

# MSME Finance in Malawi – Status and Opportunities for Financial Institutions

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## Key Points:

1. *MSMEs contribute to 35% of the value added and 63% of employment in Malawi.*
2. *Malawian financial sector is still constrained by lack of adequate financial services, which in turn handicaps the growth of the MSMEs in the country.*
3. *To adequately support MSMEs, financial institutions need to enhance efficiency and improve turn around time, relax collateral requirements, connect effectively, and offer non financial services.*

## Introduction<sup>1</sup>

Malawi, a country in sub-Saharan Africa, has a population of 16.7 million with an annual growth rate of 3.1%. Approximately 85% of Malawi's citizens live in the rural areas. The FinScope Malawi MSME Survey 2012 estimates there are 1 million enterprises employing over 1.1 million people. It is estimated that in terms of value, the MSME sector accounts for 90% of the total number of enterprises and contribute up to 35% per cent of the value added while offering 63% of employment including enterprises in the agricultural sector. MSMEs play a significant role and contribute to the economic growth of the nation.

This note considers MSMEs' access to finance in Malawi and charts a potential roadmap for banks and other financial institutions as they expand and downscale to serve the MSME market. The note is based on our assessment of the Malawian MSME sector, their financial needs and consequent product development opportunities for financial service providers. *MicroSave* conducted research to assess the state of finance to MSMEs in Malawi. The research centred on evaluating three main areas, namely, the current functioning of MSMEs; their role in the economy; and their financial needs. The analysis revealed unique patterns and issues.

The following sections detail the status of MSME finance in Malawi and highlight the areas where banks/FIs can strengthen delivery of finance to tap the opportunities that MSMEs' present.

## Profile of Malawian Enterprises

In total, 54% of MSMEs surveyed are run by men. While men are more likely to run larger businesses, women are more likely to be individual entrepreneurs. MSME entrepreneurs in Malawi are relatively young at an average of 31 years. The household head or the spouse of the household head predominantly own MSMEs. The majority of entrepreneurs have low levels of education (68% primary education, 11% no formal education) and acquired the necessary business skills informally (39% self-taught, 28% through the family).

Many entrepreneurs (46%) spend four to eight hours per day in their business, with 35% spending more than eight hours per day working in or on the business. Only 35% of entrepreneurs indicated that they kept financial records for their businesses, the majority (91%) of whom do so without receiving any assistance. MSME owners face a range of constraints with regards to starting, operating, and growing their businesses, the most significant being the lack of access to finance. In addressing these challenges, the majority of MSME owners address the issues themselves. Most owners were unaware of existing institutional support structures, but relied instead on informal means and sources such as religious and community groups.

## Finance Needs of MSMEs

Malawi's financial sector has limited outreach and is relatively small and concentrated. Banks dominate the financial system, accounting for about 80% of total financial sector assets. Concentration is high, two banks hold slightly more than half of the banking industry's total assets and deposits. The financial sector offers a limited range of financial services and products. While the financial sector has witnessed rapid growth in recent years, supported by innovation, access to financial services remains limited. Only 19% of the population have access to banking services, while a mere 3% use any insurance product apart from the ones offered by the Government on a subsidised basis.

In the 2014 World Bank Ease of Doing Business survey, Malawi's ranking on getting credit slipped from 126<sup>th</sup> to 130<sup>th</sup>. Non-banking financial institutions are emerging, including microfinance and savings institutions, and their importance in the financial system is likely to grow. Financial intermediation is characterised by high lending rates resulting from the government's tight monetary policy and weak competition among banks. High lending rates not only pose a risk to loan portfolio quality, but have also compounded the problem of access to credit, especially for smaller borrowers.

<sup>1</sup>Statistics source: World Bank 2013, Malawi Government Reports 2015.

Our sample of respondents constituted those who have been successful and unsuccessful in accessing credit, along with potential future borrowers. A total of 51% of respondents had accessed credit while 49% had not. Those who were unable to access credit despite trying had issues such as inadequate collateral, poor repayment history, low cash flows, multi-banking and over-indebtedness. For those who have been successful they have registered title deeds, have a good repayment history, use group guarantees, and have good cash flows that reflect ability to repay and good character.

The groups sampled pointed out that the mandatory loan savings, interest rate, turn-around time on loan processing and inability to graduate to individual borrowing as the main factors inhibiting them from accessing financial services. Individual borrowing would enable clients to access relatively bigger loans but the collateral requirement is a challenge to many.

The majority of respondents were unaware about any non-financial support services available. Those who had knowledge on these services were mainly respondents who were members of group lending and thus recipients of trainings conducted by the group loan officers. In spite of this, the respondents are interested in non-financial support especially in trainings. A total of 34% of respondents stated their interest in business management training since many SME businesses owners have insufficient skills and knowledge to take their businesses to the next level especially the case for illiterate clients.

Networking with business people is an attractive feature for 23% of the respondents expressing interest in sharing ideas with business owners in the same sector; and especially within individual microcredit clients. Record keeping is an attractive option for 22% of the respondents particularly the illiterate. Business development is the least attractive option garnering a mere 2% of the respondents' preferences on support services. Generally, most respondents expressed the need for training to better manage their businesses.

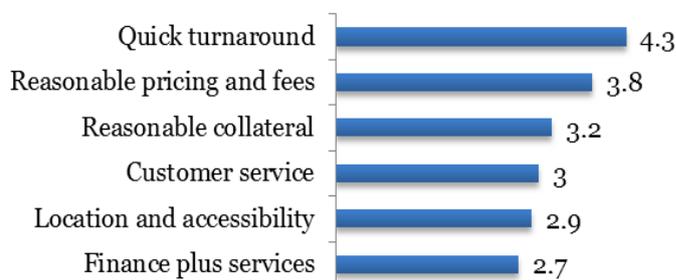
### Access to Finance for Malawian Enterprises

Though many banks and financial institutions are on the horizon for lending to micro and small enterprises sector, the sector is still constrained by lack of adequate financial services, which in-turn handicaps their growth.

Entrepreneurs surveyed were asked to provide suggestions to financial institutions in Malawi so that products and services can better meet the needs of MSMEs. Financial product attributes that Malawian enterprises value the most include as follows:

### Drivers of Choice

(rating on a scale of 1-5 where 5 is most important and 1 is least)



### Way Forward for Banks and FIs

Considering the huge number of MSMEs and the potential market/profitability it presents, banks and financial institutions must re-strategise their approach to cater to this segment. Some of the quick wins may be:

- **Reduced Turn-Around Time:** Consider review of the loan appraisal phase to minimise redundancies and bottlenecks that lead to delays in loan processing. For instance, consider adopting flexible KYC requirements for repeat clients with good loan repayment history.
- **Relaxed Collateral Requirements:** Revision of the policy on collateral requirements will be useful to achieve growth in SME portfolio taking into account the bank risk appetite and best industry practices. In other markets, financial institutions use mixed securities to accommodate those with inadequate collaterals.
- **Communicate Effectively with Consumers:** The bank can adopt various communication channels to pass information to customers such as informing customers about system downtimes, giving feedback on loan status, new products, delivery channels, informing customers about the intent to reduce the loan amount applied, among others.
- **Promote Channels:** Customers to be encouraged and informed on the available alternative channels in order to decongest the banking halls.
- **Non-Financial Support Services:** There is a need to offer training to customers on business management, record keeping and also supporting them to network with other business people for information sharing.