# IS THE QUALITY OF FINANCIAL PRODUCTS ATTRIBUTES A CAUSE TO CONSTRAINED CAPITAL ACCESS BY SMEs IN MALAWI?

MASTER OF BUSINESS ADMINISTRATION THESIS

ELUPHY BANDA

BSc (Business Administration) University of Cyprus

A thesis submitted to the Faculty of Commerce, The Malawi Polytechnic, University of Malawi, in partial fulfillment of the requirements for the degree of Master of Business Administration.

UNIVERSITY OF MALAWI

THE POLYTECHNIC

26 JULY 2012

## DECLARATION

I declare that this research report submitted in partial fulfillment of the requirements for the degree of Master of Business Administration (MBA) in the University of Malawi, Faculty of Commerce, is my own unaided work and that it has not been submitted before for any degree or examination in any other institution of higher learning or otherwise.

Where other sources of information were used, it has been acknowledged.

Name of Candidate:_____________________________________________

Signature: ____________________________________________________

Date: ________________________________________________________

## CERTIFICATE OF APPROVAL

We declare that this thesis is from the student's own work and effort. Where she has used other sources of information, it has been acknowledged. This thesis is submitted with our approval.

Signature ________________________ Date ____________________________

BETCHANI M. TCHERENI, MA (Economics) (Lecturer)

FIRST SUPERVISOR

Signature ____________________________ Date ____________________________

CLEMENT THINDWA MBA (Strategic Management) (Lecturer)

SECOND SUPERVISOR

Signature _____________________________ Date _____________________________

E.J. SANKHULANI, PhD (Senior Lecturer)

HEAD OF DEPARTMENT

## DEDICATION

I wish to dedicate this work to my family.  To my: Husband Jeremy; Son Chiyanjano; Daughter Pilirani; Mum Elita; Late Brother Damson; and Late Sister Emily.

## ACKNOWLEDGEMENTS

This study has been made possible due to the support, encouragement, and assistance rendered to me by numerous individuals and institutions. A number of them deserve special acknowledgement.

My first acknowledgement goes to God Almighty for giving me His tender care and good health throughout the period of intensive studies.

Secondly, a sincere thank you goes to my two supervisors: Messrs B. Tchereni and C. Thindwa who worked tirelessly and sometimes under great pressure throughout the period of the research giving guidance and encouragement.

I also would also like to thank all lecturers in the Faculty of Commerce in general and the MBA Programme in particular for their many presentations which contributed to the identification of the research problem and many important areas of the work. Their pieces of advice also encouraged me to work hard throughout the entire study.

To my bosses and workmates at MITC, I say thank you for your understanding. Despite the busy schedules at work, you still managed to give me time to concentrate on my studies.

Last but not least, I wish to thank my fellow students for their contributions to my topic and for their moral support which helped me to focus on the study properly.

## ABSTRACT

The need to accelerate the pace of growth of SMEs in Malawi is of paramount importance for economic growth. This study assesses whether attributes of financial products are a constraint to capital access by SMEs in Malawi. The main objective was to determine if product attributes of SME tailor made products in Malawi are structured in such a way that they create a constraint to access of finance and to analyse the successes of these purposeful funding schemes.

Apart from conducting a detailed literature review, the research collected secondary data from financial institutions and banks which was analyzed using Excel as a tool to compute tables and graphs that were used to arrive at the conclusions.

The results of the analysis show that over 60% of collateral requirements by FIs and banks remained the major impediments for SMEs to access finance in Blantyre. The study concludes that although the other product attributes posed no constraint or insignificant constraint to access credit to SMEs, there are still a number of factors embedded in the attributes which need to be improved to augment access of credit. Therefore, the study recommends to the financial institutions, and the RBM as supervisor of FIs, to consider including affordable collateral products than what is currently emphasized.

## TABLE OF CONTENTS

DECLARATION ........ ii

CERTIFICATE OF APPROVAL ........ iii

DEDICATION ........ iv

ACKNOWLEDGEMENTS ........ v

ABSTRACT ........ vi

LIST OF FIGURE ........ x

LIST OF TABLES ........ xi

LIST OF APPENDICES ........ xii

LIST OF ABBREVIATIONS AND ACRONYMS ........ xiii

CHAPTER ONE ........ 1

INTRODUCTION ........ 1

1.1 BACKGROUND AND INTRODUCTION ........ 1

1.2 RATIONALE OF THE STUDY ........ 2

1.3 RESEARCH QUESTIONS ........ 3

1.4 RESEARCH OBJECTIVES ........ 3

1.5 CONTENTS OVERVIEW ........ 4

1.6 CHAPTER SUMMARY ........ 5

1.7 LIMITATIONS OF THE STUDY ........ 5

CHAPTER TWO ........ 7

LITERATURE REVIEW ........ 7

2.2 RESEARCH GAP ........ 7

2.3 STUDY OF THE MALAWI FINANCIAL SECTOR AND CREDIT CLIMATE ........ 8

2.3.1 Malawi financial system ........ 8

2.3.2 Interest rates and interest rate trajectory ........ 10

2.3.3 Credit climate ........ 12

2.4 THEORETICAL STUDIES ........ 13

**2.5 EMPIRICAL STUDIES** ..... **15**
2.5.1 Managerial competencies as a determinant of debt access ..... 15
2.5.2 Collateral ..... 16
2.5.3 Business information ..... 16
2.5.4 Networking ..... 16
2.5.5 Location ..... 17
**2.6 OTHER RESEARCHERS' STUDIES** ..... **17**
**2.7 SUMMARY** ..... **20**
**CHAPTER THREE** ..... **21**
**METHODOLOGY** ..... **21**
**3.1 INTRODUCTION** ..... **21**
**3.2 RESEARCH PHILOSOPHY, DESIGN AND STRATEGY** ..... **21**
**3.3 DATA COLLECTION** ..... **23**
3.3.1 Classification of Financial Institutions/Banks used in the Study ..... 23
3.3.2 Data Reliability and Validity ..... 24
**3.4 DATA ANALYSIS AND INTERPRETATION** ..... **24**
**3.5 OVERCOMING LIMITATIONS** ..... **25**
**3.6 SUMMARY** ..... **25**
**CHAPTER FOUR** ..... **26**
**RESEARCH RESULTS** ..... **26**
**4.1 DEFINITION OF SME IN MALAWI** ..... **26**
**4.2 ANALYSIS AND FINDINGS** ..... **27**
4.2.1 Attributes of SME Funding Products ..... 27
4.2.2 Financial Institutions Competitiveness ..... 41
4.2.3 Performance of SME Purpose Fund Schemes ..... 47
**4.3 SUMMARY** ..... **62**
**CHAPTER FIVE** ..... **63**
**DISCUSSION OF FINDINGS** ..... **63**
**5.1 INTRODUCTION** ..... **63**

5.1.1 Attributes of SME Funding Products ........ 63
5.1.2 Financial Institutions' Competitiveness ........ 64
5.1.3 Perception of SMEs by Financial Institutions ........ 65
5.1.4 Performance of SME Purpose Fund Schemes ........ 67
**CHAPTER SIX ........ 69**
**CONCLUSIONS AND RECOMMENDATIONS ........ 69**
**6.1 INTRODUCTION ........ 69**
**6.2 CONCLUSIONS ........ 69**
**6.3 RECOMMENDATIONS ........ 71**
6.3.1 SME Product development ........ 71
6.3.2 Relaxing Collateral requirements for SMEs ........ 71
6.3.3 A quest to achieve competitiveness ........ 72
6.3.4 Mitigations by Purpose Schemes ........ 72
6.3.5 Considerations when setting up Purpose Schemes ........ 72
**6.4 AREAS OF FURTHER RESEARCH ........ 72**
**REFERENCES ........ 74**

## LIST OF FIGURES

Figures Pages

Figure 4.1: Analysis of Repayment Terms…………………………..………34

Figure 4.2: Analysis of Collateral Ownership…………………………………. 41

Figure 4.3: Competitiveness Average Score …………………………………. 47

## LIST OF TABLES

Tables Pages

Table 4.1: Classification of SME sector………………………………………….. 27

Table 4.2: Facility Limits for the sampled institutions…………………………….. 28

Table 4.3: Analysis of Facility Limits: Description of Quartiles………………….. 30

Table 4.4: Pricing for the Sampled Institutions……………………………………. 31

Table 4.5: Term of Repayment in months for sampled institutions……………… 33

Table 4.6: Financing sources of SMEs by stage of development………………… 36

Table 4.7: The allowed purposes of facilities for sampled institutions…….……. 37

Table 4.8: Allowed Collateral and coverage for facilities in sampled institutions… 39

## LIST OF APPENDICES

APPENDIX A: ANALYSIS OF FACILITY LIMITS ........ 83

A1: Description of Quartiles ........ 83

A2: Number and Percentage of financial Institutions in each quartile. ........ 84

APPENDIX B: COMPARISON OF FLAT AGAINST REDUCING BALANCE INTEREST CALCULATION ........ 85

APPENDIX C: ANALYSIS OF COLLATERAL ........ 86

C1: Description of Scores ........ 86

C2 Scores for Each Type of Collateral ........ 87

APPENDIX D: EVALUATION OF SAMPLE INSTITUTIONS' COMPETITIVENESS ........ 88

D1: Allocation of Points ........ 88

D2: Description of Quartiles ........ 89

D3: Points Obtained by Each Sampled Institution on Collateral Type and Coverage. ........ 90

D4: Consolidation of Points earned by each Financial Institution ........ 91

## LIST OF ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| BAM | Bankers Association of Malawi |
| CBM | Commercial Bank of Malawi |
| DDC | District development Committee |
| DEMATT | Development of Malawi Traders Trust |
| FI | Financial Institution |
| FINCA | Foundation for International Community Assistance |
| FMB | First Merchant Bank |
| IFC | International Finance Corporation |
| Inde Fund | Investment Development Fund |
| MIRTDC | Malawi Industrial Research and Technology Development Centre |
| MAMN | Malawi Microfinance Network |
| MSB | Malawi Savings Bank |
| MIPA | Malawi Investment Promotion Agency |
| MITC | Malawi Investment and Trade Centre |
| MMF | Malawi Mudzi Fund |
| NABW | National Association of Business Women |
| NGO | Non Governmental Organisation |
| OIBM | Opportunity International Bank of Malawi |
| Qtle | Quartile |
| RBM | Reserve Bank of Malawi |
| SAP | Social Adjustment Program |
| SME | Small and Medium Enterprise |

| | |
|---|---|
| SEDOM | Small Enterprises Development Organisation of Malawi |
| SMEDEF | Small and Medium Enterprise Development Fund |
| SDAP | Structural Dimensions of Adjustments Program |
| SSA | Sub -Saharan Africa |
| TB | Treasury Bill |
| WB | World Bank |
| WWB | Women's World Banking |
| UNDP | United Nations Development Program |
| UNCDF | United Nations Capital Development Fund |
| YEDEP | Youth Enterprise Development Project |

# CHAPTER ONE

## INTRODUCTION

### 1.1 BACKGROUND AND INTRODUCTION

Private sector is the engine for economic growth of most economies which are constituted by large scale corporate as well as Small and Medium Enterprises (SMEs) (Ayyagari, Beck & Demirgüç-Kunt, 2007). Ayyagari et al (2007) assert that SMEs account for close to 60% of the manufacturing in developing economies. Unlike in developed economies, the demography and economy of Malawi dictate that the SME sector must play a key role in the overall output of the economy through production of key raw materials, value addition to raw materials, creation of employment and the generation of export earnings (Ayyagari et al, 2007). However, this is not a case unique to Malawi, as most emerging economies have also relied on SMEs to accelerate the pace of economic growth. A vivid case is that of the Asian tigers, a term which refers to the emerging economies of South East Asia including Malaysia, Indonesia, South Korea and Singapore.

It is therefore expected that there will be deliberate policies by both government and the private sector to allocate more capital resources to this crucial sector to foster economic growth. Due to this expectation, the study of financing of SMEs has been a subject of great interest to policymakers and researchers around the world. However, results from the world at large have shown that SMEs not only perceive access to finance and the cost of credit to be greater obstacles than large firms, but these factors constrain SMEs (affect their performance) more than large firms (Beck, Demirgüç-Kunt & Pería, 2008). Similarly in Malawi previous research has revealed that capital access to this sector of the Malawian economy is rather constrained (Government of Malawi, UNDP & UNCDF, 2007 & Sanches de Carmona, 2007).

Kedrock and Agar (2007), noted that there were a number of financial institutions in Malawi which had restarted targeting the SME sector for financing, mainly due to the

fall in the demand for Treasury Bills by Government but also the fall in the returns on the Treasury Bills which then propelled the SME market as an alternative. It therefore could be speculated that in trying to maintain the high returns which financial institutions were earning on Treasury Bills, the SME market could have been viewed as one with low bargaining power hence the interest by the financial institutions. Not much is known on how these financial institutions have packaged their products to reach out to the SME sector and whether the quality of the product attributes is favourable to foster access of capital by SMEs in Malawi. Further, Kedrock and Agar (2007) make reference to the Malawi Investment Climate report (2005 and 2006) and demonstrate that access to capital still remains the main constraint for the growth of SMEs in Malawi. It may be probable that the packaging of products which is reflected in the product attributes is not favourable, hence still impedes access to banking facilities by SMEs in Malawi despite the deepening of the market as alluded hitherto. This thesis, therefore, investigates whether financial product attributes have a causal effect on constrained capital access by SMEs in Malawi by analyzing the prevailing attributes of products offered by financial institutions to SMEs.

In the introduction, it draws attention to the rationale, justification and significance of the study. Then, research questions and specific objectives that have acted as a guide throughout the study are outlined. In the latter chapters, it gives the definition of SMEs in the Malawian context and the role they play both economically and as a safety net in Malawi. Further, an analysis of the Malawian macroeconomic environment and socioeconomic factors which affect SME entrepreneurs in Malawi are briefly tackled following a comprehensive evaluation of literature. Finally, an outline of the attributes of the tailor-made SME products offered by financial institutions in Malawi is presented and analysed to denote their quality. This analysis formed the discussion point of the study upon which conclusions and recommendations are drawn in the closing chapters.

## 1.2 RATIONALE OF THE STUDY

This study is important as it establishes whether with the inflow of capital provided by lenders, SMEs might still fail if other underlying factors dealing with the packaging of

the funding are unfavourable. There have been numerous studies in Malawi on identifying constraints impeding SMEs growth (Government of Malawi et al 2007). However, as most of these research programs are donor funded and the donors are also funding most of the intervention funds, the research has not specifically examined the attributes of the funding products but "sweeping" statements have been made alluding to the fact that SMEs are more concerned with simplification of access at whatever cost. This has resulted in funding to SMEs bearing terms and conditions which are not in tandem with all the other players (the corporate and large scale individual entrepreneurs) and as such the funding market for SMEs is treated as a parallel one on the Malawi financial market.

## 1.3 RESEARCH QUESTIONS

The study is designed to answer the following questions that provide the focus of the investigation:

- Do the attributes of the funding product have a bearing in the access to credit?
- How have financial institutions serving the SME market made themselves competitive?
- How have purpose created fund schemes in Malawi targeting SMEs performed?
- How extensive is the range of tailor made products targeting SMEs in Malawi?
- What are the products' attributes which are the major barriers in Malawi in the eyes of the beneficiaries?

## 1.4 RESEARCH OBJECTIVES

The study's major objectives were to:

- Determine if product attributes of SME tailor made products in Malawi are structured in such a way that they create a constraint to access of finance by SMEs, and if so which of the attributes is the major impediment.
- Understand the successes of SME purpose-created fund schemes in Malawi and how, if any, have they augmented access to finance by SMEs in Malawi.

## 1.5 CONTENTS OVERVIEW

This thesis has been conducted to establish whether product attributes are part of the causes of constrained capital access by SMEs in Malawi. It focuses on analysis of the supply side by studying the attributes of SME financial products; evaluation of financial product attributes to determine if they constrain SMEs to access capital and finally reviews the performance of interventions to financing SMEs through the creation of special purpose fund schemes by studying a sample of some of the schemes which have run in Malawi. Below is an outline of how the study has been organized.

Chapter one introduces the thesis by giving a background on SMEs and the role which they play both economically and as a safety net in Malawi and further defines the SME financing. The introduction then draws attention to the rationale, justification and significance of the study, research questions and specific objectives.

In chapter two a review of the literature of studies conducted by other researchers on this topic which have been applied in this thesis have also been presented.

Chapter three gives a scenario of the Malawi financial sector, its players and the credit climate.

The detailed research methodology and techniques used in gathering, analyzing, interpreting and presenting data to achieve objectives of this research has been presented in chapter four.

Chapter five is very critical as it is where an outline and analysis of findings of the research conducted are given. This is subsequently followed by detailed discussion of results which is supported by context from the studied literature in chapter six.

Finally, chapter seven presents summary of conclusions and recommendations of the study.

## 1.6 CHAPTER SUMMARY

This introductory chapter presents a brief background of SMEs and also briefly discusses the rationale, justification and significance of the study, research questions and specific objectives.

