Malawi
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MAKING ACCESS POSSIBLE (MAP) FOR MSMEs:

MALAWI DIAGNOSTIC 2019

FINMARK TRUST

Making financial markets work for the poor

TABLE OF CONTENTS

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ACRONYMS AND ABBREVIATIONS

ACE	Agriculture Commodity Exchange for Africa
ADMARC	Agricultural Development and Marketing Corporation
AfCFTA	African Continental Free Trade Area
AGF	African Guarantee Fund
AHCX	AHL Commodity Exchange
ATM	Automated Teller Machine
AU	African Union
BAM	Bankers' Association of Malawi
BDS	Business Development Services
CABS	Common Approach to Budget Support
CAGR	continuous annual growth rate
COMESA	Common Market for Eastern and Southern Africa
COMSIP	Community Savings and Investment Promotion
CRB	Credit reference bureau
DEMAT	Development of Enterprises Malawi Trust
DFI	Development Finance Institutions
DFS	Digital financial services
EDF	Export Development Funds
E-KYC	Electronic Know Your Customer
EU	European Union
FGD	Focus Group Discussions
FISP	Malawian Government's Farm Input Subsidy Programme
FMT	FinMark Trust
FSP	Financial service providers
GDP	Gross Domestic Product
GoM	Government of Malawi
GSMA	Global System for Mobile Communications
HDI	Human Development Index
HRDC	Human Rights Defenders Coalition
ICRISAT	International Crops Research Institute for the Semi-Arid Tropics
ICT	Information and Communications Technology
IMF	International Monetary Fund
IPRSE	Institute for Policy research and Social Empowerment
ITTF	Local Information Technology Task Force
KYC	Know Your Customer
MACRA	Malawi Communications Regulatory Authority
MAIC	Malawi Agriculture and Industrial Corporation Plc
MAP	Making Access Possible
MBS	Malawi Bureau of Standards
MEDI	Malawi Enterprises Development Institute
MEPD	Ministry of Economic Planning and Development
MFI	Microfinance institutions
MGDS	Malawi Growth and Development Strategy
MICF	Malawi Innovation Challenge Fund
MIS	Management information systems
MIT	Malawi Institute of Tourism
MITA	Malawi Information Technology Agency
MITASS	Malawi Interbank Transfer and Settlement System
MMO	Mobile money operator
MNO	Mobile network operator
MRA	Malawi Revenue Authority
MSE	Malawi Stock Exchange
MSME	Micro, small and medium sized enterprises
Mt	Metric tonne
MUSCCO	Malawi Union Of Savings and Credit Cooperatives
NAP	National Agriculture Policy
NASFAM	National Smallholders Farmers' Association
NBM	National Bank of Malawi
NEPAD	New Partnership for Africa's Development
NES	National Export Strategy
NFIS	National Financial Inclusion Strategy
NGO	Non-governmental organisation
NIP	National Industrial Policy
NSL	National Switch Limited
NSO	National Statistical Office
ODA	official development assistance
OSSC	One Stop Service Centre
PE	Private Equity
POS	Point of sale
PPSR	Personal Property Security Registry
PSP	Payment service providers
RBM	Reserve Bank of Malawi
RCIPMS	Regional Communications Initiative Project Malawi
SACCO	Savings and credit cooperative societies
SADC	Southern African Development Community
SLPCG	Second loss partial credit guarantees
SME	Small and medium sized enterprises
SMEDI	Small and Medium Enterprise Development Institute
SSA	Sub-Saharan Africa
TEVET	Technical, Entrepreneurial and Vocational Education and Training
TNM	Telekom Networks Malawi
UNECA	United Nations Economic Commission for Africa
UNDP	United Nations Development Programme
USAID	United Agency for International Development
USD	United States dollar
VAT	Value Added Tax
VC	Venture Capital
VSLA	Village savings and loan association
WBG	World Bank Group
WEF	World Economic Forum
WRS	Warehouse Receipt System
WTTC	World Travel & Tourism Council

GLOSSARY OF TERMS

TERM	DEFINITION
Access strand	A measurement of financial inclusion across the formal-informal institutional provider continuum.
Banked	Individuals using one or more traditional financial products supplied by commercial banks.
Business Development	Refers to any activity which serves to develop the business in some way. It entails tasks and processes to develop and implement growth opportunities for businesses.
Credit	Obtaining funds from a third party with the promise of repayments of principal, and in most cases, with interest and arrangement charges in exchange for the money.
Demand-side barriers	Barriers to access financial services and business development support related to characteristics inherent to the individuals within the business.
Formal products	Products provided by government-regulated financial institutions including but not limited to commercial banks, insurance companies and microfinance institutions.
Formally included	MSME owners using formal financial products supplied by institutions governed by a legal precedent of any type. This is not exclusive usage, as these individuals may also be using informal products.
Formal MSME	MSMEs who are either registered with the Registrar General or licensed with a local authority.
Financial Access Landscape	A measurement of usage of both formal and informal products across the four main product groups: transactions, savings, credit, and insurance.
Financially served	SME owners using one or more formal and/or informal financial products/services.
Financially excluded	SME owners who are not using any formal or informal financial products/services.
Financial inclusion	The extent to which the adult population in the country engages with financial products and services, such as savings, transaction banking, credit and insurance, whether formal or informal.
Insurance	A financial service where payment is made as a premium for risk of an event happening, where pay-out is made if or when the event occurs.
MSME	The MSME Policy, 2018 defines MSMEs based on number of employees, annual turnover or maximum assets.
Supply-side barriers	Barriers to access financial services and business development support related to factors inherent to providers that prevent individuals from using their services.
Youth	Youth are defined as people aged between 10 and 35 years.

EXECUTIVE SUMMARY

The Malawi Making Access Possible (MAP) for Micro, Small and Medium Enterprises (MSME) study entailed carrying out an evidence-based diagnostic study to identify the key barriers and opportunities in the market to grow MSMEs. The study involved a review of the country's context, demand-side, supply-side and policy and regulatory considerations that affect MSMEs.

This review was achieved through the use of broad stakeholder dialogue (i.e. Government, donor agencies, private-sector players and industry associations), FinScope survey of MSMEs in Malawi, qualitative interviews with key MSME groups, financial service provider (FSP), data reviews and in-depth desktop research to develop the current view of the state of MSMEs in Malawi. As part of the analysis, key segments of MSMEs that have the potential to have the largest impact on economic activity and employment in the country were identified as the target market b. The classification used to classify these small- and medium-sized enterprises (SMEs) is as follows:

1. **Personal income is above the median of the segment –** this measure is correlated to business performance and provides a useful benchmark for showing businesses who are performing slightly above average.

2. **The business has employees –** all businesses which have employees other than the owner. This is done on the basis that businesses which employ are able to contribute to economic growth as well as employment.

3. **The business views itself to be growing or stable in the past year -** this provides insight around business perception and in conjunction with the previous two indicators provides a rounded view of high-impact businesses.

   The high-impact segments were further subdivided into aggressive growth and employment generation SMEs to develop a more nuanced understanding of SMEs based on the sectors in which they are active. The criteria used include:

- **Aggressive growth** – these are businesses in agriculture and/or farming, manufacturing, construction, and business services sectors. This target group is identified to be key in industrialising the SME economy and is purported to grow substantially in its contribution to economic growth.

- **Employment creation –** this comprises wholesale and/or retail, community and households, tourism, agro-processing, and natural resources and mining.

The key findings from the diagnostic are captured below:

Sectoral and macroeconomic focus

- Agriculture remains the biggest contributing sector in terms of Gross Domestic Product (GDP), contributing 28 per cent. Despite agriculture's dominance, a greater prioritisation of key value chains is required to grow the sector.
- The trade and hospitality sectors are the second largest GDP contributors at 18 per cent. These sectors have high linkages to the agricultural sector and have potential to grow employment.
- The Malawi population is largely young (81% are youth); poor, with 70 per cent of Malawians living on less than USD 1.9 per day (i.e. MWK 1,368); and rural, with 83 per cent of the total population residing in rural areas. In addition, education levels are low with an adult literacy rate of 73 per cent and with 68 per cent of adults not having any education qualifications.
- Limited infrastructure is a key driver of low productivity which limits domestic production and international trade. This is exemplified by the country facing frequent and lengthy electricity outages, and poor and limited reach of road and Information and Communications Technology (ICT), infrastructure.

Supply-side constraints

- There is a lack of a diverse range of providers that are able to meet specific sector and lifecycle needs of MSMEs.
- FSPs lack robust lending models that adequately assess the risk profile of MSMEs. As a result they rely on traditional forms of collateral and manual processes which limit credit extension to MSMEs. Innovations such as credit information sharing, personal property security registry (PPSR) are in their infancies.
- Information asymmetry between lenders and borrowers drives perceptions of high risk in lending to SMEs.
- There is a lack of innovative credit assessment methods that limits lenders' ability to apply risk-based lending and pricing.
- A lack of payment interoperability and partnerships with informal providers limits the reach of formal FSPs.
- Product innovation is required to better serve the needs of SMEs.

Demand-side constraints

- Malawi MSMEs are characterised as being informal and micro enterprises. 89 per cent of all MSMEs in Malawi are informal. Furthermore, 74 per cent of all MSMEs are micro businesses.
- Sourcing capital is the leading challenge faced by SMEs across business life cycles from start-up to mature enterprises.
- Limited access to markets stifles the growth of SMEs.
- Low levels of business and financial management skills affect the operations of SMEs and also impact their ability to access finance.
- Formalisation and compliance are constrained by low awareness and knowledge.
- Women and youth face a number of challenges in growing businesses from micro to small and medium enterprises.

Policy and regulatory

- Regulations are often slow to be implemented, hampering their potential impact. The development of the MSME policy begun in 2012, was only approved in 2019 and has yet to begin its implementation.
- There is a need for improved flexibility of MSME policy to cater to business needs agnostic of sector.
- Government procurement policy is currently not implemented fully, and greater focus has to be given to youth-owned and women-owned enterprises.
- The Malawi Investment and Trade Centre's One Stop Service Centre (OSSC), needs to be scaled up and streamlined to support formalisation and compliance.
- Usage of the Government's services such as the warehouse receipt system (WRS), personal property security registry (PPSR), and Malawi Bureau of Standards (MBS), is low, which limits opportunities to de-risk lending and improve access to markets.

SECTION 1

INTRODUCTION

Micro, small and medium-sized enterprises (MSMEs) account for up to 90 per cent of all businesses in Sub-Saharan Africa (SSA) and contribute a significant share to total employment in the region[1]. MSMEs are therefore an important vehicle through which the continent can achieve sustained and inclusive economic growth and employment generation. Acknowledging this importance, the Southern Africa Development Community's (SADC) Industrialisation Strategy and Roadmap for Small-Medium Scale Enterprise (SME) development has placed MSMEs at the core of the developmental integration agenda for the region[2].

The Government of Malawi (GoM) has long recognised the role and importance of MSMEs in developing its economy. This was evidenced by the passing of an SME Policy in 1998, which was later revised to include d in 2018. Additionally, the Government has provided financing, capacity development and business support to MSMEs in the country.

Despite all of these efforts, there has been limited MSME growth and development in the country. This has been a result of regulatory and institutional weaknesses, policy inconsistencies, poor coordination of business development service providers and rapid changes in the business environment both locally and internationally[3].

In an effort to address these shortcomings, the GoM, donor agencies and private sector players, jointly referred to as the MSME Reference Group, sought to carry out in-depth research to establish the current state of MSMEs in Malawi. The MSME Reference Group is made up of the Ministry of Finance, Economic Planning and Development; Reserve Bank of Malawi (RBM); Ministry of Industry, Trade and Tourism; National Statistical Office; European Union Delegation (EU); World Bank; United Nations Development Programme (UNDP); Bankers Association of Malawi (BAM); Malawi Confederation of Chambers of Commerce and Industry (MCCCI); SME Chamber and the National Association of Small and Medium Enterprises (NASME).

This report captures the findings of the country context, demand-side, supply-side and policy and regulatory reviews. The rest of this chapter describes the approach that was employed and the timelines of the project. Chapter Two provides the macroeconomic, demographic, infrastructure and political context of Malawi. Chapter Three details the current and expected policy and regulatory frameworks affecting MSMEs. Chapter Four describes the target market of MSMEs with the most potential to have lasting economic and employment impact on the economy. Chapter Five describes the findings from the review of financial service providers (FSPs). And finally, Chapter Six summarises the diagnostic findings and describes the implications for the national roadmap.

1. IMF, SME Initiatives
2. SADC INDUSTRIALISATION STRATEGY AND ROADMAP, 2015-2063, Approved by Summit 29 April 2015, accessed at http://www.ilo.org/wcmsp5/groups/public/---africa/---ro-addis_ababa/---ilo-pretoria
3. GoM, MSME Policy, 2019

1.1. Methodology

The methodology is premised on the Making Access Possible (MAP) methodology. This entails carrying out an evidence-based diagnostic study of the country context, demand-side, supply-side and policy and regulatory factors affecting MSMEs to identify key barriers and opportunities in the market. This is achieved through the use of broad stakeholder dialogue (i.e. MSMEs, the Government, private sector players and donor agencies), data reviews and in-depth desktop research to develop a view of the present state of MSMEs. As part of the analysis, key segments of MSMEs that have the potential to have the largest impact on economic activity and employment in the country are identified as the target market. A national roadmap is then developed that identifies key drivers of change that can impact these segments. The roadmap identifies key practical activities which are prioritised and set against responsibilities and timelines. Figure 1 summarises this process.

A further description of the individual components of the research are provided below.

- **Country context:** Desktop research was used to provide the overall country context. This analysis explored the macroeconomic, socio-economic and demographic infrastructure and political drivers that impact the Malawian economy.

- **Qualitative demand-side research:** The analysis draws from the FinScope MSME Malawi Survey carried out in 2019. FinScope is a nationally representative demand-side survey that was implemented by FinMark Trust (FMT). The survey sought to understand how MSME business owners source their income and manage their financial lives. The MAP Malawi analysis uses quantitative data from this survey to obtain insights into the MSME sector and the realities, needs and profiles of various target-market groups.

- **Qualitative demand-side research:** The analysis utilises qualitative demand-side research that was conducted by FMT in October 2019. Individual interviews and focus group discussions (FGDs) were conducted with sampled enterprises to get insights into the nature of operations of target-market MSMEs and their views on key constraints to their development. These complemented the quantitative survey results to provide a deeper level of insight into attitudes and other drivers of the target-market MSME behaviour, and their usage of financial services and business development support (BDS).

- **Supply-side data analysis:** Thirty-three interviews were held with major suppliers of financial services and BDS by the authors in June to July 2019. The main stakeholders interviewed included providers of financial services (i.e. banks, microfinance institutions (MFIs), financial savings and credit cooperative societies (SACCOs), credit reference bureaus (CRBs), and mobile money operators (MMOs), government agencies, industry associations, donor agencies and private sector players. A full list of stakeholders interviewed is provided in the Appendix Table 21. These consultations were further supported with a review of RBM annual report and data requests made to FSPs.

- **Policy and regulatory analysis:** Supply-side consultations were accompanied by in-depth analysis of policy and regulatory environment that affects the operating landscape of MSMEs. The review sought to identify any potential policy and regulatory barriers or gaps currently faced.

- **Synthesis:** The information derived from the country context, demand-side, supply-side and policy and regulatory analysis was synthesised to develop key priority areas to support the target MSME segments.

FIGURE 1: MAP approach

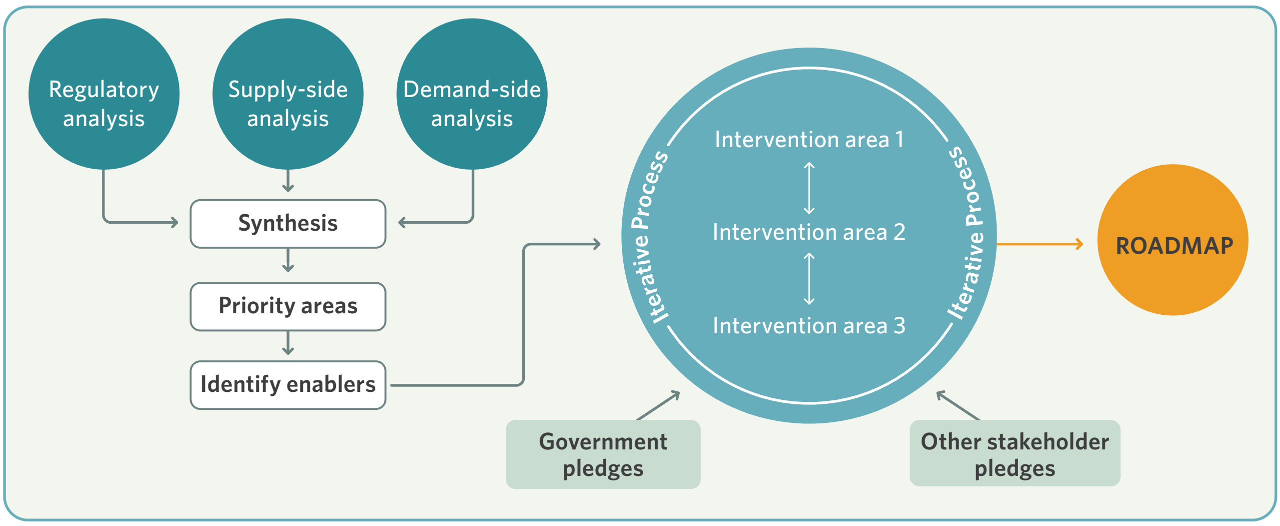


FIGURE 2: Map of Malawi

Source: United Nations (UN), Malawi Country Profile, 2019

SECTION 2

COUNTRY CONTEXT

Malawi is a landlocked country in south-eastern Africa. It is bordered by Zambia to the west, Mozambique to the south and Tanzania to the north-east. Malawi is currently a member of SADC, the Common Market for Eastern and Southern Africa (COMESA), the African Union (AU), the Africa Free Trade Area (AfCFTA) and New Partnership for Africa's Development (NEPAD).

Figure 2 provides a view of Malawi's position relative to its neighbours as well as detailing districts and regions in Malawi. Malawi is split into three regions; Northern, Central, and Southern. Lilongwe City in central Malawi is the national and administrative capital where parliament and various government ministries are stationed. Blantyre City is the capital of Southern Region and the country's commercial and manufacturing hub. Mzuzu is the main town in Northern Region which is a gateway city to Lake Malawi[4].

