



SME Financing Role in Developing Countries: Evidence from SMES in Malawi.

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ABSTRACT

This paper aims at determining the impact of Small and Medium Enterprises (SME) financing in developing business environment and economic growth in Malawi. The study examines the connection between the business environment, GDP growth, and financing choices in Malawi. Statistical data will be applied. Ministry of Finance data, Limestone analytics report, and Finscope study data were analyzed. The result of the study shows that giving SMEs access to finance has a positive impact on the business environment and economic growth. However, some other factors such as the formalization of SMEs, training, and government initiatives to increase manufacturing firms have to be considered.

Introduction

Small and Medium Enterprises are considered the major contributor to financial activity in many nations including least developed and developing nations. They provide jobs to a large proportion of the local communities yet they still face challenges of financing (Huang et al. 2021b; Van 2019) which are attributed to a lack of Government regulatory arrangements. SMEs are an important part of the ecosystem and they provide over 90% of the total workforce yet only 7% access bank credit (FINTECH, 2021). Malawi's SME sector represents a large proportion of its total GDP about 40% (Limestone analytics report 2021). In recent years, more businesses have emerged and more have not progressed while some have managed to progress. There are challenges that SMEs face in Malawi and the major ones include lack of financing, lack of production space, and lack of market for the products. Many financing institutions are assisting Small and Media Enterprises (SMEs) by providing loans to boost businesses. Some have benefited from the financing they get while in some, the financing has brought more problems than they were before accessing financial assistance. The study by Zidana (2015) on SME financing and economic growth in Malawi with a focus on the impact between 1981 and 2014 concluded that widening access to finance only has not positively impacted the growth of SMEs in Malawi. Finscop (2021) study concluded that increasing SME financing would grow the economy and has a positive impact on employment. The study further highlighted that demand for SME financing is weak as many SMEs are not prepared to access finance from financial institutions. There has been no improvement in access to formal finance since 2011 standing at 11%.

According to the studies above, there are contradicting views on SME financing's role in economic growth, hence this study seeks to get major insight as to whether SME financing has a role in economic growth. The study also extends to gaining insight into SME financing's role in developing the business environment. The study is very important as it will assist in scaling up access to finance in Malawi by looking at the key pillars which are economic enablers, governance, financial infrastructure, economic competition, and business environment.

LITERATURE REVIEW

Upheaval of economic systems is one of the challenges facing SME growth according to a study on role of Fintech in circular economy practices to improve sustainability performance (saddik et al. 2023). Over the last years, global SME surveys have begun to reflect additional data on the banking industry. To demonstrate this, Thai (2019) utilized the World Bank Enterprise Survey (WBES) from 2002 to 2010, competitive indicators for non-structural banks. Its results are similar for both structural and non-structural variables. Chien et al. (2021c) and Ha and Nguyen (2020) utilized a smaller 33-country sample and found similar findings. Both studies utilize an equivalent binary variable when an SME has access to financing to assess its financial condition. Micro-level barriers to SME funding impact company operations and development (Hoang and Shin 2020; Sadiq and Zhang 2021). The World Bank Economic Survey (WBES) showed that small and medium-sized enterprises are more likely than big to focus on banking in low-level economic and institutional development nations (Cong and Thu 2021; Xiang et al. 2021a). Study by (Li W, Pang W, 2023) noted that financing by commercial banks is inclined to companies with strong solvency and good business base performance. Some studies have suggested the need for product innovation as a contributing factor to better business performance (Rubio-Angres M et al. 2023)

DATA AND METHODOLOGY

Study data

Two secondary sources of data were used in this research: Global Entrepreneurship Monitor (GEM), a group of people who focus on how people start a business around the world. This research gathers data from technical Small and Medium-sized technical owners in Malawi to seek official and informal funding options providing the newest data for the public and Government. Secondly, data was obtained from Finscope 2019 Micro, Small, and Medium Enterprise survey. This is a survey designed to size and scope Micro, Small, and Medium Enterprises (MSME) while focusing on the levels of financial access for MSMEs in Malawi. Thirdly data was collected from Malawi priorities- Government services to support MSMEs in Malawi report 2021 by Limestone analytics. The study measured the cost-benefit analysis of Government services to support MSMEs in Malawi.

Variables of study

The research focuses on four financing options available to SMEs namely: 1 series of other financial institutions 2 own saving 3 family members and friends 4 Administration programs, grants, and donations.

The financing options were classified into two namely formal loans and informal loans. Formal financing included public and private banks, registered microloan institutions, and government grants and donations while informal financing consists of own savings, family members, and friends. The research also looks at MSMEs by industry and their turnover rates. It also focuses on the source of start-up capital for MSMEs. The study also analyses the contribution that MSMEs make towards GDP and the business environment.

