well as navigating difficult economic landscapes. Therefore the paper investigates the implications of foreign direct investment on SME growth in Bulawayo. A qualitative research approach aligned with interpretivism research philosophy was adopted in this paper. The research subjects were selected using a convenient sampling technique. A total of 20 interviews were conducted with the managers and business owners of SMEs. The related challenges faced by SMEs in the Bulawayo metropolitan are increased competition, access to capital difficulties, skill and technology gaps, and regulatory and bureaucratic hurdles. The findings revealed that FDI plays a multifaceted role in shaping the SME landscape in Bulawayo metropolitan. The positive effects included opportunities for technology transfer, market expansion, improved infrastructure, capacity building, and training opportunities, and inclusion of the small and medium enterprises in supply chain integration. The study recommends a broader discussion with policymakers, business leaders, and other stakeholders to maximise the benefits of foreign direct investment on small to medium enterprises while mitigating its adverse effects.

**Keywords:** Small to Medium Enterprises, Foreign Direct investment, Survival, Competitiveness, Growth, Sustainability, Economic Growth, Zimbabwe, Bulawayo, Africa.

## INTRODUCTION

Foreign direct investment is crucial for global economic growth and development, benefiting both first world countries and developing countries (The Organization for Economic Cooperation and Development (OECD) 2022 Report). Since 2018 as the government of Zimbabwe adopted progrowth policies under the mantra 'Zimbabwe is Open for Business' foreign direct investment has gradually grown upwards across all provinces thus boosting provincial economies. FDI increased from US\$ 40.2 million to US\$103.5 million over 1991 to 2018 (Setoboli *et al*, 2024) as the economy was resuscitating due to attractive policies.

According to ZIDA, (2023) Bulawayo Province attracted foreign direct investment worth USD\$77.28 million. Bulawayo metropolitan province is historically known to be the anchor of manufacturing hub in the Zimbabwean industry. The province boasts of an efficient transport system that links the country to SADC & COMESA markets making it a strategic location attractive spot for foreign investors looking to capitalize on regional trade opportunities and efficient logistics networks. Further, Bulawayo benefits from a relatively skilled and experienced labour force, which has been a magnet for FDI. However, Bulawayo has not spared to the challenges facing the whole economy of Zimbabwe. Since 2000, the province has gone through massive deindustrialization followed by largescale retrenchments of skilled and unskilled labour workforce. The colossal decay of the economy has seen rise of the informal sector. While, economic activity was waning

during the last two decades SME economic activity created employment and household income (Nyathi, 2021). According to Medina & Schneider (2018) Zimbabwe is the second informalised economy after Bolivia. Hence most economic activities happening 80 percent are controlled by the strong SME enterprise. RBZ (2022) stated that FDI inflows into the country witnessed a notable increase, rising from US\$237.5 million to US\$326.2 million in 2022, reflecting an enhanced investment climate prevailing within Zimbabwe. Presence of FDI across all sectors of the economy has some linkages with SMEs, hence a conduit for their growth. Therefore, the study focuses on exploring the implications of Foreign Direct Investment and SMEs growth in Bulawayo City.

## **Theoretical Framework**

The theoretical framework underpinning the study include the Eclectic Paradigm Theory, The Product Life Cycle and the Internalization Theory. The Eclectic Paradigm Theory and the Internalization Theory can be unpacked to explore the impact of foreign direct investment in Bulawayo Metropolitan Province because they point out that the benefits of internalising market activities that should outweigh the associated costs buttressed by localisation and ownership. While, the Product Life Theory firms establish themselves in their home country, benefiting from easy market and competitor information access. They begin to meet foreign demand through exporting, compelling them to establish subsidiaries in foreign markets over time.

### **The Eclectic Paradigm Theory**

This is a theory formulated by Dunning in the 1970s. It is also called the OLI (Ownership, Location, Internalisation) framework, which explains the motivations and determinants of FDI. The framework encompasses three primary elements: ownership advantages, location advantages, and internalisation advantages. According to Nayak *et al* (2014), the theory proposes that FDI occurs when firms possess specific advantages related to ownership (O) that generate revenue, and they seek to leverage these advantages in foreign locations (L), which they can only do profitably through internalising those advantages rather than outsourcing. The crucial aspect of the eclectic theory is that all three conditions must be fulfilled for FDI to take place.

