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The effects of depreciating Kwacha on the financial performance of Small and Medium Scale Enterprises (SME'S) In Zambia

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Abstract

This study aimed at investigating the effects of the depreciation of the Zambian Kwacha against the US Dollar on SMEs in Lusaka Central Business District. The base line of the study was 2017 to 2023. This study employed the quantitative research design and data was collected using a closed ended-structured questionnaire. Statistical Package for Social Sciences (SPSS version 22) was used to analyze quantitative data. A descriptive research design was used employed in the research. A total of 70 SMEs whose core business was importation of goods such as phones and clothes for sell were sampled. The first objective was to establish the effects that the kwacha depreciation had on SME's decision making in Kalingalinga area and the study discovered that 20 (29%) of respondents indicated that access to foreign capital was heavily influenced, highlighting the challenges SMEs face in securing funding amidst currency fluctuations. Increased import costs affected 16 (23%) of the respondents.. Financial planning and budgeting were impacted for 13 (19%). Price adjustments and inflation were acknowledged by 12 (17%). Lastly, 9 (13%) of SMEs reevaluated their market strategies, suggesting that businesses are adapting to the new economic environment to remain competitive. The second objective was to understand the extent to which depreciation of the Kwacha affects the SMEs financial performance and position and the study revealed that 13 (19%) said sales revenue, 18 (26%) said cost of raw materials and imported products, 22 (31%) said transportation costs and 17 (24%) indicated that job cuts and employment stability. Overall, these findings highlight the multifaceted impact of currency depreciation on SMEs operating in Kalingalinga area, affecting various aspects of their operations from revenue generation to cost management and workforce stability. The third objective was to recommend copying strategies employed to avert the effects depreciation of the Zambian Kwacha against the US dollar and the study established that 12 (17%) said increasing foreign exchange supply, 22 (31%) said enhancing export performance for SMEs, 18 (26%) said boosting economic activities, 10 (14%) said strengthening current account balance for SMEs and 8 (11%) said debt restructuring.. The recommendations of the study were that SMEs needed to reassess their investment plans and prioritize on projects or businesses that are less exposed to currency risks or export oriented.

In conclusion, there is need for SMEs to explore strategies to hedge against currency risk. Policymakers also play a critical role in providing a conducive economic environment that ensures the stability of the local currency and supports SME development.

Keywords: SMEs; Imports; Exports; Profitability; Depreciation

1. Introduction

Since 2017 to date, there has been an excessive depreciation of the Zambian kwacha against United States dollar. By end 2017 the dollar kwacha ratio was at $1= K9.99 and by end 2023 $1 = K24.67. The depreciation of the Zambian Kwacha has had profound implications for small and medium-sized enterprises (SMEs) in Zambia, particularly in there financial-performance and operations. As the value of the Kwacha declines, these businesses face increased costs

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for imported goods, capital equipment, and foreign-sourced services, which in turn affects their profitability and growth potential. Currency depreciation can lead to inflationary pressures, which reduce consumer spending power and limit SME growth by increasing operating costs (Chirwa, 2019). Moreover, SMEs in Zambia often have limited access to foreign exchange hedging instruments, leaving them vulnerable to currency volatility (Chisala, 2019). The overall impact of a depreciating Kwacha challenges the sustainability of SMEs within Zambia's financial sector, potentially hampering economic development and employment growth in the country (Musonda, 2019).

According to Bank of Zambia (2021), baseline survey on micro and small enterprises in Zambia, the SME sector consists of approximately 97% of all enterprises in the country and employ 18% of the labour force of whom 47% are women. the fluctuations in exchange rates due to currency depreciation can introduce uncertainty for SMEs, especially those engaged in international transactions or dealing with foreign currencies. Managing exchange rate risks becomes crucial for these businesses. The combination of higher operating costs, inflationary pressures, increased borrowing costs, and exchange rate volatility can collectively impact the profit margins of SMEs in the financial industry. Maintaining competitiveness and sustainability under these conditions becomes a significant challenge.

1.1. Statement of the problem

For the past 7 years (2017 to 2023) the Zambian kwacha has not fared well against the dollar and this has sent shivers in the Zambian economy, By end 2017, for instance, the US dollar: Zambian Kwacha exchange rate was US$1 : 9.99 ZMW, by end 2018 the rate had increased to US$ 1 : 11.92 ZMW and by end 2019 it increased to US$ 1 : 14.44 ZMW (Bank of Zambia report, 2020). In 2020, it had increased further to US$1: 21.17 ZMW, in 2021 it decreased went to US$: 16.67 ZMW (Bank of Zambia annual report; 2022). The rate increased to US$: 17.58 ZMWin 2022 and further increased to US$1: 24.75 ZMW in 2023 (Bank of Zambia annual report;2023). The downward spiral of the Kwacha has continued to the extent that the currency is now trading at around 28 ZMW per dollar. With the above statistics, there has been a sustained depreciation in the Zambian Kwacha, meaning every year higher cost of importing goods and commodities For SME's.

A study by the Zambia Development Agency (ZDA) in 2016 revealed that over 50% of SMEs in Zambia faced difficulties in repaying their loans due to the depreciation of the local currency, which inflated their debt repayments, thereby reducing their overall profitability and ability to reinvest in their businesses.

Despite a growing amount of literature on the impacts of the depreciation of the kwacha on SMEs in Zambia, there is still a gap in information as to what extent this affects their financial performance and there are many other effects which are have not yet been well documented.

Therefore, the study focusses on the local SMEs in particular as their products are imported.. A depreciation of the Kwacha against the US dollar therefore causes a problem to this industry as it uses the US dollar as a medium of exchange(Shula, 2015). It is therefore necessary for the research to be carried out to explore and determine the extent to which the depreciation of the Kwacha affects local costs and profitability of their businesses.

1.2. Research Objectives

- To establish the effects that the Zambian kwacha depreciation against the US dollar had on SME's business decisions making.
- To understand the extent to which depreciation of the Kwacha affects the SMEs financial performance and position.
- To recommend copying strategies employed to avert the effects depreciation of the Zambian Kwacha against the US dollar.

2. Literature review

The chapter reviews literature on the effect of the depreciation of the Zambian Kwacha against the US Dollar on SMEs in Zambia. Kumar, (2005) explained the importance of doing a literature review that brings clarity and focuses on the research problem, as it helps the researcher to understand the subject area better, thus helps to conceptualize the research problem clearly and precisely.