Study model measurement

The study utilizes percentage analysis and statistical charts in analyzing the data.

Access to appropriate technology, high cost of product development, and lack of efficient marketing methods are fundamental challenges for SMEs to compete in today's global market. Business owners in undeveloped nations like Malawi face various challenges including a shortage of competent staff, inability to reach the international market due to regulations, and scarcity of financial resources to support them.

Results and Discussion

Empirical outcomes

In Malawi, many SMEs are in wholesale and retail contributing 73.7% of average turnover seconded by manufacturing with 9.4% of average turnover (Finscope, 2019). Table 1 shows MSMEs by industry and turnover rates in Malawi.

Table 1: MSMEs by industry and turnover rates in Malawi

INDUSTRY	TOTAL NUMBER OF MSMES	PERCENTAGE SHARE OF AVERAGE TURNOVER	TOTAL ANNUAL TURNOVER IN (\$)
Wholesale/ retail	787,756	73.7%	11,656,776,122
Agriculture/ farming	18,888	6.1%	967,085,553
Community & household	51,181	4.4%	699,737,961
Manufacturing	42,897	9.4%	1,485,163,872
Natural resources & mining	37,931	1.5%	230,021,441
Agro-processing	15,764	0.06%	88,414,218
Business services	9,848	2.3%	355,901,718
Tourism	4,392	1.6%	254,821,984
construction	3,010	0.05%	71,549.734

Source: fin scope, 2019

SMEs have a critical role in Malawi's economy. Their ability to create employment of nearly 2 Million people (1, 825,219) when combined part-time and seasonal employees and entrepreneurs. In addition, the sector generated approximately USD 15.8 billion in revenue and about USD 6.8 billion in profits in 2019. This would equate to an additional 40% of the estimated GDP of USD 8.1 billion as estimated by the Ministry of Finance in 2019. Many informal SMEs are operating in Malawi contributing about USD 3.2 billion of the USD 6.8 billion in profits contributed by overall SMEs. The registered business contributed USD3.6 billion representing 53% of MSME contribution towards GDP. There is only 125 business which is registered. The 47% contribution of informal MSMEs is from over 89% of total MSMEs in Malawi. Figure 1 shows the reasons why most SMEs are not registered. (Finscope, 2019)

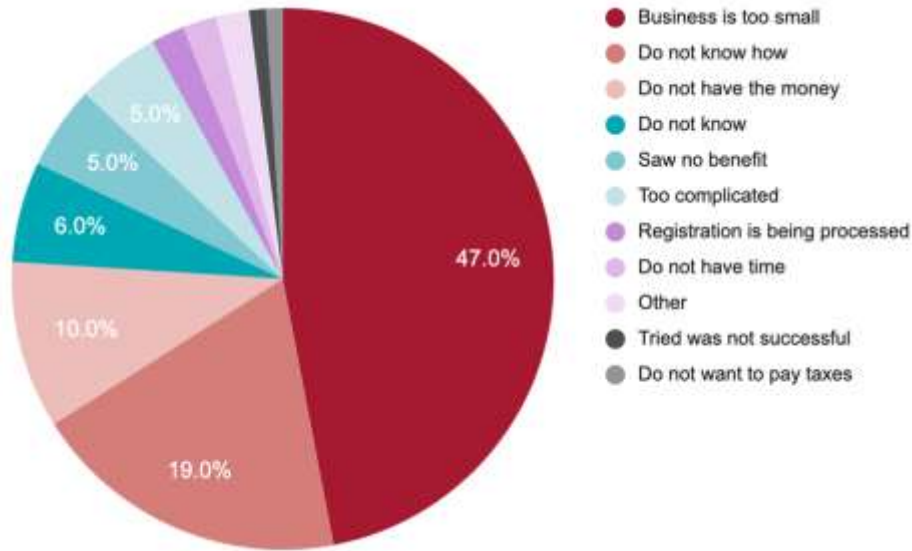
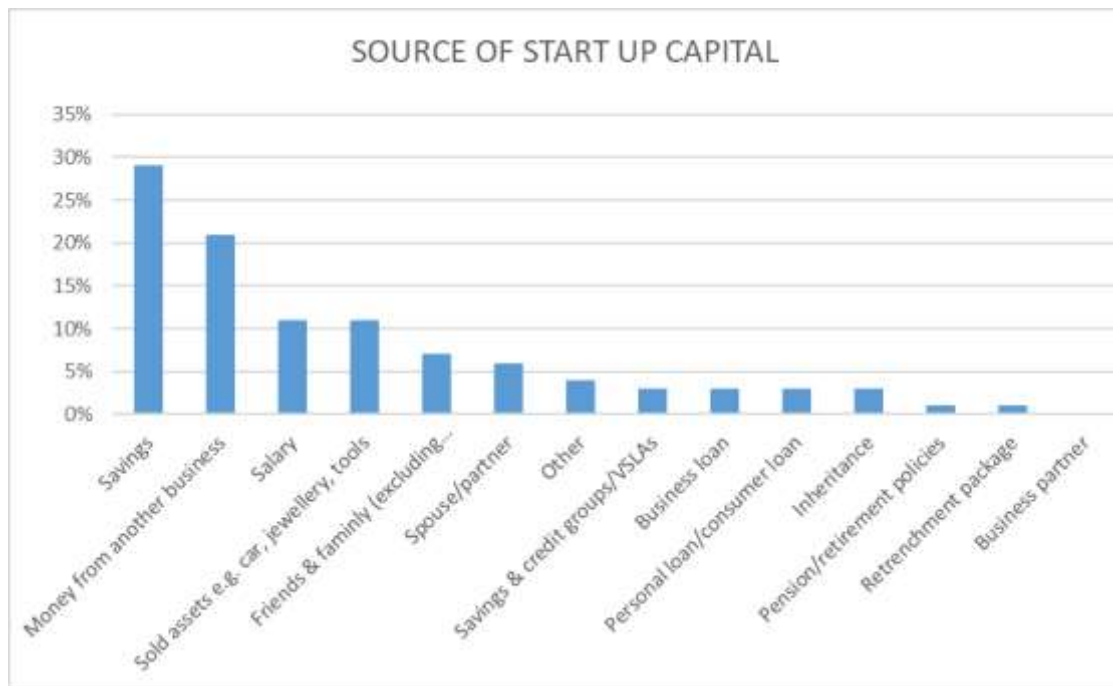