### **The Internalisation Theory**

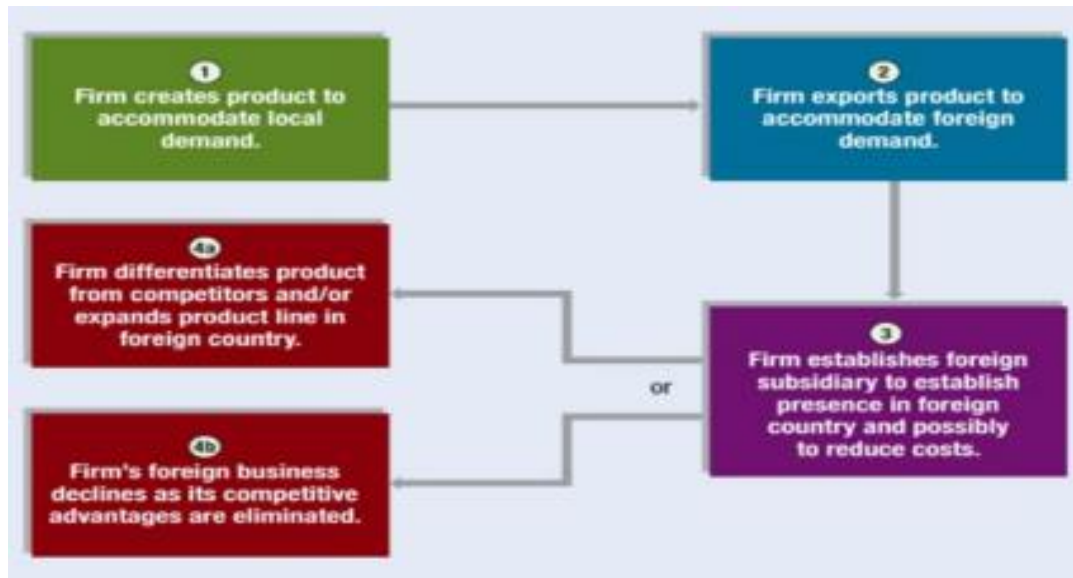
The internalisation theory was initially formulated by Buckley and Casson in 1976. This theory builds on the work of Coase (1937), who proposed that certain transactions are more efficiently conducted within an organisation rather than through external means due to market imperfections. The theory explains why FDI is concentrated in knowledge-extensive industries and provides insights into the choice between market entry modes and non-market modes of operation. The core idea of internalisation theory is that the benefits of internalising market activities should outweigh the associated costs. It posits that firms opt for FDI when the advantages of internalising foreign operations surpass the costs and risks associated with market-based transactions. The motivation for internalisation lies in firms' desire to gain control over assets, exploit location-specific benefits, and mitigate transaction costs and uncertainties in foreign markets. The theory emphasizes the significance of firm-specific advantages that confer a competitive edge in foreign markets. Various factors, including market imperfections, cultural differences, and host country regulations, shape firms' decisions regarding internalisation.

### **The Product Life Cycle Theory**

According to Madura (2020), one popular explanation for why firms delve into FDI investments is the product cycle theory. Initially, firms establish themselves in their home country, benefiting from easy market and competitor information access. They begin by meeting foreign demand through exporting, but they establish subsidiaries in foreign markets over time. Narula and Lee (2020) further note that as the product becomes standardised and mature, consumer demand becomes more price-sensitive. Consequently, cost factors become crucial, leading many firms to move their production activities to countries with lower labour costs. This trend intensifies with the imposition of tariff barriers and the expansion of foreign market demand. Madura (2020) explains that in response to competition in the foreign market, firms develop strategies to sustain foreign

demand, such as product differentiation to set themselves apart from competitors. Moreover, this theory suggests that as a product matures, production shifts to countries with lower labour costs. This results in job losses in high-cost countries, while creating jobs in the low-cost countries where production is located. Figure 1 illustrates the stages in the product life cycle.