2.1. The effects of currency depreciation following currency devaluation

Currency depreciation and devaluation are related concepts but differ in terms of mechanisms and causes. Currency depreciation refers to a fall in the value of a currency in a floating exchange rate system due to market forces, while

devaluation occurs when a government deliberately reduces the value of its currency in a fixed exchange rate system (Krugman & Obstfeld, 2018). Both actions lead to a decline in the currency's purchasing power and have wide-ranging effects on an economy. One of the immediate effects of currency depreciation following devaluation is higher inflation. Imported goods become more expensive as the currency loses value, contributing to cost-push inflation (Dornbusch, 1987). This can erode consumers' purchasing power, leading to a decline in real incomes and aggregate demand in the economy. A study by Acar (2000) found that inflationary pressures in developing economies are significantly influenced by currency depreciation, especially when there is a high dependency on imported goods.

Kushnir (2013) postulates that while there are different definitions of small business enterprises according to context, there have been attempts to come up with a universal conceptualization of SMEs. While there are advantages within the global economic transactions and lending regimes, Kushnir (2013) acknowledges that this marks important purposes of small businesses in different countries. In the same line, Rogerson (2011; 2012), acknowledges that SMEs tend to have strategic objectives for countries, which include economic (job creation, economic growth and international competitiveness), welfare (poverty alleviation) and political (equalizing racial/class distribution of wealth) objectives.

Acar (2000) studied the effects of depreciation on growth in less developed countries (LDCs). A simple macro model was used to analyze the effects of depreciation on real output. Economic growth (GDP) was used as a dependent variable explained by movements in the explanatory variables, namely; real exchange rate, terms of trade, government expenditure and money supply. The results indicated that depreciation created a contractionary effect on output in the first year, whereas it had an expansionary effect in the following year.

Rodrick (2008) provided evidence that depreciation (a high real exchange rate) stimulates economic growth. The study was done on seven countries (China, India, South Korea, Taiwan, Uganda, Tanzania, and Mexico) during 1950-2004. Two categories of explanations were presented focusing on; (a) institutional/contractual weaknesses, and (b) market failures using a formal model. The findings indicated that an increase in real exchange rate causes an increase in output of tradable (relative to non-tradeable) resulting in an increase in growth. His second explanation was that depreciation is a second-best mechanism for alleviating market failures in that, an increase in the real exchange rate causes an increase in output of tradable (relative to non-tradable) which will cause an increase in growth because: information and coordination externalities are rampant in low-income economies and tradable are more subject to market imperfections.

Aslam (2016) tested the impact of exchange rate on economic growth in Sri Lanka using annual time series data from 1970 to 2015. The variables used included gross domestic product, exchange rate, inflation and interest rates. A multiple regression model using the ordinary least square method was employed and the results indicated that exchange rate positively impacted on economic growth in Sri lanka.

There are various studies globally and in Zambia which has attempted to study the effect of depreciation of the currency on businesses. For instance, Lionel et al., (2017) did a study investigating the dynamics between the exchange rate and consumer price inflation in Zambia. The findings suggested that the pass through of exchange rates to consumer prices depended greatly on the shock that originally caused the exchange rate to fluctuate. Shahzad (2018) analyzed the effects of currency depreciation on CO2 emissions and energy consumption in Pakistan between the years 1995 and 2018. The findings of this study suggested that currency depreciation stimulated economic development by increasing energy use and carbon dioxide emissions.

2.2. The effects that the Zambian kwacha depreciation against the US dollar had on SME's making business decisions in Lusaka

The exchange rate system in Zambia was broadly characterized by both fixed and floating exchange rate policies. From independence in 1964 to 1982, and from 1987 to 1991, the monetary authorities adopted a fixed exchange-rate regime. This regime was sustained by an occasional adjustment of the exchange-rate system and other measures such as the issuing of import licenses instead of official interventions in the exchange-rate market (Kalyalya 2007).

Lungu D and Kabubi M (2017) assessed the economic impact that the depreciation of the Zambian currency has had on the Micro and Small-Scale enterprises (SMEs) in the Lusaka central business district (CBD). The study found that negative impact on SMEs was greater in the short term than in the medium or long term. It was noted that there might be long term consequences of businesses being forced to adjust to a sharp decline in the value of the kwacha. Examples included the reduction in sales, Inflation, cost of raw materials and imported products, increased transportation costs, and job cuts by the direct assessment.

The Kwacha's depreciation against the US dollar has increased the cost of imported goods and raw materials for SMEs in Lusaka, leading to higher production costs. Many SMEs rely on imported inputs for manufacturing or retail goods, meaning that a weaker Kwacha results in higher prices for essential goods (Mwale & Chanda, 2018). Consequently, SMEs are forced to either absorb the costs or pass them on to consumers, reducing their competitiveness in the domestic market (Ndulo et al, 2023).

The increase in input costs from a depreciating Kwacha directly impacts the profit margins of SMEs. Those unable to adjust their pricing strategy quickly or effectively may experience eroded profits, while others might overcompensate, pricing themselves out of the market (Mutale& Munthali, 2019). The fluctuating exchange rates create an unstable business environment, making it difficult for SMEs to set sustainable prices for their goods and services (Lungu & Kabubi, 2017).

Access to credit is crucial for SMEs to manage short-term financial needs, especially during times of economic instability. However, the depreciation of the Kwacha has exacerbated the cost of borrowing for SMEs, particularly those who rely on foreign loans or credit lines. Many SMEs have reported higher interest rates on foreign currency-denominated loans due to the exchange rate risk (Chisanga & Mwale, 2022). This has restricted their ability to invest in new opportunities or expand their operations (Mumba & Phiri, 2018).

Financial planning becomes increasingly difficult when the domestic currency is in decline. SMEs in Lusaka struggle to predict future costs and revenues due to unpredictable exchange rates (Mutale & Banda, 2023). Inaccurate forecasts lead to cash flow problems and ineffective budget allocation, further constraining the decision-making process (Munthali & Mwila, 2018). Without reliable financial projections, SMEs are often hesitant to pursue growth opportunities or invest in innovation (Munthali & Mwila , 2018).