2.1. Key context drivers

The development of high-impact, growth-oriented MSMEs in Malawi requires a foundational understanding of the broader country context. This section seeks to unpack the key contextual drivers of growth in the MSME sector with particular reference to the macroeconomic, socio-economic, infrastructural, and political context.

The key context drivers are summarised in Table 1.

4. United Nations, Malawi Country Profile, 2019

TABLE 1: Key context drivers

Context driver	Description
Macroeconomic context	• Malawi has undergone volatile economic growth over the past ten years owing primarily to climate-related shocks. • Informal microenterprise sector is responsible for 89% of employment. • Inflation has averaged around 20% over the last five years mainly due to changes in exchange-rate framework and climate-related shocks. • Agriculture is the dominant sector contributing 28% towards annual GDP as well as more than 80% of export earnings.
Socio-economic and demographic context	• High levels of poverty persist with 70% of Malawians living on less than USD 1.9 per day (i.e. MWK 1,368). • 81% of the population are youth, which presents both challenges and opportunities. • Literacy rates of those above 15 years old is 73%, with 68% of individuals not having attained any education qualification.
Infrastructure context	• Electricity infrastructure has improved, but still faces frequent and lengthy shortages. • Similarly, road networks have expanded. However, mismanagement of road-development projects is evident. • These infrastructure limitations impede MSME growth.
Political context	• Relatively stable political environment. • High dependence on donor funding. Donor spending as a proportion of the Government's spending has been 128% from 2017.

2.2. Macroeconomic context

As of 2018, Malawi has had a GDP of USD 7.1 billion (i.e. MWK 5.1 trillion) with a GDP per capita of USD 389 (i.e. MWK 280,092).[5] Based on this measure, this makes Malawi one of the poorest countries in the world. As evidenced in Figure 3, Malawi has undergone volatile economic growth over the past 10 years owing primarily to exogenous shocks to agricultural produce. Malawi has averaged 5 per cent annual growth in GDP over the period 2009 up to and including 2018.

The growth in the Malawian economy has slowed in recent years and the economy has been characterised by its dependence on the agriculture sector and its vulnerability to climate-related shocks. Table 2 displays a breakdown of sectoral contribution to GDP for years 2013 and 2017. Agriculture remains the most important sector in terms of GDP contribution at 30 per cent, followed by wholesale trade and hospitality industry at 19 per cent. Given the significant contributions of these sectors towards Malawian GDP, a more detailed context section is provided at the end of this section which outlines the key drivers and players within the agricultural, wholesale trade and hospitality sector.

Malawi has experienced significant fluctuation in inflation, reaching 27.3 per cent in 2013 and averaging around 20 per cent over the last five years. The spike in inflation, experienced in 2013, is primarily due to changes in the exchange-rate framework from fixed to floating in April 2012, and climate-related shocks (droughts and floods). The 'cashgate' scandal, which first came to light in 2013, also impacted inflation rates, given poor fiscal-management regime that led to the higher printing of money and issuing of government securities to the private sector.

The agricultural sector employs more than half of the Malawian population and accounts for nearly a third of the country's GDP. Eighty-nine per cent of total employment is situated in the informal sector and 11 per cent employed in the formal sector[6]. Agriculture is not only an important contributor to GDP, but is also a key employer with about 65 per cent of individuals informally employed working within the agricultural sector.[7]

The reliance placed on the agricultural sector, which is predominantly rain fed, leaves Malawi particularly vulnerable to events such as droughts, floods, and natural disasters. In 2016, Malawi experienced a shortage of maize as a result of severe drought. This resulted in a 12 per cent drop in maize production which placed 2.8 million Malawians (20% of the population), at risk of limited access to food. Additionally, given the importance of agricultural produce for exports, reductions in agricultural produce could further depress revenues from exports and place a damper on economic growth.

5. World Bank Data, 2018 | Note: Using the exchange rate at 31 December 2018 from Oanda.com

6. Malawi National Statistics Office, 2013, Labour Force Survey

7. ibid.

FIGURE 3: GDP growth rate (%, 2009 - 2018)

Source: IMF: Malawi Economic Development Document

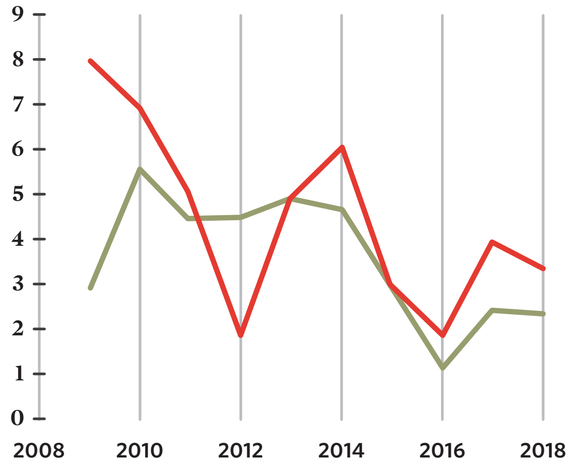


FIGURE 4: Inflation (consumer prices) (%, USD, 2005 - 2018)

Source: WBG, World Development Indicators database, 2019

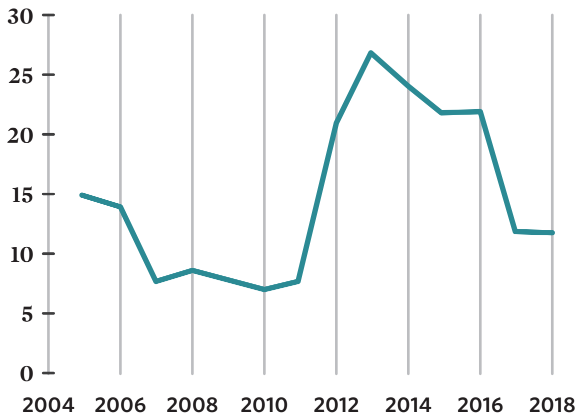


TABLE 2: GDP contribution by sector (%, 2013- 2017) | *Source: Reserve Bank of Malawi, 2017*

Note: ***Light green reflects top three sectors per year*** ***Light red reflects the bottom three sectors per year***

** NSO growth figures of 2017 were significantly higher than the World Bank and IMF numbers, and were excluded*

	Sectoral share of GDP		Real growth rates		
	2013	2017	2013	2016*	Ave '13-'16
TOTAL	100%	100%			
Agriculture	28%	30%	6%	1%	4%
Trade, restaurants & hotels	21%	19%	8%	3%	7%
Finance, real estate & business services	17%	15%	3%	5%	6%
Other services	10%	5%	6%	6%	7%
Manufacturing	9%	10%	6%	2%	6%
Transport, storage & communication	6%	8%	7%	6%	8%
Construction	5%	3%	2%	4%	5%
Public administration, education & health	2%	8%	5%	8%	7%
Electricity, gas & water	1%	1%	6%	1%	4%
Mining & quarrying	1%	1%	7%	1%	2%

TABLE 3: Nature of employment, by sector and gender
Source: Malawi Labour Market Profile, 2016

	TOTAL		MALE		FEMALE	
	Number	%	Number	%	Number	%
Agriculture, forestry and fishing	3,977,800	64%	1,807,349	59%	2,176,625	70%
Mining and quarrying	18,617	0%	6,179	0%	9,342	0%
Manufacturing	254,430	4%	139,027	5%	112,101	4%
Electricity, gas, steam and air conditioning supply	12,411	0%	9,268	0%	0	0%
Water supply, sewerage, waste management and remediation activities	12,411	0%	12,358	0%	3,114	0%
Construction	161,346	3%	129,758	4%	31,139	1%
Wholesale and retail trade and repair of motor vehicles	1,005,310	16%	466,512	15%	541,821	17%
Transport, storage and communication	124,112	2%	117,400	4%	6,228	0%
Accommodation and food service activities	43,439	1%	21,626	1%	24,911	1%
Professional, scientific and technical	12,411	0%	9,268	0%	3,114	0%
Administrative and support services	43,439	1%	24,716	1%	15,570	1%
Public administration defence	124,112	2%	101,953	3%	21,797	1%
Education	136,524	2%	86,506	3%	49,823	2%
Human health and social work	86,879	1%	49,432	2%	34,253	1%
Other services	111,701	2%	80,327	3%	31,139	1%
Activities of households as employers	80,674	1%	27,806	1%	52,936	2%
Total	**6,205,616**	**100%**	**3,089,485**	**100%**	**3,113,913**	**100%**

2.2.1. Agricultural context

The Malawian agricultural sector is the biggest contributor to the Malawian economy in terms of both GDP contribution and employment. It accounts for 60 per cent of males and 70 per cent of females in the workforce[8]. Given the importance of the sector in terms of economic activity and employment activity, the development of MSMEs within the agricultural sector requires a better understanding of the key-value chains, with specific reference to the main activities within the sector, value chain opportunities to leverage, as well as key players within the sector.

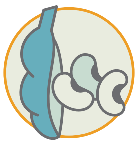
At a high-level, there are two major players in the Malawian agricultural sector; smallholder farmers and estates. The smallholder farmers, who are mainly subsistence farmers, account for 80 per cent of the country's agriculture production and 20 per cent of exports. Estate farms are mainly SME and large companies which majorly focus on exports.[9] In addition to the key role-players within the agricultural sector, the Government has various policies and regulations in place to assist in growing the sector; (See the regulation section for a detailed breakdown of the agricultural policies).

An important government initiative is the Farm Input Subsidy Programme (FISP). The goal of the FISP is to enhance food security by increasing smallholder farmers access to, and use of improved agricultural inputs which ultimately boost incomes of resource-poor farmers.[10] The FISP programme operates primarily through allowing certain larger-scale fertiliser distributors to sell FISP fertiliser at their retail outlets in select districts on a pilot basis while smaller-scale agro-dealers are excluded. An experimental field study was conducted which looked at the relationship between the FISP and potential

8. Malawi Labour Market Profile, 2016
9. FAO, Malawi Country Profile, 2018
10. Feed the Future, Malawi: Desk Study of extension and advisory services, 2017

crowding out of private-input providers. The study found that distributors who sold the FISP fertiliser, experienced a 299 metric tonne (Mt) increase in the volume of sales, on average. However, agro-dealers, excluded from the pilot programme, experienced a 28 Mt decrease in fertiliser sales, on average. This finding suggests that reforms have benefited distributors who sell 90 per cent of the fertiliser in Malawi. However, it has harmed agro-processors, who are only responsible for 10 per cent of Malawi's fertiliser sales, who critically conduct their businesses in more remote areas.[11]

Given characteristically low farm yields, and smallholder-subsistence farming dominating the agricultural sector, key value chains ought to be identified where SMEs can improve market linkages. The criteria for identifying the key value chains are productivity, value-addition potential, climate resilience, and youth engagement[12]. In addition to this criteria, a review of the Government's national strategy documents has resulted in the identification of four high-potential value chains; namely, soybean, groundnut, pigeon pea, and onion.



SOYBEAN

Soybean is among the major valuable and versatile grain legumes because it can be an input for many products, such as soya milk, animal feed and fuel. Most of the current demand for soybean in Malawi is seen in animal feed operations that are undergoing expansion in line with population increase and rapid urbanisation. There is an increasing demand for direct human consumption of soybeans, specifically looking at enriching maize flour with up to 20 per cent soybean flour. Soybean-crop production is largely dominated by smallholder farmers who are located in Central and Northern Regions of Malawi.

Soybean is increasingly becoming an alternative food and cash crop in Malawi due to the emerging policy direction by the Government on crop diversification, agro-processing and value addition for both domestic and export markets.[13] Malawi produces more than 35,000 Mt of soybeans per year, reaching over 132,000 Mt in 2016.[14] The introduction of high-yielding soybean varieties has significantly enhanced productivity from 600kg per hectare to 800kg per hectare, which has resulted in the national production increase of about 4.6 per cent over 10 years.[15]

Soybean is considered an opportunity for export growth because the crop is well adapted for production in all agro-ecological zones in Malawi. Initially, most of the soybean was exported raw and little was processed for domestic use due to limited processing capacity. However, this has changed with investment in the sector, and consequently, most locally produced soybean is now processed in Malawi[16].

The inputs (certified seed, inoculant and fertiliser), for this value chain are sold at seed stores and to a small proportion of farmers, who have been contracted by agro-processors, to produce soybean for them as part of contract-growing arrangements[17]. However, the use of certified seed and inoculant is low among smallholder farmers; instead, they tend to use retained seed, and this reduces the quantity and quality of the soybean yield[18].

Once harvested, soybean is shelled and the seed is used in the following ways: retained for seed; used for domestic consumption; or sold to informal traders who aggregate and sell it on to agro-processors; or farmers sell it directly to the agro-processors[19]. Processors in the soybean value chain include Grain & Milling, KK Millers, RAB Processors, National Oil, Sun Seed Oil, Mount Meru, Capital Oil, Lever Brothers, Seba Foods, Alpha Milling and ADMARC.

GROUNDNUTS

Groundnuts are among the major valuable and versatile grain legume crops with incredible contributions to improving household food security, nutrition, soil health and soil fertility. Groundnut is one of the readily available sources of vegetable protein, vitamins and vegetable oil.

The crop is produced in Central and Southern Regions of Malawi. Groundnut yields increased by 12 per cent on average from 2005 to 2013, partially due to the introduction of improved adapted varieties and recommended agricultural practices through the Malawian Government's Farm Input

11. Kaiyatsa et al, Supply-side Crowding out and Crowding in Effects of Malawi's Farm Input Subsidy Programme on Private-Sector Input Marketing: A quasi experimental field study, 2018
12. Given how young the population of Malawi is, youth economic participation, particularly in the agriculture sector is considered a key determinant of future prospects for growth. It is therefore important to include youth participation as a key determinant.
13. African Institute of Corporate Citizenship (2016) (AICC) 'Malawi's Soybean Outlook'
14. FAOSTAT, 2018, http://www.fao.org/faostat/en/accessed: 10 April 2019
15. Kananji et.al., 2013, 'A guide to soybean production in Malawi'
16. Malawi Times Group (2016). Soya production, marketing in Malawi
17. Mugwagwa et al. (2018). Why do agribusiness firms simultaneously source from different contract farming arrangements? Evidence from the soybean industry in Malawi. International Food and Agribusiness Management Review Volume 22, Issue 1, 2019
18. African Institute of Corporate Citizenship (2016). Malawi Soybean Outlook
19. Mugwagwa et al. (2018). Why do agribusiness firms simultaneously source from different contract farming arrangements? Evidence from the soybean industry in Malawi. International Food and Agribusiness Management Review Volume 22, Issue 1, 2019

Subsidy Programme (FISP).[20] The groundnut sector has also benefited from extension services such as the 3-2-1 service which provides crop pricing via native Chichewa-speaking voice recordings.[21]

It is estimated that 93 per cent of production is realised by smallholder farmers. Estates represent only 7 per cent of total production and are mainly concentrated in the central region[22]. Groundnut is grown during the rainy season by farmers with little access to certified seed and other support services. However, the production of groundnuts in Malawi is characterised by poor crop husbandry due to farmers using recycled seeds, which has resulted in a high incidence of aflatoxin in dried groundnuts. Due to the toxins' association with cancer, developed markets have reduced tolerance limits of this substance over time. Currently, Malawi is not able to test or grade its production, which prevents exports to these countries.[23]

Key players in the production of groundnuts are usually supplied by extension services and donor research centres such as the International Crops Research Institute for the Semi-Arid Tropics (ICRISAT) and the Malawian Government's Farm Input Subsidy Programme (FISP), among others. Even with these efforts, in 2016 groundnut production dropped to 296, 332 Mt from 399,702 Mt in 2015 due to the use of poor quality seed.

From the farm, marketed groundnuts (with shell) are sold to small traders or channelled through the National Smallholders Farmers' Association (NASFAM), which has its own processing facilities. While NASFAM is supplied directly by its member farmers, processors usually procure their raw material through the middlemen traders who buy directly from farmers. However, the processing is limited and consists mainly of sorting, grading and packing.[24] Processing, which is conducted by RAB Processors, Transglobe, Mulli Brothers and Equator Nuts, consists of roasting and the manufacturing of flour and peanut butter.

PIGEON PEA

Pigeon peas are mainly grown in the southern and central regions of Malawi. They are a versatile crop, grown primarily as a vegetable and are easily intercropped with maize, sorghum or groundnuts without significantly reducing their yields. Furthermore, pigeon peas are one of the most drought-resistant crops and an excellent source of nitrogen fixation, thus benefiting other crops. In terms

FIGURE 5: Trends in the production of soybeans (Mt)

Source: FAOSTAT, 2018

FIGURE 6: Trends in the production of groundnuts (Mt)

Source: FAO Stat, 2018

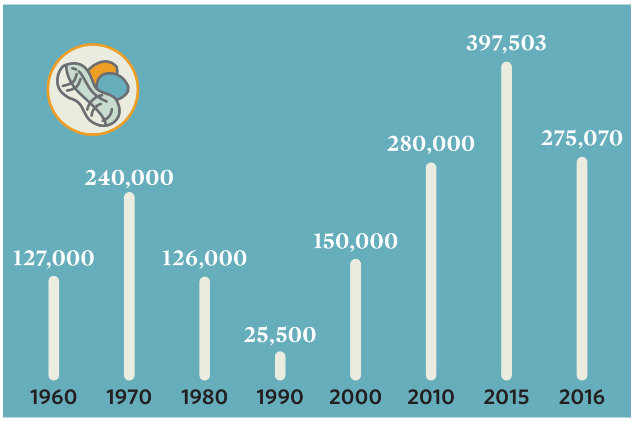
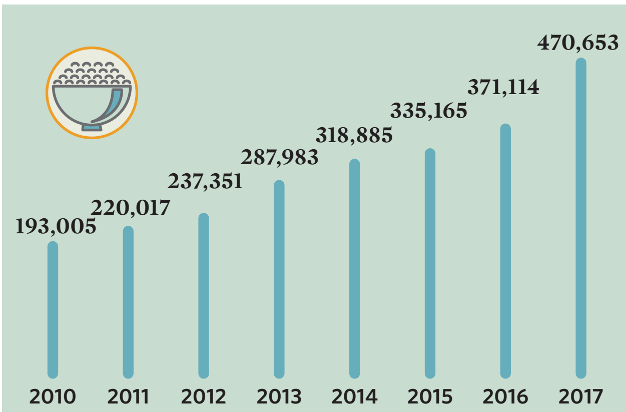


FIGURE 7: Trends in the production of pigeon peas (Mt)

Source: Malawi Pigeon Pea outlook, 2017



20. Food and Agriculture Organisation of the United States (FAO), 2017, Assessing the policy environment for cash crops in Malawi: what could hinder the achievement of NES objectives?'