Figure 1: International Product Life Cycle



Source: International Finance Management (2021, p 9)

## Empirical Literature Review

Chinyerere (2020) explored the effects of FDI on SME employment generation and technology transfer in Zimbabwe. Using an econometric model the author found out a positive correlation between FDI inflows and SME employment growth, emphasizing the potential of FDI to create job opportunities. The study also revealed limited technology transfer effects, with only a few benefiting from the knowledge spillovers from foreign investors. Mwika (2018) explored the relationship between SMEs and FDI in Zambia, and the findings discovered that FDI negatively impacted these SMEs. In Nigeria, Oladimeji (2017) analysed the relationship between FDI and SMEs' performance. The study used a co-integration model and found that factors like interest rates, bank lending, and trade openness had a partial effect on SME production. Chingwaru (2015) underlined the impact of trade and economic liberalisation on manufacturing SMEs in Zimbabwe and South Africa and found that these policies harmed their operations. Cash-strapped SMEs struggled to compete with resource-rich MNCs and cheap imports. The study recommended that governments introduce incentives to encourage exports and technology transfer to SMEs and reintroduce tariffs in certain sectors to protect them from cheap imports.

Another research by Nadide and Ibrahim (2014) focused on the effects of FDI on SME productivity in Turkey. The study employed a panel data analysis and discovered a significant positive correlation between FDI inflows and the productivity growth of SMEs. FDI plays a crucial role in enhancing SME performance through the transfer of technology, managerial expertise, and access to international markets. Love & Ganotakis (2013) studies revealed that exporting through FDI can enhance the capabilities and competitiveness of SMEs. Chinembiri (2011) highlighted the importance of a supportive policy environment in facilitating the FDI-SME relationship in Zimbabwe. The study emphasized the need for investment incentives, streamlined regulations, and infrastructure development to attract FDI and promote SME growth. Subair and Salihu (2011) conducted a study in Nigeria to investigate how FDI affects the development of SMEs using the least squares method. The findings revealed that FDI negatively affected the growth. Meanwhile, Dogan (2010) also shares a similar viewpoint, asserting that foreign investors with exceptional performance can stimulate intensified competition in the service industry where domestic SME firms operate. The underlying rationale is that to thrive in a fiercely competitive service sector, SMEs must enhance their productivity and overall performance.

Cuevas & Fischer (2006) examined the role of SMEs in international trade and FDI in the Southern African Development Community (SADC) region. The study revealed the challenges faced by SMEs in accessing and benefiting from FDI. The challenges included limited access to finance, lack of infrastructure, regulatory hurdles, and competition. In spite of the limitations, SMEs remain vital global value chains, job creation and supply chain integration as well as regional development. Maeseneire and Claeys (2006) explored the problems experienced by SMEs with international ambitions in gaining access to finance from FDI on 32 SMEs from Belgium. The findings indicated that the market for FDI finance available to SMEs suffers from notable imperfections in the capital market. Consequently, the FDI finance gap obstructs small firms in their pursuit of internationalisation strategies and harms their overall economic performance.

While on the same note, Damooei and Tavakoli (2006) suggested that FDI can enhance the effectiveness of local SMEs positive spillover effects such as employees receiving training and acquiring new skills. Hu and Jefferson (2001) also found a positive spillover effect of FDI on innovation activity in each industry in China. Loungani and Razin (2001) emphasize that FDI promotes domestic market competition for inputs. This happens when domestic firms are compelled to improve their performance and productivity to compete with both foreign companies and other local businesses, capture a larger market share, and increase sales. Aitken and Harrison (1999) examined the spillover effects of FDI on SMEs in Venezuela using panel data. The findings revealed that there is a positive effect of FDI on the productivity and export performance of domestic firms.

These studies collectively emphasize the effects of FDI on SMEs. The literature suggests that FDI can positively and negatively affect SMEs. On the positive side, FDI can provide SMEs with access to new markets, modern technology, managerial knowledge, and financial resources, all of which can help them expand, compete, and innovate. FDI can also foster knowledge spillovers and links between local SMEs and international businesses. However, there is an emphasis on the importance of understanding the individual mechanisms and contextual elements that influence FDI's effects on SMEs to maximize advantages and mitigate risks. While on the other hand, empirical literature also highlights potential challenges, such as the risk of crowding out local SMEs, technology dependency, and limited opportunities for local value addition. The host country's institutional environment, absorptive ability, and policy frameworks all play an important role in defining the outcomes of FDI-SME interactions. This study takes Zimbabwe as an example, selects city of Bulawayo which is the second largest city of the country once used to be the country's industrial hub too.