Many SMEs in Lusaka depend on international suppliers for raw materials or finished goods. The depreciation of the Kwacha has disrupted supply chains, with many businesses facing delays or reduced access to vital inputs. Importers must deal with higher transaction costs and shipping fees due to the weak Kwacha, which reduces the reliability of their supply chains and forces SMEs to adjust procurement strategies (Lungu & Kabubi , 2017)

While Kwacha depreciation may benefit export-oriented SMEs by making their products cheaper on the international market, the benefits are often offset by increased operational costs in Zambia (Ndulo et al, 2023). Exporters face higher prices for imported inputs, fuel, and other necessities, which erode the price advantages that a weaker Kwacha provides. As a result, SMEs that rely on export markets may struggle to balance the benefits and challenges of currency depreciation (Mwale & Chanda, 2018).

In response to the volatility of the Kwacha, some SMEs have adopted basic risk mitigation strategies, such as holding foreign currency accounts or negotiating longer payment terms with suppliers (Kabwe & Zulu, 2021). However, these practices are not universally adopted due to limited financial literacy and resources among many SME owners. Additionally, the cost of hedging currency risks may be prohibitive for smaller businesses, leaving them exposed to further depreciation of the Kwacha (Chisanga & Mwale, 2022).

The uncertainty surrounding monetary and fiscal policies in Zambia during times of currency depreciation further affects SME decision-making. Fluctuating exchange rates, inflationary pressures, and unclear government responses create an environment where SMEs are reluctant to invest or expand (Mutale & Munthali, 2019). Without a stable policy framework, SMEs often adopt conservative strategies, such as reducing operational expenses or delaying long-term investments (Sichinga, 2019).

2.3. The extent to which depreciation of the Kwacha affects the SMEs financial performance and position

The depreciation of a nation's currency, particularly in developing economies, can have profound effects on businesses. Small and Medium Enterprises (SMEs), which are crucial contributors to economic development, often face financial volatility in such environments. The Zambian Kwacha, for instance, has experienced notable depreciation in recent years, affecting SMEs' financial performance and overall position. According to (Lungu & Kabubi, 2017), exchange rate volatility has a direct impact on the operational costs and profitability of SMEs, making it essential to explore these relationships in greater detail.

Currency depreciation, such as that of the Kwacha, often results in higher import costs for goods and raw materials, increasing operational expenses for SMEs. Kazembe (2020) argues that SMEs reliant on imported materials or foreign technology experience shrinking profit margins due to the increased cost of inputs. This can lead to reduced

competitiveness and profitability, especially in the manufacturing and retail sectors. Furthermore, SMEs that do not have hedging mechanisms or forward contracts are particularly vulnerable to these cost increases (Kabwe & Zulu, 2021).

The relationship between currency depreciation and profitability is a critical aspect of financial performance. When the Kwacha depreciates, SMEs that import raw materials or finished goods face higher procurement costs, directly cutting into their profit margins. Sichinga (2019) highlight that SMEs in Zambia report lower profit margins and in some cases, operational losses, when the Kwacha weakens, especially in industries like textiles, electronics, and machinery. This forces many SMEs to either raise their prices or absorb the losses, both of which negatively affect their financial performance.

Access to financing is an essential element of SME financial health, and currency depreciation can impact credit availability and risk. Many SMEs in Zambia are dependent on loans from local and international financial institutions. Sichinga(2020) argue that a depreciating Kwacha makes it more expensive for SMEs to service foreign-denominated loans, increasing the likelihood of loan defaults. Additionally, banks may tighten lending conditions, requiring higher interest rates or more collateral, which further limits SMEs' access to financing (Kalaba, 2021).

According to Kalaba (2021), SMEs in Zambia face significant cost-push inflation due to the increased price of imported goods and services. This inflationary pressure forces businesses to increase their prices, which can reduce demand for their products or services. Chilufya et al. (2019) found that in periods of high inflation following Kwacha depreciation, SMEs experience a marked reduction in sales, making it difficult to maintain financial stability. The long-term financial position of SMEs can be jeopardized by prolonged currency depreciation. According to Mulenga et al (2021), sustained periods of Kwacha weakness can erode the capital base of SMEs, leading to a deterioration of their balance sheets. This depreciation can reduce the value of assets, impair profitability, and lead to increased borrowing costs, all of which negatively affect the long-term sustainability of these enterprises. SMEs in sectors that are capital-intensive, such as manufacturing and construction, are particularly at risk (Chisanga & Mwale, 2022).

In their 2017 study, Lungu and Kabubi looked at the effects of kwacha depreciation on small and micro businesses (SMEs) using SMEs in Lusaka's CBD as a case study. In this study, the economic effects of the depreciation of the Zambian kwacha on small and medium-sized businesses (MSMEs) in the CBD of Lusaka were evaluated. The study examined the effects of the depreciation on SMEs' enterprises between 2012 and 2017. The cost attributable to the loss of value of the kwacha was calculated using direct loss as part of the direct assessment approach methodology. The cost of the kwacha's depreciation is estimated using the direct assessment approach, a methodology for economic appraisal.

2.4. Coping strategies employed to avert the effects currency depreciation by businesses in practice.

Currency depreciation has significant implications for businesses, especially those involved in international trade, as it affects profitability, costs, and overall financial stability. To mitigate the adverse effects of currency depreciation, businesses employ a range of coping strategies. These strategies are grounded in financial management theories and empirical studies on currency risks. According to Dornbusch(1976), the pass-through effects of exchange rates are often incomplete, which allows businesses to adjust their pricing strategies to offset currency depreciation. Moreover, Krugman (1987) argues that firms with market power in international markets can adjust export prices in response to exchange rate changes, thereby protecting their profit margins.

One common strategy is currency hedging, which involves using financial instruments such as futures, forwards, options, and swaps to lock in exchange rates for future transactions. This allows businesses to shield themselves from volatile exchange rate movements. Giddy and Dufey (1992) suggest that currency hedging is particularly effective for multinational corporations that engage in significant cross-border transactions. The hedging process helps to stabilize cash flows and minimize potential losses from fluctuating exchange rates. Studies by Allayannis and Weston (2001) also indicate that firms with more extensive hedging strategies experience lower levels of exchange rate risk and are more resilient during periods of currency volatility.