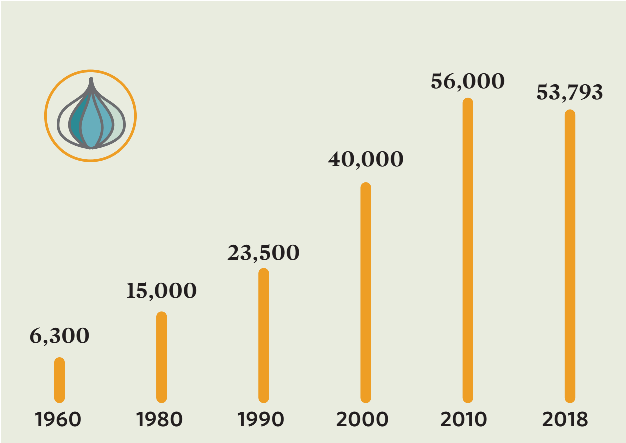
21. Feed the Future, Malawi: Desk Study of extension and advisory services, 2017

22. FAO, Analysis of Incentive and Disincentives for Groundnuts in Malawi, 2012

23. International Trade Centre, 2018, 'Malawi's Export Potential'

FIGURE 8: Trend in the production of onions (Mt)

Source: Foundation for Smoke Free World, Transitioning Tobacco Smallholder Farmers to Alternative Livelihoods, 2019

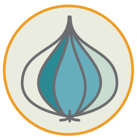


of export potential, there is a high demand for Malawi's pigeon pea (unprocessed dried grains and dal[25]) in India, and in particular a high preference for dal made from Malawi's pigeon pea. The International Institute of Tropical Agriculture (IITA) works with local extension-service providers and NGOs to promote new pigeon pea crop varieties to help increase production, consumption and marketing of new crops.[26]

Given the size of market and taste preference for pigeon pea, it is unsurprising that India is the biggest importer of pigeon pea in the world (200,000 tonnes per country). However, recently, the amount of produce they have imported from Malawi has decreased due to intense competition from countries such as Tanzania, Mozambique and Myanmar.[27]

Inputs for pigeon peas are usually supplied by extension services and donor research centres, such as International Crops Research Institute for the Semi-Arid Tropics (ICRISAT), the Farm Input Subsidy Programme (FISP) and NASFAM. The pigeon peas value chain includes seed breeders who work with the Government extension to receive seed. Intermediate traders buy large quantities of dried pigeon pea grains directly from farmers and vendors, from NGOs or from associations such as NASFAM. Retailers sell pigeon pea in two major forms of dried whole grains or split or whole dried grains. The dried grain is procured directly from farmers or other retailers, while the decorticated split grains are from other retailers.

Despite the increase in yield, the pigeon peas produced in Malawi do not meet the quantity and quality required by the market. Farmers' heavy use of recycled seeds was identified as a major factor limiting productivity. Historical analysis of pigeon pea yields was an estimated yield of 1.71 Mt/ha in 2016/2017 against an estimated potential yield of 2.5 Mt/ha for improved varieties.



ONIONS

The onion value chain provides an example of the potential for horticultural crops within Malawi. Onion is used for domestic consumption and in the hospitality industry, and there is currently limited use in the processing of other food products. Onions are produced by both smallholder and commercial farmers. In smallholder-farming systems, they are predominantly produced by women. Onion grows in almost any kind of soil, which makes it attractive as it can be harvested more widely across Malawi. Onions are also relatively cheap to produce, requiring low labour and relatively cheap inputs, such as seed, fungicides and pesticides. Unlike other crops, which are grown and marketed once a year, onions can be marketed over a long period ranging from seven months to throughout the year if grown under irrigation.

Smallholder farmers, who have limited access to support services at the production stage of the value chain, are the main producers of onions in Malawi. In 2018, these farmers produced 53,793 tonnes per Mt[28]

Informal trading dominates the chain, acting as an important link between production and the market. These informal traders are an important source of market information for these smallholder farmers, as most do not know how the value chain is structured. Apart from domestic consumption, there is significant potential for linkages with the hospitality industry. However, this sector prefers the Texas Grano onion, and Malawi imported 61 Mt of this variety between 2009 and 2010, showing that there is significant demand for this product[29]. The Nali Group, famous for their range of hot sauces, purchases a large portion of the onion produced in Malawi, for use in production. While the value chain is largely undifferentiated, there is potential to manufacture pickles and dried onion[30]. The demand for Texas Grano is an opportunity for smallholder farmers to produce them locally and boost import substitution.

24. FAO, Technical note Analysis of price incentives for groundnuts in Malawi, 2014
25. Dal is a term used in the Indian subcontinent for dried, split pulses
26. Feed the Future, Malawi: Desk Study of extension and advisory services, 2017
27. Nankhuni & Me-Nsope, 2018, 'Is the future of Malawi's pigeon pea industry at the mercy of India?'
28. Foundation for a Smoke Free World, Transitioning Tobacco Smallholder Farmers to Alternative Livelihoods, 2019
29. Microloan Foundation (2011). Value Chain Analysis: Tomato, Onion and Irish Potato in Jenda, Mzimba District, Malawi
30. Foundation for Smoke Free World, Transitioning Tobacco Smallholder Farmers to Alternative Livelihoods, 2019

2.2.2. Wholesale and retail trade context

Wholesale and retail trade is the second largest sector in Malawi. Because of the ease of entry, the sector is dominated by micro and small enterprises that predominantly trade in agricultural products and imported durable goods such as clothes from China. Given agriculture's role in Malawi, the sale of agricultural products is the largest opportunity for linking agricultural SMEs (both primary producers and agro processors) to the wholesale and retail sector.

Agricultural food retailers, particularly those dealing with fresh fruit and vegetables in Malawi comprise three groups. First, there are traditional markets, which are usually open-air, although in some places they are covered. They are commonly found at the centre of cities, towns, and neighbourhoods. In trading centres within the districts, such markets operate on a specified day of the week. The group encompasses vendors who have small stands serving pavement traffic in the three major cities of the country, Lilongwe, Blantyre, and Mzuzu. This category often buys its products from the local markets within the city and sells them along the roads at a higher price.

Second, there are small self-service stores, that are much smaller than supermarkets, which deal with fresh fruit and vegetables. These tend to be in the neighbourhoods of the cities of Blantyre and Lilongwe. Most of these, however, usually fail to establish a name, and command a significant share of the fresh fruit and vegetable market within the neighbourhoods. Third, there are the large self-service stores, i.e. supermarkets. These are located in large cities and sell different types of fresh fruit and vegetables, meat, and meat-related products, and dairy products.

In the last two decades, the wholesale and retail sector in Malawi has been slowly changing in terms of the size of market players. The liberalisation of the economy in 1994 made Malawi a preferential destination for foreign direct investment, including investment of foreign retail chains that were seeking a competitive territory. The opening up of the economy created opportunities for foreign retail operators, especially well developed South African retail chains.

Malawi has also witnessed high levels of urbanisation rates, as people move to cities and towns in search of employment, educational opportunities, and higher standards of living. The increase in the urban population consequently creates opportunities for supermarket stores. Because of these developments, Malawi now has several local and foreign supermarkets including Spar, Shoprite and Shoprite U-save, Chipiku Stores, Game Stores, Chiku's Supermarket, First Choice Supermarket, and others.

SUPPLY OF AGRICULTURAL PRODUCTS TO SUPERMARKETS

Agricultural-related food products in Malawi are mainly produced and supplied by small-scale farmers, who dominate the agricultural sector. As discussed earlier, small-scale farming in Malawi is mostly primitive, i.e. largely manual with little mechanisation, rain-fed, and seasonal. The nature of the farming practices in small-scale farming severely undermines both the volume and quality of their produce.

Supermarkets are only emerging as an alternative marketing channel for agri-food products in Malawi. The majority of the supermarkets procure some of their fresh fruit and vegetables from local suppliers. It is important to note however, that about 50 per cent of the fresh fruit and vegetable products that are available in supermarkets in Malawi are sourced internationally. This has implications on the ability of local producers to access supermarkets as a market for their fresh fruit and vegetable products.

Choice of fresh fruit and vegetable suppliers to supermarkets in Malawi is determined by a number of factors such as:

- Contracts in Malawi are given to suppliers on their ability to supply high-quality products. This is particularly important because supermarkets are increasingly becoming shopping places for fresh fruit and vegetables for the high-income and middle-income classes in Malawi. In this respect, supermarkets aim at providing their customers with high-quality carrots, tomatoes, and other vegetables.

- Consistency of quality and actual supply of the products is crucial. Supermarkets in Malawi aim at ensuring that the needs of their customers with respect to quality are always met. Unlike the customers who buy their fresh fruit and vegetables from the open market, supermarket customers are very particular about the issue of quality of the products that they buy. In this regard, procurement officers only offer contracts to suppliers who have the means to maintain the quality of the products that they supply.

- Furthermore, because supermarkets are in competition to increase their share of the fresh fruit and vegetable market, contracts are given to suppliers who are able to be consistent in their supply. This is done to ensure that incidents of being out of stock are minimised.

Local suppliers face a number of challenges as they supply fresh fruit and vegetables to supermarkets in Malawi. First, local suppliers have to adhere to strict food safety and quality standards that are demanded by supermarkets. Unlike supplying to the open market, suppliers to the supermarkets have to ensure that the quality of their products is compatible with the needs of the high-income customers. This poses a challenge because the suppliers, mainly small and medium-scale fresh fruit and vegetable producers, have to ensure that their products are of the required quality right from the nursery stage in the gardens. In the country where quality agricultural inputs such as fertilisers and seeds are very expensive, and agricultural extension services are very weak so that farmers lack the knowledge of good husbandry practices (particularly in the fresh fruit and vegetable sub-sector), most local farmers are automatically excluded from supplying to the supermarkets.

Second, in the supermarket supply channel, suppliers are expected to deliver the agricultural produce directly to the backdoor of the supermarkets. However, with poor private infrastructure, such as packing houses, and lack of pre-cooling and cooled transportation, post-harvest losses among local suppliers are very high. Tomatoes, lettuce, carrots and other perishable products require special transportation facilities that ensure that quality and safety standards of the products are maintained. The majority of local suppliers cannot afford the refrigerated vehicles that would ensure the quality of the products.

The third factor that is undermining local suppliers' ability to participate in the supermarkets' channel is their ability to remain consistent in their supply to the markets. Contracts with supermarkets in Malawi require a supplier to deliver the agri-food products to the door of the supermarket at least twice a week. Under such conditions, suppliers need a high level of professionalism to be able to consistently produce high-quality products. However, fresh fruit and vegetables are largely smallholder crops so that for most suppliers, supplying the products at least twice a week is not feasible.

2.2.3. Tourism context

The Malawi Growth and Development Strategy III (MGDS III) highlighted the role of tourism as a priority sector for growth. It stated that Malawi would be established as a principal and leading ecotourism destination in Africa and domestic tourism would be increased.

The country's greatest tourism assets include Lake Malawi, its rich diversity of flora and fauna, its nine national parks and wildlife reserves, and its beautiful landscapes of the green, lush country, highlands, forests, and mountains.[31] Currently, Malawi's conservation areas, including national parks, forests and wildlife reserves, support the small but growing ecotourism subsector.[32]

In 2017, the total contribution of the travel and tourism industry to Malawi's GDP was MWK 345 billion (USD 479.1 million), 7.7 per cent of GDP. This is higher than the average contribution of the industry to GDP for Social Security Administration (SSA) (7.1%). The total contribution to Malawi's GDP is expected to rise to MWK 563 billion (USD 781.9 million) in 2028 (+63%)[33].

The total contribution of the travel and tourism industry to employment in Malawi in 2017 was 525 thousand jobs, 6.7 per cent of total employment, again higher than the average for SSA (5.8%). The total contribution to employment in Malawi is expected to rise to 707,000 jobs by 2028 (+35%). In terms of long-term growth of Malawi's travel and tourism industry, the World Travel & Tourism Council (WTTC) ranked Malawi 66 out of 185 countries globally as a tourist destination, significantly higher than South Africa for example (121 out of 185 countries).[34]

In order to improve the economic contribution of the sector, the Government has already undertaken a number of development interventions with a view to transforming the tourism sector landscape. These include expansion of hotel and catering training institutions; construction of access roads to tourism sites in Mangochi; improvements of airports and airstrips; construction of Mpale Cultural Village in Mangochi and the 1500-seater Bingu International Conference Centre, and 5-star Presidential Hotel in Lilongwe. In addition, Malawi has experienced increased investments in the travel and tourism sector and the private sector has invested in new and more modern hotels, lodges, motels and rest houses throughout the country.[35]

Malawi is relatively underdeveloped in terms of its infrastructure and skills development, which has hindered the achievement of Malawi's tourism potential.[36] A Travel and Tourism Competitiveness Index report released recently by the World Economic Forum (WEF), ranks Malawi 123rd out of 136 world economies that were measured for competitiveness in 2016.[37] Malawi scored poorly on some key benchmarks, namely air transport infrastructure, health and hygiene, and tourist service infrastructure, all of which Malawi has failed to register tangible improvements.[38]

The cost of air travel to Malawi, and poor access options are also a major constraint for operators targeting international business and tourist visitors. For example, there is a lack of direct long-haul flights to Malawi, which discourages potential visitors from other continents.

Skilled labour in Malawi is also not abundant, and many investors rely on expatriate management staff. Current graduates from public and private institutions are not sufficient

31. Malawi Tourism
32. The World Bank, 2018, 'Malawi Systematic Country Diagnostic'
33. Note: Using the exchange rate at 31 December 2018 from Oanda.com
34. WTTC, Travel & Tourism – Economic Impact 2018 – Malawi
35. UNDP, 2016, Malawi National Human Development report
36. The World Bank, 2010, Malawi Travel and Tourism
37. Nhlane. C., 2017, 'Special Pull Out Inside Tourism"
38. WBG, Malawi Systematic Country Diagnostic, 2018

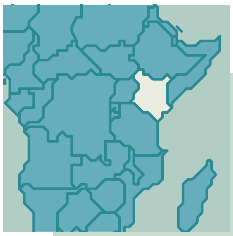
in their skill sets, quality, and numbers. Malawi mostly has small and/or undeveloped training institutions such as the Malawi Institute of Tourism (MIT) which offer diplomas to its students.[39] These institutions usually have inadequate or no up-to-date equipment and personnel to deliver the courses.

Furthermore, the training is also mainly focused on on-the-job hospitality and catering training, which means there are gaps in entrepreneurial skills needed to develop original tours and leisure activities. In the tourism-value chain, a number of skills gaps have been identified: communication and interpersonal skills; customer service; tourism marketing; leadership and managerial skills; entrepreneurial skills and Information and Communication Technology (ICT) skills.[40]

The challenges faced in the sector are made worse by coordination challenges inherent in the sector's cross-cutting relations to other sectors which call for sector-wide approaches to planning, programming, and implementation that should consider complementary and support sectors such as agriculture linkages, environment, infrastructure development, and private sector providers of travel and accommodation services.

LESSONS FROM OTHER COUNTRIES

For many years now the Government of Malawi has identified tourism as a potential for economic growth and development but there is still a lot to be done in order to realise this potential. Two case studies showcase how Kenya and Tanzania have overcome similar challenges to those of Malawi, relating to their tourism industries. The first case study deals with how Kenya overcame various infrastructure-related challenges and went on to further market itself as a number one destination for travel in Africa. The second case study relates to ecotourism as a leading tourist attraction and how Tanzania has leveraged its ecotourism sector to attract tourists and still conserve its wildlife.



BOX 1: Tourism in Kenya

Tourism in Kenya

Kenya is home to 60 national parks and reserves, offering broad cultural and historic attractions, and over 500km of sunny coastline, making it one of the world's most popular tourist destinations. The Kenyan tourism sector has risen to become the second-largest foreign exchange earner in the country.[41]

Recognising the critical role that tourism plays in employment and earnings, the Government has moved to support the sector with the launch of its tourism-recovery programme. The programme is a 10-point strategy emphasising marketing, infrastructure development and private sector investment.[42] To this end, 2018 marked the year of the most significant improvement. Some of the contributions that resulted in these improvements include[43]:

- Tembea Kenya initiatives to boost local tourism[44]
- Air France flies to Nairobi 3 times per week
- Revamping transport infrastructure[45]
- Open border policy for Africans[46]
- Revitalised marketing efforts such as digital marketing and global campaigns
- Hosting of international conferences such as the 1st ordinary session of the African Union ministerial Sub-Committee on Tourism

Kenya's favourable tourism outlook has attracted the highest amount of hotel investments in the East African region given the country's diverse opportunities for tourism development and therefore the large capacity to absorb hospitality investment.[47] There has been a string of heavy investments by leading luxury hotels in Kenya since late 2016. The list includes Accor Hotels, Hilton, Carlson Rezidor and Acacia Premier.[48]

The overall achievement of the tourism sector in Kenya is as a result of coordinated efforts between various arms of government, the private sector as well as concerted efforts in marketing Kenya as a destination of choice.

39. WBG, Travel & Tourism – Economic Impact 2017 Malawi
40. IPRSE on behalf of Mzuzu University, Tourism Skills Gaps Survey, 2016
41. Oxford Business Group, 2017, Tourism rises in Kenya once again
42. Ibid
43. Ministry of Tourism and Wildlife
44. These are cheaper travel packages for local Kenyans to increase domestic tourism.
45. Construction of the standard gauge railway in partnership with the Chinese Government which allows for easy travel from Nairobi to Mombasa which is Kenya's coastal town and tourist hub
46. Africans wishing to visit Kenya will be eligible to receive a visa at the port of entry, unlike in the past when many had to go through a rigorous and often costly process to secure a visa in Kenyan embassies abroad.
47. Africa Business Insight, 2017, 'African hospitality market attracting new investors'
48. Business Daily, 2017, Kenya, SA hotspots in luxury hotels investment

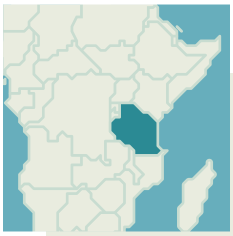
2.3. Socio-economic and demographic context

The Malawian population has grown at approximately three per cent over the period 2013 to 2018. Currently, the population is 18.1 million and the gender split is approximately 51 per cent female and 49 per cent, male. A defining factor of the Malawian population is that 81 per cent of the population is younger than 35 years old[54]. The current population characteristics of steady population growth, and the high proportion of youth, emphasise the importance of ensuring the development of productive capacity so as to increase youth employment and drive economic growth.