## METHODOLOGY

This study adapts the method used by Nkomo *et al* (2024) who in their study applied a qualitative research approach which is aligned with the interpretivism philosophy. Saunders *et al* (2016) affirms that such typical methods are for information gathering technique that generates or uses non-numeric data. Furthermore, according to Chinjova (2019) qualitative researches generates a lot of data relating to the genuine concerns and viewpoints on the analysis of effects of foreign direct investment to small and medium enterprises in Bulawayo Metropolitan Province. A convenience sampling technique was utilized to select the business owners or managers of SMEs in Bulawayo Metropolitan Province. Primary data was collected using a validated questionnaires since much of the information sought needed a considered response and reference to records and collected in a standardized way. Interviews were also conducted on a small number of companies, with the questionnaire as the interview guide, to collect comprehensive facts to enable proper analysis of a problem.

Moreso, survey were also used to collect data from business organizations representative such as Bulawayo Chamber of Small and Medium Enterprises, Ministry of Women Affairs, Small and Medium Enterprises, Visat, ZIDA including SME owners, managers and employees. A representative sample of 20 SMEs and organizations representing them. A descriptive survey design was employed to gather all the necessary data. It involves making appropriate and precise interpretations of data to draw meaningful insights. Consequently, descriptive research provided valuable insights, a detailed description, and a solid foundation for further research. Its ability to provide in-depth understanding and serve as a stepping stone for future research made it a valuable and applicable method for this study. Calderon (2006) mentions that a descriptive survey design entails a deliberate process of collecting, analyzing, categorizing, and summarizing data concerning existing conditions, practices, trends, processes, and cause-and-effect relationships.

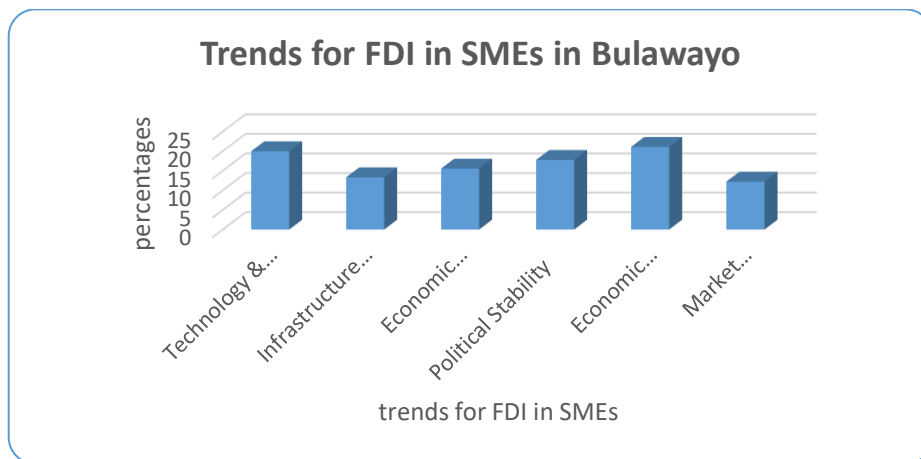


## RESULTS AND DISCUSSION

The study will use the thematic approach to establish themes, analyse and interpret the data. Data was collected using semi-structured interviews. The study targeted business owners, managers, employees and representative organizations for SMEs. SMEs covered for the study include those in agriculture and agribusiness, professional services, retail industry, hospitality, construction, information communication technology real estate, and manufacturing. Median & Schneider (2018) Zimbabwe is the most informalised country in Africa and it's second from Bolivia. This makes SMEs as the main driver of economic activity in Zimbabwe. SME participation in the local economy is integral for attainment of national development.