Another strategy is operational hedging, where firms diversify their production and sourcing across different countries. By shifting operations to countries with more stable currencies or where costs are lower, businesses can reduce their exposure to currency depreciation. Froot, Scharfstein, and Stein (1993)highlight that operational hedging complements financial hedging by addressing the operational risks associated with currency fluctuations. This strategy not only helps in mitigating financial losses but also offers flexibility in responding to changes in both currency values and global market conditions.

Pricing adjustments are also a crucial coping strategy for businesses facing currency depreciation. Firms may increase prices in foreign markets to compensate for the reduced value of their home currency. Goldberg and Knetter (1997) note that export prices are often adjusted in response to exchange rate changes, with the degree of price pass-through varying by industry and market structure. Additionally, businesses may also shift their product mix to higher-value goods or services to maintain profitability. This strategy, however, depends on the price elasticity of demand in the foreign market and the competitive landscape.

Reducing operating expenses, renegotiating supplier contracts, and optimizing logistics are some ways firms can lower costs and maintain profitability.

According to the study conducted by Chisala (2008) his paper examines the SMEs performance in Zambia and attempts to identify some practical lessons that Zambia can learn from Southeast Asian countries (with reference to Malaysia) in order to facilitate industrial development through unlocking the potential of its SMEs sector. Malaysia and Zambia were at the same level of economic development as evidenced by similar per capita incomes but Zambia has remained behind economically and its manufacturing sector has stagnated as if both countries did not have similar initial endowments. It therefore, becomes imperative that Zambia learns from such countries on how they managed to take-off economically with a focus on SME development. Training (education), research & development, market availability and technological advancement through establishment of industrial linkages coupled with cluster formation were some of the outstanding strategies identified that Zambia could use as a potential to unlock its SMEs potential as it strives to meet the UN MDGs in particular halving its poverty levels by 2015 and also realizing its vision of becoming a middle income earner by 2030.

This study provided information on the struggles of SMEs in Zambia and how they are not supported by policies in place. However, the research had gaps in that it did not offer solutions to handle delayed payments to SMEs. Furthermore the SMEs in distress brought about by delayed payments were not offered any solutions to overcome financial stress. According to another study by Nuwagaba (2015) on SMEs in Zambia, states that it is imperative for a country to make relevant and business friendly legislation that would enable SMEs growth in the country. They contribute greatly in jobs creation and GDP.

3. Theoretical framework

The theoretical outline for this study was anchored on the Comparative Advantage Theory, purchasing power parity theory and interest rate parity theory.

3.1. Comparative Advantage Theory

The comparative advantage theory by David Ricardo assumes the existence of two countries, two commodities and one factor of production. The theory states that, a country exports the commodity that has lower comparative advantage and import the commodity whose comparative cost is higher (Usman, 2011).

In the case of Zambia, it is not competitive where export goods are concerned in the international market. This is why Zambia has more imports than it does exports. Many SMEs in Zambia depend on imports for their survival, due to Zambia not having a competitive advantage to producing many products, but due to currency depreciation, the cost of imports has become expensive.

- **Purchasing power parity:** is a theory that explains the relationship between exchange rate movements and the price levels in different countries. When applied to SME profitability, the theory helps to understand how fluctuations in exchange rates, particularly through the impact on import costs, export competitiveness, and inflation, can influence the financial performance of small and medium-sized enterprises (SMEs)(Dornbusch, 1976).

The purchasing power parity theory suggests that currency depreciation can lead to inflation as the cost of imports rises. For SMEs that rely on domestic consumers, this could reduce the purchasing power of consumers, leading to lower demand for goods and services and a potential reduction in profitability (Frenkel, 1976).

- **Interest Rate Parity Theory**: this theory states that the difference in interest rates between two countries is equal to the expected change in exchange rates between their currencies (Fama, 1984). In essence, IRP posits that the opportunity for risk-less arbitrage between countries with different interest rates will be eliminated by exchange rate movements (Fama 1984).

In the context of Small and Medium Enterprises (SMEs), IRP theory provides a framework to understand how exchange rate fluctuations and interest rate differentials between countries affect the firm's profitability. If an SME has foreign-denominated debt or engages in international trade, the changes in exchange rates driven by interest rate differentials can impact their cost of borrowing and profit margins (Fama, 1984).

3.2. Conceptual Framework

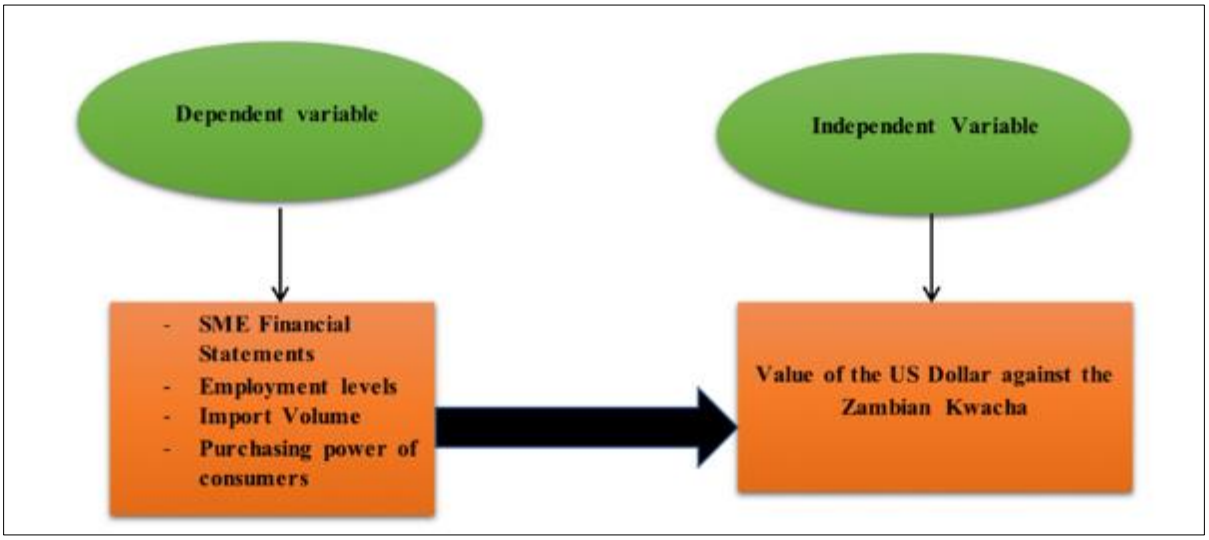

Figure 1 Conceptual framework

4. Methodology

4.1. Research Philosophy

The study used a quantitative research philosophy. The philosophical foundation of this research guided the methodological approach on understanding the relationship between the Kwacha depreciation and SME financial performance.