Malawi is one of the world's poorest countries in the world. 70 per cent of Malawians live on less than USD 1.90 per day (i.e. MWK 1,368).[55] It currently ranks 171 out of 182 countries in the Human Development Index (HDI).[56] Figure 10 displays the GDP per capita of Malawi versus the SSA. The trend has shown that Malawian GDP per capita is consistently lower than its neighbouring peer countries.

Education and skills remain a key impediment in the way of unlocking the potential of Malawi's youth. It is difficult to provide technical assistance when grappling with high illiteracy rates; a 68 per cent literacy rate for individuals aged 15 years and older.[57] This has a knock on effect on the level of business support that can be provided and the efficacy thereof.

The current socio-economic and demographic drivers are guided primarily by high levels of poverty and an overwhelmingly young population. As many as 2.1 million Malawian children remain trapped in child labour while young adults in the 15 to 35 years age group are concentrated within low skill jobs that offer little prospect for advancement or for escaping poverty.[58] However, Malawi's Age dependency ratio of 2.97 dependents per working-age person, down from 7.56 in 2005, suggests an improvement in alleviating the level of dependency placed on the working-age population.[59] This alludes to the importance of ensuring the development of children and youth who can then be better equipped to serve the Malawian economy and ultimately reap the rewards of a young and vital population.



BOX 2: Tourism in Tanzania

Tourism in Tanzania

According to the World Travel Tourism Council, the total contribution of tourism to GDP in Tanzania in 2017 was 9 per cent. In 2017 the tourism sector directly supported 3.3 per cent of total employment; this was expected to rise to 7.1 per cent in 2018. Between 2007 and 2017 Tanzania's tourism sector grew by over 300 per cent, attracting more than 1 million visitors annually.[49]

Most of the country's tourism offerings fall under the banner of ecotourism. Tanzania's wildlife resources include the last intact fully functioning savanna wilderness ecosystem in Africa. It also has the world's largest terrestrial mammal migration and is also home to the world's highest densities of predators and elephants.[50] But Tanzania's wildlife resources are under threat. Wildlife populations have suffered from poaching, and clashes between wildlife and people involved in other economic activities like farming and mining. In addition, the benefits of wildlife-based tourism are not shared equally.[51]

The World Bank found that the most successful overall development strategy for ecotourism should maximise tourism revenue by increasing quality over quantity, and that it should strengthen links with the local economy by sharing benefits with those who live close to tourist attractions.[52] The most important part of the approach is that user rights are transferred from central Government to local communities. The model is being increasingly promoted as a conservation tool and has become the dominant approach in natural resource conservation worldwide.

Tanzania's approach to community-based natural resource management has been through the establishment of Wildlife Management Areas, where a few villages set aside land for wildlife conservation in return for the majority of tourism revenues from these areas. This policy promotes wildlife management at the village level by allowing rural communities and private landholders to manage wildlife on their land for their own benefit.[53]

49. Tanzania Travel and Tourism, 2019
50. Mail and Guardian, 2018, Community-based wildlife conservation is bringing success to Tanzania.
51. Ibid
52. WBG, Global Wildlife Programme, 2018
53. Mail and Guardian, Community-based wildlife conservation is bringing success to Tanzania, 2019.
54. World Bank data, 2019
55. Ibid. | Note: Using the exchange rate on 31 December 2018 from Oanda.com
56. UN, Human Development Index, 2018
57. Malawi National Statistics Office, 2018
58. ILO, Understanding child labour and youth employment in Malawi, 2018
59. Ibid.

FIGURE 9: Population split by gender and age (Gender: Million, 2013 - 2018; Age, % of total, 2018) | *Source: World Bank data, 2019*

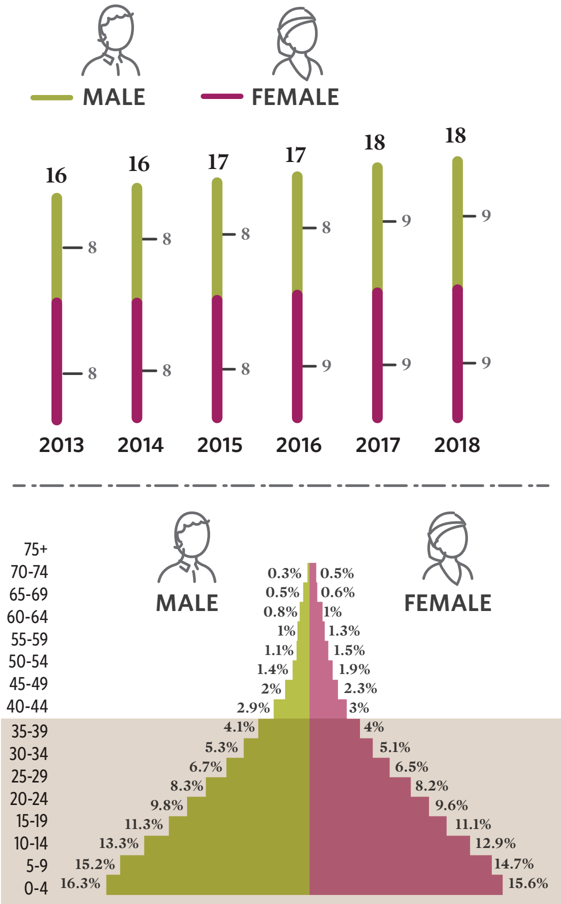
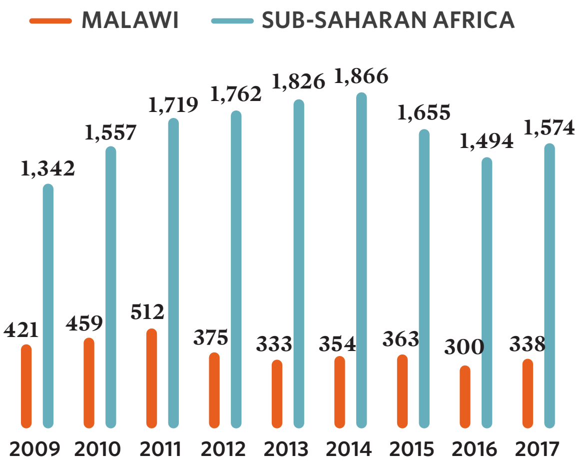


FIGURE 10: GDP per capita of Malawi vs Sub-Saharan Africa | (USD, 2009 - 2017) | *Source: World Bank data, 2019*



The World Economic Forum currently ranks Malawi 132 out of 141 countries for the state of its infrastructure.

2.4. Infrastructure context

Limited infrastructure is a key driver of low productivity which ultimately limits the facilitation of domestic production and international trade. The World Economic Forum currently ranks Malawi 132 out of 141 countries for the state of its infrastructure.[60] An IMF country report on Malawi cited frequent and lengthy electricity shortages due to weak capacity and dependence on drought vulnerable hydroelectricity generation, central to the country's infrastructure challenges.[61] The World Bank's development indicators show that less than 4 per cent of the rural population and 57 per cent of the urban population have access to electricity.[62]

The limited electrification of Malawi is a significant infrastructure context driver as it affects productivity at all levels of Malawian life. Moreover, the lack of electrification also dictates the productivity of sectors and also the development of sectors where it is possible to operate with little to minimal electrification.

Malawi's road network has improved following significant spending on the road infrastructure of around 4 per cent of GDP in the early 2000s. However, mismanagement of road development projects is evidenced through over-engineering of roads in some parts, while funding for road preservation and maintenance remains a challenge.[63] Additionally, only 26 per cent of Malawi's population lives within two kilometres of an all-weather road.[64] This raises an area for strategic investment for accessible road networks to ensure the growth of the agricultural sector.

Malawi's ICT infrastructure has improved significantly following the introduction of an independent regulatory agency and the establishment of a competitive market for mobile services. The country scores close to 60 per cent on an index of institutional best practices for the ICT sector, well above the SSA average.[65] However, Malawi could improve the reach and quality of mobile connectivity as only ten per cent of the population are making use of smartphones.[66]

In an MSME development context, it is critical that the provision of electricity, road networks and ICT infrastructure continue to be developed to provide a suitable environment for small businesses to develop.

60. World Economic Forum, Global Competitiveness Report, 2019
61. IMF, Selected Issues, 2018
62. World Bank data, 2017
63. Over engineering of roads refers to paving of roads where there are minimal traffic volumes.
64. WBG, Malawi Infrastructure- A continental perspective, 2011
65. Ibid.
66. GSMA, Digital Identity Country Report, Malawi, 2019

2.4.1. The technology and digital landscape

The Government of Malawi recognises Information and Communications Technology (ICT) as essential for the country's development. In 2013, the Government adopted the National ICT Policy aimed at *developing the ICT sector, promoting the development and use of ICT in all sectors, and enhancing universal access to ICT services to achieve widespread socio-economic development*.[67]

The National ICT Policy is operationalised through the National ICT Master Plan. The Plan covers 18 years from 2014 to 2031 and is centred around the need for transformation using ICT in four dimensions: the Government, infrastructure, capacity and knowledge community, and businesses.[68] The process for developing the National ICT policy and Master Plan was led by the local Information Technology Task Force (ITTF), which included representatives from the Department of Information Systems and Technology Management Services; Malawi Communications Regulatory Authority (MARCA); Ministry of Information and Civic Education; Ministry of Home Affairs and Internal Security; and the Ministry of Finance, Economic Planning and Development.[69] The process was externally funded by the United Nations Economic Commission for Africa (UNECA); UNDP; and the Common Market for Eastern and Southern Africa (COMESA).[70]

NATIONAL ICT POLICY OF 2013

The National ICT Policy is '*a framework for deployment, exploitation and development of ICT to support the process of accelerated socio-economic development in Malawi*'. The stated objective of the policy is to create an enabling environment for efficient, effective, and sustainable use of ICT in all economic sectors for Malawi to become an information-rich and knowledge-based society and economy. According to the policy, implementation, monitoring and evaluation should be the responsibility of a new quasi-state institution, the Malawi Information Technology Agency (MITA). In a review of the literature, it is unclear whether this organisation has been established or not. As a result, the Ministry of Information and Communications Technology, together with MARCA, appears to be the leading government entity for ICT development.

There are 10 priority areas in the National ICT Policy that are clustered in four strategic pillars, namely[71]:

1. Innovation and Human Capital Development
2. ICT Industry Development and e-business
3. ICT Infrastructure development
4. E-government and growth sector

THE NATIONAL ICT MASTER PLAN 2014 - 2031

The objective of the ICT Master Plan is to operationalise the National ICT policy. The National ICT Master Plan 2014 - 2031 focuses on promoting social and economic transformation by creating inclusive opportunities for Malawians to have a better quality of life. The plan places special attention on ICT innovation and developing human capital in ICT, as per the first pillar in the ICT policy. Furthermore, it aims to accelerate economic growth through ICT and e-business.[72]

PROGRESS TOWARDS OBJECTIVES

Part of developing the National ICT Master Plan involved a baseline survey to establish a starting point to guide the implementation of the plan and contribute towards monitoring its progress and impact. The baseline survey was conducted by the Malawi Institute of Management, which was contracted by the Department of e-Government. A sample of 250 rural and urban households was drawn to study the availability of ICT services and assess how ICT is used in Malawi. The study was also supplemented by secondary data sources from the Regional Communications Initiative Project Malawi (RCIPMS), National Statistical Office (NSO) and Ministry of Economic Planning and Development (MEPD).

While progress has been made on all of the indicators, review of the available data (shown in the following section), suggests Malawi is still considerably distant from achieving universal access, as envisaged under Phase 1 of the Master Plan, and may take several years to reach it.

2.4.2. Digital access and usage

There are a number of challenges that affect Malawi's achievement of the ICT Policy and Master Plan, including low ICT literacy levels, competition for financial resources by other national priorities, and a lack of crucial infrastructure, such as electricity and ICT equipment.

Malawi continues to have limited ICT Infrastructure, particularly phone and internet connectivity. There are two main mobile network operators (MNOs) in Malawi: Airtel and Telekom Networks Malawi (TNM). Although these MNOs offer fixed and mobile telephone services, less than 5 per cent of the population uses fixed phones or landline[73] and there is a greater reliance on mobile telephone services. Based on the GSMA Malawi Feasibility Study in 2012, the two operators (TNM and Airtel), share 25 towers and provided 80 per cent coverage to the whole country. The study shows that TNM's network is evenly distributed across the country's

67. GoM, National ICT Policy, 2013
68. GoM, National ICT Master Plan 2014 - 2031,2014
69. Kunyenje and Chigona, 2017, External Actors in the Formulation of a National Information and Communication Technology Policy in Developing Countries such as Malawi.
70. GoM, National ICT Master Plan 2014 - 2031,2014
71 and 72. Ibid.
73. National Statistics of Malawi, 2014, Survey on Access and Use of ICT Services Malawi

geographical regions. TNM's coverage extended to 74 per cent of the country in 2012, which equates to 84 per cent of the population[74]. There is, however, poorer connectivity in rural areas and both operators prioritised increasing access to their networks by deploying new network towers in remote areas in 2017 for TNM, and in 2019, for Airtel[75]. However, it is unclear whether this was completed, or whether network coverage has improved in rural areas.

In Malawi, the mobile phone penetration rate remains low at 44 per cent (about 8.6 million mobile subscribers).[76] This is considered low when compared to other countries in Africa and globally. A major contributor to low mobile phone penetration is the high level of poverty across the country. The low income per capita also means that smartphone ownership is low and the majority of mobile phone owners use feature phones. The Digital Insights Malawi 2018 Report also showed that in all districts, mobile phones were widely shared among communities between friends, family, and neighbours[77].

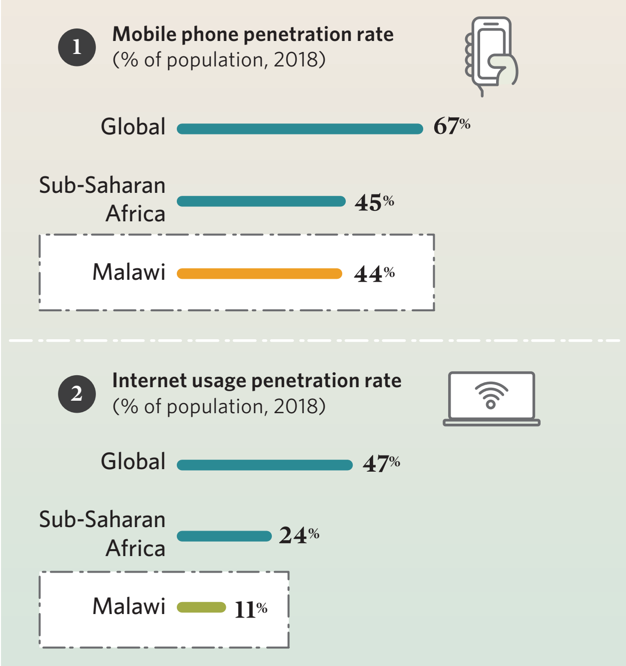
In terms of the gender split, male Malawians are more likely to own a mobile phone compared to females. Based on the 2018 Digital Insights Malawi Report, there is a wide gender disparity in mobile phone ownership, especially in the northern and central regions (which are mostly rural regions)[78]. The gender gap in phone ownership is about 40 per cent[79] (for every 100 men that own mobile phones, only 60 women own mobile phones). Mobile phone sharing is also characterised by gender discrimination. In the Digital Insights Report, females who do not own mobile phones and shared with their husband, father, or mother-in-law reported that they had no control of when they could use the phone. Men would generally share with other men - and had a more equal sharing agreement. Younger females did not have access at all[80].

While the number of people with access to the internet in Malawi has increased from 9.6 per cent in 2016 to 11 per cent in 2018 (about 2.2 million users), the number is still very low. The vast majority of active internet users make use of mobile internet services. According to the Inclusive Internet Index, 2019, Malawi ranks 98th out of 100 countries globally in terms of availability, affordability, relevance and readiness[81]. This suggests that globally, and even when compared to regional peers (i.e. Zambia, Rwanda), Malawi fairs lower in terms of its adoption of digital technologies and solutions.

Of specific importance to MSMEs in Malawi, e-commerce is not widely used or available. Most of the Malawian population does not have access to debit or credit cards,

FIGURE 11: Mobile phone and Internet usage penetration rates

Source: GSMA, 2019, The Mobile Economy



which limits their ability to access and use e-commerce platforms. According to the Hootsuite Digital Malawi 2019 report, only 8.3 per cent of the adult population makes online purchases and/or pays bills online. Additionally, only 5.4 per cent of adult women and 12 per cent of adult men make use of online transactions respectively.

As discussed above, the latest data shows that internet penetration is only 9.6 per cent, and most Malawians choose to access the internet on their mobile phones. This suggests that there could be a window of opportunity for e-commerce using mobile money and mobile banking in the long term, provided internet and mobile penetration rates and the enabling infrastructure improve[83].

In addition to limited usage of e-commerce, MSMEs also have limited opportunities to market their goods using social media, with only 2.8 per cent of the population being active social media users (about 540 thousand users). Facebook is the only social media platform with a large advertising audience (around 530 thousand monthly active users) and other platforms (e.g. Twitter, Instagram, LinkedIn) report very low numbers.

74. GSMA, TNM Malawi Feasibility Study, 2012
75. Ibid.
76. WBG Database, 2019 | Genesis Analytics Team Analysis
77. DAI, Digital Insights Malawi: Information and Communication in Rural Communities, 2018
78, 79 and 80. Ibid.
81. The Economist, Inclusive Internet Report, 2019
82. Note: Using the exchange rate on 31 December 2018 from Oanda.com
83. GSMA, Payment Solution for E-commerce: Mobile money as a key enabler, 2017

TABLE 4: Inclusive Internet Index Categories | *Source: The Economist, Inclusive Internet Report, 2019*

Categories	Definition	Malawi's performance
Availability	Quality and breadth of available infrastructure required for access and levels of internet usage	Malawi ranked 97th out of 100 countries. There is a general lack of electricity and frequent blackouts affect access to and availability of internet. Poor infrastructure and low quality of internet experience are also factors that contribute to the low ranking. In addition, the 2018 Freedom on the Net Report reveals that the internet connection speed in Malawi has declined from 1.7 Megabits per second (Mbps) in 2017 to 1.3 Mbps in 2018. These internet connection speeds are especially slow compared to the global average of 7 Mbps.
Affordability	Cost of access relative to income and the level of competition in the internet marketplace	In terms of affordability, Malawi ranked 98th out of 100 countries. For the internet to be considered affordable, the cost of 1 Gigabyte of unbundled mobile data should be 2% or less of a person's average monthly income. In Malawi, the cost of 1 GB of unbundled mobile data is about 17% of a person's average monthly income. The average monthly income in Malawi is MWK 29 200 (i.e. USD 40.6) and 1 GB of unbundled data costs MWK 5 000 (i.e. USD 6.9)[82]. This shows that, relative to average income, the internet is expensive in Malawi and partly accounts for the low internet access rates.
Relevance	Existence and extent of local language content and relevant content	Malawi ranked 94th out of 100 countries. This ranking suggests that internet content such as news, health, or financial information may not necessarily be available in local languages. The relevance category requires further investigation as current research does not report much on this.
Readiness	Capacity to access the internet, including skills, cultural, acceptance, and supporting policy	Malawi ranked 78th out of 100 countries. Of the four categories, Malawi performed the highest in readiness. The 2019 Inclusive Internet Report shows that in terms of readiness, Malawians are ready to embrace the internet based on cultural acceptance and existing supporting policies as highlighted above. It is, however, critical to creating an enabling environment for affordable access. The report suggests that limited internet access could be a result of the Government's failure to implement conducive policies.