### Trends in FDI in Zimbabwe's SME Sector in Bulawayo

Figure 2: Foreign Direct Investment Trends amongst SMEs in Bulawayo



Source: Primary data (2024)

According to the findings of the study, the most influential factor is economic policies and regulations contributing 21.11%, suggesting that this factor is the most crucial in attracting FDI. This also suggests that regulatory frameworks that support business operations and ease of doing business are likely to attract more FDI. The second highest factor contributing 20% of the total is technology and innovation development. Investors are attracted to markets where there is robust technological infrastructure and innovative capabilities. These factors ensure competitiveness and growth potential for SMEs, making the sector more appealing to foreign investors. Additionally, political stability is also a key consideration for investors contributing 17.78% of the total from the findings of the study. Aisen and Fransisco (2010) posit that a stable political environment reduces the risks associated with sudden policy changes, unrest, or governance issues. This stability ensures that businesses can operate smoothly without disruptions. Moreover, the overall economic stability and performance also significantly affect FDI contributing 15.56%. This is because strong economic performance indicates a healthy market with growth opportunities.

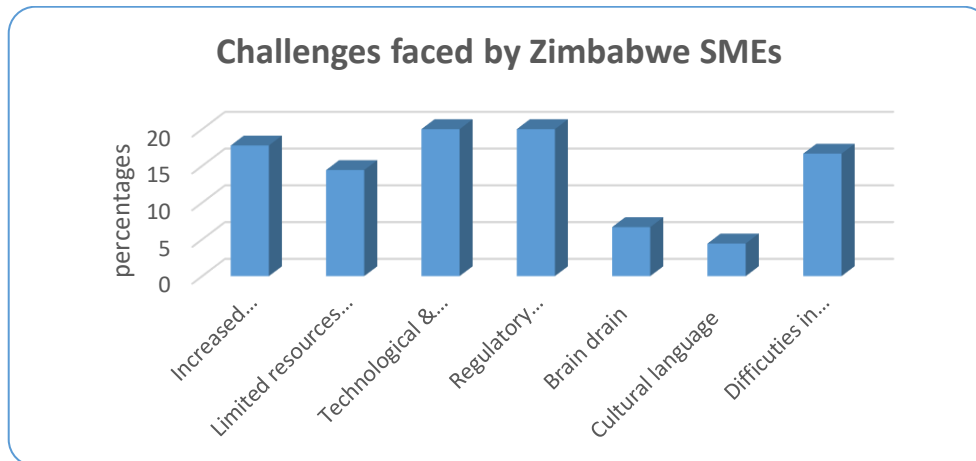
Participant **P1** had this to say, “*Stable and transparent economic policies provide investors with confidence and predictability, reducing the risk associated with their investments.*” Participant **P2** alluded that, “*Investors look for economies that show positive growth trends, low inflation, and a stable currency.*”

Finally, infrastructure development and market demand and opportunities have a moderate influence contributing 13.33% and 12.22% of the total respectively. Good infrastructure is essential for business operations, reducing operational costs and increasing efficiency hence making the environment more attractive. On the other hand, market opportunities and demand also attract FDI, posing an effect on domestic SMEs.

Participant **P6** mentioned that “*Market demand opportunities are enhanced by availability of foreign currency and normal costs of compliance.*” Participant **P9** indicated that “*The government of Zimbabwe needs to pursue deep and more consistent economic reforms to improve the overall business climate in Bulawayo.*”

## Challenges Faced by Zimbabwe's SMEs in Bulawayo in the Presence of FDI

Figure 3: Encounters experienced by SMEs in Bulawayo in the Presence of FDI



Source: Primary data (2024)

SMEs operating in Bulawayo find themselves operating in oscillating economy due to macroeconomic challenges experienced in Zimbabwe. The study identifies the challenges faced by SMEs in the presence of FDI. Technological and knowledge gaps and regulatory complexities of 20% indicate that SMEs struggle to keep up with the advanced technologies and expertise brought by foreign investors, and navigating the regulatory environment in the presence of FDI makes it difficult for local SMEs.