The next chapter discusses and reviews the literature that was done by other authors in the area of study.

## 1.7 LIMITATIONS OF THE STUDY

This research work encountered the following limitations:

- There was inadequate literature on SME access to financing in the context of Malawi which limited the study point of reference to specific areas.
- Information on product attributes offered by each respective financial institution is normally general public information and as such is supposed to be displayed in banking halls and on brochures, but the majority of the banks sampled did not display that information or had brochures which were outdated.
- There was need to access data on the portfolio of the sampled financial institutions, which all the financial institutions treated as confidential and were not willing to release it to a third party.
- Under normal circumstances, research work demands funding to cover for travelling and other logistics which are involved. This research was not

funded which contributed to the researcher having financial problems when carrying out the activities.

# CHAPTER TWO

## LITERATURE REVIEW

### 2.1 INTRODUCTION

This chapter presents previous work done by various researchers in establishing whether product attributes are a cause to constrained capital access by SMEs in Malawi. Each study is reviewed independently though two or more studies may be on one topic. The findings, methodology and conclusions are reviewed. Then it winds up with a summary of the chapter discussions.

### 2.2 RESEARCH GAP

The study of access to finance by SMEs ought to be a subject of great interest to Malawi considering its demography pattern and that the sector is largely underdeveloped. Kedrock et al (2007) used data from the Malawi Gemini survey of 2000 and extrapolated that the SME sector had a probable range of 70,300 to 87,875 enterprises in 2006, and, therefore, requires access to finance to grow.

However, globally there have been a number of studies using firm-level survey data which have shown that SMEs not only perceive access to finance and the cost of credit to be greater obstacles than large firms (Schiffer & Weder, (2001); IADB (2004); Beck, Demirgüç-Kunt & Maksimovic (2005); Beck, Demirgüç-Kunt, Laeven & Maksimovic (2006). Locally, there have also been studies which have pointed out that access to finance by SMEs is constrained (de Carmona et al, (2007); Kedrock et al, (2007). Although other researchers studied some areas of capital access by SMEs in Malawi, there has not been a study which specifically explored the context of the quality of Malawian financial product attributes vis-a-vis access to finance by SMEs. This study sought to address this gap in SME research for Malawi.

In other environments, researchers have drawn conclusions from their studies as regards product attributes for SMEs in Africa. Collier (2009) argued that for many years Africa's formal banking system faced both high risk and high transaction costs

in lending to small enterprises. Such impediments largely precluded their access to formal finance while Peria (2009) demonstrated that bank financing to SMEs in Africa was less significant and more short-term than in other developing countries and Tadesse (2009) explained SME financing gaps by three factors: the merit-based explanation that many SMEs lack the requisite collateral and other risk protection in order to effectively access available loans at competitive prices, the lack of management and absorptive capacities on the part of African SMEs to profitably utilize available capital and that there are extraneous factors that tend to discriminate against SMEs with certain attributes, the main factors being the gender of owners (women-owned enterprises are typically disadvantaged), the age of the firm (newer SMEs with no track record receive little or no financing), the location of firms (rural enterprises, for example, have restricted access to financing), and lack of political (patronage) connections. Most of the aspects singled out in these studies had not been confirmed in the Malawian environment and therefore this study sought to undertake that.

## 2.3 STUDY OF THE MALAWI FINANCIAL SECTOR AND CREDIT CLIMATE

### 2.3.1 Malawi financial system

A financial system consists of institutional units and markets that interact, typically in a complex manner, for the purpose of mobilizing funds for investment, and providing facilities, including payment systems, for the financing of commercial activity (OECD glossary of statistical terms, 2012). Typically a financial system comprises all financial institutions in a country including the central bank, financial regulatory bodies, banks and non-bank financial institutions. The role of financial institutions within the system is primarily to intermediate between those that provide funds and those that need funds, and typically involves transforming and managing risk.

The Malawi financial system comprises of 11 banks, two (2) discount houses, four (4) capital market players, two (2) leasing companies and twenty one (21) insurance market players. There are forty three (43) SACCOs all affiliated to the Malawi Union of Savings and Credit Cooperatives (MUSCCO) and numerous MFIs offering credit

facilities and other financial services most of them affiliated to the Malawi Microfinance Network. At the apex is the Reserve Bank of Malawi which is the regulator of all the financial institutions and also the lender of last resort.

There is a relationship between the extent of development of a country and that of its financial system. Well functioning financial systems provide good and easily accessible information. That lowers transaction costs, which in turn improves resource allocation and boosts economic growth. Both banking systems and stock markets enhance growth, the main factor in poverty reduction. At low levels of economic development commercial banks tend to dominate the financial system, while at higher levels domestic stock markets tend to become more active and efficient relative to domestic banks (World Bank Group and The development of an economy's financial markets, 2012). Malawi is one of the low income sub Saharan countries ranked 171 out of 187 countries on the human development index by the United Nations World Food Program. As such its financial system follows the pattern of those of low developed economies as described above. As such, the analysis undertaken in this thesis demanded an evaluation of the product parameters of these market players. Out of these, a total of seven (7) institutions, six (6) banks and one (1) MFI were sampled for the study. The rationale for sampling has been articulated in chapter four below.

The Malawi financial sector is one of the shallow markets in the world and SSA in particular (Chipeta & Mkandawire, 1998) and its banking system classified as small, with a low but increasing level of financial intermediation (IMF's Financial sector assessment program – Malawi, Banking sector: Towards a path to a deeper and more inclusive system, 2008). In their analysis of the commercial banking and microfinance industry in Malawi, de Carmona et al (2007) observed that the industry in Malawi had high barriers to entry due to high operating costs and uncertainty generated by macroeconomic instability. Furthermore, due to the low number of players and the strong role of the government in lending operations, the banking industry in Malawi was not attractive for new players. But the low rivalry, low bargaining power of customers, and low availability of substitutes (other alternatives

for lending) presented great opportunities for new financial institutions or incumbents to expand services and gain market share. While on the other hand, Malawi's microfinance sector was marked by medium rivalry {(market dominated by two main players, high barriers to entry, and high bargaining power of suppliers), (from government and donors)} which prevented new players from entering the market. There was also low bargaining power of customers (rural households basically depend on limited services offered by informal systems or self finance), and low substitutes (only a limited number of products are available for low income individuals and SMEs) which made the Malawi microfinance market attractive for competition and expansion of players. Those factors all point towards a non conducive capital accessibility regime in Malawi. Further, there is empirical evidence which indicates that Malawi's banking system is very profitable, mainly due to a non-competitive foreign exchange market. This profit base does not provide banks with an incentive to go down market in the deposit and loan segments to reach out to smaller clients. In addition, going down market is further hampered by high overhead costs and intermediation spreads, in part caused by a lack of economies of scale and an unproductive but highly compensated labour force and a poor enabling environment (IMF's Financial sector assessment program – Malawi, Banking sector: Towards a path to a deeper and more inclusive system, 2008).

### 2.3.2 Interest rates and interest rate trajectory

The Malawian financial market was liberalized following the institution of Structural Adjustment Programs (Saps). Prior to that, the basic structure of interest rates was directly administered by Reserve Bank of Malawi (RBM), hence interest rates were almost fixed over considerable periods of time and also less attention was paid to underlying macroeconomic conditions, especially inflation as well as the demand and supply of money, with more emphasis on controlling the exchange rate. Another important feature which was controlled was government expenditures. With this under tight control, government would not borrow much on the local money market hence resources would be redirected to promote private investment. During that monetary

regime, deposit rates were set by RBM while lending rates were set by commercial banks, but subject to a ceiling rate (Bankers Association of Malawi, 2004).

During the implementation of the Saps, Malawi adopted the inflation targeting regime, and from July 1987 interest rates were gradually deregulated as follows: In July 1987, commercial banks were given the freedom to set their own lending interest rates and in April 1988, deposit rates were deregulated. In August, 1988 preferential interest rates to the agricultural sector were abolished. By May 1990 all rates became fully liberalized.

Since the complete interest rate liberalization was launched, the bank rate (the rate at which commercial banks borrow from the RBM) has played a more important role in the financial system. The role of the bank rate has been enhanced by the development of the money market and the frequent use of open market operations as a tool of monetary policy. The Reserve Bank of Malawi subsequently used the bank rate as an indicator of the stance of monetary policy. Many times, the adjustment of the bank rate led to adjustment of interest rates in the financial market. The bank rate was set on the basis of interest rates on the Treasury Bill (TB) market as well as developments in inflation rates (Bankers Association of Malawi website et al). That succeeded in creating a base for strong and robust open market operation in the country where inter-bank dealings were enhanced. This effectively created competition with government and RBM money dealings, hence a much stable money market was created.

During the period 1985 to 1990, the bank rate and the savings rate hovered around 10.0 percent with hardly any changes while the minimum lending rate remained at 13.0 percent. As noted earlier, the full liberalization of interest rates in 1990 meant that commercial banks could set their own interest rates. However, in practice during the period 1990 to 1992 the commercial banks moved their own rates only after the RBM moved its bank rate. The bank rate was adjusted at least seven times by RBM mainly to reduce excess demand for cash, particularly during the period 1994-1995. This was also the period when Malawi experienced high levels of inflation. From the end of 1994, to curb inflationary expectations, the bank rate was raised to 50.0

percent by May 1995. This was also in line with Treasury Bill yield which soared during this period. From 1996, however, the bank rate had been steadily adjusted downwards and as at January 2000 stood at 47.0% and by 2010 at 15.0 %. This downward adjustment resulted from developments in the economy as both TB yield and inflation followed a downward trend Bankers Association of Malawi, 2004) until 2011. In the recent past there has been an upward movement in both the rate of inflation and interest rates also resulting from an upward adjustment in TB yield due to monetary policy implementation by the RBM.

This trend points to the fact that each player in the Malawi financial system is at liberty to formulate their own product parameters including interest rates which have a direct bearing on the accessibility of capital by the private sector. Further it also demonstrates the fact that macroeconomic policies implemented by government have a significant bearing on capital accessibility as they have a direct impact on inflation and public borrowing which competes with private sector borrowing. Further, RBM notes that complete liberalization has not brought about what was intended to be achieved, as the Bank rate has been used by commercial banks as an indicator of where the Reserve Bank wishes the interest rates to move. Indeed, when it was adjusted downwards, the banks adjusted the lending and deposit rates as well without exercising their own flexibility and independence depending on their risk/return profiles. Further, there is a possibility of collusion by banks to reduce their rates by identical magnitudes, reflecting structural rigidities. Another problem is that the spreads have not narrowed with interest rate liberalization. This points to an adverse capital accessibility situation in the country.

### 2.3.3 Credit climate

The cost of credit in Malawi usually constituted of processing fees which were paid upfront and interest payments. There were two main methods of applying interest on the Malawi market i.e. reducing balance and flat. The requirement for collateral for credit in Malawi was very stringent, and de Carmona et al (2007) noted that most MFIs accepted only traditional collateral such as leasehold land and buildings, vehicles and equipment. Almost 33% of commercial banks only accepted as collateral

land located in Malawi's four main cities (Lilongwe, Blantyre, Mzuzu and Zomba), 71% of MFIs accepted collateral only in main cities and major trading centers, and only 29% of MFIs took collateral anywhere in Malawi. Collateral requirements in general were high, with an average value of collateral exceeding the value of the loan by 43% for commercial banks and 105% for MFIs.

## 2.4 THEORETICAL STUDIES

The capital structures of SMEs are explained by the most relevant capital structure theories that are related to adverse selection, static trade-off, the agency theory and the pecking order theory (Sogorb & Mira, 2002). According to Andree and Kallberg (2008), the beginning of modern capital structure theory lies in irrelevance theorem by Modigliani and Miller (1958). The theorem suggests that the choice of capital structure does not affect a firm's market value as an implication of equilibrium in perfect capital markets. Modigliani and Miller (1958) used certain perfect market assumptions such as no corporate taxes, floatation or brokerage, no cost for securities and symmetrical information to base their irrelevance theorem.

The initial Modigliani and Miller theory of the perfect market of 1958 was later reviewed in 1963 with the introduction of the tax benefits of debt. This is attributed to the fact that in the real world, a perfect market does not exist. Modiglian and Miller (1963) state that the firms find it not possible to minimize their costs of capital and maximize shareholders' wealth by using debt since interest on debt is tax-deductible, thereby creating tax savings for the borrower. Modiglian and Miller (1963) called this the leverage effect of debt.

According to Modigliani and Miller (1963) capital structure of a firm should have 100% debt in it to enable the firm take absolute advantage of the tax-shield. Scott (1972) and Kraus & Litzenberger (1973) state that in reality distress costs theoretically cause 100% tax shield to be non- existent. Debt leads to a legal obligation with principal and interest charged. A firm is forced into bankruptcy and incurs related costs if it cannot meet its debt obligations. New SMEs may not be profitable and be able to use debt for acquiring tax shields and as a result of this the fiscal advantage of debt cannot be

applied in the new SME context (Mira, 2002 and Andree et al, 2008). Daniel, O., Masli, E., Rahman, K., & Selvarajah S.F. (2006) assert that new SMEs have high expected bankruptcy costs and any potential benefits from tax shield may be outweighed by costs of financing. However, new SMEs also have limited access to external equity capital such as venture capital and the stock market which entails that source of capital for new SMEs will have to be only internal equity which is obviously inadequate. According to Frelinghaus et al (2005), the limitations of static trade off theory suggest that new SMEs rely on internal equity yet the reality for growing new SMEs is that they rely on debt and external equity due to the fact that the internal equity is not adequate.

Impact on the availability of credit and hence the capital structure of new SMEs can be caused by agency problems, for example moral hazards and asymmetric information which was termed as phenomenon credit rationing by Stiglitz and Weiss (1981). This is argued so because suppliers of finance may choose to offer varied interest rates that would make credit inaccessible to a large number of potential borrowers. The theory therefore suggests that there are a large number of SMEs that cannot access finance from formal institutions but could use funds productively if they were made available to them. On the other hand, the agency cost argument suggests that the capital structure of new SMEs reflects a pattern of relationship which is low-high-low implying low amount of debt at the beginning of the enterprise, high amount of debt during development of the firm and low debt when retained earnings are accumulated. The agency cost theory also suggests that new SMEs should have the smallest amount of debt that will increase little by little during the development of the firm. However, Frelinghaus et al (2005) disagree with the pattern of relationship by the agency theory and argue that the theory cannot explain why firms in the early stages of development incur more debt than those in the prime. However, Myers (1984) in his theory of the pecking order suggests that there is no well defined optimal capital structure.

It is the prerequisite of management to choose the type of financing whether internal or external. A firm prefers debt to equity when forced to use external financing. All in

all, the three theories suggest that the important source of financing to new SMEs is debt. The most important thing is striking a balance between debt and equity when financing a new SME and ensure the business' suitability on the kind of the funding structure (Rungani, 2008). To determine the appropriate capital structure for an SME, Martinovic (2008) agrees on the importance of examining the business' requirements and the timeframe for achieving financial goals. Cassar (2004) also agrees with this due to the fact that current assets are financed with a source of long term funds which allow a business to achieve breakeven when small business starts. However, Kortschak (2007) argues that debt financing can be an important part of a firm's growth when used meaningfully. The difficult part is the determination of the right amount of debt the new SME can source without affecting its potential for growth.

## 2.5 EMPIRICAL STUDIES

### 2.5.1 Managerial competencies as a determinant of debt access

Managerial competencies are sets of knowledge, skills, behaviours and attitudes that contribute to personal effectiveness (Hellriegel et al, 2008). The importance of management competence in small firms' success is examined by Martin and Staines (2008). The main reason for failure of small businesses include lack of managerial experience, poor personal and skills qualities, poor economic conditions, poor business proposals and lack of resources. Education and training experiences distinguish the growth of small firm, thus from high and low growth. According to Lyles et al (2004) managerial competencies is measured by the founder's education, managerial experiences and know how of running the firm. These also affect the performance of the new firm positively. Other empirical studies done by Smallbone and Welter (2001) and Hisrich & Drnovsek (2002) agree. Herrington & Wood (2003) point out that in South Africa, reasons for high failure rate in SMEs include lack of education and training which reduce capacity of management in running the SMEs effectively. These study findings conclude that access to finance by new SMEs will depend on managerial competencies.

### 2.5.2 Collateral

Collateral is defined by Gitman (2003) as assets that are pledged by a borrower to a lender as security for the payment of debt. Barbosa and Moraes (2004) argue that firms that invest heavily in tangible assets are highly geared since financial institutions lend to them at low interest rates since the assets are used as security. Coco (2000) points out that collateral can solve problems derived from the riskiness of borrowers, problems cost of monitoring borrowers' behaviour, asymmetries in valuation and quality of projects and moral hazard by charging the borrowers if best effort is not made. Availability of collateral will also prevent the borrowers from diverting funds to personal use hence impact on ability of SMEs to access to debt finance.

### 2.5.3 Business information

Pretorius & Shaw (2004) point out that financial information is crucial to the capacity of repayment of a credit to a business. A business plan is one of the most important documents developed by a business promoter which contains financial and business information of a new SME and can be presented to the banks and financial institutions for accessing debt.