2.5. Political context

Malawi is a generally peaceful country and has had stable governments since independence in 1964. Malawi's sixth tripartite elections were conducted in May 2019 where President Peter Mutharika was re-elected. Despite this relatively peaceful past, there has been recent ongoing protest action led by the Human Rights Defenders Coalition (HRDC) and supported by opposition parties following alleged irregularities in the vote-counting process.

The legislative branch of the Government consists of a national assembly where members are elected by popular vote. Malawi has an independent judiciary which by and large inspires the highest levels of confidence from the public owing to several provisions in the constitution which guarantee its independence.[84]

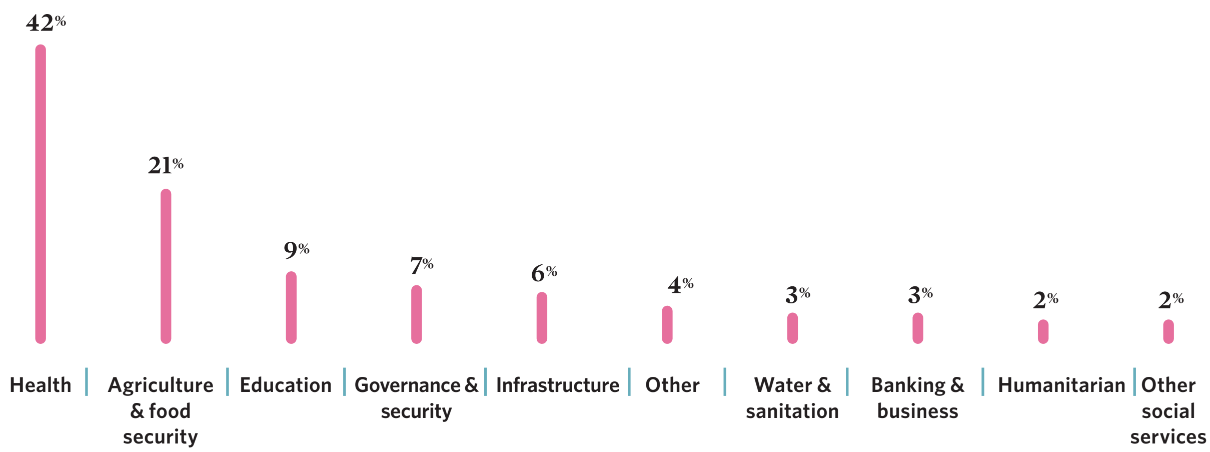
Malawi is one of the most aid-dependent donor countries and uses official development assistance to fund social expenditure such as education, health and welfare. Figure 12 displays the Official Development Assistance (ODA) received as a proportion of GNI and Government spending. Volatility in donor spending has a significant impact on Malawi as indicated by donor spending as a proportion of the Government's spending which is 128 per cent as of 2017. A key driver behind the volatility is the cash-gate scandal that occurred in 2012 and 2013 resulted in the majority of the members in the European and multilateral agency Common Approach to Budget Support (CABS), putting a hold on aid[85].

In 2011, over 40 per cent of ODA went to health, mostly as cash grants with some commodities and food aid and technical cooperation[86]. A further 20 per cent went to agriculture and food security, the next largest sector, which has a similar mix, with more commodities and food aid (36%), and equity and loans.

The regulatory and policy landscape indicates that poverty reduction and economic development is a key priority of the Government. However, a key driver for the successful implementation of poverty-reducing policies is for the successful coordination amongst government departments and donors in order to ensure effective programming.

FIGURE 12: Net ODA received (% of GNI and Government spending, 2009 - 2017) | *Source: World Bank data, 2018*

FIGURE 13: ODA Spent per sector (% of total ODA, 2011) | *Source: Development initiative, 2013*



84. BTI 2018, Malawi Country Report

85. Malawi: Key Developments and U.S. Relations, 2017

86. Ibid.

SECTION 3

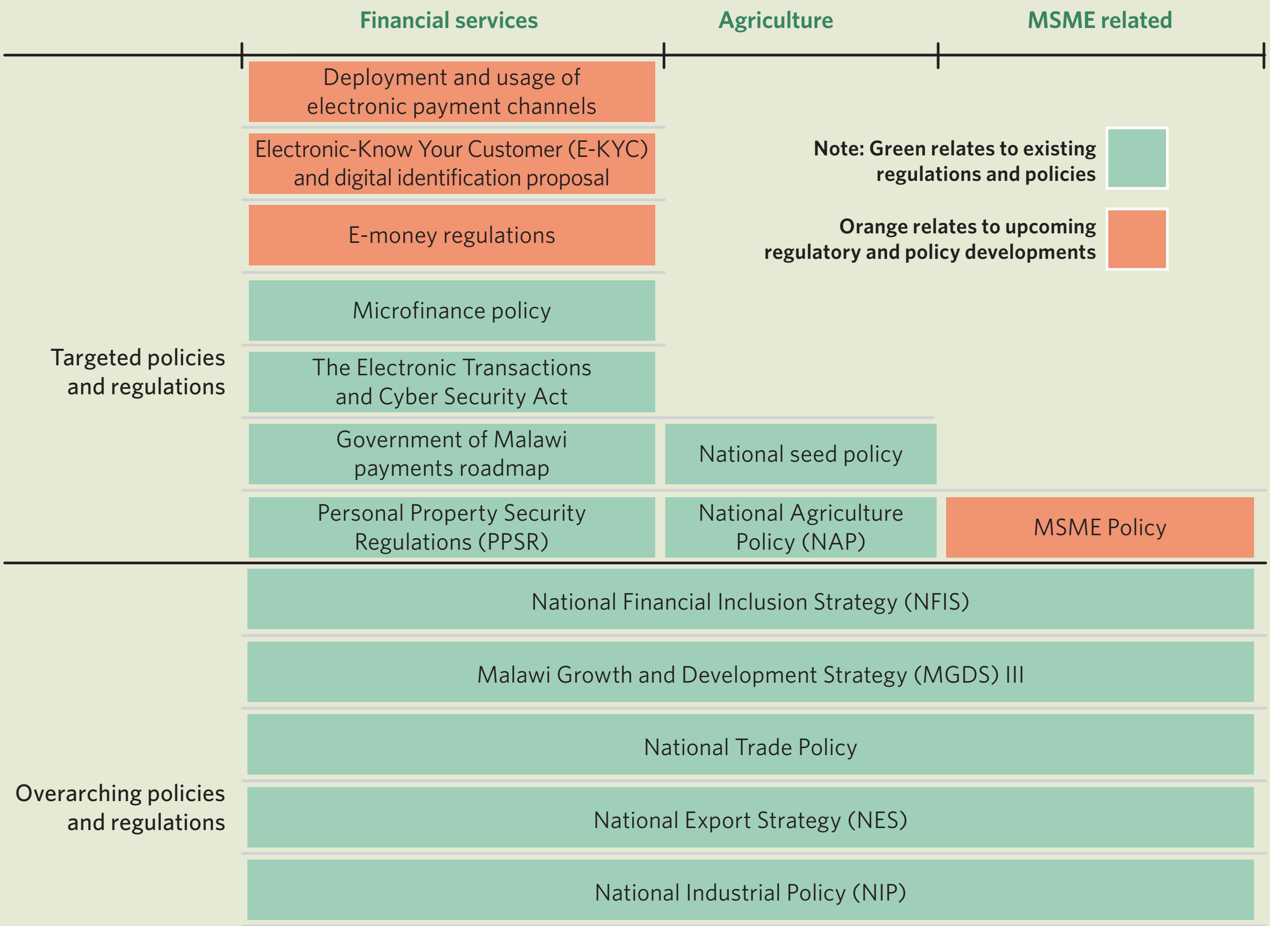
REGULATORY FRAMEWORK TO PROMOTE MSME DEVELOPMENT

This section summarises the policy and regulatory environment that affects the operating landscape of MSMEs in Malawi. The review sought to identify any potential policy and regulatory barriers or gaps currently faced that may inhibit the growth of MSMEs. The review was carried out through both stakeholder consultations and by evaluating the individual policy and regulatory frameworks. Note this review does not constitute a thorough legal evaluation of the policy and regulatory frameworks.

3.1. Policy and regulation overview

Malawi has a number of policies and regulations that impact the operating landscape of MSMEs. These relate to both broad cross-cutting frameworks encompassing multiple sectors and more targeted frameworks relating to MSMEs specifically. Figure 14 summarises the main frameworks before describing them.

FIGURE 14: Summary of the regulatory and policy framework in Malawi



3.1.1. Overarching policies and regulations

This section summarises broad cross-cutting policy and regulatory frameworks that seek to attain overall national strategic objectives. These by extension impact MSMEs operations.

1. **National Financial Inclusion Strategy (NFIS), 2016 - 2020:** The NFIS sets out to increase the level of financial inclusion in Malawi to 55 per cent by 2020 from 34 per cent in 2014 in order to improve the welfare of households. It identifies MSMEs as a key target group (among others). A broad range of stakeholders is charged with the execution of the NFIS. These include regulators, ministries, associations and networks, private sector entities, and development partners[87].

2. **Malawi Growth and Development Strategy (MGDS) III, 2017 - 2022:** MGDS III builds on two prior iterations of the strategy towards achieving Malawi's long-term development aspirations, namely the environment, social, and economic goals. The objective of MGDS III is to move Malawi to a productive, competitive and resilient nation. This is to be achieved through investing simultaneously in areas that can spur growth through the linkages they have with the other sectors of the economy. The Government leads the implementation of the MDGS III through coordination of different stakeholder initiatives and its consolidated national budget[88].

3. **National Trade Policy, 2016:** The National Trade Policy aims to address weak linkages between trade and other binding constraints (such as market-access barriers, imperfect business operating environments, narrow productive base and high costs of entry), that hinder Malawi's ability to take full advantage of existing and emerging market-access opportunities such as bilateral, regional and multilateral-trade agreements. The National Trade Policy, therefore, aims to make Malawi a globally competitive export-oriented economy, which generates higher and sustainable livelihoods. The policy recognises the role that MSMEs can play towards achieving this goal and seeks to support their growth and operations.

   The Ministry of Industry, Trade and Tourism, leads the implementation, and is supported by public, private, academic institutions and civil society players. The policy was designed in alignment to the MGDS III, the National Export Strategy (NES), the National Industrial Policy (NIP) and the MSME Policy[89].

4. **National Industrial Policy (NIP), 2014:** The NIP aims to enhance the country's productive capacity through structural transformation to a more diversified and industrialised economy. This aims to ensure rapid long-term economic growth that raises per capita incomes, creates sufficient rural and urban jobs, widens the tax base and addresses unsustainable trade deficits in an environmentally and socially sustainable way. The policy makes specific mention of supporting MSMEs to achieve its overall vision.

   The Ministry of Industry, Trade and Tourism acts as the lead implementation of NIP. It is supported by a wide number of stakeholders including the OPC, other ministries, and private and public-sector institutions. The NIP is aligned to the MGDS III, NFIS, National Trade Policy and NES and the Southern African Development Community (SADC) Industrial Policy Framework[90].

5. **National Export Strategy (NES), 2013 - 2018:** The duration of the NES officially ended in 2018. The strategy is currently under review with a new strategy expected to be developed for the period 2019 to 2023. The new strategy is expected to maintain the overall export growth focus, but may identify new products for export.

   The Ministry of Industry, Trade and Tourism was charged with overall implementation, and was supported by multiple stakeholders including: Malawi Investment and Trade Centre; Small and Medium Enterprise Development Institute (SMEDI); Malawi Bureau of Standards (MBS); Department of Agricultural Extension Services; Department of Cooperatives; Department of Irrigation; Ministry of Labour; the Ministry of Education, Science and Technology; Ministry of Finance, Economic Planning and Development; RBM; and the Ministry of Lands and Housing[91].

3.1.2. Targeted policies and regulations

This section summarises policies and regulations with a more targeted focus. These either relate to MSMES directly, sectors which they operate in, or financial services that they may use.

1. **Personal Property Security Regulations (PPSR), 2015:** The PPSR sets out to regulate the movable property registry. The registry is an online public database that allows lenders interested in accepting movable collateral as surety for loans to check if the proposed collateral has an existing security interest registered against it, and to register an interest against collateral offered by a debtor in order to access credit. The registry allows for non-traditional collateral to be used as security in an attempt

87. GoM, NFIS, 2016
88. GoM, MGDS III, 2017
89. GoM, National Trade Policy, 2016
90. GoM, NIP, 2014
91. GoM, NES, 2013

to extend access to finance. Implementation of the registry requires further and ongoing enhancements such as consumer education and overcoming challenges such as uniquely identifying non-traditional assets.

The Department of the Registrar General within the Ministry of Justice and Constitutional Affairs hosts the registry[92].

2. **GoM Payments Roadmap, 2017:** The payments roadmap aims to confirm the Government's commitment to shift Malawi from a cash-based economy to a digital payments economy. Through this, the Government also aims to develop a pervasive digital payments ecosystem that improves financial inclusion, accountability, efficiency and transparency of the payment system. This is to be achieved by ensuring the general public has access to digital financial services (DFS) that are easily accessible, affordable, reliable, transparent and secure.

   The roadmap is implemented by steering and technical committees made up of GoM agencies, ministries and the BAM[93]. The roadmap is further aligned to both the MGDs III and NFIS.

3. **The Electronic Transactions and Cyber Security Act, 2016:** The Act makes provisions for the use and acceptance of electronic forms of payments and for criminalising offences related to computer systems and ICT. The Malawi Communications Regulatory Authority (MACRA) is charged with implementing the Act[94].

4. **Microfinance Policy, 2018 - 2023:** The Microfinance Policy seeks to develop a conducive environment for increased provision of financial services to the unserved and underserved segments through the microfinance sector. A broad definition of microfinance is used to incorporate micro-credit, micro-savings, micro-leasing, micro-insurance, micro-pension, and transfer and payment service providers (PSPs). This includes MFIs, SACCOs, MMOs and other non-bank financial institutions.

   A wide range of stakeholders is involved in the implementation of the policy including: the Ministry of Finance, Economic Planning and Development; Ministry of Justice and Constitutional Affairs; Ministry of Industry, Trade and Tourism; Registrar of Financial Institutions; microfinance service providers; industry associations and development partners[95].

5. **National Agriculture Policy (NAP), 2016 - 2020:** The NAP defines the Government's vision of the agriculture sector by 2020. This will involve transforming the sector towards profitable commercial farming through the specialisation of smallholder farm production, output diversification at the national level and value addition in downstream value chains. This is aimed to expand farm household incomes, improve food and nutrition security and increase agricultural exports.

   A wide range of stakeholders is involved in the implementation of the NAP. These stakeholders include ministries, trusts, councils and boards, private-sector players, farmer-based organisations, donor agencies, civil society and academic institutions and research organisations[96].

6. **National Seed Policy, 2018:** Given the importance of seeds as a key component to Malawi's agricultural sector, the National Seed Policy aims to provide clear guidelines for the development and promotion of the seed industry to raise agricultural productivity.

   The Ministry of Agriculture, Irrigation and Water Development is in charge of the implementation of the National Seed Policy. The Department of Agricultural research services will be responsible for agricultural technology development related to the seed industry. The National Seed Commission will be mandated with ensuring high-quality seeds are made available to the farming community. Other government ministries, departments and agencies will play a role insofar as the seed industry intersects with their respective mandates[97].

7. **Interoperability of Retail Payment Systems Directive, 2017:** The Interoperability of Retail Payment Systems directive was gazetted on 15 September 2017. The directive applies to banks, MNOs, the national switch and all other PSPs offering auto-teller machines, point of sale (POS) devices, mobile payments and internet-based payments. The directive sets requirements for interoperability. The directive has been implemented by the RBM[98].

8. **MSME Policy, 2018:** The MSME policy was approved on 26th February 2019; with the process having begun in 2012. Its implementation has yet to begin, though. The MSME policy aims to create a modern and effective framework that guides the development of vibrant, competitive and sustainable MSMEs in Malawi. It succeeds the SME Policy first approved in 1998. This seeks to increase productivity

92. Registrar General Malawi Website and consultations
93. GoM, GoM Payments Roadmap, 2017
94. GoM, The Electronic Transactions and Cyber Security Act, 2016
95. GoM, Microfinance Policy, 2018
96. GoM, NAP, 2016
97. GoM, National Seed Policy, 2018
98. RBM, Payment Systems (interoperability of Retail Payment Systems) Directive, 2017

and growth of MSMEs, increase value addition, empower Malawians economically, enhance economic inclusion, enhance policy coherence and enhance the competitiveness of MSMEs.

The implementation of the Policy will be coordinated by the Ministry of Industry, Trade and Tourism, in collaboration with other government agencies, private sector players, non-government organisations and community-based organisations. The policy is linked to Vision 2020, the MGDS III, NES, National Trade Policy, NIP, Microfinance Policy and NAP[99].

9. **E-money regulations:** The E-money Regulations were gazetted in June and became effective on 1 July 2019. The E-money Regulations aim to provide a regulatory framework that governs various aspects of the operations of e-money services.

   The regulations were prepared by the Ministry of Finance, Economic Planning and Development and fall under the Payment Systems Act[100]. The regulation assigns an oversight role for the RBM pertaining to the submission of data and information.