Participant **P5** weighed in and mentioned that, *“The rapid pace of technological change makes it difficult for local SMEs to continuously upgrade equipment and systems to remain competitive.”*

Mazikana (2019) asserted that foreign-owned firms with greater access to legal and compliance support are better equipped to handle complex regulatory requirements. This disparity in regulatory burden places the SMEs at a disadvantage, hindering their ability to compete with FDI-backed enterprises.

Participant **P10** mentioned that *“The greater efficiency and productivity of foreign firms puts pressure on local SMEs to innovate and improve their operations to remain competitive.”* Meanwhile, participant **P12** alluded that *“Businesses have shifted focus to niche markets and specialized products in an attempt to differentiate our products from the foreign competition.”* Additionally, participant **P14** stated that *“Businesses have resorted to compete based on price making it difficult for businesses to invest in quality improvements, technology upgrades, and expansion”*.

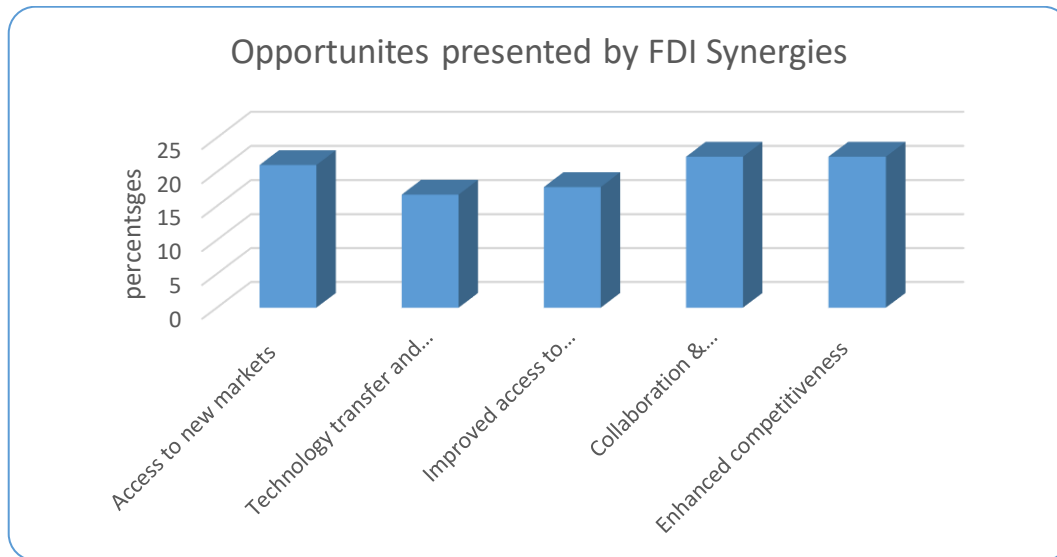
Mirza and Giroud, (2004) acknowledges that SMEs lack the financial resources to provide adequate training and development opportunities for their employees.

Participant **P15** mentioned that *“Businesses faces significant barriers in obtaining financing from financial institutions due to a perceived preference for providing capital to foreign enterprises over domestic SMEs.”* Another participant **P19** mentioned that *“Foreign-owned companies operating in Bulawayo have an easier time accessing capital as compared to local SMEs.”*

A significant proportion of SMEs (17.78%) reported increased competition from foreign investors as a major challenge as FDI often brings in more competitive business which can overshadow local SMEs. Foreign firms can offer lower prices, which makes it difficult for local SMEs to maintain their market position (OECD, 2015). Additionally, limited access to resources and finance is another critical challenge for 14.44% of the SMEs. This is because foreign businesses attract more financial support, leaving local SMEs with fewer opportunities. Moreover, brain drains and cultural and language barriers contributed 6.67% and 4.44% respectively. This suggests that a smaller percentage of SMEs are affected by employees leaving for better opportunities with foreign companies and cultural and language barriers.

## Opportunities Faced by Zimbabwe's SMEs in Bulawayo in the Presence of FDI

Figure 4: Prospects presented to SMEs in Bulawayo



Source: Primary data (2024)

Figure 4 above reveals that FDI brings access to advanced technologies, production methods, and managerial expertise that local SMEs may not have exposure to as supported by study done by (Sugiharti *et al* , Yasin, Purwono, Esquivias, and Pane, 2022). Bulawayo's SMEs have benefited from technology spillovers and demonstration effects, observing and learning from the foreign firms' technological capabilities (ZIDA, 2020). FDI has been seen opening up new avenues for SMEs in Bulawayo to access international markets that were previously inaccessible (ZIDA, 2020). Foreign partners have also provided Bulawayo's SMEs with technical assistance, training, and resources to help meet international standards and customer preferences (UNCTAD, 2023).