According to Kitindi et al (2007) financial information that is submitted by SMEs provides the banks and other financial lenders the ability to assess the performance of the SMEs. Further, the financial information points to the SMEs' ability to repay a loan hence banks and other financial lenders rely on this information.

### 2.5.4 Networking

Networking in a new business is regarded as an activity in which SME owners develop and manage personal relationships with particular individuals in their surroundings (Coulthard & Loos, 2007). Shane & Cable (2002) point out that information asymmetry can be reduced by networking in a borrower and lender relationship.

Networking and long-term relationship between a lender and new SME borrower create an advantage and legitimacy when the borrower wants to access financing. Networking also influences social responsibility on behalf of the firm where in turn the firm gets support from the general public and key stakeholders (Owualah, 2002).

### 2.5.5 Location

Location has an impact on a new firm's potential for market and growth of the business as noted by Dahl and Sorenson (2007). So a firm needs to make a crucial decision in choosing the geographical area which would facilitate access to the markets and increase growth opportunities (Gilbert, 2008). Firms located in metropolitan areas may therefore have higher chance of success than those located in rural areas.

## 2.6 OTHER RESEARCHERS' STUDIES

This section covers contributions from various researchers drawn from different parts of the world with particular emphasis on those who conducted studies on SMEs in Malawi. The identified studies provide a base of comparison with the results of the study.

In an article by Kedrock et al (2007), an analysis of the Malawian SME sector from the agricultural perspective is presented. This was particularly in response to the USAID/Malawi Government's interest in establishing a Development Credit Authority (DCA) Loan Portfolio Guarantee program. Further, the country's credit climate and the perception of financial institutions to SMEs in Malawi were discussed and in that process an attempt was made to redefine SMEs in Malawi. The position presented in the article would be analyzed vis-a-vis the current situation to denote whether there has been an improvement in the credit climate as regards access of credit by SMEs.

In his article, Rethinking Finance for Africa's Small Firms, Collier (2009), identifies the financial crisis as the drive which has rekindled banks' and financial institutions' interest to fund SMEs. However, he notes that there is inadequate dissemination of information and inappropriate use of information technology which may ultimately not

foster this interest further. This research will seek to identify how banks and financial institutions may deploy ICT and information sharing as a means of enhancing the structure of SME financing in Malawi.

Further, Derreumaux (2009) identifies other shortcomings in the resource allocation by banks when targeting SMEs generally in sub-Saharan Africa. He singles out two major shortcomings being a weakness in the supervision of credit portfolios: the lack of specific reference framework based on an in-depth experience of SME financing; and the weakness in institutional (especially legal) environment which penalizes banking activities. These aspects will be researched to provide understanding how banks and financial institutions in Malawi have mitigated them to ensure that they deepen their participation in SME financing.

Research data by Peria et al (2009) on eight sub-Saharan countries including Malawi, has revealed that bank financing to SMEs in Africa is less significant, more short term and more expensive than in other developing countries. This pointed to a general weakness in the structuring of the products targeting which will have to be cross referenced against an appropriate standard as regards depth and width of the product. Allen & Udell (2005) argue that conceptual frameworks for SME lending presented in most literature is oversimplified and advocate for framework which includes an analysis of the depth of the sector and how they lend as well as the different types of transaction technology. This framework will be utilized in this research to evaluate the extent to which the SME products on the Malawi market are friendly to SMEs.

The World Bank in its paper titled, Making Finance Work for Africa of 2006, make an analysis of the financial systems in Africa which includes the depth, competition and efficiency (interest rate margins, costs and profitability) of financial markets and the range of products they offer. This provides an input to understand the environment in which banks are as they are ready to fund SMEs.

A paper by Beck & Demirguc-Kunt (2006) presents recent research on access to finance by SMEs and goes further to substantiate the evidence that small firms face

larger growth constraints and have less access to formal sources of external finance which potentially explains the lack of SMEs' growth. They further argue that financial and institutional development help alleviate SMEs' growth constraints and increase their access to external finance and thus levels the playing field between firms of different sizes. The linkages between access to finance and SME sector growth which this paper explains will be utilized to analyze the Malawian context and provide understanding if the situation is the same in Malawi.

Moorsom (1998) describes, analyses and evaluates selected micro-projects and microcredit schemes, which includes financial interventions to SMEs in Malawi from the perspective of social dimensions of adjustment program and poverty alleviation objectives. In that context the successes and shortcomings of the projects are properly detailed and further, recommendations drawn on how such projects must be structured in future to ensure that they are successful. The work will be reanalyzed and compared to the current financial interventions to explain whether the recommendations have indeed been taken into consideration.

Cetorelli (1999) analyzed competition in the banking industry by highlighting a very fundamental issue, how to measure market power. In that context, she also explored whether regulators relied on accurate and effective procedures to evaluate the competitive effects of a merger of banks. The analysis was based on structural analysis of the US banking market, which had experienced significant structural changes as a result of an intense process of consolidation. Further, she described an alternative methodology of competitive analysis that does not infer banks' conduct through the analysis of market structure. Demirgüç-Kunt (2010) in a blog post explored trade-offs between bank competition and access to finance. She used enterprise survey data from 74 countries and assessed the effect of banking market structure on the access to bank finance. The framework in these articles was used to suggest possible ways in which the Malawi financial market could be evaluated to explain whether it was concentrated hence affected competitiveness.

## 2.7 SUMMARY

This chapter has highlighted and discussed the ideas and views that were accessible in other literature including the theoretical and empirical studies. The facts established provide the basic framework of comparison with the results of this study. The next chapter presents the research methodology that was used and the philosophy that guided data collection and the data analysis.

# CHAPTER THREE

## METHODOLOGY

### 3.1 INTRODUCTION

This chapter outlines and presents a discussion of the research philosophy, strategy, design, approach and methods used in data collection, analysis and interpretation in addressing the purpose and objectives of the study. This is essential in order to appreciate the nature of the research and how the research was conducted which has an impact on validity and reliability of the findings.

### 3.2 RESEARCH PHILOSOPHY, DESIGN AND STRATEGY

This study collected secondary data from financial institutions and other organizations. The data was mainly from product/services brochures; financial institutions audited annual reports from MSB and in the outline of the findings the names of the respective banks and MFIs were mentioned as the information used is considered not sensitive as it was meant to be used by the public.

NBS Bank, Reserve Bank of Malawi (RBM) annual and quarterly reports, periodic reports by the Malawi Microfinance Network (MAMN), and field reports from Malawi Investment Promotion Agency (MIPA) are some of the documents used. From these publications, the data obtained included facility limits, interest rate levels and charging methodologies, arrangement fee structures, repayment terms, security requirements and eligibility criteria. In facility limits, data on absolute amounts of financing to an individual SME for each of the financial institutions were obtained to identify important variables which impede access of the desired amount of financing to an SME. The data for each bank was analysed in Table 4.2 which depicts lower limits, upper limits and the tiered facilities of the banks. Further, details of the analysis was done in Table 5.3 where the amounts were segmented into quartiles for the lower limits, the first quartile was noted not to be a constraint to access, the second as an insignificant constraint, the third as a normal constraint and the fourth quartile as a significant constraint. As for the higher limits the converse was true.

Interest rates charged on the facilities to SMEs and processing fees were noted to be the major components of the price of the funding facilities and these variables were also investigated. The investigation looked at both the amount and the charging methodologies of variables and analysed results are contained in table 4.4 below.

Analysis on the acceptable repayment periods for facilities were also done by obtaining the acceptable facility tenures from each of the financial institutions in the sample and the results are presented in table 4.5 below.

As can be noted from table 4.6 below, the need for bank loans was evident in almost all the stages in the SME life cycle. In Malawi, banks have categorized SMEs into two for purposes of providing loans i.e. the start up of the business and augment existing operations of a business.

Table 4.8 below is a summary of the allowable collateral type and a detail of the required collateral coverage to facility amount.

This section investigated the principle eligibility criteria for an SME to qualify for a loan from the sampled financial institutions. Information was therefore collected from brochures in order to investigate and analyse what makes an SME eligible.

Microsoft Excel was used to analyse the data that has been put in tables mentioned above. For clarity purposes, some of the data was summarised and put in tables and graphs within the report. Subsequently, this information was used in the discussion of findings.

The research philosophy that guided this study to attain its results was phenomenology approach. This approach is primarily descriptive and it attempts to present and describe possible relationships between two or more variables. The philosophy is more appropriate in situations where it is necessary to analyze trends under ever-changing business environments. This is so because generalization of facts does not hold true for each situation in the ever-changing world of business (Saunders, Phillip & Achian, 2000, Cooper & Schindler, 1998). This study also adopts the phenomenology philosophy. Nagel (1974) defines phenomenology as the

study of apparent phenomena, and in simpler form, the study of how things seem rather than how they are.

Another philosophy that this research has utilized to come up with its results is inductive approach where data is collected and a theory developed on the analyzed data (Saunders et al, 2007). This approach is utilized in combination with phenomenology approach since it also uses a multi-method approach that enables collection of data depending on context (Blunden, 2005).

This study was conducted in the city of Blantyre, which is the main commercial city in Malawi and where most banks and Microfinance Institutions (MFIs) have their head offices.

## 3.3 DATA COLLECTION

### 3.3.1 Classification of Financial Institutions/Banks used in the Study

This research deals with secondary data from financial institutions, specifically banks and MFIs. This was so because these are the renowned sources of substantive capital for SMEs and therefore all data was obtained from them. In the outline of the findings the names of the respective banks and MFIs were mentioned as the information used is considered not sensitive as it was meant to be used by the public.

In Malawi, there are thirteen (13) financial institutions registered under the Banking Act, and therefore mandated to undertake deposit taking and lending activities. Out of these, six (6) indicated that they have a special purpose window offering SME financing. Further, there are twenty one (21) registered MFIs who undertake lending activities, out of which eighteen (18) offer financing to both Micro and SMEs. It was also found out that two (2) of the six banks offering SME financing are included in the eighteen (18) MFIs offering finance to both Micro and SMEs while the remaining three (3) only lend to the micro sector (Market Share of MAMN Members, 2010). Therefore, the population for this study comprised the six (6) banks and the sixteen (16) MFIs. Out of this population, all the banks and one (1) MFI were sampled in addition to the two (2) banks which are included in the eighteen (18) MFIs.

### 3.3.2 Data Reliability and Validity

The basis of the choice was to ensure that there is adequate representation of both banks and MFIs in the study. This was so as product attributes were identified to be an important variable of the study, and it was discovered that product attributes differed considerably between banks and MFIs. The composition of this variable was compiled directly from brochures of the sampled banks and MFIs, therefore there should be little chance of wrong data contained in it. Secondly, the information in the brochures was confirmed to be up-to-date and in some instances updates were obtained. The data is, therefore, taken to be accurate and the sample to be well representative of the financial market offerings to SMEs.

This research will not deal with testing hypothesis and confidence levels. The reliability and validity of the results is based on that the data used was posted for use by the general public and was subject to inspection by RBM and also audited by reputable accounting firms. Secondly though this data is partially dealing with figures, the analysis will be treated as qualitative as this is used as a component of the SME product to determine how they constrain access to finance. Thus the determinant percentages for some variables which had a diverse range were segmented into quartiles while those with positive/negative were segmented in half. The description of the quartiles/halves was contained in each appendix where the variable was analyzed.

## 3.4 DATA ANALYSIS AND INTERPRETATION

In this study some quantitative data has been used seeking to analyze how financial product attributes constrain access to finance and most of these attributes are of a qualitative nature. Where quantitative data has been used, it has been transcribed to draw a qualitative conclusion from it.

The analysis involves the documentation of secondary data which reviewed all the major attributes of products by comparing them against each other and the sector's average where possible. The results were then segmented with a score and qualitative description ascribed.

## 3.5 OVERCOMING LIMITATIONS

This research proposed the following steps to overcome limitations:

- Other areas of study in the Sub-Saharan Africa (SSA) region were used since there was inadequate literature on SME access to financing in the context of Malawi.
- Sometimes the researcher could take advantage to accompany work colleagues going on official visits on the same route where institutions to collected secondary data in the form of brochures were located.

## 3.6 SUMMARY

This chapter described the methodology and techniques applied to address the research questions and objectives of the study. In particular, the following were described: the research philosophy, research strategy and design, data sources and collection and the techniques of analyzing and interpreting data.

# CHAPTER FOUR

## RESEARCH RESULTS

### 4.1 DEFINITION OF SME IN MALAWI

In line with the Ministry of Trade and Industry's Small Enterprise Policy Statement (2007), the SME sector in Malawi was classified by using two factors, that was the number of employees which the undertaking had recruited which included the owners of the undertaking but excluded any part time worker; and the level of turn over the business was able to achieve. Using these parameters the sector was classified as follows:

**Table 4.1: Classification of SME Sector.**

| | **Micro** | **Small** | **Medium** | **Large** |
|---|---|---|---|---|
| **Classification criteria** | | | | |
| No. of employees | Up to 4 | 5 to 20 | 21 to 100 | >100 |
| Turnover (US$'000) | Up to 8 | 9 to 267 | 268 to 667 | >667 |

Source: Ministry of Trade and Commerce annual report 1996

There had never been a revision of these criteria parameters since they were first published in 1996 but due to the significant changes of the macroeconomic conditions the country had witnessed since 1996, it would have been prudent to revise the definition parameters.

## 4.2 ANALYSIS AND FINDINGS

### 4.2.1 Attributes of SME Funding Products

The attributes of SME funding products in Malawi were the following:

#### 4.2.1.1 Facility amount

In this section, the study investigated whether financial institutions had set funding limits to SMEs and also if facilities were tiered per amount. The absolute amounts of financing to an individual SME for each of the financial institutions in the sample were obtained and presented in table 4.2 below:

**Table 4.2: Facility Limits for the sampled Institutions**

| | NBS | MSB | OIBM | FMB | INDE-FUND | NED-BANK | FINCA | AVG |
|---|---|---|---|---|---|---|---|---|
| **Lower Limit (US$'000)** | 1.4 | 14.2 | 0.2 | 0 | 2.1 | 0 | 0.4 | 2.6 |
| **Upper Limit (US$'000)** | 106.2 | 1418.4 | 1773 | Unlimited | 71 | Unlimited | 17.7 | 990 |
| **Tiered Facilities** | No | No | Yes | No | No | No | Yes | No |

Source: Compiled by the researcher, 2011. Note for purposes of computing the average the unlimited upper limit were set as US$1.8 million which was the known upper limit.

It was found that all the institutions had set a minimum financing amount apart from two, and the average minimum amount was US$2,600. On the maximum funding amount, it was found out that all but two had an upper limit, with an average of US$0.9million.

Further, it was noted that only two of the financial institutions had tiered their facility amounts. The amounts were cascaded upwards with the rate of interest reducing per tier (the higher the amount funded the lower the rate).

Of the three variables the study identified the lower and upper limits as important variables as they impeded access of the desired amount of financing to an SME, while the tiering/levels was merely an incentive. Therefore the analysis on whether facility amounts could constrain financing was based on the two important variables, and the results of the analysis were presented in A under item A1.

The amounts were segmented into quartiles for the lower limits, the first quartile was noted not to be a constraint to access, the second as an insignificant constraint, the third as a normal constraint and the fourth quartile as a significant constraint. As for the higher limits the converse was true. It was found that 85.7% fell in the first quartile as regards the lower limit with none in the second and third quartile while 14.3% were in the last quartile. It was concluded that the lower limit did not pose a constraint to access of credit by SMEs as the median point of the result fell in the first quartile. As for the upper limits, it was found that 57.0% fell in the fourth quartile with none in the third and second quartiles and 43.0% were in the first quartile. The median point for the results fell in the second quartile, therefore, it was concluded that upper facility limit posed an insignificant constraint to access to credit. On the average of the two variables, it was found that 71.4% were in the first quartile with none in the second and third and 28.6% in the fourth quartile. Using the matrix which was constructed, it can, therefore, be concluded that facility amounts posed an insignificant constraint to SMEs access to credit and generally the results revealed that the financial market could accommodate most of SME funding demands amounts.