Positivism is based on the belief that knowledge is derived from observable and measurable phenomena. It emphasizes objectivity and the use of quantitative methods to test hypotheses and establish causal relationships. This research philosophy is often applied when a researcher aims to quantify relationships between variables, such as the financial performance of SMEs and the depreciation of the Kwacha (Saunders & Thornhill, 2019).

The focus on objective financial performance metrics such as profitability, costs and revenue fits well with positivism's emphasis on quantifiable data. Positivism allows for statistical methods such as regression analysis to explore the relationship between the depreciating currency and SME financial outcomes (Neuman, 2014).

4.2. Research Design

To gain an understanding on the impact of the depreciation of the Zambian Kwacha against the US Dollar on SMEs in Zambia, the researcher collected data from the profit or loss statement of businesses. It also covered the loss of employees and statues of their financial positions following the continued depreciation of the Kwacha. Therefore, this study employed a descriptive research design.

4.3. Sample size

The sample size is a collection of items from the population or a subset of a group of interest that is studied in research (Macnee & McCabe, 2008). To select the number of workers to be part of the study, the researcher established the total number of business workers were 100. Therefore, the following formula by Cochran, (1963) will be used to come up with the sample size for workers.

$$\text{The formula:} n = \frac{N}{1 + N\,(e)\,2}$$

Whereas: N= Target population

n=Total sample size

e = Desired margin error

Respondents' sample size for business workers

N=100 desired margin error (0.05)

n = 100/1+100(0.05) ^{2} = **80 business workers**

In the study, out of the 100 business personnel as the population size, 80 participants were sampled using the formula above; this is because of limited resources and time for the researcher to collect data from a sample size bigger than the one used.

5. Research Findings and Discussions

In this study, 80 participants from Kalingalinga Area were sampled giving a total of 80 questionnaires that were distributed. A total of 70 (88%) were fully completed and returned of which 10 (13%) were not returned. This gave a response rate of 88% as illustrated in Table 1 below.

Table 1 Questionnaire Return Rate

Respondent category	Sampled	Returned	Percentage
Participants	80	70	88%
Total	**80**	**70**	**88%**

Source: Formulated by Author (2024)

5.1. Demographic Characteristics of the Respondents

To analyses the demographical data of this study, frequency tables and charts were produced using the software program Statistical Package for Social Sciences (SPSS version 20) and it covered information concerning the respondents' education level, and work experience. The background information is necessary for understanding the dynamics of respondents.

5.1.1. Gender Distribution

Table 2 Gender of respondents

Gender of respondents		
Gender	**Frequency**	**Percentage**
Male	27	39%
Female	43	53%
Total	**70**	**100%**

Source: Formulated by Author (2024)

To assess the proportion of male and female respondents, the frequency for gender was calculated, Tables 2 gives a summary of the findings.

The data in Table 2 above shows 43 (53%) were females compared to male 27 (39%) who took part in the study. This shows that the majority of the respondents were females.

5.2. Form of SME Businesses

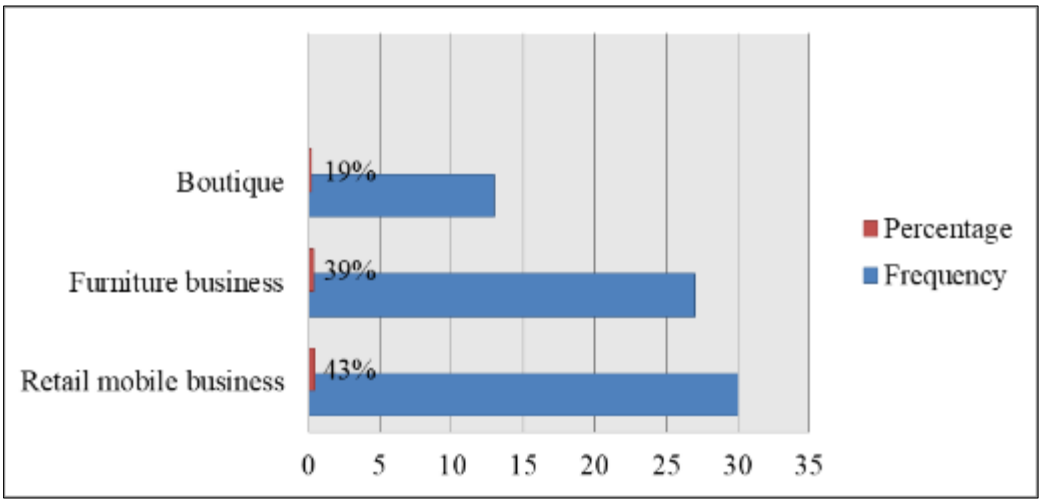

Figure 2 Forms of businesses in the study

Participants were asked to state their business and the study revealed that 13 (19%) were running boutiques, 27 (39%) were running furniture business and 30 (43%) were running retail mobile money. Based on the study findings, it can be concluded that retail mobile money operations had the highest representation among the participants, followed by furniture businesses, with boutiques being the least common type of business in this particular group.

5.2.1. Cross border trade

In the study conducted on participants regarding their involvement in cross-border trade, it was found that 13 individuals (19%) responded "No" when asked if they engage in cross-border trade, while 57 individuals (81%) answered "Yes." This data provides insights into the prevalence of cross-border trade among the participants surveyed.