10. **Deployment and usage of electronic payment channels regulations, 2018:** The regulations are currently under review having undergone stakeholder consultation in 2018. Next, they would need to be gazetted by Parliament before they can come into effect. The regulations seek to make it mandatory for all qualifying businesses to offer at least one form of digital payment, so as to increase access points, adoption and usage of electronic payment services. The readiness of businesses to launch this and the demand from consumers (in relation to their ability to make digital payments) is not yet clear.

    The bill was jointly prepared by the RBM, MRA, BAM, Ministry of Industry, Trade and Tourism and the Ministry of Justice[101].

11. **E-know your customer (KYC) and digital identification proposal:** These regulations seek to commit FSP to make use of electronic KYC processes and national digital identifications when opening new accounts for customers. This seeks to not only enhance the process of account opening but to reduce the risks of fraud for FSPs.

BOX 3: Analysing regulatory issues for financial inclusion 2015 vs 2019

Analysing regulatory issues for financial inclusion 2015 vs 2019

The MAP Malawi Demand, Supply, Policy and Regulation Diagnostic Report 2015 provided an analysis of the state of regulation in Malawi at the time. Although the 2015 diagnostic reviewed policy and regulations pertaining to broader consumer financial inclusion, there is significant overlap between those regulations reviewed and those that were identified as relevant for MSMEs specifically. Table B3 provides a summary of key changes in regulation that were identified in the 2015 diagnostic.

TABLE B3: MSME relevant regulatory issues for financial inclusion

Source: FinMark Trust, Malawi Demand, Supply, Policy and Regulation Diagnostic Report, 2015

Key regulatory issues, 2015	Status update on regulatory issues
Lack of National ID increases cost and risk for financial providers	The Malawi National ID project registered 9.2 million Malawians between May and November 2017[102]. Various stakeholders have recognised the importance of the new national ID in alleviating KYC costs.
NPS bill delayed and lacks interoperability requirement	The Interoperability of Retail Payment Systems Directive 2017, directly addresses issues by making it mandatory for PSPs to put in place infrastructure for interoperability.
Mobile money regulations do not permit providers or users to earn interest on their own funds in suspense	E-Money regulations gazetted in July 2019 addresses the issue of earning interest by providing guidelines on the appropriate management of interest, fees, charges and distribution of interest to customers' accounts.
Concerns around client privacy through the establishment of credit reference bureaus	The CRB Act was amended in 2015 and the new amendment came into law on 1 August 2016. Additionally, stakeholder consultations revealed that the issues pertaining to the privacy of information has been resolved and progress has been made in improving data return forms to benefit parties submitting and making use of credit records.

As shown in the table, there has been significant progress in addressing regulatory barriers to financial inclusion. This serves as a clear message of intent from the Government and development partners to address issues affecting financial inclusion.

99. GoM, MSME Policy 2019

101. IT WEB Africa, Malawi to enforce digital payment channels, 2018

100. GoM, Payment Systems (E-money) Regulations, 2019

102. GSMA, Digital Identity Country report; Malawi, 2019

3.1.3. Envisaged impact of policies and regulations

The review of the regulations and policies can be summarised into four key categories related to their intended impact on MSMEs. They are:

1. **Enhancing access to financial services:** including access to finance, savings, insurance, payments and financial literacy training.
2. **Enhancing business operating environments:** including development of enabling-operating environments, market access, supporting specific sectors and development of enabling infrastructure.
3. **Regulatory and policy frameworks:** involves consumer protection and creating enabling regulatory and policy frameworks.
4. **Capacity building:** of both MSMEs and institutions or regulators that serve MSMEs.

TABLE 5: Categorisation of the intended impact of Malawian policies and regulations

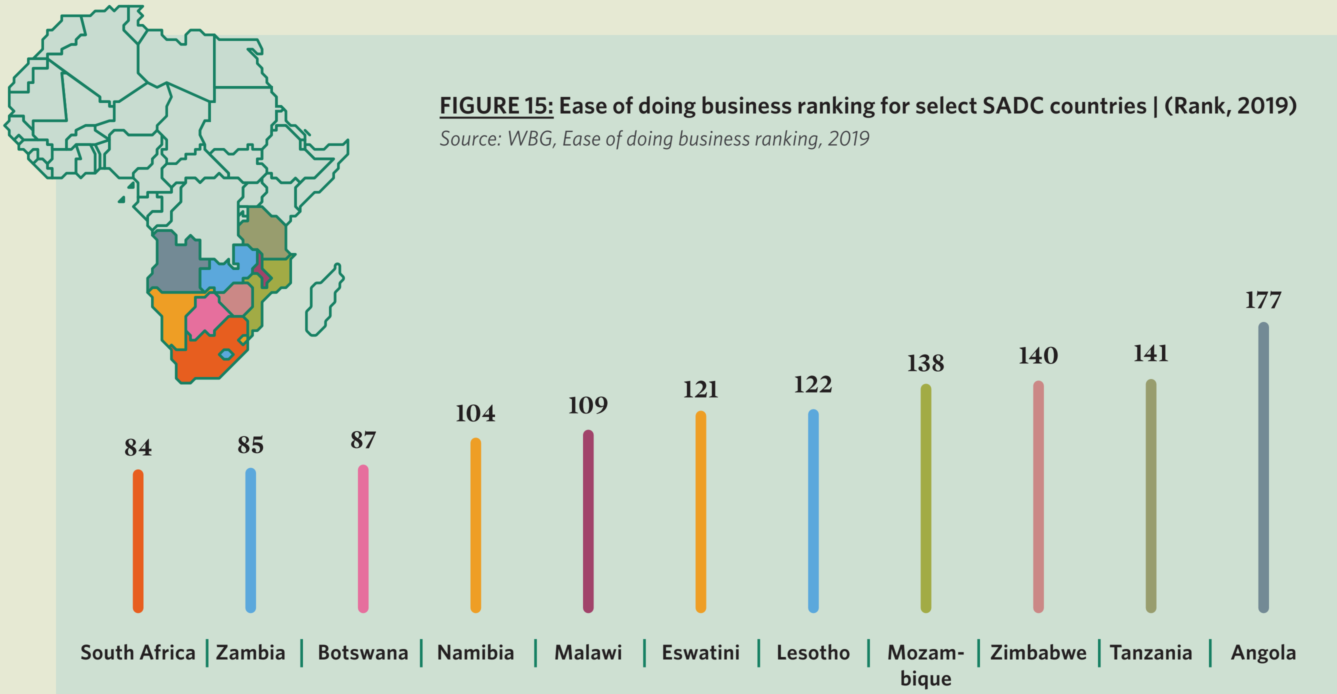
Policy/Regulation	Enhancing access to financial services	Enhancing the business operating environment	Regulatory and policy framework	Capacity building
NFIS	Green		Green	
MGDS III		Green		Green
National Trade Policy	Green	Green	Green	
NIP	Green	Green		Green
NES		Green		Green
PPSR	Green		Green	
GoM Payments Roadmap	Green		Green	
The Electronic Transactions and Cyber Security Act	Green		Green	
Microfinance Policy	Green	Green	Green	Green
NAP	Green	Green	Green	Green
National Seed Policy		Green	Green	Green
Interoperability of retail payments	Green		Green	
MSME Policy	Orange	Orange	Orange	Orange
E-money Regulations	Orange			
Deployment and Usage of Electronic Payment Channels Regulations	Orange			
E-KYC and Digital Identification Proposal	Orange			

Green refers to existing regulations

Orange refers to incumbent regulations

FIGURE 15: Ease of doing business ranking for select SADC countries | (Rank, 2019)

Source: WBG, Ease of doing business ranking, 2019



3.1.4. Business operating landscape/ environment

As of 2020, Malawi was ranked 109 out of 190 economies in the WBG's ease of doing business ranking; having risen from 171 in 2014[103]. This shows substantial improvements in the business operating environment within Malawi. Figure 15 highlights how Malawi compares to a selection of other SADC countries.

The key areas identified requiring further enhancement in Malawi are as follows[104]. For reference they are compared against SSA averages which in some instances are equally low:

1. **Starting a business:** in relation to the number of procedures involved (7 against SSA average of 7.4) and time taken to complete (37 days against SSA average of 21.5).

2. **Dealing with construction permits:** in relation to the number of procedures (13 against SSA average of 15.1) and time taken to complete (153 days against SSA average of 145.4 days).

3. **Getting electricity:** in relation to the number of procedures involved (6 against SSA average of 5.2), time taken to complete (127 days against SSA average of 109.6 days) and reliability of supply and transparency of tariff index (0 against SSA average of 1.6 - index between 0 and 8). Frequency and length of electricity shortages have further been reported as a result of weak capacity and dependence on drought-vulnerable hydroelectricity generation[105].

4. **Paying taxes:** in relation to the number of tax payments in a year (35 against SSA average of 36.6) and post-filling index (33.2 against SSA average of 54.7 - index between 0 and 100).

5. **Trading across borders:** in relation to the time to export - border compliance hours (78 hours against SSA average of 97.1 hours), time to export - documentary compliance (75 hours against SSA average of 71.9 hours) and cost to export - documentary compliance (USD 342 - MWK 246,250 against SSA average of USD 172.5 - MWK 124,205). This is affected by limited transport infrastructure and trade logistics[106].

6. **Enforcing contracts:** in relation to the cost as a percentage of claim value (69% against SSA average of 41.6%) and quality of judicial process index (9.5 against SSA average of 6.9 - index between 0 and 18).

7. **Resolving insolvency:** in relation to the recovery rate (15.6 cents on the dollar against SSA average of 20.5 cents on the dollar), cost as a percentage of the estate (25% against SSA average of 22.8%) and strength of insolvency framework index (8.5 against SSA average of 6.5 - index between 0 and 16).

8. **Malawi Bureau of Standards (MBS) delays:** stakeholders identified that the MBS takes too long to provide approvals, analyse samples or to respond to requests, in some cases years, which inhibits business operations. Similarly, the standards that MBS requires are not aligned to business needs.

103. WBG, Ease of doing business ranking, 2020

104. Note: These are areas ranked 100 or below

105. IMF, Malawi selected issues, 2018

106. Ibid.| Note: Using the exchange rate at 31 December 2018 from Oanda.com

3.2. MSME institutional landscape

This section highlights GoM agencies that are charged with MSME development. These agencies provide amongst others, business development and financial services support.

1. **Ministry of Industry, Trade and Tourism:** The ministry is responsible for the overall coordination of MSME development in Malawi, as required by the MSME Policy, 2018[107]. The coordination extends across nine priority areas: namely, legal, regulatory and institutional environment; access to finance; access to markets; entrepreneurship development; business information and skills; operation of value chains; business infrastructure; MSME networks and clusters; and cross-cutting issues (as described in section 3.2.1). From an access to finance perspective, the ministry is in the process of operationalising an indirect funding mechanism through banks. This financing will be available to MSMEs in all sectors only for the purpose of purchasing equipment and improving buildings.

   The ministry is further charged with the implementation and support of additional policies and regulations that directly and indirectly impact MSMEs. These include the National Trade Policy, 2016; NIP, 2014; Microfinance Policy, 2018 to 2023; and NES, 2013 to 2018.

   The ministry faces key capacity challenges to effectively execute its broad mandate. This requires accurate monitoring of different stakeholders implementation and the harmonising of related activities to ensure efficiency. In addition, the ministry also lacks specific capacity around sustainable enterprise development, as opposed to the current social approach to MSME development.

2. **Ministry of Agriculture, Irrigation and Water Development:** The ministry seeks to promote agricultural productivity and sustainable management of land to achieve food security, increased income and ensure sustainable socio-economic growth in Malawi[108]. This includes the implementation of the NAP, 2016 to 2020 and National Seed Policy, 2018.

   More specifically to MSMEs, the Agriculture Extension Services department promotes the commercialisation of farming and the organisation of farmers into formal and informal groups. This is achieved through the extension of capacity building, advisory and other services for groups.

   The ministry faces a number of challenges in the execution of its mandate. The first challenge relates to the target market of subsistence farmers that face literacy, capacity and capital challenges. These limit the commercialisation opportunities available. The next challenge relates to budgetary allocations, with donors often having to offer supplementary assistance to implement technical activities. Lastly, the ministry faces resource constraints, with 31 agribusiness officers serving 28 districts, and having 1,700 extension officers against a planned 2,880.

3. **Small and Medium Enterprise Development Institute (SMEDI):** SMEDI is a parastatal organisation under the Ministry of Industry, Trade and Tourism. SMEDI's main roles include MSME research and policy advocacy; help and support in the implementation of MSME related policies; business management training and advisory services which include best financing options for MSMEs; and improving information availability, product standards and quality in the market. At present SMEDI has three regional offices in Zuzu, Lilongwe and Blantyre, and an incubation centre in Mponela focused on agro-processing.

   SMEDI was established in 2013 after the merging of the Malawi Enterprises Development Institute (MEDI), SEDOM, and the Development of Enterprises Malawi Trust (DEMAT). The merger was aimed at improving the efficiency in BDS delivery to MSMEs through effective utilisation of the available meagre resources.

   At present, SMEDI is unable to provide scale assistance to MSMEs due to limited resourcing and regional reach.

4. **Technical, Entrepreneurial and Vocational Education and Training Authority (TEVET Authority):** TEVET Authority was established in 1999 to create an Integrated TEVET system in Malawi that is demand driven, competence based, modular, comprehensive, accessible, flexible and consolidated enough to serve both rural and urban populations. Through this, the TEVET Authority seeks to contribute to human resource development by enabling sustainable training and development.

   The TEVET Authority's exact roles include: monitoring gaps between supply and demand for skills; supporting the adoption and application of appropriate technologies; promoting managerial, business and entrepreneurial skills; facilitating sound and sustainable financing and funding mechanisms for technical education and training; and to promote growth in the sector.

5. **Export Development Funds (EDF):** EDF is a development financial institution wholly owned by the RBM. Its key objective is to increase the productive potential of the country through the provision of finance, equity participation or credit guarantees, and advisory services for the set-up, expansion and modernisation of viable medium and large enterprises.

107. GoM, MSME Policy, 2018

108. Ministry of Agriculture, Irrigation and Water Development website

Stakeholder interviews identified that the EDF was not operating as intended. In a number of instances, instead of providing funding to an MSME with an export opportunity, the EDF would, in fact, take over the contract and deliver the export goods itself. The MSME would then be paid a 15 per cent finder's commission. Where loans were provided, the EDF would seek guarantees or collateral as would be required by banks. This suggests a need to re-evaluate the implementation of the EDF's mandate.

6. **Malawi Agriculture and Industrial Corporation Plc (MAIC):** MAIC is a development finance entity initiated by the Government but led by the private sector. The ownership structure reflects this intention, with the Government expected to own 20 per cent and the remainder by private-sector shareholders such as financial institutions and foreign investors.

   MAIC is expected to provide financing and technical advice for start-up or growing businesses in agriculture and manufacturing (i.e. industrialisation) sectors. As at the writing of this report, MAIC was yet to begin its operations[109].

3.3. Key regulatory gaps

Based on the analysis of Malawi's MSME regulatory framework and in-country consultations with key stakeholders, the following high-level regulatory gaps emerged:

- **Coordination of MSME regulatory framework requires attention -** although the MSME Policy addresses many of the issues facing small businesses in Malawi, its implementation has yet to begin. This suggests there needs to be more coordination among stakeholders. Stakeholder engagements echoed the issues around coordination and the duplication of efforts, which need to be addressed to ensure interventions are more effective.

- **Regulatory compliance can be costly and onerous, requiring a more flexible approach -** FSPs report difficulties in maintaining compliance with regulatory standards. This includes a large number of recent directives issued by the RBM in the last two years. The Table 6 provides an example of directives introduced by RBM in 2019 alone.

  Compliance with these directives requires continual oversight and maintenance of systems. However, failing to comply with these directives attracts sizable monetary penalties.

- **Regulations are often slow to be implemented -** although a widely consultative process is an important input into the drafting of the legislature, concerns are raised with regard to the turn-around time of drafting legislature with specific reference to the implementation of laws.

- **Interest rate regime reportedly places strain on FSP's -** following RBM reducing the Policy Rate from 16 per cent to 14.5 per cent at the beginning of 2019, various FSPs have followed suit in reducing their base lending rate on loans. During stakeholder consultations, various FSPs have noted that this reduction in interest rate stifles bank earnings, given the high cost of financing, driven predominantly by infrastructure and compliance costs. Although interest rate capping under the Financial Services Act has not yet been passed. The sentiment from FSPs is that there would be far-reaching consequences on all FSPs as the cost of financing is driven by high operating costs.

TABLE 6: List of directives for banks introduced by RBM in 2019

Source: RBM, Financial Sector Regulation, Directives

Agent Banking Regulations	Foreign Currency Lending Directive
Annual Audit Directive	Information Management Directive
Asset Classification Directive	Large Exposure Directive
Capital Adequacy Directive	Licensing Directive
Consolidated Supervision Directive	Prompt Corrective Action Directive
Credit Reference Bureau Regulation	Premises Inspection Directive
Disclosure of Credit Products Directive	Prudential Liquidity Directive
Fit and Proper Directive	Related Party Directive
Risk and Governance Directive	Submission of Information Directive

109. Malawi Confederation of Commerce & Industry Website

SECTION 4

SUPPLY-SIDE ANALYSIS (PROVIDER OVERVIEW)

This section of the report highlights findings from a review of the FSPs and BDS providers currently operating in Malawi.

4.1. Provider overivew

Table 7 highlights the main type of service providers currently operating in the market. As is evident, the list of providers ranges from private, donor and public sector providers.

The banking and SACCO sectors have been experiencing consolidation, while MFIs and pension funds have been growing markedly.

The following chapters provide further insights into these providers, the type and nature of services offered, and highlight key providers.

4.1.1. Distribution of financial services and BDS providers

Bank branches and automated teller machines (ATMs) have experienced moderate growth from 2015 to 2018. Unlike other developing markets, bank agent numbers have decreased from 216 in 2015 to 116 in 2018[110]. This was reportedly a result of some agents being converted into branches[111]. Similarly, stakeholders identified liquidity management as a key inhibitor to agent operations, particularly in rural areas.

Mobile money agents and POS devices have seen the highest growth at a continuous annual growth rate (CAGR) of 49 per cent and 26 per cent, respectively. They accounted for the largest number of channels at 39,434 (MMO agents) and 1,978 (POS devices), in 2018 (see Figure 16).