**Table 4.3 : Analysis of Facility Limits: Description of Quartiles**

| | | 1st Quartile | 2nd Quartile | 3rd Quartile | 4th Quartile |
|---|---|---|---|---|---|
| **Lower Limit** | **Range (US$'000)** | 0 to 4 | 4.1 to 7 | 7.1 to 11 | 11.1 to 14 |
| | **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |
| **Upper Limit** | **Range (US$'000)** | 1330.1 to 1773 and above | 887.1to 1330 | 443.1 to 887 | 0 to 443 |
| | **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |
| **Average** | **Range (%)** | 100 to 75 | 74.9 to 50 | 49.9 to 25 | 24.9 to 0 |
| | **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |

#### 4.2.1.2 Pricing

Interest rates charged on the facilities to SMEs and processing fees were noted to be the major components of the price of the funding facilities and these variables were investigated in this section. The investigation looked at both the amount and the charging methodologies for both variables and the results are contained in table 5.4 below:

**Table 4.4: Pricing for the Institutions**

| | | NBS | MSB | OIBM | FMB | INDE-FUND | NED-BANK | FINCA | AVG |
|---|---|---|---|---|---|---|---|---|---|
| **Interest Rate (%)** | **Minimum** | 2.75 | 22.0 | 21.6 | 25.0 | 21.0 | 23.0 | 3.5 | 17.0 |
| | **Maximum** | 3.0 | 25.0 | 23.5 | 25.0 | 26.0 | 23.0 | 4.0 | 18.5 |
| | **Average** | 2.9 | 23.5 | 22.6 | 25.0 | 23.5 | 23.0 | 3.8 | 17.8 |
| **Base Rate (%)** | | 17.5 | 17.0 | 17 | 17.0 | 21.0 | 17.5 | 3.5 | |
| **Interest Charging Methodology** | | Flat | Reducing Balance | Reducing Balance | Reducing Balance | Reducing Balance | Reducing Balance | Flat | |
| **Processing Fee** | | 2.5% | 1.5% min. US$64 | 1.5%-2% | 1.5% | 3.5% first timers, 1.75% repeat | 1.5% min. US$53 | US$11 | |

Source: Compiled by the researcher, 2011. Note that the flat rates were annualized for purposes of computing the average rate.

Interest rates were liberalized in Malawi and this was evidenced in that the market players did not have a uniform rate of interest for the SME sector and even within the institutions different SMEs were not offered a uniform rate but rather had a range, on average between 2.9% (flat rate, annualized to 34.8%) and 25% over which different SME borrowers were offered. Generally, several factors were considered when offering a rate to an SME borrower and the key ones being the perceived riskiness of the borrower (the riskier the borrower the higher the rate) and whether the borrower was a repeat borrower (repeat borrowers were offered lower rates).

The research revealed that on the Malawi financial market two methods were applied when charging interest on facilities i.e. reducing balance and flat. With reducing balance, repayments were subtracted from the facility balance before charging interest effective the date of payment and interest was charged on daily balance and capitalized monthly. While with the flat methodology, interest was charged on the day of draw down for the entire year and the effective date of repayments do not affect the amount of interest paid. The two methodologies when applied yielded different interest payable and it was revealed that the flat methodology was more expensive than the reducing balance method assuming the repayments on the facility were maintained regularly by the borrower, this was illustrated in appendix B under item B2. A further enquiry revealed that the flat rate was only applicable on facilities to micro and SME customers and no other products.

The results also showed that all the financial institutions charged processing fees. However, they were structured differently, with some applying a percentage of the loan, others a percentage of the loan with a ceiling and others a flat fee. All institutions required that the fees be paid upfront before the release of the facility proceeds.

However, Kedrock et al (2007) observed that in Malawi the cost of finance was a major problem for medium and large businesses, which considered it a more serious issue (71%) than access to finance (43%). For informal firms such as micro and small, it was reported that access to finance (84%) was a more serious impediment to growth than cost of finance (51%). The research observed that micro and SMEs in

Malawi were willing to access credit despite high price if all the other constraints were overcome. Due to this reason, pricing was considered not to be an important variable and was not analysed further for purposes of constraint to access but for purposes of financial institution competitiveness.

#### 4.2.1.3 Term

In this section, the acceptable repayment periods for facilities were evaluated. This was done by obtaining the acceptable facility tenures from each of the financial institutions in the sample and the results were presented in table 4.5 below:

**Table 4.5: Term of Repayment in Months for sampled institutions**

| | **NBS** | **MSB** | **OIBM** | **FMB** | **INDE-FUND** | **NED-BANK** | **FINCA** |
|---|---|---|---|---|---|---|---|
| **Minimum (Months)** | 6 | 12 | 12 | 2 | 6 | 12 | 6 |
| **Maximum (Months)** | 24 | 60 | 48 | 60 | 60 | 24 | 12 |

Source: Compiled by the researcher, 2011.

It was standard practice on the Malawi financial market to describe a facility by its repayment tenure such as those repayable up to 12 months as short term, those of a repayment term of between 13 and 48 as medium term and those in excess of 48 months as long term. Technically, it was essential to match the term of a facility to its usage. Short-term facilities were typically utilized for short term working capital needs while medium term facilities were usually for capital acquisitions. Major projects, business start ups and substantial expansions of business were usually funded using long term financing (Bankers Association of Malawi, 2004).

Duarte (2004) argued on the need for SMEs to continuously grow if they are to survive, this signified the need for SMEs to continuously access funding to attain such growth. It was therefore apparent that the type of funding suitable in this case was the medium to long term facilities. In this respect therefore the maximum term limit was considered to be the important variable and the analysis was centered on that. Using the descriptions for the short, medium and long term segments as above, the data for maximum term contained in table 4.5 was further analysed to ascertain the percentages of institutions offering only which type of facilities and the results were presented in figure 4.1 below:

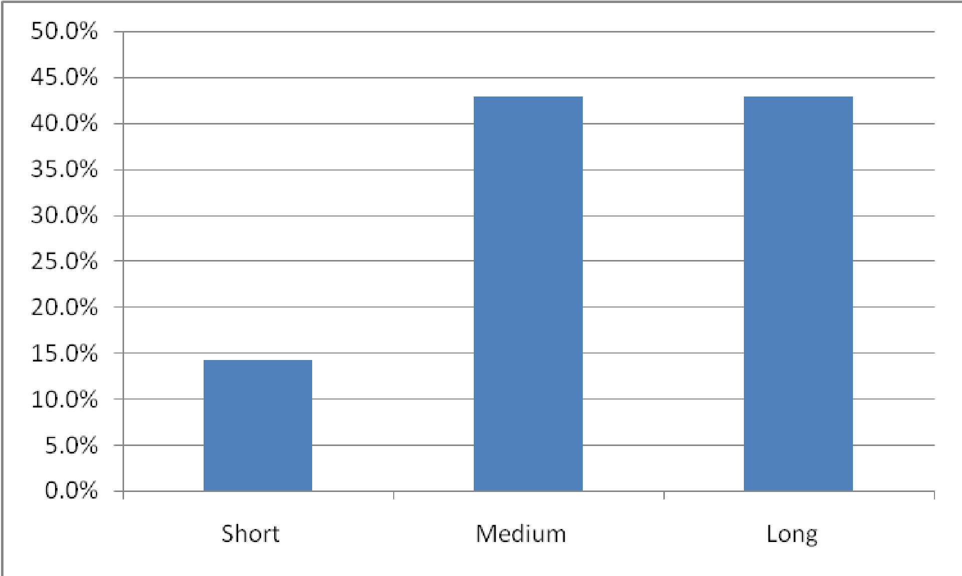


Figure 4.1: Analysis of Repayment Terms

As discussed earlier, the ideal facility types for SMEs were the medium to long term ones. The results showed medium term facilities were being offered by 42.9% and the long term ones were also offered by 42.9% with only 14.2% offering short term facilities. With the mean point at 33.33% it was found that the medium and long term facilities were both above the average line, therefore, it was concluded that the term of repayment posed no constraint to access to finance by SMEs in Malawi.

#### 4.2.1.4 Purpose

In their article, Ruis et al (2009) pointed out that there were a number of stages in the SME life cycle, which were the initial start-up phase, the early development phase, and the growth phase and maturity phase. The financing needs of SMEs varied depending on a number of variables including the stage of development of a business, its growth objectives, the sector in which the firm operates, and management attitudes towards risk. With regard to the stage of development of a business, they quoted research by the European Venture Capital Association (EVCA), which examined the appropriateness of different financing sources to SME depending on the development phase. The report summarized them as follows:

**Table 4.6: Appropriate Financing sources of SMEs by stage of development**

| Phase in SME lifecycle | Type of financing required |
|---|---|
| Seed stage | Informal equity and loans from founder and associates; Bank loan if available and needed. |
| Start-up stage | Informal equity and loans from founder and associates and contacts; Bank loan if available; Leasing for equipment. |
| Expansion stage | Equity from original sources, plus trade investments or venture capital; Loans from bank; Other sources of finance including leasing and factoring; Retained profits |
| Replacement Capital | Trade investment, venture capital or IPO |

Source: European Venture Capital Association (EVCA), 2008.

As could be noted from table 4.6 above, the need for bank loans was evident in almost all the stages in the SME life cycle. Generally in Malawi, banks have categorized SMEs into two for purposes of providing loans i.e. the start up of the business and augment existing operations of a business.

**Table 4.7: The allowed purposes of facilities for sampled institutions**

| | | NBS | MSB | OIBM | FMB | INDE-FUND | NED-BANK | FINCA |
|---|---|---|---|---|---|---|---|---|
| **Start up** | **Working Capital** | No | Yes | No | No | Yes | No | No |
| | **Capital Expenditure** | No | Yes | No | No | Yes | No | No |
| | **Asset Finance** | No | Yes | No | No | Yes | No | No |
| **Existing** | **Working Capital** | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| | **Capital Expenditure** | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| | **Asset Finance** | Yes | Yes | Yes | Yes | Yes | Yes | Yes |

Source: Compiled by the researcher, 2011.

The results showed that 100% of the financial institutions provided funding to existing businesses to be utilized as working capital or for capital expenditure and asset financing, while only 29% of the financial institutions provided similar funding to SMEs for start up purposes. By applying the quartiles analysis as per the matrix in appendix A, the existing operations financing fell in the first quartile hence not a constraint while the start up fell in the third quartile making it a normal constraint to SMEs to access financing from banks. The average was calculated to be 64.5% and fell in the second

quartile and it was therefore concluded that the purpose posed an insignificant constraint to SMEs to access financing from banks.

#### 4.2.1.5 Collateral

In this section, the study investigated the collateral requirements of financial institutions before they offered credit facilities to SMEs. Further, the type of collateral allowable and the required coverage of the collateral to facility amount were also investigated. In table 4.8 below is a summary of the allowable collateral type and a detail of the required collateral coverage to facility amount.

**Table 4.8: Allowed Collateral and coverage for facilities in sampled institutions.**

| | NBS | MSB | OIBM | FMB | INDE-FUND | NED-BANK | FINCA |
|---|---|---|---|---|---|---|---|
| **Allowable Type** | | | | | | | |
| Business machinery | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| House with Title Deeds | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| House without Title Deeds | No | No | Yes | No | No | No | No |
| Motor Vehicles | Yes | Yes | Yes | Yes | No | No | Yes |
| Household Property | Yes | Yes | Yes | Yes | No | No | Yes |
| Animal Stocks | No | No | Yes | No | Yes | No | No |
| Third Party Guarantees | Yes | Yes | Yes | Yes | No | Yes | Yes |
| | | | | | | | |
| **Acceptable Coverage (%)** | 100 | 125 | 120 | 100 | 125 | 167 | 125 |

Source: Compiled by the researcher, 2011.

Both the two variables i.e. the type of collateral and required cover were deemed as important variables as the absence of collateral impeded access of a facility even if an SME qualified on other aspects and the coverage limited the ability to access the desired amount. To explain whether collateral constrained access to financing, the results in table 4.8 were further analyzed to see how readily each type of collateral was on average, owned by Malawians. First, a scoring matrix was created with scores ranging from 1 to 4. The score 1 denoted that the asset (collateral) was commonly owned and therefore was not a constraint, the score 2 was for assets owned by average income earning household and posed an insignificant constraint, the score 3 for assets which were barely owned hence normal constraint while score 4 for assets scarcely owned and therefore posed a significant constraint. The scoring matrix is presented in appendix C, item C1. Based on the opinion and experience of the Malawian demographic/economic environment of the researcher, scores were allocated to each type of collateral reflecting the extent to which Malawians own each type of asset. The results were presented in appendix C, item C2 below. The results of scores earned for type of collateral in C, item C2 were aggregated per score, the percentages calculated for each score and the results presented in figure 4.2 below:

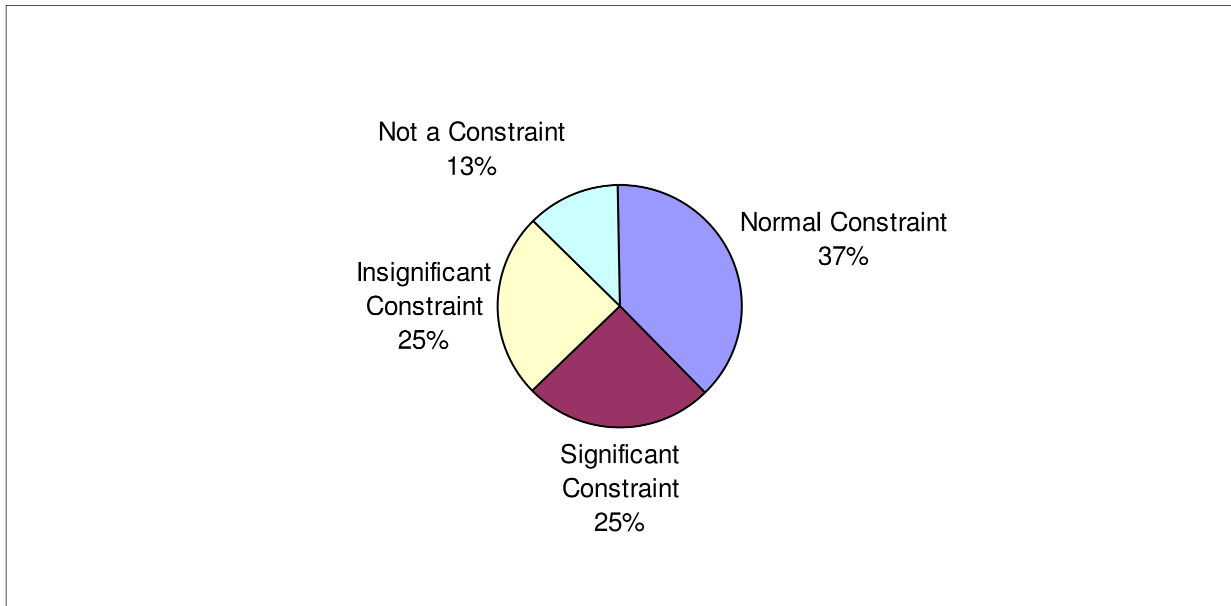


Figure 4. 2: Analysis of collateral ownership

From the figure above it can be seen that only 13% of the assets which were acceptable as collateral were readily available and therefore did not pose a constraint to SMEs. Therefore, it was concluded that the type of collateral which financial institutions accepted as collateral in Malawi also contributed in constraining access to finance by SMEs as they were not readily owned by most Malawians.

It was also revealed that 100% of the financial institutions demanded collateral for any kind of facility to SMEs but generally, allowed a wide range of assets as collateral for facilities which could be combined to arrive at the required cover. Further, financial institutions sampled indicated that their preferred collateral was real estate property with formal title deeds and in an urban setting (i.e. in the cities of Blantyre, Lilongwe, Mzuzu and Zomba). Only one financial institution allowed real estate property without title as collateral. Some of the collateral e.g. animal stocks, could not be used alone as collateral but only to augment the value of the principal collateral. It was also discovered that the preference for real estate collateral was significantly high if the facility being requested was a medium to long term facility. Further, all the institutions

required collateral cover for facilities ranging from 100% to 167% of the amount of the facility.

Considering that the results of this study revealed that type of collateral which financial institutions accepted as collateral in Malawi were a constraint to access to credit, that financial institutions could not make available facilities to SMEs without collateral and that average the requirement for collateral from SMEs was stringent, it was therefore concluded that the requirement for collateral was a significant constraint to access to credit by SMEs.

#### 4.2.1.6 Eligibility

This section investigated the principle eligibility criteria for an SME to qualify for a loan from the sampled financial institutions. Information was therefore collected from brochures in order to investigate what makes an SME eligible.

It was found out that all the financial institutions required that an SME must satisfy the registration requirements for the kind of business they are in. This included business registration with the Registrar General and registration with the relevant regulator of the sector they will operate in. In terms of existence, 72% of the financial institutions demanded that the business must have operated for a period of not less than 6 months prior to seeking the funding and this must be evidenced by the provision of bank statements for the recent past 6 months together with the application.

It was considered that these were reasonable eligibility requirements as they ensured that the business which was to be funded was legal and therefore it was concluded that eligibility was not a constraint to access to credit by SMEs.

### 4.2.2 Financial Institutions Competitiveness

In general, a financial sector of an economy is expected to comprise multiple players so as to offer the consumer choice. In his article, ‘Bank Competition and Access to Finance’ Demirgüç-Kunt et al (2010) articulate theory related to this. According to standard economic theory, a banking system characterized by market power i.e. a

few major players, delivers a lower supply of funds to firms at higher cost; hence greater competition improves access. However, several theoretical contributions showed that when information asymmetry problems are taken into account, this relationship may not hold. For example, banks with greater market power can have more of an incentive to establish long-term relationships with young firms and extend financing since the banks can share in future profits. In competitive banking markets, however, borrower-specific information may become more dispersed and loan screening less effective, leading to higher interest rates. Using enterprise survey data for 74 countries on the access that firms have to bank finance (specifically, the survey data was on the financing obstacles perceived by firms which was related to the competitive environment in a respective country's banking market), Demirgüç-Kunt et al (2010) found evidence which supported theories that suggested that market power was associated with less access to credit, especially for developing countries and generally no evidence was found consistent with theories that predicted positive impact of bank concentration and market power on alleviating financing obstacles for small firms and allowing them access to credit. He concluded therefore that overall, bank competition seemed to be good for access to credit.