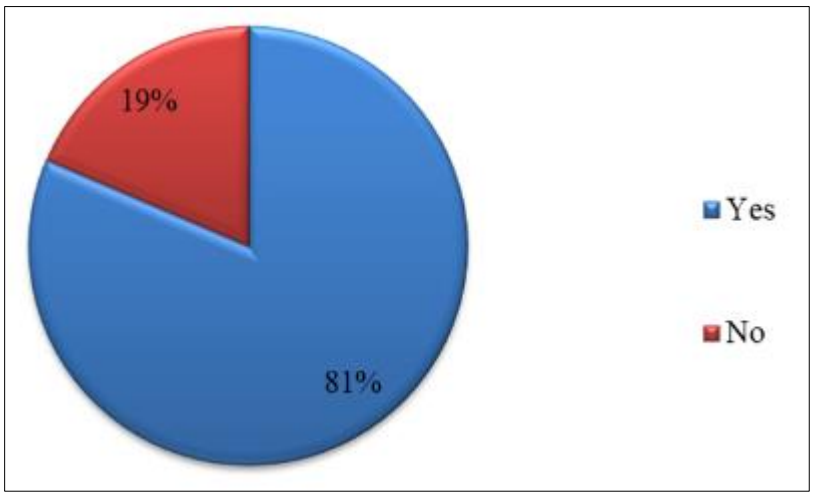

Figure 3 Cross Border Trade Cross border trade

5.3. Effects that the Zambian kwacha depreciation against the US dollar had on SME's making business decisions in Lusaka.

The data reveals the significant impacts of the Zambian kwacha's depreciation against the US dollar on SMEs' business decisions. A notable 20 (29%) of respondents indicated that access to foreign capital was heavily influenced, highlighting the challenges SMEs face in securing funding amidst currency fluctuations. Increased import costs affected 16 (23%) of the respondents, further emphasizing the financial strain on businesses reliant on imported goods. Financial planning and budgeting were impacted for 13 (19%), demonstrating a shift in how SMEs manage their finances in response to changing exchange rates. Price adjustments and inflation were acknowledged by 12 (17%), indicating the broader economic implications of currency depreciation. Lastly, 9 (13%) of SMEs reevaluated their

market strategies, suggesting that businesses are adapting to the new economic environment to remain competitive. Overall, these findings illustrate the multifaceted challenges SMEs in Zambia encounter due to currency depreciation, necessitating strategic adaptations in their operations

Table 3 Effects that the Zambian kwacha depreciation against the US dollar had on SME's making business decisions

Variables	**Effects that the Zambian kwacha depreciation against the US dollar had on SME's making business decisions**	
	Frequency	**Percentage**
Price adjustments	12	17%
Financial planning and budgeting	13	19%
Access to foreign capital	20	29%
Market strategy reevaluation	9	13%
Increased import costs	16	23%
Total	70	100%

Source: Formulated by Author (2024)

5.4. The extent to which depreciation of the Kwacha affects the SMEs financial performance and position.

Participants were asked to what extent to which depreciation of the Kwacha affects the SMEs financial performance and position and the study discovered that 24 (34%) said decrease profit margins, 20 (29%) said increase operating cost, 16 (23%) said reduced purchasing power and 10 (14%) said inflationary pressure. Overall, these responses reflect various negative impacts on SMEs resulting from the depreciation of the Zambian Kwacha against the US dollar, affecting different aspects of their operations and financial performance.

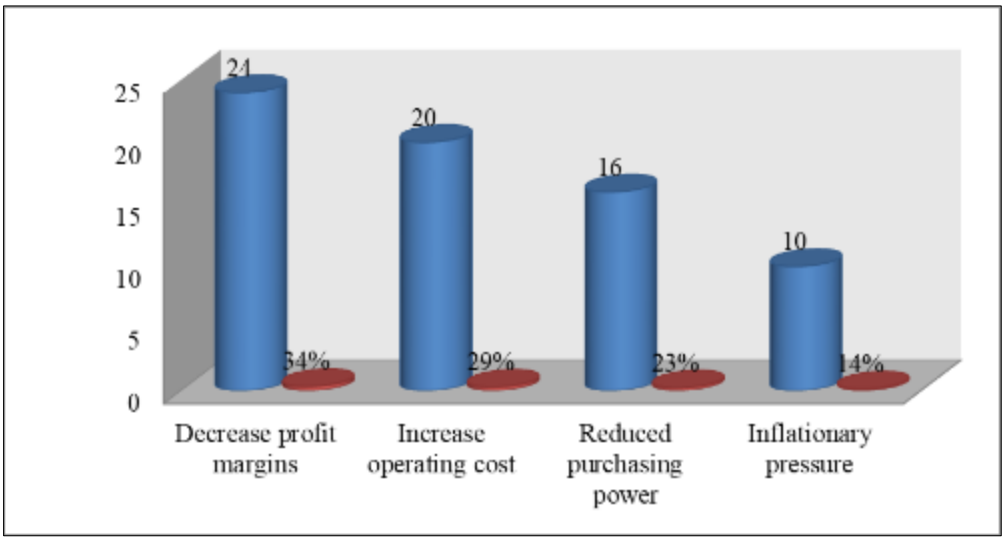

Figure 4 The extent to which depreciation of the Kwacha affects the SMEs financial performance and position Effects of the Zambian Kwacha depreciation against the US dollar on SMEs' business

5.5. How SMEs areas of operations are affected by depreciation of the Zambian Kwacha against the US dollar?

Participants were asked what are the areas of operations affected by depreciation of the Zambian Kwacha against the US dollar and how have they been affected? and the study revealed that 13 (19%) said sales revenue has been affected due to reduced imports, leading to lower sales revenue, 18 (26%) said cost of raw materials and imported products have been affected leading to lower commodities to produce and sell, 22 (31%) said the transportation area has been affected leading to a higher amount of expenses going into transportation and 17 (24%) indicated that job cuts and employment stability has been affected leading to lower man labour in the business. Overall, these findings highlight

the multifaceted impact of currency depreciation on SMEs operating in Kalingalinga area, affecting various aspects of their operations from revenue generation to cost management and workforce stability.

Table 4 SMEs areas of operations are affected by depreciation of the Zambian Kwacha against the US dollar?

Variables	**SMEs areas of operations are affected by depreciation of the Zambian Kwacha against the US dollar?**	
	Frequency	**Percentage**
High Sales revenue	13	19%
Higher Cost of raw materials and imported products	18	26%
Higher Transportation costs	22	31%
Reduced man labor due to job cuts and employment stability	17	24%
Total	70	100%

Source: Formulated by Author (2024)

5.6. Reforms are required to avert the effects depreciation of the Zambian Kwacha against the US dollar

Participants were asked what reforms are required to avert the effects depreciation of the Zambian Kwacha against the US dollar and the study established that 12 (17%) said increasing foreign exchange supply, 22 (31%) said enhancing export performance for SMEs, 18 (26%) said boosting economic activities, 10 (14%) said strengthening current account balance for SMEs and 8 (11%) said debt restructuring. The responses from participants indicate a diverse set of perspectives on the reforms necessary to address Zambian Kwacha depreciation. From increasing foreign exchange supply to supporting SME exports, boosting economic activities, strengthening current account balances, and implementing debt restructuring measures, these suggestions collectively underscore the multifaceted approach required to mitigate currency devaluation risks effectively.