TABLE 7: Summary of type of providers and the associated services provided | *Source: Stakeholder interviews, 2019*

TYPE OF PROVIDER	SERVICE PROVIDED: Credit /finance	Savings /investment	Payments	BDS	Insurance
Banks	■	■	■	■	■
MFIs	■	■	■		
SACCOs	■	■			
VSLAs	■	■			
Malawi Stock Exchange (MSE)	■				
Pension funds		■			
General insurance providers					■
MMOs			■		
Donor agencies	■			■	
Government agencies	■			■	

110. RBM, Bank supervision annual reports, 2015 - 2018

111. Ibid.

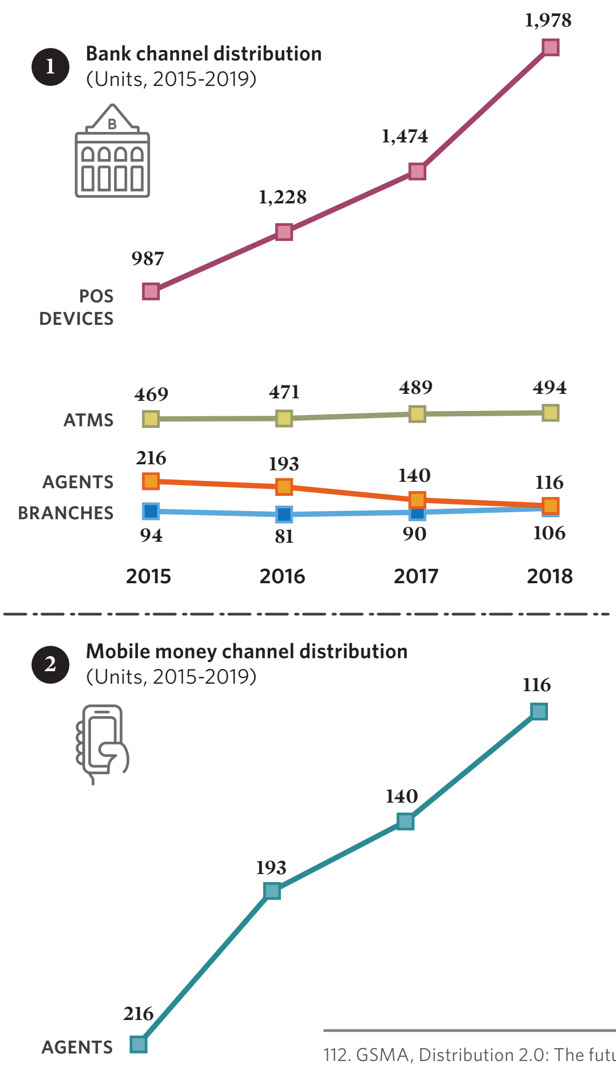
TABLE 8: Number of service providers

Source: RBM Bank supervision annual reports, 2015 - 2018 | Care Global VSLA Reach 2017 | Ministry of Finance, Economic Planning, Village Savings and Loans Programme Mapping Report, 2014

TYPE OF PROVIDER	2013	2014	2015	2016	2017	2018
Banks	11	12	12	10	9	9
MFIs	19	25	27	36	45	49
SACCOs	45	45	45	30	34	37
VSLAs		35,351			23,071	
Pension funds			12	26	24	32
General insurance providers	7	7	8	8	8	8

FIGURE 16: Bank and MMO channel distribution

Source: RBM Bank supervision annual reports, 2015 - 2018; Care Global VSLA Reach 2017



There is currently no reporting on MFI and SACCO networks, and therefore, a direct comparison of reach is difficult. However, anecdotal insights from stakeholder interviews highlight that MFIs and SACCO networks have greater reach than formal providers, particularly in rural areas where they are leveraging their own agent networks.

POTENTIAL ACTIONABLE AREAS

1. The RBM could enhance reporting of FSP distribution channels to include non-bank providers and provide a regional split. This would serve to identify areas that are underserved and could be used by private sector players to make strategic decisions on where to expand.
2. Continued efforts by the Government to extend road, electricity and internet infrastructure is required to extend distribution channels to rural areas.
3. Private sector players should deploy strategies to improve agent float-liquidity management. Examples of potential strategies include the use of predictive data analytics to enable the forecasting of demand to allow agents to plan accordingly; or deploying float-delivery mechanisms that reduce the rebalancing costs for agents (i.e. the costs incurred and time taken to rebalance floats)[112].

4.1.2. Credit or finance overview

OVERVIEW OF CREDIT OR FINANCE PROVIDERS

Findings from the supply-side research estimate that in 2018 the credit or finance extended to MSMEs stood at MWK 59 billion (i.e. USD 82 million)[113]. Of this, banks provided most financing at 68 per cent, followed by MFIs at 18 per cent and donor agencies at 8 per cent.

A summary of the key lending requirements per type of provider is highlighted in Table 10.

TABLE 9: Estimated credit or financing to MSMEs in 2018

Source: Stakeholder consultations, 2019 | Data request submissions, 2019 | RBM Bank supervision annual reports, 2015 - 2018 | Care Global VSLA Reach 2017 | Ministry of Finance, Economic Planning, Village Savings and Loans Programme Mapping Report, 2014 | Genesis Analytics team analysis, 2019
Note: Currency figures are inflatio adjusted and presented as at 2013

TYPE OF PROVIDER	Credit /financing MWK billion	Credit and financing USD million	% distribution
Banks	MWK 40.0	USD 55.6	68%
MFIs	MWK 10.4	USD 14.5	18%
SACCOs	MWK 4.9	USD 6.8	8%
VSLAs	MWK 1.9	USD 2.6	3%
SACCOs	MWK 1.7	USD 2.3	3%
MSE	-	-	-
TOTAL	**MWK 58.9**	**USD 81.8**	**100%**

112. GSMA, Distribution 2.0: The future of mobile money agent distribution networks, 2018
113. Genesis Analytics team analysis, 2019 | Notes: Currency figures are inflation adjusted and presented as at 2013

TABLE 10: Summary of credit or finance requirements per type of provider

	BANKS	MFIS	SACCOS	VSLAS	DONORS	MSE
Product offering	Term loans Revolving credit facility Operating leases Vehicle and asset finance Specialised agric loans Credit cards	Short-term loans	Short-term loans	Short-term loans	Challenge funds Grants Indirect	Equity investment
Eligibility requirements	Proof of residence Proof of income ID document Collateral	Collateral ID document	Member of SACCO	Member of VSLA	Specific sector or group	Incorporated Minimum subscribed capital 20% issued capital to public Listing fees Fully underwritten
Interest rate (annualised)	23% - 31%	60% - 72%	60%	20% per month (effective 792% per annum)	Varies	N/A
Average loan size	Varies	MWK 200,000	Proportion of contribution	Proportion of contribution	Varies	N/A
Tenure	12 - 40 months	6 - 24 months	6 - 12 months	6 - 12 months	N/A	N/A
Target size	SMEs	Micro & small	Micro & small	Micro & small	Micro & small	SMEs
Target maturity	Growth Established Mature	Start-up Growth Established	Start-up Growth	Start-up Growth	Start-up Growth	Established Mature

BANKS

Total bank assets grew from MWK 653 billion (i.e. USD 906 million) in 2013, to MWK 1,422 billion (i.e. USD 1,975 million) in 2018, reflecting a CAGR of 17 per cent. Total bank loans and leases grew at a lower CAGR of 11 per cent from MWK 257 billion (i.e. USD 357 million), to MWK 426 billion (i.e. USD 591 million) (see Figure 17)[114]. Over the same period, banks have averaged a loan-to-asset ratio of 34 per cent. As at 2018, cash and dues from other banks, securities and investments accounted for 55 per cent, compared to 2013 where these accounted for 48 per cent of assets. Together, this suggests overall restrained lending by banks to the private sector.

Trade, agriculture, and manufacturing have accounted for 60 per cent of bank loans and leases over the last six years. This is aligned to overall MSME distributions, where 90 per cent of MSMEs reported these sectors as being their main activity or service[115].

The overall banking industry lending to MSMEs was estimated to account for MWK 40 billion in 2018 (USD 55.6 million), based on data submissions from five banks and stakeholder consultations[116]. This is likely a result of banks generally focusing on formal, small and medium-sized enterprises. These are often either in the growing, established or mature phase of their business life cycle - which make up a small proportion of overall businesses. Banks are, however, exhibiting increased interest in the MSME sector,resulting in the development of dedicated business units to develop tailored offerings for the segment.

Banks, in general, classify MSMEs based on the **annual business revenue turnover**. No further segmentation between the different sizes of business is made. Instead, sectoral classifications are in some cases used. Examples of some classifications include:

- **National Bank of Malawi (NBM):** businesses with turnovers up to USD 2 million (i.e. MWK 1,440 billion). Above this turnover, the businesses are classed as corporates.
- **Standard Bank of Malawi:** businesses with turnovers up to USD 10 million (MWK 7,200 billion). Above this turnover, businesses are classed as corporates[117].

FIGURE 17: Overall bank sector trends

Source: RBM Bank supervision annual reports, 2014-2018 | Note: Currency figures are inflation adjusted and presented as at 2013

114. Notes: Currency figures are inflation-adjusted and presented as of 2013
115. FinMark Trust, FinScope MSME Survey, 2019
116. RBM, Bank supervision reports 2018 | Stakeholder consultations, 2019 | Note: 1. Currency figures are inflation adjusted as at 2013; 2. Using the exchange rate at 31 December 2018 from Oanda.com
117. Stakeholder consultations, 2019 | Note: Using the exchange rate on 31 December 2018 from Oanda.com

The key lending products available to MSMEs are as follows:

- **Term loans:** short to medium term loans, i.e. ranging from one year to three years. The average reported interest rate charged by the five sampled banks ranged from 25 per cent to 31 per cent.
- **Vehicle and asset finance:** including finance leases[118]; operating leases[119]; and sale and leasebacks[120]. The average interest rate charged ranged from 23 per cent to 30 per cent. The average tenure of the loan was one year to five years.
- **Trade financing:** includes invoice or contract factoring and discounting. Sixty-seven per cent of the banks that were interviewed and that submitted data returns offered these products. The spreads of reported interest rates charged were narrower, ranging from 25 per cent to 28 per cent. All banks reported offering only one-year tenure of these loans.
- **Working capital:** short term loans provided to aid businesses to meet their day-to-day needs. The average interest rates charged ranged from 20 per cent to 30 per cent.
- **Specialised agriculture loans:** Eighty-three per cent of banks reported offering these products. These products are often concentrated in structured value chains such as tobacco, maize and sugarcane, and could range from input, asset or working-capital financing. Other value chains were described as being underserved.
- **Credit cards:** only one of the interviewed and sampled banks reported offering credit cards to MSMEs.

Banks offer additional products to businesses including savings and/or deposits, insurance (through bancassurance), payments and BDS (see sections 4.1.3, 4.1.4 and 4.1.6). The complementary nature of these services to business operations increases the use case for MSMEs.

Key challenges to banks when it comes to providing credit to MSMEs are as follows:

- A lack of robust lending models results in the reliance on traditional forms of collateral, which are often limited for MSMEs. As such, banks continue to perceive it too risky to extend financing to MSMEs.
- Low literacy levels of MSME owners and entrepreneurs inhibits MSMEs from meeting the requirements to formal finance. This means that even credible businesses are unable to present the relevant financial history to meet the requirements of banks.
- There are no obvious MSME financing product gaps from a bank perspective. However, there seems to be a lack of well-trained sales personnel particularly in rural areas that are able to understand the consumer needs and adequately match them with bank products and services. Similarly, stakeholder consultations identified the time taken to process loans as being too long, requiring automation where possible.

BOX 4: New private sector business models

Source: Stakeholder engagements, 2019 | NBM Website, 2019 | Note: Using the exchange rate at 31 December 2018 from Oanda.com

National Bank of Malawi (NBM) Development Bank

NBM Development Bank is a wholly-owned subsidiary of NBM that seeks to offer long term finance to start-up and growing businesses. These segments are currently underserved by the banking sector due to their limited collateral endowments, business skills and operating history. The Development Bank is expected to offer either direct equity capital or long-term loans, i.e. mezzanine finance. NBM expects to capitalise the Development Bank with up to USD 1.5 million (i.e. MWK 1,080 billion).

From a loan perspective, the Development Bank is expected to offer loans ranging from MWK 15 million to MWK 150 million (i.e. USD 20,833 to USD 208,325) charged at 15 per cent to 18 per cent interest. The bank will also offer a grace period of up to two years before loan repayments become due.

The NBM Development Bank also seeks to be a one-stop-shop that offers ancillary business development services (BDS) to prospective MSMEs; for example, the NBM Development Bank will work with NBM to facilitate services such as deposit-taking and short-term financing if the project requires it.

This type of innovation is welcomed in a sector that faces a number of constraints to extend financing to MSMEs. However, a number of challenges will need to be overcome in order to achieve significant scale. This will include:

1. Effective targeting of MSMEs that would benefit the most from this long term financing.

2. Staffing of seasoned professionals that would provide useful skills to businesses where direct equity is provided.

3. Skilful asset-liability matching that does not stress the operations of NBM Bank.

118. Where the bank maintains ownership of the asset while the lessor uses the asset for the duration of the lease agreement usually accompanied by an option to buy the asset at the end of the contract
119. Where the ownership of the asset does not transfer to the MSME
120. Where a bank buys back an asset at an agreed price and leases it back to the business

BOX 5: Collateral finance through commodity exchanges

Source: IFPRI, Baulch B, Gross A, Nkhoma J C & Mtemwa C, Commodity exchanges and warehouse receipts in Malawi, 2019

Agriculture Commodity Exchange for Africa (ACE) and AHL Commodity Exchange (AHCX)

Malawi is unusual in having two commodity exchanges (Comex); namely, ACE, established in 2006 - privately owned, and AHCX, established in 2013 - owned by a parastatal; and in having two separate auction systems for tobacco (established in the 1930s), and tea (established in 1970s).

Since the collapse of the pigeon pea export market in mid-2016, both exchanges have experienced a considerable decline in trading volumes, impacting their financial viability. Maize is by far the most important crop traded, making both Comex vulnerable to fluctuations in harvests and traded volumes.

The fragmented nature of the exchanges extends to the WRS. These are made up of the two formal systems operated by ACE and AHCX, and warehouse receipts issued by the commercial warehouses. Warehouse receipts issued by one of the two formal WRS have the benefit of a centralised register that is also digitised that can check whether there are any prior claims to the receipt. Warehouse receipts issued by commercial warehouses are not able to do this. FSPs consequently employ collateral managers to help verify claims, raising the cost and level of effort required.

Five banks and one government-backed fund - the EDF, have advanced financing through the Comexes over the last five years. Terms of finance are reportedly the base rate plus 3 per cent or 4 per cent for a fixed period (usually three months), with around 70 per cent of the underlying value of the commodity advanced as a loan. The perceived risk of lending through such alternative methods remains high, with most banks only piloting WRS backed loans. However, one commercial bank and the EDF advanced more substantial financing and have suffered substantial defaults on export contracts for pigeon peas.

Most commercial banks make direct commodity financing available to large trading companies and processors. The volumes loaned here are much larger than by the official WRS. As the reputations of these large trading companies are well-known to the banks these loans are generally regarded as more secure than WR loans. For the financial institutions, one advantage of Comex backed WRS schemes is that the Comex performs the role of the collateral manager or monitors.

Some key recommendations to improve the working collateral-based finance from Comexes are:

1. Explore merging the ACE and AHCX into a single exchange to attain scale.
2. Explore the set-up of a single WRS to attain scale and to have one centralised registry.
3. FSPs should continue innovating with product offerings such as setting ‘strike prices’ for sale of stocks, and establish term limits for collateral-based loans. These would limit the FSPs’ financial exposures.

- Credit information sharing through credit reference bureaus (CRBs) remains in its infancy, having begun in 2016. Despite continued efforts by CRBs and the RBM, FSPs still face challenges around data quality, the usability of templates and compliance.
- Uptake and usage of the PPSR remain limited because of current design limitations (see Section 3.1.2) and limited consumer education on it.

POTENTIAL ACTIONABLE AREAS

1. The PPSR requires further enhancements to improve customer usability to SMEs and banks. Examples of these include developing interfaces with the road registry, and developing a system of unique identifiers for other forms of assets (e.g. livestock). Furthermore, public awareness campaigns are required for consumers to be sensitised on its use.
2. Efforts are required to scale and streamline the operations of the Comexes and the WRS. This could entail the development of a single WRS and the merging of the two Comexes.
3. Further technical assistance for banks could be required to help banks develop new risk management and lending models. These may include the development of cash-flow-based lending (that would equally require further pushes to digitise SME payments described in Section 4.1.3) and predictive-data analytics.
4. Development Finance Institutions (DFIs) could continue to lend to banks at long tenures and stipulate that banks on-lend to MSMEs. Comprehensive monitoring and evaluations are needed to ensure on-lending goes to those businesses that may otherwise not have received it.
5. Continued efforts are needed to enhance credit information sharing. This could include further improvement in the quality of data submitted through the CRB submission templates (which is reportedly being carried out), cleaning of reported data within the CRBs, exploring a single submission portal and ensuring all credit institutions submit full positive and negative data. Furthermore, efforts may be made to increase the richness of the data by mandating utility providers and government institutions to submit payment data as well.

MFIS

Total MFI assets grew from MWK 11.6 billion (i.e. USD 16 million) in 2013, to MWK 34.7 billion (i.e. USD 48.2 million), in 2018, reflecting a CAGR of 21 per cent. Total MFI loans and leases grew at a CAGR of 25 per cent from MWK 6.6 billion (i.e. USD 9 million), to MWK 17 billion (i.e. USD 24 million), (see Figure 18). MFIs' higher average loan to asset ratio of 52 per cent suggests a high appetite for overall loan extension compared to banks, though off a lower base. Stakeholder interviews identified that the agriculture and trade sectors receive up to 60 per cent of overall loans.