Generally, the Malawi financial market could be seen as having some competition as far as the access of credit to SMEs is concerned due to the multiple number of players providing the service. It was expected that each of the players would therefore make itself attractive by offering competitive product attributes. In this section, the study investigated how the sampled institutions positioned themselves to be competitive to the SME market.

In his article, Demirgüç-Kunt et al (2010) measured competitiveness, using two parameters, the market share of the largest three banks and the regulatory policies that influence the competitive framework in which banks operate, such as share of bank license applications rejected and restrictions on banks' activities. This was not a dimension which this study took as it was perceived that the regulatory environment in which the institutions operated was by and large similar and, as stated earlier, it was challenging to obtain market share information from the institutions. The study,

therefore, was premised on comparing the favourableness of the attributes of the products offered by the institutions to arrive at which institution had less constrained product attributes, thereby more competitive.

The evaluation of the product attributes was approached in five steps as follows:

**Step 1 – Identification of variables**

All the product attributes analysed in 4.2.1 above were included in the evaluation, apart from eligibility which was viewed as not critical. However within each of the attributes important variables were identified as follows:

(a) Facility amounts: The lower and upper limits were identified as they could impede access of the desired amount of financing to an SME.

(b) Pricing: The average interest rate and the interest calculation methodology were identified as critical since they have a direct impact on the consequential amount of interest to be paid by the SME but also these are posted to the general public to see.

(c) Term: The minimum and maximum term limits were identified as critical since the lower term limit denies the SME from accessing bridging finance funding (which is critical in cashflow management) while the upper limit constrains consolidation/expansion of business for the SME.

(d) Purpose: The provision of funding to start-up SMEs was identified as a critical variable as it was the major factor which distinguished the institutions in this regard.

(e) Collateral The composition of acceptable collateral as well as the required collateral cover were identified as critical variables as they both have a major effect on the structuring of the facility.

**Step 2 – Allocation of Points**

Based on the opinion of the researcher as regards the perceptional importance of the five attributes and their variables to the SMEs points were allocated to each of them. First, the five attributes were allocated points which totaled up to 100, and then each of the points allocated to a respective attribute was further broken down to the identified variables, with the total adding up to the points allocated to that respective attribute. The results are presented in appendix D, item D1.

**Step 3 - Construction of Descriptive Matrix**

To transcribe the points which would be earned into a qualitative nature, a descriptive matrix was constructed. First, the points were segmented into quartiles and the first quartile was noted not to be a constraint to access, the second as an insignificant constraint, the third as a normal constraint and the fourth quartile as a significant constraint. The results are presented in appendix D, item D2 below.

**Step 4 – Scoring**

Product attributes were scored as follows:

(a) Facility Limits: The lower limit points were allocated as a proportion of the best which was those institutions which had no lower limit (therefore the numerator was 1 for all while each respective lower facility limit was the denominator) while the upper limits were allocated as a proportion of the best which was those institutions which had no upper limit (therefore the numerator was the upper limit for each respective institution while each the denominator was US$1.8 million. The results for the two variables were aggregated and this represented the points allocated to each respective institution.

(b) Pricing: The average interest rate points were allocated as a proportion of the best rate i.e. which was the lowest average rate on the market (therefore the numerator was 22.5% for all while each respective average rate was the

denominator) while for the computation method those offering the reducing balance method were allocated the maximum points and those offering the flat rate were allocated no points at all. The results for the two variables were aggregated and this represented the points allocated to each respective institution.

(c) Repayment Term: The lower limit points were allocated as a proportion of the best lower term i.e. which was the lowest term on the market (therefore the numerator was 2 for all while each respective lower term limit was the denominator) while the higher limits were allocated as a proportion of the best which was those institutions which had no higher limit (therefore the numerator was each respective higher term limit for all while each denominator was 60 months). The results for the two variables were aggregated and this represented the points allocated to each respective institution.

(d) Purpose: Those offering the facilities for start ups were allocated the maximum points and those not offering were allocated 50% of the points.

(f) Collateral – those accepting a particular type of collateral were allocated maximum points while those not accepting that collateral were allocated none at all. As for the collateral coverage points were allocated as a proportion of the best rate i.e. which was the lowest acceptable cover on the market (therefore the numerator was 100.0% for all while each respective average rate was the denominator). The results for the two variables were aggregated and this represented the points allocated to each respective institution.

The results for the evaluation of all the product attributes are presented in appendix D, item D4 and D5.

**Step 5 – Analysis of the Scores**

The points earned by each respective financial institution from step 4 above were then transcribed to a qualitative score using the matrix constructed in step 3 and the

results are presented in appendix D, item D5 below. Further, an average score was worked out for each respective financial institution and this was used to form a conclusion on the competitiveness position of each institution and the results were presented in figure 4.3 below. As described above, the scores ranged from 1 to 4 with score 1 showing that the financial institution's product attributes did not have any constraints to SMEs access to credit hence the institution was very competitive, score 2 the financial Institution's product attributes had insignificant constraints to SME's access to credit hence the institution was competitive, score 3 the financial institution's product attributes had normal constraints to SME's access to credit hence the institution was less competitive, and score 4 the financial Institution's product attributes had significant constraints to SMEs access to credit hence the institution was not competitive. The results were presented in a bar graph in figure 5.3 below:

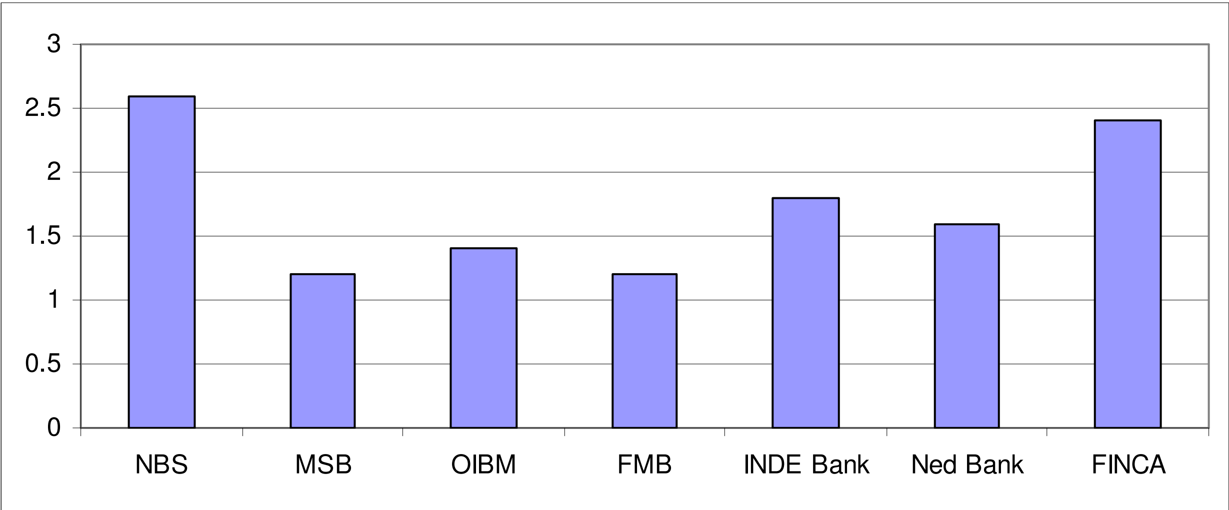


Figure 4.3: Competitiveness Average Score

From the results, it was noted that none of the financial institutions were at or below one concluding that all the financial institutions have product attributes which had some constraint towards SMEs when they sought credit from them. However, relatively it was found that MSB, OIBM and FMB were the most competitive as their score fell below 1.5 and could be rounded off to 1 while Inde Fund and Ned Bank were above 1.5 but below 2 and could be rounded up to 2. On the other hand, NBS

was the most uncompetitive as its score was above 2.5 and could be rounded up to 3 showing that its product attributes had normal constraints and the rest had product attributes with insignificant constraints to SMEs. There was no institution with product attributes which had significant constraints to SMEs.

### 4.2.3 Performance of SME Purpose Fund Schemes

In many countries including Malawi there were programs to assist the growth of SMEs. The programs mainly took three forms i.e. subsidized credit facilities, guarantee facilities to provide credit risk mitigation tools, and provision of technical assistance and capacity building. Moorsom et al (1997) observed that until 1994 the Malawi Government concentrated on macroeconomic development that focused on industrial and private sector reform and the creation of large scale enterprises, a policy environment which actually discriminated against SMEs. The rationale behind that was that there would be a trickle down effect from the large scale sector to the SME/general public in terms of income distribution, employment and a general increase in the level of economic development.

However, post 1994 the Government realized that the missing link in Malawi economic policy was the development of the micro, small and medium enterprise sectors and therefore with support of the donor community set out initiatives to foster the growth of the sector. One of such initiatives was the setting up of a number of MSME credit schemes which primarily provided funding to the sector. Of the schemes which had been implemented, five are the most significant ones due to the amounts of seed capital which were earmarked. The performance of these schemes were analysed as follows:

#### 4.2.3.1 Poverty Alleviation Program

The Malawi Government in the 1990s instituted the Poverty Alleviation Program, which had 18 strategic sectors, one of which was the microenterprise development. Effectively this was a continuation of earlier poverty eradication enterprise related programs like the Social Dimensions of Adjustments Program (SDA) and the Malawi

Mudzi Fund (MMF). Moorsom (1997) observed that this was the first significant MSE initiative as until then the Malawi Government only focused marginally on the MSE sector.

This came against a backdrop that the MSE sector faced formidable problems as follows:

- Inadequate access to credit: Access to credit was the single biggest barrier facing the rural poor, who lack adequate means of creating wealth without external resources to empower them. Moorsom et al (1997) noted that the only organisation that had been providing credit to SMEs in Malawi then was SEDOM (Small Enterprises Development Organisation of Malawi), but was under capitalized and eventually was unable to offer credit in 1991.
- Unequal distribution of income to the rural poor: Due to the income distribution of the country then, which had per capita income skewed towards the urban population, it meant that the actual rural per capita income was less than what was being indicated in Government statistics.
- Difficulty in obtaining cost effective inputs: The fiscal regime was riddled with restrictions which hindered players in the MSE sector to arrange their own imports.
- Lack of managerial skills especially in the finance areas: Most of the practitioners in the MSE sector had underdeveloped managerial skills which eventually impeded their financial management and consequently resulted in failure to meet financial obligations.
- High interest rates and massive currency devaluation: By 1997 the average commercial rate of interest was above 50 per cent which was prohibitively high for any SME borrower. In the 1990s Malawi embarked on a Structural Adjustment Program where one of the factors was the floating of the exchange rate. This resulted in a massive devaluation of the Kwacha 1993.

Other than the joint private sector/UNICEF initiative, starting in April 1995, MSEs had neither schemes nor institutions which provided them with funding. Further, there

were no private sector support mechanisms for SMEs. The financial institutions were not keen to handle small scale credit because of the high costs of administration, the history of poor loan recovery rates and the general lack of profitability in lending to this sector (Moorsom et al, 1997).

It had become apparent to both the government and the donor community that one of the missing links in Malawian economic policy was the development of the micro, small and medium enterprise sectors. The government then together with donors took initial steps towards formulating and implementing a microenterprise development strategy under the auspices of the Poverty Alleviation Program. Under this strategy, the Government set out to mitigate this gap by introducing MSME credit schemes, as one component of the Social Dimensions of Adjustments (SDA) Program's Social Program Support Fund (SPSF). Under the project, six implementing agencies were identified and disbursed loans and Moorsom et al (1997) summarised the projects as follows:

- **Women's World Banking - Malawi Affiliate (WWB):** US$64,610 of which US$58,250 was disbursed via Non Governmental Organisations (NGOs) and other intermediaries to women borrowers, the main intermediary was the Limemakers Association at Balaka. The grant agreement was concluded in January 1994 and was disbursed over two years. Generally, the project was unsuccessful as it was the subject of protracted difficulties and dispute over apparent accounting discrepancies between the program office and WWB.
- **Foundation for International Community Assistance (FINCA):** US$75,000 was approved in September 1993 and disbursed over two years. The funds were applied as seed capital to promote the women's village banking concept. By September 1995 US$0.07 million had been disbursed in loans through 36 village banks on the group banking model with 1,093 members, giving an average loan size of US$63 to an average group of 30 women. The usual loan cycle was 4-6 months at an interest rate just above inflation. The success of the project included the accumulation of savings amounting to US$0.03 million or 46% of loan disbursed and a close to 100% loan repayment rate.

- **National Association of Business Women (NABW):** US$52,000, of which US$33,800 was in a revolving fund disbursed between June 1993 and April 1995. The project was implemented in six pilot districts on a group lending basis. The loans ranged from US$33-US$196 repayable over 3 months, later the tenure was extended to 6-9 months. A total of 121 businesses comprising 213 women at an average loan size of US$104 per business obtained loans from the project. The success of the project included the considerable high repayment rate of 87.5%, with only one district lower at 64%. Also the fact that the project managed to lend to microenterprises in food processing (estimated at 17% of the loans) as opposed to the traditional trading and further the fact that at least 75% of the enterprises subsisted after the close of the project.
- **Chikondano Village Community Development Small Scale Business Group**: It was administered by Ministry of Women, Children Affairs and Community Services, had an initial grant of US$1,815 which grew to US$2,465 by December 1995. The number of borrowers was 40 which had doubled from the original projections. The loan sizes varied between US$33 and US$126 with an average US$62, at an interest rate of 20 per cent on each loan. Total recovery of the original loans was 47%.
- **Youth Enterprise Development Project - Mulanje:** Administered by the District Youth Officer, had a grant of US$1,699 disbursed through seven groups of 81 beneficiaries, and also 15 individuals. The average loan size was US$40.
- **Youth Enterprise Development Project - Thyolo:** Targeted 100 unemployed persons aged 16-39 years over a three year period. Out of the grant of US$2,288, US$2,220 was disbursed to 60 individual beneficiaries by March 1994, averaging US$80.

Moorsom et al (1997), citing a 1995 evaluation report of the project, found an apparent lack of effort in a couple of projects to build the capacity of beneficiaries towards long term sustainability but considerable success in several of the schemes targeting women. Most of the schemes it considered had reasonable potential for sustainability. Even though the six projects had mixed results (with some registering

impressive repayment rate, high outreach, while some had very low repayment rates) but the 1995 evaluation report commented adversely on a number of aspects concerning the implementation and supervision of projects which showed an ill performance of the project as follows:

- The hardships and disruption caused by the volatile economic environment of the country in the 1990s during much of the program period.
- The credit provided by three of the NGOs targeting women benefited somewhat better-off individuals and largely failed to reached the poorest households.
- Weak monitoring tended to reinforce a tendency for capital resources to be concentrated at the implementation agency level rather than with the beneficiaries.
- A general lack of knowledge amongst the agencies of community based and participatory approaches affected the relationship between agencies and clients in some cases, for example making collections difficult in one project where the terms of lending were not properly communicated to the borrowers.
- A lack of a sense of ownership amongst the borrowers, who generally perceived the credit schemes as belonging to the implementing agencies.
- Very small loans, however, tended to benefit traders rather than producers.

#### 4.2.3.2 The UNDP Pilot Microenterprise Program

In 1995 the Commercial Bank of Malawi (CBM), (currently the Standard Bank of Malawi) signed an agreement with the United Nations Capital Development Fund (UNCDF) to administer a UNDP microcredit program. Under the agreement, UNCDF provided full cover collateral of US$0.3 million by guaranteeing credit which CBM provided to MSMEs thereby removing all financial risk from the bank. In its pilot phase the project targeted on six districts in Malawi i.e. Nkhata Bay; Dedza; Mchinji; Nsanje; Thyolo and Mangochi.

Moorsom (1997) highlighted that the donor's (UNCDF) strategy under this program stressed on the following:

- Development of 'capital' in a broader sense, ranging from small scale infrastructure to institutional capacity.
- The importance of the multi-sectoral support approach to development, in which social and economic investments contribute towards both poverty alleviation and economic growth.
- The importance of decentralisation of management and development of democratic institutions in the handling of such funds, both as a means of enhancing sustainability and as a means of empowering the communities they serve.

The program was implemented through partners as follows:

- Policy aspects, were administered by a unit in the Ministry of Works;
- Entrepreneurial and skills development, was administered by the Development of Malawi Traders Trust (DEMATT);
- Credit administration, was administered by DEMATT;
- Marketing information services, was administered by DEMATT; and
- Dissemination of appropriate technology, administered by the Malawi Industrial Research and Technology Development Centre (MIRTDC).