Furthermore, FDI has funded the construction and upgrading of roads and airports in Bulawayo (ZIMCodd, 2018). This has improved connectivity and accessibility for local SMEs, allowing them to efficiently transport goods and access wider markets. The reduced transportation costs and travel times have enabled SMEs to be more competitive. FDI has also supported the expansion and modernization of telecommunication networks, including the rollout of high-speed internet and mobile coverage. SMEs have benefited from this, enabling them to better coordinate with suppliers and customers.

Participant **P3** states that, *"The access to reliable and fast internet has allowed our business to adopt digital technologies and expand online presence, improving their reach and competitiveness."*

While on the same note, the study reveals that SMEs in Bulawayo have experienced an improvement in the managerial and technical skills of their workforce due to training programs. SME owners have also noted that their improved skills have enabled them to better adapt to changing market conditions and customer demands. FDI has facilitated the transfer of knowledge and best practices from the parent companies to the local SMEs. SMEs have had the opportunity to observe and learn from the operational and management strategies of foreign firms. This knowledge spillover has been beneficial for SMEs in sectors such as manufacturing and services. The exposure to advanced technologies has encouraged local SMEs to innovate and modernize their operations. Participant **P17** stated that *"Training programs help employers and employees to have enhanced understanding of modern business practices, technological advancements, and industry best practices. This has increased local SMEs' efficiency, productivity, and competitiveness."*

According to the study, some local SMEs have integrated into the supply chains of MNCs operating in Bulawayo, becoming suppliers or service providers. This has exposed local SMEs to new technologies, management practices, and quality standards, helping them improve their operations and competitiveness.

However, many local SMEs lack the capacity and resources to consistently meet the demanding standards set by MNCs. One participant **P16** also weighs in, *“Some local SMEs have leveraged their proximity, local knowledge, and flexibility to secure contracts with MNCs for various business services. However, intense competition and the bargaining power of MNCs have put pressure on profit margins for some SME suppliers.”*

## CONCLUSION AND RECOMMENDATIONS

The government's economic reform agenda, which includes introducing various investment incentives, has significantly enhanced Zimbabwe's attractiveness for FDI. These reforms have opened up the economy, making it more conducive to international business operations and investments, thereby boosting investor confidence. Growth of investors across all sectors has had spillover effects to Bulawayo city inspite strong commanding influence of the informal sector. Bulawayo metropolitan province is historically known to be the anchor of manufacturing hub in the Zimbabwean industry. Further, Bulawayo benefits from a relatively skilled and experienced labour force, which has been a magnet for FDI. The province has an efficient transport system that could link the country to SADC & COMESA markets. This strategic location makes it an attractive spot for foreign investors looking to capitalize on regional trade opportunities and efficient logistics networks. During the deindustrialisation phase experienced by the country since 2000 Bulawayo has seen a surge of SMEs activities. Participant **P12** mentioned that, *“Employees have understood modern business practices, technological advancements, and industry best practices and this has increased local SMEs' efficiency, productivity, and competitiveness.”*

The study makes the following recommendations to explore the nexus of foreign direct investment and SMEs growth in Bulawayo city. To begin with, Government of Zimbabwe should create deliberate policies to establish special economic zones or industrial parks that provide targeted support and incentives for SMEs to integrate with FDI firms. Secondly, there is need to provide SMEs with information, advisory services, and assistance in navigating administrative procedures for engaging with FDI firms. Lastly, policymakers should encourage financial institutions to design and offer tailored financial products, such as trade finance, working capital loans, and equity financing, to address the specific funding needs of SMEs seeking to engage with FDI firms. They also ought to develop targeted financial products and services, such as credit guarantee schemes, venture capital funds, and microfinance programs, to help SMEs access affordable financing.

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