Table 5 Policies changes or reforms are required to avert the effects depreciation of the Zambian Kwacha against the US dollar

Variables	**Policies changes or reforms are required to avert the effects depreciation of the Zambian Kwacha against the US dollar**	
	Frequency	**Percentage**
Increase foreign exchange supply	12	17%
Enhance export performance	22	31%
Boost economic activities	18	26%
Strengthen current account balance	10	14%
Debt restructuring	8	11%
Total	70	100%

Source: Formulated by Author (2024)

6. Discussion

The study showed that out of 70 participants', 43 (53%) were females compared to male 27 (39%) who took part in the study. This shows that the majority of the respondents were females. The results showed that out of the 80 participants, 12 (15%) were aged between 15-20 years, 18 (23%) were aged between 21-25 years, 29 (36%) were aged 26-30 years and 21 (26%) were age 31 years and above. Participants were asked to state their highest level of qualifications, out of the total number of participants. 8 (11%) ended at the primary level, 25 (37%) ended at the secondary level and 38 (54%) ended at the tertiary level.

According to the findings of the study, workers had different working experiences, with the majority 27 (39%) having 5-8 years of working experience. The next big share had 1-4 years of working experience forming 20 (29%). The other one had 9-12 years of work experience forming 13 (16%), and the least was 12 years and above had 10 (14%).

Participants were asked to state their business and the study revealed that 13 (19%) were running boutiques, 27 (39%) were running furniture business and 30 (43%) were running retail mobile money. Based on the study findings, it can be concluded that retail mobile money operations had the highest representation among the participants, followed by furniture businesses, with boutiques being the least common type of business in this particular group. In the study conducted on participants regarding their involvement in cross-border trade, it was found that 13 individuals (19%) responded "No" when asked if they engage in cross-border trade, while 57 individuals (81%) answered "Yes." This data provides insights into the prevalence of cross-border trade among the participants surveyed.

6.1. Effects that the Zambian kwacha depreciation against the US dollar had on SME's making business decisions in Lusaka

The data reveals the significant impacts of the Zambian kwacha's depreciation against the US dollar on SMEs' business decisions. A notable 20 (29%) of respondents indicated that access to foreign capital was heavily influenced, highlighting the challenges SMEs face in securing funding amidst currency fluctuations. Increased import costs affected 16 (23%) of the respondents, further emphasizing the financial strain on businesses reliant on imported goods. Financial planning and budgeting were impacted for 13 (19%), demonstrating a shift in how SMEs manage their finances in response to changing exchange rates. Price adjustments and inflation were acknowledged by 12 (17%), indicating the broader economic implications of currency depreciation. Lastly, 9 (13%) of SMEs reevaluated their market strategies, suggesting that businesses are adapting to the new economic environment to remain competitive.

6.2. To understand the extent to which depreciation of the Kwacha affects the SMEs financial performance and position

Participants were asked what is the effect of the Kwacha depreciation against the US dollar on SMEs' business and the study discovered that 24 (34%) said decrease profit margins, 20 (29%) said increase operating cost, 16 (23%) said reduced purchasing power and 10 (14%) said inflationary pressure.Overall, these responses reflect various negative impacts on SMEs resulting from the depreciation of the Zambian Kwacha against the US dollar, affecting different aspects of their operations and financial performance.

The findings of the study have also been demonstrated by other studies of the similar nature, as Lungu and Kabubi (2022), conducted a study that assessed the economic impact of the Zambian currency depreciation on SMEs in Lusaka's CBD between 2012 and 2017. Their research focused on analyzing the short- and medium-term effects of the kwacha's loss of value on micro and small-scale enterprises. They utilized direct assessment methods to estimate the costs attributed to the devaluation of the kwacha, including factors such as reduced sales, inflation, increased transportation costs, and job cuts.

Path (2023) in her study emphasized the relationship between China as a major trading partner of Zambia and its impact on the country's economy. The dependence on imports from China, which are often priced in US dollars, contributed to the pressure on the Zambian kwacha when facing depreciation against the dollar. Graig's insights likely shed light on how external trade dynamics influenced SMEs' ability to cope with currency devaluation.

The above findings are similar to those of Shula (2015) on the perspective challenged the common perception that a strong kwacha equated to a robust economy. By highlighting flaws in this belief, Shula likely discussed how SMEs and businesses in Zambia needed to adapt to currency fluctuations regardless of public sentiment regarding exchange rates. This critical view may have provided valuable insights into how SMEs could navigate challenges posed by currency depreciation.

6.3. How SMEs areas of operations are affected by depreciation of the Zambian Kwacha against the US dollar

Participants were asked what are the areas of operations affected by depreciation of the Zambian Kwacha against the US dollar and How those operations have been affected and the study revealed that 13 (19%) said sales revenue, there has been lower sales revenue due to lower imports, 18 (26%) said cost of raw materials and imported products, the cost of raw materials has gone up leading to lesser goods been produced 22 (31%) said transportation area , there has been higher transportation costs which has led to higher expenses on transport and 17 (24%) indicated that there have been job cuts and employment stability and this has led to the reduced man labor, meaning lesser produced products. Overall, these findings highlight the multifaceted impact of currency depreciation on SMEs operating in

Kalingalinga area, affecting various aspects of their operations from revenue generation to cost management and workforce stability.

Rodrick (2008) provided evidence that depreciation (a high real exchange rate) stimulates economic growth. The study was done on seven countries (China, India, South Korea, Taiwan, Uganda, Tanzania, and Mexico) during 1950-2004. Two categories of explanations were presented focusing on; (a) institutional/contractual weaknesses, and (b) market failures using a formal model. The findings indicated that an increase in real exchange rate causes an increase in output of tradable (relative to non-tradeable) resulting in an increase in growth. His second explanation was that depreciation is a second-best mechanism for alleviating market failures in that, an increase in the real exchange rate causes an increase in output of tradable (relative to non-tradable) which will cause an increase in growth because: information and coordination externalities are rampant in low-income economies and tradable are more subject to market imperfections.