The Loans had the following parameters:

- Targeted at a group of between 10 and 15 (however, smaller group as low as three were considered if a good project was identified) and not an individual entrepreneur. However, within the group an individual could access loans of up to US$200, repayable within six months without a grace period.
- A project was to be selected after a rural business group applied for a loan through the DEMATT offices.
- Prior to loan application a group had to open a group savings account with CBM, operate it for over three months and must have saved at least 25 per cent of the required loan amount.

- Be trained by DEMATT in the application forms/process; assessment of project viability; basic procurement; basic sales and marketing; credit systems and controls, loan repayment; dealing with CBM; and other technical skills if required.
- The loan amount was between US$325-US$2,600 at the prime bank interest rate, more than 50% in late 1995, hence a loan on commercial terms. Repayment term was 180 days with the first 90 days as a grace period. A 2% application fee was charged.
- Project appraisal was by a joint team from all the implementing partners and approval by DEMATT.
- Repayment monitoring was by the DEMATT loans officer.

The project seemingly underperformed, as Moorsom (1997) quoted a DEMATT status report as at March 1996 that by December 1995 only 40 groups from four of the districts had borrowed a total of US$13,473 against total savings of US$11,719, which would presumably include those prequalifying for a loan. The average size of loan liability per group was thus US$340. The number of clients was given as 135, an average of little over three per group, which implies that the designed intention of establishing group dynamics was not being fulfilled. When these figures were compared to the guarantee cover, only an insignificant percentage had been taken up. In the report DEMATT pointed out a number of problems of the scheme, as follows:

- The low individual loan ceiling effectively excluded new enterprises;
- To expand outreach especially to women some local NGOs were subcontracted as implementing agencies but had serious management problems which affected progress;
- Only two of the six pilot districts had CBM branches therefore the majority of potential clients were looked too far from CBM branches;
- The lack of a “package” approach was depriving clients of other essential support such as skills upgrading, marketing and appropriate technology.

Also, Moorsom et al (1997) quoted a UNDP evaluation of late 1995 which cited a number of weaknesses but delivered a cautiously positive report on the pilot scheme, especially in outreach to existing micro-traders. In general, the savings and credit groups were sustainable and self-reliant. The business training had also effectively targeted micro traders and especially women, who formed 59 per cent of the 2,311 persons trained. However, in addition to the problems cited above by DEMATT, particular weaknesses included a complicated and ineffectual management structure for the whole program, a failure to address the needs of small as opposed to micro enterprises and of new enterprises generally, and limited impact due to the small capital funds provided.

Subsequently, demand for the project collapsed upon the launch of the Small and Medium Enterprises Development Fund (SMEDF) in 1995, since it was offering credit to the same clientele at a heavily subsidised rate of interest.

#### 4.2.3.3 Small and Medium Enterprise Development Fund

In early October 1995 following a political directive the Malawi Government set aside US$13 million for MSE loans. Only US$6.5 million of the amount was disbursed immediately of which US$2.0 million was for immediate loan disbursement and US$4.58 million was invested with the Reserve Bank of Malawi as an endowment fund whose interest was to sustain the US$1.97 million revolving fund. The lower ceiling for loans was US$650 for new enterprises which construed to target the informal sector and the upper ceiling was US$16,300 which safely accommodated both existing MSEs and first-time enterprises. Due to these amount parameters, the Fund appeared to target mainly at MSEs despite the inclusion of 'medium' in its title.

According to Moorsom et al (1997), the initiative was a government response to the growing pressure for short term measures aimed at facilitating the access of the poor to credit in a general context of rapidly falling urban and rural living standards due to the introduction of structural adjustment programs in the 1990s. Therefore the fund was viewed by the general public from the onset as a safety net. This view of the

general public was compounded by the product parameters which were heavily subsidised and typically not on commercial terms as follows:

- The interest rate was fixed (as opposed to the standard floating rate) at 15%, far below the bank rate which was in excess of 50%.
- The low ceiling of US$650 for new enterprises was generally insufficient for any meaningful capital even at a micro level considering the level of inflation at that time.
- A parastatal (DEMATT) which was not immune to political pressure was chosen as the principal organisation charged with administering the Fund.
- The Reserve Bank of Malawi, another government institution which also was not immune to political pressure was mandated to screen and select other agents (on top of DEMATT) to administer the Fund. They did not issue out transparent criteria to qualify for participation.

The Fund was renowned to have greatly underperformed mainly in respect to loan repayment. However, it was not possible to access any evaluation data for this fund and therefore this study was unable to substantiate this. However, Moorsom (1997) quoted a summary DEMATT status report as at mid-March 1996 which presented the following picture:. A total of 2,014 business plans had been appraised, including direct contact with the clients of which 72% (1,460) had been submitted for consideration and of those in turn 91% had been approved for lending. Commitments thus amounted to 1,331 loans valued at US$1.97 million. However, actual disbursements were only just over half that at US$1.09 million , but funds received from the Reserve Bank were only US$1.19 million, leaving a small balance of US$0.1 million. Given that the capital originally provided by the Reserve Bank was stated as US$1.97 million, the total allocation had nominally been committed already by March 1996. At that point, however, 683 appraised business plans were awaiting decision and another 10,583 were waiting in the queue, plus 667 received in the post and not yet registered. In practice the number of outstanding applications was estimated by DEMATT by early April at nearer 15,000 applications. If the average loan size was an accurate indication, then the total value for these applications was estimated at

roughly US$16.6 million, far beyond the capacity of the Fund to satisfy. This data indicated the extent of the mismatch between client expectations and the resources actually provided. Further, the report noted several major constraints, including understaffing, delays in Reserve Bank disbursements, lack of basic equipment such as computers, photocopiers and vehicles, and lack of funding for training of staff, delaying loan appraisals and management functions.

The implementation of this Fund pointed out some of the major weakness of SME schemes in Malawi which led to the underperformance of this particular Fund, as follows:

- High administration costs: In the instance of the Fund DEMATT was allowed by the Reserve Bank to retain 10% of the15% interest charged from recoveries. However, DEMATT's early estimate was that transaction costs were at US$0.11 for every US$0.07 lent out.
- Soft interest rate loans made it eminently more attractive (15% as opposed to rates in excess of 50%). This scenario created a general problem in that it seriously impinged on the viability of other microcredit schemes, as it did to the UNDP pilot program.
- Lack of careful preparation, implementation and monitoring, e.g. all the implementation agents DEMATT, Women's World Banking, and the National Association of Business Women (NABW) were ill-equipped to handle loan administration. DEMATT was effectively the lender but its officials were reported giving informal assistance to groups of applicants on how to formulate their business plans which are conflicting roles in loan risk management.
- Subsidised credit tended to crowd out microenterprises and the poorest applicants in two ways. First, the demand for cheap loans advantaged the already better off and more influential applicants. Secondly, enforcement against defaulting local notables, particularly those with political influence, was impossible. This led to a higher default rate and unsustainability of the Fund.

#### 4.2.3.4 The Malawi Mudzi Fund

The Fund was founded in 1988 and started operations in April 1990, to run over two phases of five and two years respectively. It was intended to establish in each phase two branch offices serving about 2,000 borrowers. Thus, by the end of 1996, it was planned to have four branches with 4,000 members. The International Fund for Agricultural Development (IFAD) provided startup capital of US$0.95 million in 1990. USAID provided additional grant funding in 1993-94 and other smaller amounts from several other donors were also sourced.

The operations of the Fund were organised into: a central Management Unit (scheme administrator, accountant) answering to a seven member Board of Trustees appointed by the government; branch offices (branch manager, bookkeeper) managing four project areas, each run by a project officer who was expected to build up a clientele of 250 in 50 registered groups, thus 1,000 members and 200 groups per branch; clients were combined into centres of 4-5 adjacent groups, thus 20-25 clients with a centre executive comprising a centre chief, secretary , treasurer and deputies.

The Fund's central objective was to provide loans, savings instruments and technical assistance to rural Malawians with little or no land for generating self-employment in off-farms activities; as such the Fund was from the onset a safety net. The parameters of the fund were:

- The core criterion for eligibility was registration of a group of five, which must be ownership of less than 1 ha of land or assets worth not more than 5 bags of maize, generally the poor and of similar socioeconomic status; Malawian, permanent residents of the area, living close together, not closely related, same sex and knowing each other well; aged 20-60 years and of trustworthy character.
- Setting up groups of members involved a two-stage process of screening and training: once five clients had formed a group and registered, each was individually screened for eligibility using a questionnaire and for accuracy of

information and good character by consultation with other community members and village leaders.

- All members received orientation training one day a week for eight weeks and then given a group recognition test. The topics included Malawi Mudzi Fund principles, the need for group solidarity, members' and leaders' roles, loan and savings procedures, marketing and business management (the training helped staff assess commitment and clients develop a relationship with Malawi Mudzi Fund).
- Business loans ranged from (worth up to US$1,470 in 1990, US$260 in 1995) but had no formal ceiling.
- The application procedure for a business loan relied heavily on peer group evaluation. The business requirements were first reviewed by the applicants' own group but then also by the other members of the centre, exposing them to scrutiny by members with less strong personal links and also drawing on their experience and knowledge. After modification, the final step was submission to the centre executive. Endorsed applications then went up the chain from recommendation by the project officer through the branch manager up to the Management Unit for final approval and disbursement.
- Loans carried a simple interest charge of 18.5 per cent per annum and were repayable in fixed weekly installments over 50 weeks with a two week grace period. This was reduced to 25 weeks in 1992 to cater for seasonal fluctuations. However, members were encouraged to repay more than the standard installment when their profits were good so as to cover for later periods of low income when they might not afford the repayments.
- Members received loans individually but in a staggered rotation separated by a few weeks, with the group leader being the last to receive.
- Farm inputs loans (introduced in 1992) had a ceiling of US$83.33 that was introduced to pay for farm inputs. This was at the request of borrowers to strengthen their food collateral. Only applicants having business loans and a good profit achievement could qualify.

- Participation in savings instruments: Compulsory group savings fund starting in the third week of training, raised to US$0.08 per person per week by 1994/95, to provide for group members' investment or consumption needs but in fact used mostly as extra insurance against default; a group tax of 5 per cent of the loan value, usually raised as an extra loan amount (abolished in 1994); emergency savings as insurance cover to the amount of a quarter of the total interest on the loan; personal savings in an interest-bearing pass book account with a minimum initial deposit of US$0.16, offered as a service for those too far from a bank or post office; voluntary special savings agreed by centre members and including fines for group indiscipline, the funds being used at centre level, commonly for welfare purposes.
- The early emphasis on targeting the poor was found to provide borrowers with an alibi for defaulting and was refocused on group self-reliance and borrowers' obligations.
- Refunds of interest were introduced in 1993/94 as an incentive to borrowers to repay faster than their schedule and group sizes were made more flexible within a range of 3-6 and centres increased to 15-30 clients.
- In 1992 the Fund made a major switch in emphasis from external sanctions on defaulters to getting mutuality principles understood and peer group pressure operational.
- In 1994 centres were strengthened in their executives, a written constitution and powers to fine members. Executives were delegated the power to hold the weekly meetings without the presence of a project officer.

According to Moorsom (1997), this is one of the credit schemes whose implementation achieved an impressive record. By April 1995, 2,673 members in 561 groups were trained, making an average of 4.8 members per group well above the phase 1 target of 2,000. A total of 2,676 loans (including repeat loans) valued at approximately US$55,000 in early 1995 were approved during the period, thus the average loan was US$21. The credit scheme achieved an overall repayment rate of 85 per cent over the five year period and saving rates of 46% in the group fund, 24%

in the emergency fund, 28% in personal savings and 3% in the special account of funds lent out.

Despite the highly noted success of the Fund, the 1995 evaluation revealed a number of constraints in the design and implementation and Moorsom (1997) summarised them as follows:

- A number of issues and problems were identified during the course of implementation. These included geographical dispersion where DDCs rather than the MMF decided the project areas to be covered within the district and emphasised a broad spread, raising the cost of scheme services. Some selected areas lacked markets or transport.
- Member selection: Insufficient involvement of group leaders in selecting other members allowed the entry of less committed borrowers, especially in the male groups, since project staff doing the selection were strangers. The addition of business experience as a criterion of eligibility tended to exclude the poorest lacking adequate off-farm earning possibilities, a deviation from the scheme's intended targeting.
- Staff performance: most field staff were at the start inappropriately trained, none having any prior experience of rural credit administration. This led to some ineffectual screening of applicants and poor technical and financial project appraisals. But frequent contact between field staff and borrowers built up confidence. The lack of performance-related pay and group rather than individual accountability for the motorcycles lessened the motivation of field staff.
- Transaction costs: arising from mobilisation efforts, screening, group training, compulsory weekly meetings and weekly repayments proved costly in staff time.
- Client ownership: the centres functioned primarily for the administrative benefit of MMF project officers through the compulsory weekly meetings. Groups became subordinated to centres. In the early stages many clients saw the scheme as a government poverty alleviation hand out.

- Employment creation: 85 per cent of clients were already self-employed before joining, while only 5 per cent employed paid workers.
- Group savings: the savings instruments failed to achieve their potential and were relatively unattractive to members because interest was not fully passed on, savings could be used as collateral for other defaulters and there was no confidentiality.
- Policy and accountability: because most trustees were senior civil servants, membership of the board changed frequently and its proceedings lacked continuity.
- Another evaluation by the World Bank in 1994 noted that expenditures under the Technical Assistance Fund, a parallel trust fund that accounted for all operational expenses of the Fund, exceeded loans granted by a factor of 5-10 times and staff salary costs alone by more than double.

At the end of the first phase the Malawi Mudzi Fund was combined with another government project the Small Agricultural Credit Agency and incorporated in August 1995 to establish Malawi Rural Finance Company (MRFC).

As can be seen from the experiences above credit schemes were not highly successful in Malawi which required a rethink of strategy by both government as well as the donor community. As opposed to the earlier thinking worldwide, which was based on the premise that lack of long-term credit was a major constraint to industrial investment and capacity utilization for SMEs, such interventions emphasized more on the provision of subsidized credit. Batra & Mahmood (2003) argued that there was a total rethink of this concept in the mid 2000s and a new approach emerged. The new approach discouraged the use of interest rate subsidies and argues for subjecting business development services and market disciplines. It called for redirecting efforts away from helping SMEs directly to developing financial and consulting markets that serve SMEs. A reflection of the new approach was the growing emphasis by IFC on increasing the cost-recovery rate in its project development facilities and tends to lend to reputable financial institution on commercial terms for on lending to SMEs on commercial terms. Typical examples in Malawi were the facility extended to NBS

Bank and First Merchant Bank in this respect. Also the World Bank's experimentation with a variety of matching grant schemes was a reflection in that direction. Under those schemes, the World Bank loans financed part of advisory services, as long as the private firm matched the amount in some proportion. Other new approaches aimed at reducing the costs of market access or transaction costs for SMEs, by strengthening information systems, and helping develop management tools for SMEs. In this regard, interventions by these donors in Malawi also adapted to this new thinking. From the schedule it can indeed be concluded that donor interventions have shifted to align to the new thinking as there are no direct capital injection schemes set up but rather institutional support and capacity building.

From the analysis, it could be concluded that the performance of SME Purpose Fund Schemes in Malawi, which are meant to assist the growth of SMEs have not been successful. Of the four major schemes which have operated in Malawi, only one, the Malawi Mudzi Fund was successful. There was only one known fund, the Malawi Rural Development Fund in operation from which SMEs could tap. It was not possible to evaluate the performance of this fund as no information is accessible by the general public at present.

### 4.3 SUMMARY

This chapter presented results of the impact of the attributes of SME funding products, financial institutions' competitiveness, perception of SMEs by financial institutions, and performance of SME purpose fund schemes. The findings augmented by literature from other researchers as highlighted in the literature review chapter form the basis of the discussion presented below.

# CHAPTER FIVE

## DISCUSSION OF FINDINGS

## 5.1 INTRODUCTION

This chapter presents discussion of results of the study. The relevant observation from literature review on the impact of attributes of SME funding products, financial institutions competitiveness, perception of SMEs by financial institutions and performance of SME purpose fund schemes have been discussed in comparison with the findings of this study.

### 5.1.1 Attributes of SME Funding Products

Five product attributes were identified and studied as those which were embedded in SME products and were the drivers of decision making by financial institutions when extending funding to SMEs. The review of the attributes revealed that there is reasonable flexibility and when they are considered across the institutions it was discovered that on all the attributes apart from one, collateral accommodated all the requirements of SMEs and therefore it was viewed that they did not constrain access to finance. The position of collateral was compromised because of the following three conditions associated with collateral:

- The findings revealed that 100% of the financial institutions demanded collateral for any kind of facility to SMEs, which was in tandem with research findings of Beck et al (2006) "at least three-quarters of banks require collateral to make business loans. Furthermore, there are no significant differences for small, medium-sized, and large firm financing. As expected, however, given that the informational and institutional environment is weaker in developing countries, a slightly higher percentage of banks require collateral to make business loans in these countries relative to banks in developed countries". This position then meant that even if an SME qualifies on all the other attributes but did not possess

collateral, the facility would not be extended and therefore this was deemed the most important attribute and a major impediment to access to credit.