Figure 1: firm's informality reasons

Many MSMEs are labeled as sick units due to the challenges that they face. Many SMEs attribute their challenges to a lack of formal financing for both start-up businesses and existing businesses. Figure 2 shows the percentage source of start-up capital.



Source: Finscope, 2019

Discussion

The results show that many SMEs are informal (not registered or have no trading license). Informal SMEs contribute to GDP though they are not fully utilized. They would contribute more if they were registered to gain recognition and to be able to access finance through recognized and well-established microfinance institutions and public and private finance companies. i.e. Banks. Formal loan providers offer loans with fair interest rates as compared to informal loan providers. The Government should therefore sensitize people on how to register businesses and the importance of registering a business. This will increase the uptake of MSMEs registration in Malawi which in turn will increase the chances of MSMEs' access to formal finance.

The results show that many SMEs are started using their savings and money from another business with little about 11% accessing loans from established finance companies. Businesses starting and relying on their savings only have minimal chances of growing due to limited capital. This has resulted in

many businesses falling out and not being able to face competition with big firms on the market. Limited capital has also contributed to many SMEs engaging in wholesale/ retail which have little profit margin as compared to manufacturing which has a high-profit margin and allows for more exports. This has resulted in the country (Malawi) being more dependent on imports. Only 2% of MSMEs export their products while 6% import some of their raw materials and this already shows a trade imbalance (Finscope, 2019). A high import rate has a detrimental effect on the economy of the country, especially in developing countries like Malawi. Financial institutions should have platforms where they can disseminate information about their credit facilities. They can also train MSMEs in financial management. This will close the knowledge gap that exists among MSMEs and will enhance them to get formal financing to sustain their business.

Many SMEs start business out of desperation rather than an opportunity that they see. This also contributes to unstable businesses with more proprietors willing to leave the business for employment once an opportunity emerges.

From the results, MSMEs that are registered are the ones that can access loans from formal financing entities and are the ones that are contributing more to GDP with 53% of total MSMEs' contribution towards GDP from only 11% of the MSMEs in Malawi.

Conclusion and policy implications

Overall results show that funding SMEs have an impact on the business environment as many people get employment and on economic growth as witnessed in the GDP. However, the financing of SMEs relies on the formalization of the SMEs which Government has to take an initiative to achieve a high percentage of registered SMEs. The other factor to be considered is training for SMEs to enlighten them about the services that financial institutions are offering. SMEs need to migrate from wholesale/ retail trading to manufacturing to add value to their products. Government should take an initiative to encourage manufacturing, especially agricultural produce which is locally found. This will, in turn, reduce imports and increase exports which will in turn boost the trade balance and economy.

This study had some limitations, the data used is only secondary data. Future studies should use both secondary data and primary data. Future studies should also take into account Government plans on SME funding and the roles that SME associations are doing to enhance the growth of SMEs.

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