The Foreign Exchange Exposure Theory, Black (1973), discusses the potential effects of currency fluctuations on a company's financial performance. Research investigations in the fields of international finance and accounting can benefit from this idea. Foreign exchange exposure, sometimes referred to as exchange rate exposure, is the possibility that shifts in exchange rates will influence a company's cash flows and earnings. Changes in exchange rates may have a detrimental impact on a sizable number of contractual agreements for multinational firms with several overseas branches. Future changes in the currency rate could influence the company's manufacturing and marketing operations

6.4. Reforms are required to avert the effects depreciation of the Zambian Kwacha against the US dollar

Participants were asked what reforms are required to avert the effects depreciation of the Zambian Kwacha against the US dollar and the study established that 12 (17%) said increasing foreign exchange supply, 22 (31%) said enhancing export performance for SMEs, 18 (26%) said boosting economic activities, 10 (14%) said strengthening current account balance for SMEs and 8 (11%) said debt restructuring. The responses from participants indicate a diverse set of perspectives on the reforms necessary to address Zambian Kwacha depreciation. From increasing foreign exchange supply to supporting SME exports, boosting economic activities, strengthening current account balances, and implementing debt restructuring measures, these suggestions collectively underscore the multifaceted approach required to mitigate currency devaluation risks effectively.

Similar findings have also been reported by the studies of other researchers like Schumpeter (1939) who emphasized the role of entrepreneur, as a prime cause of economic development, being this development achieved through innovation. Therefore, it is evident that SMEs have been considered to be very vital in any society as early as the beginning of the 20th century. Drawing from how important those SMEs are with regards to size by distribution and amount by Gross Domestic Product share one could determine the significance of the problem of delaying payments to SMEs. This pretty much gives an idea of the direction of the effects, if not, otherwise would be.

7. Conclusion

The depreciation of the Zambian kwacha against the US Dollar has had significant implications for small and medium-scale enterprises (SMEs) in Zambia, particularly those in the financial sector. The devaluation of the currency has led to various challenges for SMEs, including increased costs of imported goods and raw materials, inflationary pressures, reduced sales, higher transportation costs, and potential job cuts. These effects have been more pronounced in the short term but may have long-term consequences as businesses adjust to the new economic realities.

The effect of the depreciating kwacha on SMEs in Zambia underscores the importance of effective risk management strategies, diversification of revenue sources, and proactive measures to mitigate currency fluctuations. Financial institutions operating in Zambia need to closely monitor exchange rate movements, hedge their foreign currency exposures where possible, and explore opportunities for expanding into new markets or product lines to reduce reliance on imports.

The first objective was to establish the effects that the Zambian kwacha depreciation against the US dollar had on SME's making business decisions in Kalingalinga area and the study discovered that 20 (29%) of respondents indicated that access to foreign capital was heavily influenced, highlighting the challenges SMEs face in securing funding amidst currency fluctuations. Increased import costs affected 16 (23%) of the respondents, further emphasizing the financial strain on businesses reliant on imported goods. Financial planning and budgeting 67were impacted for 13 (19%), demonstrating a shift in how SMEs manage their finances in response to changing exchange rates. Price adjustments and inflation were acknowledged by 12 (17%), indicating the broader economic implications of currency depreciation.

Lastly, 9 (13%) of SMEs reevaluated their market strategies, suggesting that businesses are adapting to the new economic environment to remain competitive.

The second objective was to understand the extent to which depreciation of the Kwacha affects the SMEs financial performance and position and the study revealed that 13 (19%) said sales revenue, 18 (26%) said cost of raw materials and imported products, 22 (31%) said transportation costs and 17 (24%) indicated that job cuts and employment stability. Overall, these findings highlight the multifaceted impact of currency depreciation on SMEs operating in Kalingalinga area, affecting various aspects of their operations from revenue generation to cost management and workforce stability.

The third objective was to recommend copying strategies employed to avert the effects depreciation of the Zambian Kwacha against the US dollar and the study established that 12 (17%) said increasing foreign exchange supply, 22 (31%) said enhancing export performance for SMEs, 18 (26%) said boosting economic activities, 10 (14%) said strengthening current account balance for SMEs and 8 (11%) said debt restructuring.

Recommendations

- The recommendations of the study were that SMEs needed to reassess their investment plans and prioritize on projects or businesses that are less exposed to currency risks or export oriented.
- The study recommends that SMEs should implement effective hedging strategies to mitigate foreign exchange risks and stabilize cash flows amidst currency depreciation.
- The study also recommends that SMEs should diversify revenue streams and investment portfolios to reduce dependency on a single currency and minimize the impact of Kwacha depreciation.
- SMEs should also focus on cost optimization measures such as streamlining operations, renegotiating contracts, and exploring local sourcing options to offset the effects of increased operational costs.
- SMEs should collaborate with industry associations, government bodies, and regulatory authorities to advocate for supportive policies, incentives, and interventions that address the specific needs of SMEs in the financial sector during periods of currency depreciation.

By implementing these recommendations, SMEs operating within financial institutions can better adapt to the challenges posed by the depreciating Kwacha and strengthen their resilience against economic uncertainties.

LIMITATIONS

- **Scope of the study**: The study focused on the effects of depreciating kwacha on the financial performance of small and medium scale enterprises (SME'S) in kalingalinga area only and no other areas where included. This may not be directly applicable to SMEs in other regions, particularly rural areas, where the economic dynamics may differ.
- **Sample Size and Representation**: Despite using simple random sampling, the sample size may still not fully represent the diversity of SMEs across all sectors. There may be biases in the sample if certain business types (e.g., large or well-established SMEs) are overrepresented or underrepresented (Bryman & Bell, 2015).
- **Respondent Bias:** SMEs' owners or managers may have subjective views on the impact of the Kwacha depreciation, especially if they have strong opinions or personal interests that influence how they perceive the effects. They may also overestimate or underestimate the impact based on their personal experiences or business strategies, leading to biased results (Neuman, 2014)

Compliance with ethical standards

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Statement of ethical approval

For the purpose of this study ethical clearance was obtained form the university of Zambia Directorate of Research, Innovation and Development (DRID). All other ethical standards appropriate for this kind of research where followed.

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