- It was also revealed that the minimum collateral coverage was 100% with an industrial average requirement as 125%. This position had not improved from the findings of research by Kedrock et al (2007) which noted that “the most commonly repeated issue (problem) in terms of access to finance is the banks’ stringent collateral requirement, often at levels in excess of 120% of the loan”. This was felt to be both stringent and also denied the SME to leverage more on their collateral hence augmenting on the impediment of the need for collateral.
- Another factor was that institutions preferred real estate property with title for collateral, with only one institution accepting real estate property without title. It was known that most smallholders who own land (SMEs) do not have title to land. This was supported by Burritt (2006) that “many banks (in Malawi) require property titles as collateral for loans, but few smallholders have land titles”. As such this also contributes to the stringent conditions of collateral requirements.

### 5.1.2 Financial Institutions’ Competitiveness

As detailed in the sampling of financial institutions in this study, there are six banks that have a special purpose window offering SME financing, eighteen registered MFIs who undertake lending activities to both Micro and SMEs. This level of institutions against the market seemed to be deep such that it could offer reasonable competition to the players. However, the pricing structure offered i.e. the average rate to SMEs when compared to the respective bank’s base rate and the charging methodologies which include a flat rate method, point to a lack of competition on the market. This was further evidenced by the results of the study which had only 43% of the institutions as having on average products which had no constraints on SMEs. This pointed to a probability of the market being concentrated in the hands of a few market players, as per Cetorelli et al (1999) who narrated the theoretical predictions of the structure/conduct/performance paradigm. According to that paradigm, structure affects the conduct of firms, which ultimately determines their performance. Concentration of market shares facilitated the adoption of collusive conduct and,

ultimately, the setting of prices departing from the perfectly competitive benchmark. In a perfectly competitive market, firms are considered too small to have an individual impact on the price of the good they produce. From the point of view of social welfare, perfect competition represents an ideal benchmark, since consumers (in the case bank customers) pay the lowest possible price for the product they demand. Any situation in which firms command some degree of market power and are therefore able to set higher than competitive prices implies a social cost in terms of welfare loss for consumers. The structure/conduct/performance paradigm predicts that there is an increasing relationship between the level of market concentration and market power. It seemed that there was need for the financial institutions in Malawi to take deliberate policies to differentiate themselves in terms of product attributes despite the perceived depth in the number of players on the market. This could be seen in the nature of the product which by and large looked fairly uniform across the market and lacked any innovation, this tended to point to the fact that there was an apparent lack of competition on the Malawian market to SMEs.

### 5.1.3 Perception of SMEs by Financial Institutions

Kedrock et al (2007) raised a number of considerations in respect to the perception which financial institutions in Malawi had towards SMEs which constrain access to credit. However, these were not unique to Malawi as some of them were also raised by Beck et al (2008) as being prevalent in the world. The consideration in this study was to check whether any gains had been achieved from the time which they were raised to the time of the study and therefore effectively improved the potential for access to credit by SMEs. The considerations raised and the current status of affairs is:

- The lack of a definition for SMEs by banks/financial institutions. In their study, out of seven banks surveyed, five had no definition, one defined it simply as sole proprietorships or partnerships while the other defined it simply by loan size. It was argued that this lack of a uniform definition for SMEs among the financial institutions led to a lack of a proper determination of the size of the enterprise

which consequently led to a lack of consensus on market potential. During this study it was discovered that almost each one of the sampled institutions still had its own unique definition of SMEs and no uniform industrial definition. This could have been the reason why the product attributes for the industry were quite diverse.

- As at that time, one bank had closed a dedicated SME operation, while two others were in the process of setting them up. Effectively, financial institutions had no dedicated set ups for servicing SMEs. This position has significantly improved as most of the financial institutions have now set up such operations as has been stated in section 3.3.1, above.

- The researchers made the following assertion "the cost of finance remains a problem for medium and large businesses, which considers it a more serious issue (71%) than access to finance (43%). Informal firms (micro and SME) report access to finance (84%) a more serious impediment to growth than cost of finance (51%). Whether it is access to or cost of credit that impedes SMEs from borrowing, excessive collateral requirements or a lack of financial products geared towards them or a lack of interest in the market by commercial banks, it is clear that only a small portion of the potential borrowing market is being serviced, as the sub-sector case studies suggest". Due to lack of demand side information and portfolio sizes of financial institutions, this study was unable to substantiate gains made in this regard but the opinion of the research was that this situation has not improved much and evidenced by the findings that financial institutions still had stringent collateral requirements.

Generally, therefore, there have been some improvements in the perception of financial institutions towards SMEs to the extent that most of them have recognized the business potential in the sector and set up dedicated operations to service the sector. However, there is need to improve internal measurements which may in turn transcend into improved products to SMEs.

### 5.1.4 Performance of SME Purpose Fund Schemes

Generally it was observed that the performance of SME purpose fund schemes in Malawi was dismal and the evaluation of each scheme isolated several factors which could have contributed to that. This study singled out the following as the possible major shortfalls which caused the under performance of the schemes:

- The perception that the general public had of the schemes that these were safety nets, hence affected the level of loan repayment.
- The low ceilings of loan amounts and the short repayment term which tended to concentrate resources on micro rather than the SME sector and as such tended to target the trading as opposed to the production sectors.
- The lack of immunity to political pressure by implementing agencies, compromised both the appraisal, monitoring and repayment enforcement.
- The deficiencies of capacity of implementing agencies also compromised both the appraisal, monitoring and repayment enforcement.
- The setting of non-commercial pricing structures e.g. fixing interest rate as opposed to the standard floating rate or subsiding interest rates. This effectively erodes the value of the scheme.

It was the opinion of the researcher that in a country like Malawi which has very weak socio economic parameters, it was not possible for SMEs to fully satisfy the requirements of commercial financial institutions and therefore government purpose fund schemes have a role to play in the access to finance to SMEs. The study had singled out two areas in which financial institutions were drastically failing to meet the expectations of SMEs i.e. the funding of start-up capital and the stringent collateral requirements. These were noted to be some of the areas which government purpose fund schemes could mitigate. However, when setting up the schemes due recognition of the set backs experienced in the past programs must be borne in mind and should not be repeated.

Burritt (2006) advocated measures which stemmed from his review of the Agricultural Productivity Program (APIP), which broadly could be borne in mind by government/donors when setting up such schemes in future which were:

- The government should move slowly with these initiatives to ensure that appropriate institutional mechanisms and risk management incentives are in place.
- Devolve key decision making process to financial intermediaries (implementing agencies) e.g. client selection, interest rates structuring, loan amounts and loan tenors.
- Ensure that financial intermediaries selected for on-lending funds have the institutional capacity e.g. MIS, lending experience, new product development capacity and a good track record for portfolio management.
- Enable institutions to reflect loans managed on their own balance sheet, building their capacity to strengthen and manage a capital structure that enables significant expansion over the long term.
- Do not set price ceilings for financial intermediaries; rather allow them to set prices that allow full cost recovery including a surplus.

# CHAPTER SIX

## CONCLUSIONS AND RECOMMENDATIONS

### 6.1 INTRODUCTION

This chapter presents conclusions and recommendations of the findings basing on the discussions from chapter 6. Then the chapter will suggest recommendations that financial institutions ought to pursue to ease access to capital by SMEs.

### 6.2 CONCLUSIONS

The objective of the study was to determine if quality of product attributes of SME tailor made products in Malawi are structured in such a way that they create a constraint to access of finance by SMEs, and if so which of the attributes is the major impediment. A secondary, but related, objective was to explore the successes of SME purpose created fund schemes in Malawi and how, if any, had they augmented access to finance by SMEs in Malawi.

It is evident from the findings of the study that collateral remained the major impediment to SMEs to access finance in Malawi with over 60% of the types of collateral which financial institutions required being those which were rarely owned by Malawians and to further worsen that, the required cover for collateral to loan was high, a situation which had not improved since the study of Kedrock and Agar in 2007. This overshadowed all the other product attributes which were analysed and found that they either posed no constraint or insignificant constraint to access to credit to SMEs.

Although the findings of the analysis in the study drew the conclusion that the other product attributes posed no constraint or insignificant constraint to access to credit to SMEs, there are still a number of factors embedded in the attributes which need to be improved to augment access of credit by SMEs like the reluctance of most institutions to finance start ups i.e. poor venture capital; and the high cost of finance (with some institutions applying flat rates and mark-up rates on SMEs above the base

rates was as high as 18.5% for NBS with the others averaging 6.5%). Even though these factors could not stop the SMEs from accessing credit, this could have supported the findings of Schiffer & Weder (2001); IADB (2004); Beck, Demirgüç-Kunt & Maksimovic (2005); and Beck, Demirgüç-Kunt, Laeven & Maksimovic (2006), that they could constrain SMEs or affect their performance).

Despite an apparent depth in the number of financial institutions offering credit to SMEs, the study noted that there was lack of innovation by the financial institutions to differentiate themselves on the market as the competition was weak and consequently financial institutions command some degree of market power and were therefore able to set higher than competitive (market driven) prices and stringent interest computation methods, supporting the assertions of Cetorelli et al (1999).

As regards the performance of SME purpose fund schemes in Malawi which were aimed at deepening SME finance market and hence easing the access of finance by SMEs by among other aspects relaxing the conditions and product attributes, the study noted that their performance was dismal. Out of the four schemes which were reviewed, only one performed successfully and achieved self-sustenance. A number of design and operational flaws were noted which needed to be avoided in future design strategies. However, it was noted that there still was room for such schemes more especially following the new thinking as articulated by Batra and Mahmood (2003), which had already been implemented in Malawi to some extent (on-lending facility extended to NBS Bank and First Merchant Bank by the IMF). However, it was noted that vividly missing in the initiatives was a credit guarantee fund, which effectively would have assisted in alleviating the stringent collateral requirements by financial institutions, as was pointed out by Kedrock et al (2007) that "partial guarantee program should further attract participating banks into SME lending".

## 6.3 RECOMMENDATIONS

This study has discussed issues which have an impact on the access of financing by SMEs in Malawi. The recommendations provided in this section are made to the financial institutions and the government/donors to increase the width and depth of funding to SMEs.

### 6.3.1 SME Product development

The study revealed that the bulk of financial institutions did not finance start up SMEs, yet this is the most critical stage in the SME cycle if the sector is to grow. It is, therefore, recommended that financial institutions must reconsider their position of not financing start-up SMEs and offer the product but undertake rigorous appraisal to screen the weak applications out. Further, financial institutions must improve their internal measurements to ensure that the treatment of SMEs is very distinct from that of the large enterprises so that the large enterprises do not get an unfair advantage over SMEs as regards extension of credit.

### 6.3.2 Relaxing Collateral requirements for SMEs

The study revealed that type of collateral and the required collateral cover were stringent for SMEs, as they created a significant constraint to access to credit by SMEs. It is, therefore, recommended that financial institutions must be innovative and develop alternative risk management tools which could assist them to tap more into the SME market.

### 6.3.3 A quest to achieve competitiveness

Even though there was no institution with product attributes which had significant constraints to SMEs but from the results, it was noted that none of the financial institutions scored on the competitiveness matrix at or below one hence concluded that all the financial institutions have product attributes which had some constraint towards SMEs when they sought credit from them. It is, therefore, recommended that financial institutions must work to ensure that all product attributes which constrained SMEs are relaxed.

### 6.3.4 Mitigations by Purpose Schemes

The study had singled out two areas in which financial institutions were drastically failing to meet the expectations of SMEs i.e. the funding of start-up and the stringent collateral requirements. It is, therefore, recommended that government purpose fund schemes must target to mitigate these areas by among others setting up venture capital funds and credit guarantee schemes.

### 6.3.5 Considerations when setting up Purpose Schemes

It is recommended that when setting up the schemes due recognition of the set backs experienced in the past programs must be borne in mind and should not be repeated and the measures advocated in item 5.1.4 must be borne in mind when setting up such schemes.

## 6.4 AREAS OF FURTHER RESEARCH

There is need for further research in regard to access to finance by SMEs to augment this research in the following areas:

- An evaluation of the portfolios of the financial institutions providing credit to SMEs to understand the extent to which credit has been accessed by SMEs in comparison to the nation credit extended and also to project the potential demand in the market.

- An evaluation of Malawi financial sector competitive conditions, possibly using concentration ratios.
- A survey of demand-side of capital, to understand the perception of the consumer on the product attributes and service delivery to SMEs.

# REFERENCES

ANDREE, C. and KALLBERG, C. (2008) *The capital structure of SMEs: Evidence from the Swedish security industry*. [Online] Available at: http://www.student.se/uppsok/search2.php?allasmes [Accessed: 17 August 2009].

AYYAGARI, M., BECK, T. and DEMIRGÜÇ-KUNT, A. (2007) *Financing of Banks for SMEs*. (Online) Available at: http//www. iadb.org/intal/intalcdi/PE/2008/02331.pdf [Accessed on 3 October, 2010].

BANKERS ASSOCIATION OF MALAWI (2004) *Interest Rates*. (Online) Available at: http://www./obmalawi.com/inf04.htm [Accessed May 22, 2009].

BARBOSA, E.G. and MORAES, C.C. (2004) *Determinants of the firm's capital structure: The case of the very small enterprises*. (Online) Available at: http://econpa.wustl.edu.8089/eps/fin/papers 0302/0302001.pdf [Accessed on August 18, 2007].

BATRA, G. and MAHMOOD, S. (2003). *Lending facilities to Banks* (Online) Available at: http//www. ccsenet.org/journal/index.php/ibr/article/download/143/775 [Accessed on 2 February, 2010].

BECK T., et al. (2008). *Bank Financing for SMEs around the World: Drivers, Obstacles, Business Models and Leading Practices*. (Online) WPS4785, Available at : http://www.iadb.org/intal/intalcdi/PE/2008/02331.pdf [Accessed 2 March, 2011].

BECK T., DEMIRGUC-KUNT A. and MAKSIMOVIC V. (2005). "Financial and Legal Constraints to Firm Growth: Does Firm Size Matter?" *Journal of Finance*, pp. 137-177.

BECK T., DEMIRGUC-KUNT A. and MAKSIMOVIC V. (2006) “The Influence of Financial and Legal Institutions on Firm Size”, *Journal of Banking and Finance, pp*. 166

BECK T., DEMIRGUC-KUNT A. and MAKSIMOVIC V. (2008) Financing Patterns Around the World: The Role of Institutions. *Journal of Financial Economics*, pp. 467-487.

BECK T. et al. ( 2006) *Small and Medium-Size Enterprises: Access to Finance as a Growth Constraint*. (Online) Available at: http://www.tilburguniversity.edu/webwijs/files/center/beck/…. [Accessed 8 July, 2012].

BERGER, A.N. and UDELL, G.G. (2005) A More Complete Conceptual Framework for SME Finance, *World Bank Policy Research journal, pp. 137* (Online) Available at: http://www.wds.worldbank.org/servelet/WDSContentServer/WDSP/.pdf [Accessed 20 January, 2011].

Blunden, M. (2005) (Online) *Data Collection Methods*. (Online) Available at http//www.home.mira.net/~andy/works/method.htm [Accessed on 22 December 2010].

BURRITT, K. (2006) *Expanding Access to Financial Services in Malawi*, UN Publications Number: E.05.III.B.22, New York, UN.

CASSAR, G. (2004) The financing of business start-ups. *Journal of Business Venturing,* pp. 19, 261-283.

CETORELLI, N. (1999) Competitive Analysis in Banking: Appraisal of the Methodologies*, Journal Article, Economic Perspectives*, Vol.23. (Online) available at: http://www.questia.com/googleScholar.qst?docID=5001244955 [Accessed 2March, 2011].

CHIPETA, C. and MKANDAWIRE M.L.C. (1998) *Malawi Financial Sector*. (Online) Available at: http://www.idl-bnc.idrc.ca/dspace/bitstream/10625/21859/1/113310.pdf [Accessed on 14 December, 2011].

COLLIER, P. (2009) Rethinking Finance For Africa's Small Firms. SME Financing in Sub-Saharan Africa, *Private Sector and Development Proparco's Journal*. (Issue 1), pp. 76 (Online) Available at: http://www.ffem.fr/jahia/webdav/site/ [Accessed 12 November, 2010]..

COULTHARD, M. and LOOS, J. (2007) *Networking, the link in firm based entrepreneurial orientation (EO) performance model.* [Online] Available at http://www.buseco.monash.edu.au/mgt/staff/coulthard.max.html [July 18, 2008].

COCO, G. (2000) On the use of collateral. *Journal of Economic Surveys*, 14, pp. 191-214.

COOPER and SCHINDLER (1998) Study *Population and Sample on SMEs*. (Online) Available at: http://www.scribd.com/doc/64175456/67/Study-Population-and-sample [Accessed 12 July, 2012].

DAHL, M.S. and SORENSON, O. (2007) *Home sweet Home/Social capital and location decisions.* [Online] Available at http://www.druid.dk/fileadmin/images/dokumenter/ sorenson. [Accessed 15 July, 2011).

Daniel, O. et al. (2006) Determinant of capital structure in new ventures: evidence from Swedish longitudinal data. *Journal of Development Entrepreneurship,* pp. 12, 47.

DEMIRGUC-KUNT, A. (2010 *Bank Competition and Access to Finance*. (Online) Available at: http://blogs.worldbank.org/allaboutfinance/bank-competition-and-access-to-finance. [Accessed 4 March 2011].

DE CARMONA ET AL. (2007) X/GSB/UNDP, 2007. *Financing Business in Malawi*.

DERREUMAUX, P. (2009) The Difficulties SMEs Face to Access Finance in Africa: Who is to Blame? *SME Financing in Sub-Saharan Africa, Private Sector and Development Proparco's* Journal, (Issue1). (Online) Available at: http://www.ffem.fr/jahia/webdav/site/ [Accessed 12 November, 2010].

DUARTE, N (2004) *The Role of SMEs for Development: A Literature Review*. (Online) Available at: http://ideas.recep.org/wiw/wiwrsa/ersa04p39.html (Accessed 4 March 2011).

RBM, RESEARCH AND STATISTICS DEPARTMENT (2009) *Exchange and Interest Rate Determination in Malawi: Past and Present*, (Online) Available at: http://www.rbm.mw.

RBM, FINANCIAL SECTOR ASSESSMENT PROGRAM (2008) *Malawi Banking Sector: The path to a deeper and more inclusive system.* (Online) Available at: http://www. Inweb90.worldbank.org/fps/fsapcountrydb.nsf.

FRELINGHAUS et al. (2005). *The Impact of Inaccessibility to Bank Finance*. (Online) Available at: http://www.academicjournals.org/AJBM/PDF/pdf2010/4Aug/Olawale [Accessed on 12 July 2012].

GERMAN ECONOMIC TEAM (2009) *Guarantee Funds for SME Loans Paper/01005*, Belarus (online) Available at: http://pdc.ceu.hu/archive/00002743/01/01e.pdf, [Accessed on 2 November 2010].

GILBERT, B.A. (2008) *New venture performance: does location matter*? [Online] Available at: http://74.125.77.132/search/q=cache.DIZnExwD91tmw.j.ftp/ftp.zew./pub [Accessed on May 17, 2009).

GITMAN, L.J. (2003) *The Principles of Managerial Finance*. 7th ed. New York: Pearson Education Inc.

GOVERNMENT OF MALAWI/UNDP/UNCDF (2007) Building an Inclusive Financial Sector in Malawi (FIMA).

GOVERNMENT OF MALAWI: MINISTRY OF INDUSTRY, TRADE AND PRIVATE SECTOR DEVELOPMENT, (2007) *Brief on Malawi's efforts to improve the business environment as measured by the Doing Business indicators journal 76, pp.143.*

.

GOVERNMENT OF MALAWI: MINISTRY OF TRADE AND PRIVATE SECTOR DEVELOPMENT (2007). *Micro and Small Enterprise Policy Statement*.

Hellriegel, D et al. (2008) *Management*. 2nd ed. Oxford: Oxford University Press.

HERRINGTON and WOOD (2003) *The Determinants of Access to Trade Credit by New SMEs.* (Online) Available at: http://www.wendang.baidu.com [Accessed on 12 July 2012].

HISRICH, R.D. and DRNOVSEK, M. (2002) Entrepreneurship and Small Business Research. *Journal of Small Business and Enterprise Development*.

IADB (2004) *Access to Credit by SMEs*. (Online) Available at: http://www.ffem.fr/jahia/webdav/site [Accessed on 9 July 2012].

KEDROCK, B. and AGAR, J. (2007) *Assessment of the SME Sector in Malawi in Preparation for a Development Credit Authority Loan Portfolio Guarantee* (Online), Available at: http://pdf.usaid.gov/pdf_docs/PNADR932.pdf, [Accessed on 2 March, 2011].

KORTSCHAK, T. (2007) *The right amount of leverage*. [Online] Available at: http://www.summitpartners.com/uploadedfiles/news/newrelaese/recentnews (Accessed on May 15, 2008).

KRAUS, A. and& LITZENBERGER, R.H. (1973) A state-preference model of optimal financial leverage*. Journal of Finance, pp. 55-58.*

KUROKAWA, TEMBO K., AND WILLEM TE VELDE, D. (2008*) Donor support to private sector development in Sub-Saharan Africa – Understanding the Japanese OVOP Programme,* JICA-ODI Journal, pp. 290.

LYLES et al. (2004) *Organisational Structure in SMEs.* (Online) Available at: http://www.dipna.com/articles/impact-of-formal-strategic [Accessed on 18 April, 2011].

MALAWI COUNTRY PROFILE (2011). (Online) Available at: http://www.worldbank.org.

MAMN, (2010) *Market Share of MAMN Members*, (Online) Available at: http://www.mftransparency.org/mftransparency-and-the-malawi [Accessed on 18 April, 2011].

MARTIN, G., & STAINES, H. (2008) *Managerial competencies in small firm*. [Online] Available at: http://www.emraldinsight.com/insight/viewcontentitem.do?contenttype. (May17, 2009). [Accessed on 18 April, 2011].

MINISTRY OF TRADE AND TRADE AND INDUSTRY (2007) *Small Enterprise Policy Statement.*

MIPA/UNDP, (2008*). Building Capacity to Grow Sustainable Businesses, Feasibility Study: SME Financing and Skills Development*. Lilongwe: MIPA

MIRA, S. (2002) *On the capital structure in small and medium enterprises: the Spanish case*. (Online) Available at: http://www.papers.ssrn. [Accessed on 20 December, 2011].

MARTINOVIC (2008). Which SMEs in South Africa Have Access to Credit? *International Journal of Business and Management*, Vol. 5, No. 10.

MYERS, S.C. (1984) Capital structure puzzle. *Journal of Finance*, PP. 39, 575-592.

MODIGLIANI, F. and MILLER, M.H. (1963) Corporate income taxes and the cost of capital: A correction. *American Economic Review* 53, pp. 433-444.

MODIGLIANI, F., & MILLER, M.H. (1958) The cost of capital, corporation finance and the theory of investment. *American Economic Review* 48, pp. 261-295.

MOORSOM, R. (1998) *Social Action and Microcredit Funds in Malawi: A Pilot Study,* (Online) Available at: http://bora.cmi.no/dspace/handle/1.pdf [Accessed 08 February 2011].

NAGEL T., (1974). What Is It Like To Be a Bat? *Philosophical Review* pp. 83.

NANKANI, G.T. (2006) *Making Finance work in Africa* (Online) Available at: http://siteresources.worldbank.org/INTAFRSUMAFTPS/Resources/.pdf [Accessed 9 November, 2010].

OECD GLOSSARY (2012) *Statistical Terms* (Online) Available at: http://stats.oecd.org/glossary/detail.asp?ID=6189 [Accessed on 20 July 2012].

OWUALAH, S.I. (2002) SMEs borrowing constraints and banking relationship in Japan. *Japan and the World Economy Journal* 14, pp. 87-100.

PERIA, M.S.M. (2009). Bank Financing to SMEs: What are Africa's Specifities? SME Financing in Sub-Saharan Africa*, Private Sector and Development Proparco's Magazine* (Issue 1), pp. 78 Available at: http://www.ffem.fr/jahia/webdav/site/ [Accessed 12 November, 2010]

PERIA et al (2009) *Banking SMEs Across Countries and Bank Ownership Types*. (Online) Available at http:www.bcb.gov.br/Pec/Depep/Seminarios/2009. [Accessed 12 July, 2012].

PRETORIUS, M., and SHAW, G. (2004) Business plan in bank-decision making when financing new ventures in South Africa. *South African Journal of Economics and Management Science* 7, pp. 221-242.

Ruis, A. et al. (2009*) Cyclicality of SME Finance, EIM Business and Policy Research, Netherlands.*

RUNGANI, E. (2008) *The determinants of the capital structure choices of SMEs in the Buffalo City Municipality*. Unpublished Masters Thesis, University of Fort Hare.

SAUNDERS, M. LEWIS, P. and THORNHILL A. (2007) *Research Methods for Business Students*. 4thed. Harlow: Pearson Education Limited, UK.

SAUNDERS et al. (2000) *Research Methods for Business Students*. (Online) Available at: http://www.pearsonhighered.com/educator/academic/product/0,3110 [Accessed 12 July, 2012].

SCHIFFER, M. and WEDER, B. (2001) *Firm Size and the Business Environment: Worldwide Survey Results,* Papers 43, World Bank – International Finance Corporation.

SCOTT, D.F. (1972). Evidence on the importance of financial structure. *Journal on Financial Management* 1, pp. 45-60.

SCOTT, KRAUS and LITZENBERGER (1977) *Trade off theory*. (Online) Available at:http//www.academic journals.org/ [Accessed 18 July, 2012].

SHANE, S., and CABLE, D. (2002) *Network ties, reputation and the financing of new ventures. Management Science.*

SMALLBONE, D. and WELTER, F. (2001). The Distinctiveness of Entrepreneurship in Transition Economies*. Small Business Economics*

SMALLBONE, D. and WELTER, F. (2000) Search for External Financing in Swedish SMEs, *Small Business Economics Journal*, Volume 15. pp. 5,37-39

TADESSE, A. (2009) *Financing in Sub-Saharan Africa*. (Online) Available at: http://www.proparco.fr/jahia/site/proparco/ [Accessed on 19 July 2011).

STIGLITZ, J. and WEISS, A. (1981) Credit Rationing. (Online) Available at: http://www.ideas.repec.org/a/aea/aecrev/ [Accessed 14 July, 2012].

WIKIPEDIA, (2010) *SME Finance* (Online) Available at: http://en.wikipedia.org/wiki/SMEfinance [Accessed 20 November, 2010].

WORLD BANK GROUP (2012) *The development of an economy's financial markets* (2012). (Online) Available at: http://www.data.worldbank.org/about/world-development.../financial-sector *[Accessed on 18 July 2012].*

ZAVATTA, R. (2008). *Financing Technology Entrepreneurs and SMEs in Developing Countries: Challenges and Opportunities* (Online)Available at: http://www.infodev.org/en/Document.542.pdf [Accessed 12 December, 2009]

## APPENDICES

## APPENDIX A: ANALYSIS OF FACILITY LIMITS

### A1: Description of Quartiles

| | | 1st Quartile | 2nd Quartile | 3rd Quartile | 4th Quartile |
|---|---|---|---|---|---|
| **Lower Limit** | **Range (US$)** | 0 to 3,450 | 3,451 to 6’910 | 6,911to 10,345 | 10,346 to 13,793 |
| | **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |
| **Upper Limit** | **Range (US$)** | 1,293 to 1,724 and above | 863to 1,293 | 432 to 862 | 0 to 431 |
| | **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |
| **Average** | **Range (%)** | 100 to 75 | 74.9 to 50 | 49.9 to 25 | 24.9 to 0 |
| | **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |

**A2: Number and Percentage of financial Institutions in each quartile.**

| | 1st Quartile | | 2nd Quartile | | 3rd Quartile | | 4th Quartile | |
|---|---|---|---|---|---|---|---|---|
| | **No.** | **%** | **No.** | **%** | **No.** | **%** | **No.** | **%** |
| **Lower Limit** | 6 | 85.7 | 0 | 0 | 0 | 0 | 1 | 14.3 |
| **Upper Limit** | 4 | 57.0 | 0 | 0 | 0 | 0 | 3 | 43.0 |
| **Average (%)** | | 71.4 | | 0 | | 0 | | 28.6 |

**A3: Calculation of quartile medians for facility limits.**

| | **Lower limit** | | | **Upper limit** | | | **Average of lower and Upper limit** | | |
|---|---|---|---|---|---|---|---|---|---|
| **Qt** | **No** | **F** | **F%** | **No** | **F** | **F%** | **No** | **F** | **F%** |
| 1 | 6 | 6 | 85.7 | 4 | 4 | 57.1 | 5 | 5 | 71.4 |
| 2 | 0 | 6 | 85.7 | 0 | 4 | 57.1 | 0 | 5 | 71.4 |
| 3 | 0 | 6 | 85.7 | 0 | 4 | 57.1 | 0 | 5 | 71.4 |
| 4 | 1 | 7 | 100.0 | 3 | 7 | 100.0 | 2 | 7 | 100.0 |
| Median | 85.7% | | | 57.1% | | | 71.4% | | |

## APPENDIX B: COMPARISON OF FLAT AGAINST REDUCING BALANCE INTEREST CALCULATION

*Refer to Attachment 1*

## APPENDIX C: ANALYSIS OF COLLATERAL

### C1: Description of Scores

| Score | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| Translation | **Commonly Owned**<br><br>(Every income earning household possesses (estimated at average USD160.00 per annum per person)*) | **Normally Owned**<br><br>(Every average income earning household possesses) | **Barely Owned**<br><br>Every medium to high income earning household possesses | **Scarcely Owned**<br><br>(Only high to affluent income earning household possesses) |
| **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |

*Source of estimated average income for Malawi:

## C2 Scores for Each Type of Collateral

| Type of Collateral | Score | Description |
|---|---|---|
| Business machinery | 3 | Normal constraint |
| House with Title Deeds | 4 | Significant constraint |
| House without Title Deeds | 2 | Insignificant constraint |
| Motor Vehicles | 3 | Normal constraint |
| Household Property | 1 | Not a constraint |
| Animal Stocks | 2 | Insignificant constraint |
| Third Party Guarantees | 4 | Significant constraint |
| Average Score | 3 | Normal constraint |

**APPENDIX D: EVALUATION OF SAMPLE INSTITUTIONS' COMPETITIVENESS**

**D1: Allocation of Points**

| **PRODUCT ATTRIBUTE** | | **VARIABLE** | |
|---|---|---|---|
| **Variable** | **Points Allocated** | **Variable** | **Points Allocated** |
| LIMIT | 20.00 | Lower | 5.00 |
| | | Upper | 15.00 |
| PRICE | 10.00 | Average interest Rate | 7.00 |
| | | Charging Method | 3.00 |
| TERM | 20.00 | Minimum | 5.00 |
| | | Maximum | 15.00 |
| PURPOSE | 20.00 | Start up financing | 20.00 |
| COLLATERAL | 30.00 | | |
| | Type = 10.00 | Business Machinery | 3.00 |
| | | House with Title Deeds | 2.00 |
| | | House without Title Deeds | 0.25 |
| | | Motor Vehicles | 1.50 |
| | | Household Property | 1.25 |
| | | Animal Stocks | 0.50 |
| | | Third Party Guarantees | 1.50 |
| | Cover = 20.00 | | 20.00 |
| **Total** | **100.00** | | **100.00** |

**D2: Description of Quartiles**

| | **1st Quartile** | **2nd Quartile** | **3rd Quartile** | **4th Quartile** |
|---|---|---|---|---|
| **Description** | Not a constraint | Insignificant constraint | Normal constraint | Significant constraint |
| **Range** | | | | |
| Amount Limit (Points) | 20.00 to 15.0 | 14.99 to 10.00 | 9.99 to 5.00 | 4.99 to 0 |
| Pricing (Points) | 10.00 to 7.50 | 7.49 to 5.00 | 4.99 to 2.50 | 2.49 to 0 |
| Term (Points) | 20.00 to 15.0 | 14.99 to 10.00 | 9.99 to 5.00 | 4.99 to 0 |
| Purpose (Points) | 20.00 to 15.0 | 14.99 to 10.00 | 9.99 to 5.00 | 4.99 to 0 |
| Collateral (Points) | 30.0 to 22.50 | 22.49 to 15.00 | 14.99 to 7.50 | 7.49 to 0 |

**D3: Points Obtained by Each Sampled Institution on Collateral Type and Coverage.**

| | NBS | MSB | OIBM | FMB | INDE-FUND | NED-BANK | FINCA |
|---|---|---|---|---|---|---|---|
| **Allowable Type** | | | | | | | |
| Business machinery | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 |
| House with Title Deeds | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |
| House without Title Deeds | - | - | 0.25 | - | - | - | - |
| Motor Vehicles | 1.50 | 1.50 | 1.50 | 1.50 | - | - | 1.50 |
| Household Property | 1.25 | 1.25 | 1.25 | 1.25 | - | - | 1.25 |
| Animal Stocks | - | - | 0.50 | - | 0.50 | - | - |
| Third Party Guarantees | 1.50 | 1.50 | 1.50 | 1.50 | - | 1.50 | 1.50 |
| **Total for Type** | 9.25 | 9.25 | 10.00 | 9.25 | 5.50 | 6.50 | 9.25 |
| **Total for Acceptable Coverage** | 20.00 | 16.00 | 16.67 | 20.00 | 16.00 | 11.98 | 16.00 |
| **Aggregate** | **29.25** | **25.25** | **26.67** | **29.25** | **21.50** | **18.48** | **25.25** |

**D4: Consolidation of Points earned by each Financial Institution.**

*Refer to Attachment 2*