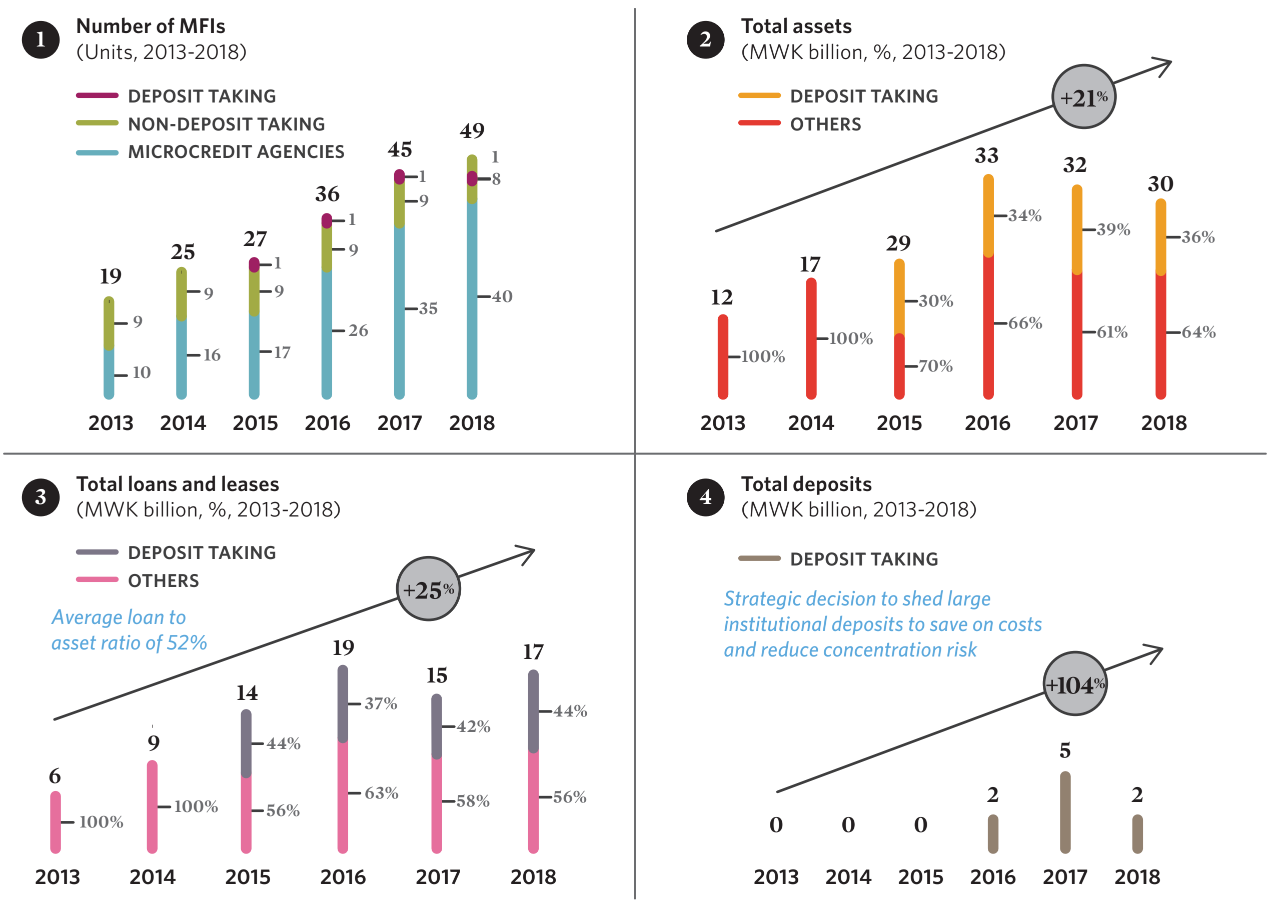
In 2015 one deposit-taking MFI was registered; with a further three reportedly intending to register in 2019. Deposits grew rapidly to MWK 5 billion in 2017 (i.e. USD 7 million)[121].The majority of these were institutional deposits that were charged at high rates - as per MFI consultations. In 2018 a strategic decision was made to reduce these institutional deposits to save on costs as well as concentration risks. Poor consumer perceptions around the stability of MFIs limits the uptake of deposit products[122]. As such the industry was pushing to adopt the term 'microfinance bank' for deposit-taking MFIs.

MFIs are better placed to serve groups and individual entrepreneurs, due to their retail-focused product and service offering. Even with this, it is estimated that 60 per cent of MFIs' loan book was lent to these micro and small enterprises in 2018, equating to MWK 10.4 billion (i.e. USD 14.4 million)[123].

The MFI Hub Company Limited was developed to provide switching/payment capabilities within the MFI sector and with the ability to connect with the banking sector, and core banking system with connectivity to e-services such as CRBs and immigration service. It was initially intended to be owned and run by the Malawi Microfinance Network and Malawi Union of Savings and Credit Cooperatives (MUSCCO)

FIGURE 18: Overall MFI sector trends | *Source: RBM Bank supervision annual reports, 2014-2018*

Note: Currency figures are inflation-adjusted and presented as at 2013 MWK



121. RBM, Bank supervision annual reports, 2013 - 2018 | Note: 1. Currency figures inflation-adjusted as at 2013: 2. Using the exchange rate on December 2018 from Oanda.com

122. Stakeholder consultations, 2019

123. RBM, Bank supervision annual reports, 2013 - 2018 | Stakeholder consultations, 2019 | Note: 1. Currency figures inflation-adjusted as at 2013: 2. Using the exchange rate on 31 December 2018 from Oanda.com

with financial support from the RBM. This support did not materialise and as such the RBM opted to have the MFIs jointly own and run the Hub. As at 2019, only 12 of 49 MFIs had purchased shares into the company, the limited uptake was driven by high user fees and as a result, scale was yet to be attained.

The key lending products MFIs offer to MSMEs include:

- Term loans: short to medium-term loans of between 6 to 24 months to finance business operations
- Agricultural loans: including loans to purchase inputs and equipment for agricultural enterprises
- Savings group linked loans: where groups may be formal or informal, but loan amounts are linked to the groups' savings.

MFIs also offer savings and/or investments, payment products and BDS.

The key barriers faced by MFIs in extending credit to MSMEs are:

- Weak capital bases of MFIs affect their ability to extend credit, apart from the deposit-taking MFI and a donor-linked MFI that can raise capital internationally, though the RBM is currently exploring avenues to channel more funds to MFIs.
- MFI products and services are mainly generic and retail-focused, limiting use cases for businesses. This is, in part, related to the limited capital bases, and a lack of capacity to develop more complex products like asset finance.
- Limited risk management capabilities have resulted in the sector facing high default rates of up to 40 per cent. Similarly, the current structure where the Government deducts loan repayments from government employees and remits them late to the MFIs, negatively impacts MFIs working capital and the ability to lend out the funds to additional customers.
- High operating costs that are driven by the high cost of funds, poor infrastructure, high administration costs, and rising regulatory compliance costs.
- A directive from the RBM has in effect created an interest-rate cap, where MFIs cannot charge more than 6 per cent interest per month. The industry reflected that this was insufficient to cover the cost of funds, operating expenses and price for risk, thereby constraining lending. Furthermore, this highlighted a more stringent approach from the regulator on the sector.
- Governance challenges exemplified by high senior staff turnover rates which affect market perceptions of MFIs
- High moral hazard associated with guarantee schemes where consumers are unwilling to pay back the monies they were lent.

POTENTIAL ACTIONABLE AREAS

1. The Government may consider developing a wholesale lending model for MFIs through an apex institution to address the weak capital base faced by MFIs. International best practice criteria should be explored to ensure the apex institution has the intended impact on the market. Best practice suggests that the apex institution would need to meet certain criteria to ensure an impact on the market such as[124, 125].
2. Additional Government and donor support to aid the initial running of the MFI Hub Company, with a view of making the Hub more sustainable in the medium term. This would serve to motivate the outstanding MFIs that have not signed up to join. This is expected to result in increasing digitisation within MFIs and increased use of digital forms of payment.
3. As with banks, technical assistance could be extended to MFIs to help them develop more robust risk management, lending models, and governance structures. These may also be coordinated to aid their efforts to digitise their operations in line with the MFI Hub Company. The risk management should seek to digitise regulatory reporting and compliance, increase IT security, and digitising credit appraisal processes.

SACCOs

Total SACCO assets grew from MWK 4.3 billion (i.e. USD 5.9 million) in 2013, to MWK 16.3 billion (i.e. USD 22.6 million) in 2018, reflecting a CAGR of 31 per cent. Total MFI loans and leases grew at a CAGR of 33 per cent from MWK 2.7 billion (i.e. USD 3.7 million), to MWK 11.1 billion (i.e. USD 15.4 million) (see Figure 19). As with MFIs, this suggests Malawians and Malawian businesses are increasingly relying on less formal mechanisms to meet their financial-service needs. The average loan-to-asset ratio over the period was 65 per cent, which reflects the easier access to loans when associated with savings and existing relationships. The most recent analysis implemented by MUSCCO reportedly found interest rates charged by SACCOs to be among the lowest in the market[126].

Airtel has partnered with SACCOs for loan disbursement and collection, thereby extending its reach in rural areas. Scoring of customers is, however, not carried out automatically as in East African markets, as credit scoring and other operations largely remain manual. Only seven of the 37 SACCOs had migrated to the MFI Hub Company, which could help automate and digitise their operations.

It is estimated from stakeholder consultations that MSME loans amount to MWK 1.7 billion (i.e. USD 2.4 million) in

124. having a clear mandate to develop sustainable MFIs; receiving funding based on a realistic assessment of qualified MFIs; funding based on clear criteria and where funding may be discontinued if the MFI fails to meet the criteria; disbursements are tailored to the cash flow patterns and planning needs of MFIs; continuous monitoring of MFIs based on a few precisely defined performance targets; and the Apex management is of high quality possessing a blend of microfinance, managerial and financial expertise
125. Swiss Development Cooperation, Lessons learnt from Guarantee Funds: The example of the International Guarantee Fund, 2006
126. Stakeholder consultations, 2019

FIGURE 19: Overall SACCO sector trends

Source: RBM Bank supervision annual reports, 2014-2018 | Note: Currency figures are inflation adjusted and presented as at 2013

2018[127]. SACCOs are tailored to serve smallholder farmers and employees, and not MSMEs due to their membership structures that make it difficult to have MSME as members.

The key lending products available to MSMEs include:

- Term/Normal loans: short to medium-term loans of between six to 24 months. Can be up to 200 per cent of shares of members and their capacity to repay the loan
- Business loans: examples include businesswomen group loans largely used for working capital.

SACCOs, with the help of MUSCCO are seeking to develop a triangular-cooperative model. This would involve integrating management information systems (MIS) between financial, marketing, and production cooperatives to more effectively link the cash flow of members across their business cycles. Similarly, there is interest to move towards a guarantor-based lending approach, where business owners could rely on their networks to gain access to loans. Lastly, SACCOs are targeting VSLAs as key segments to offer wholesale lending.

Key barriers to SACCOs extending credit to MSMEs are as follows:

- SACCOs are not tailored to focus on small and medium-sized enterprises. Similarly, their lending models rely on individual savings and/or shares.
- The majority of SACCOs are located in urban areas, often away from their agriculture target segments in rural areas.
- They face limited capabilities, such as in corporate governance, lending and risk management.
- Operations are largely manual raising the cost of operations.

POTENTIAL ACTIONABLE AREAS

1. As with MFIs, additional government and donor support can be considered to aid the initial running of the MFI Hub Company to motivate the SACCOs to sign up and digitise their operations and offer digital forms of payment to their members. The focus could mainly be placed in large and stable SACCOs.
2. Technical assistance may be provided to help SACCOs diversify away from farming and production sectors towards more value addition sectors (e.g. agro-processing), to increase SME membership.
3. MUSCCO could continue to develop the triangular cooperative model and guarantor-based lending approach.
4. SACCOs could seek to expand their partnership with TNM Mpamba to increase the reach of loan disbursement and repayment.

127. Stakeholder consultations, 2019 | Note: Using the exchange rate on 31 December 2018 from Oanda.com

VSLAs

There were 23,071 VSLAs reported in 2017, having reduced from 35,351 in 2014[128]. It is estimated that the total lending by VSLAs amounted to MWK 4.5 billion (i.e. USD 6.2 million) in 2018[129].

VSLAs are largely supported by a number of donor agencies. These agencies provide not only financial support but also the implementation of their mandates (for example Care Malawi, Action Aid, OXFAM and World Vision[130]). These donors provide specific sectoral focus such as food security and nutrition, women empowerment, health and HIV, education and community resilience to climate change.

VSLAs are mainly focused on smallholder farmers and groups, and therefore are not generally well suited to serve MSME clients. Loans are therefore generally short term and micro in size.

It is estimated that VSLA loans to MSMEs were MWK 1.9 billion (i.e. USD 2.6 million). This was estimated by using findings from the Innovations for Poverty Action (IPA) report that found 42 per cent of VSLA loans were extended for business purposes[131].

There is increasing interest from other financial institutions such as banks, to grow wholesale lending to VSLAs at reduced rates to encourage VSLAs to on-lend to their customers. This coupled with the large rural reach of VSLAs has the potential to extend other forms of financial services such as agricultural insurance and payments.

Key barriers to VSLAs extending credit to MSMEs are as follows:

- VSLAs currently charge approximately 20 per cent interest per month (i.e. effective interest of 792% per annum[132]) for low-value loans (microloans). This limits the potential impact for MSMEs with the costliness of the loans.
- VSLAs would be interested in investing their excess cash. However, accessibility to formal financial networks is difficult due to their rural locations.
- The large financial and implementation support offered by donors means that any change in their funding cycle or area of focus could interrupt VSLA operations.
- Less than 20 per cent of VSLAs grow to become SACCOs or MFIs, suggesting a lack of adequate support to ensure sustainability and scale.

POTENTIAL ACTIONABLE AREAS

1. VSLAs may explore partnerships with the MMOs, to extend their reach of loan disbursements and repayments, and banks as potential sources of capital.

MALAWI STOCK EXCHANGE (MSE)

The MSE is comprised of 14 corporates which have seen their market capitalisation grow steadily from MWK 527 billion (i.e. USD 730 million) in 2013, to MWK 1,094 billion (i.e. USD 1,516 million) in 2018 (i.e. CAGR of 16%). The volume of shares traded has dropped sharply over the same period by -26 per cent.

To date, there has been no listing on the Alternative Capital Market which was developed specifically to aid MSMEs to raise equity financing. The listing requirements for a company include:

- Being duly incorporated in accordance with the Companies Act, 2013.
- Must have a minimum subscribed capital of at least MWK 250 million to MWK 500 million (i.e. USD 346,351 to USD 692,701) - relating to small and medium-sized businesses.
- At least 20 per cent of the issued capital for which a listing is being sought must be offered to the public.
- Must have not less than 10,000,000 equity shares in issue.
- The company must submit a satisfactory analysis of future earnings indicating credible returns on capital.
- The company's securities must be fully underwritten
- Listing fees ranging from MWK 500,000 to MWK 5 million (i.e. USD 694 to USD 6,944)[133].

Once listed, businesses are also required to have a designated sponsor at all times; submit annual and interim financial reports; publish trading statements; publish cautionary statements, as soon as possible, of material price-sensitive information, and hold annual general meetings. Furthermore, FGD discussions identified that there is currently very limited understanding or knowledge about the stock markets.

MSE's key barriers to extending financing to MSMEs are as follows:

- High capital and stringent requirements prior to, and post listing, limit the use case for small and medium businesses as a source of finance.

POTENTIAL ACTIONABLE AREAS

1. MSE may re-evaluate the listing requirements of the Alternative Capital Market bourse to better suit Malawian SMEs.
2. The MSE could consider providing additional value-added services such as business incubation and training to assist prospective and listed SMEs in meeting the requirements.

128. Care Global VSLA Reach, 2017 | Ministry of Finance, Economic Planning, Village Savings and Loans Programme Mapping Report, 2014
129. Stakeholder consultations, 2019 | MUSCCO data, 2019 | Genesis Analytics team analysis, 2019 | Note: This was estimated by estimating the average financial asset per VSLA multiplied by the total number of VSLAs and assuming a similar loan to asset ratio of VSLAs to that of SACCOs
130. Ministry of Finance, Economic Planning, Village Savings and Loans Programme Mapping Report, 2014
131. IPA, Impact assessment of savings groups, 2012
132. Note: Calculated by compounding 20% monthly interest for a year and comparing the amount to an annual interest rate
133. MSE Website, 2019

IMPACT INVESTING

Non-DFI impact investing in Malawi is relatively small at an estimated MWK 28 billion (i.e. USD 38.9 million) as at 2015. Relative to the overall financial sector, this reflects only 3 per cent of total assets. The average non-DFI impact capital deal size in 2015 was MWK 1.4 billion (i.e. USD 2 million), suggesting this was targeted at big-ticket deals aimed at corporates and not MSMEs. Likewise DFI impact capital was reportedly worth MWK 135 billion (i.e. USD 187.5 million), with an average deal size of MWK 5 billion (i.e. USD 7 million)[134].

Agriculture accounted for 68 per cent of non-DFI impact capital, while financial services and infrastructure accounted for 58 per cent of DFI impact capital. Together, this suggests that investment-ready corporates enjoy the majority of the impact of investing, with limited investment going to MSMEs.

POTENTIAL ACTIONABLE AREAS

1. Impact investors could work closely with business incubators in Malawi to source potential MSME clients to invest in smaller ticket sizes.
2. The linkage between and visibility of investors and investees could be improved through the development of digital platforms.

DONOR AGENCIES

Donor agencies in Malawi offer both direct and indirect forms of financing to MSMEs. The direct financing involves the offering of grants, matching grants and business plan competitions to businesses within a few sectors including agriculture, manufacturing, and agribusiness. Current examples of these include the Malawi Innovation Challenge Fund (MICF) worth USD 24 million (i.e. MWK 17.3 billion) and Growth Accelerator Entrepreneurship Challenge worth USD 2 million (i.e. MWK 1.4 billion). These often are required to have specific social impact outcomes such as employment.

Indirect forms of finance involve the offering of risk-sharing facilities to FSP providers to extend the offering of financial services. Some examples of running risk-sharing facilities include:

- World Bank Malawi Agricultural Commercialisation Project: The project seeks to increase the commercialisation of agricultural value chain products. It falls under the Financial Inclusion and Entrepreneurship Scaling project. In part, it involves a partial credit guarantee fund targeting 150 loans from FSPs worth USD 12 million (i.e. MWK 8.6 billion) in value by 31 May 2023[135].
- African Guarantee Fund (AGF): The AGF has partnered with FDH Bank to offer a credit guarantee scheme worth USD 3 million (i.e. MWK 2.2 billion),[136] to extend financing to MSMEs.

BOX 6: Malawi Innovation Challenge Fund

Source: Stakeholder consultations, 2019 | MICF Newsletter, 2019 | Note: Using the exchange rate at 31 December 2018 from Oanda.com

Malawi Innovation Challenge Fund (MICF)

The MICF is run under the Private Sector Developing Projects (PSDP) of the United Nations Development Programme (UNDP). PSDP seeks to contribute to the transformation of the private sector into the engine of real growth and anchor for economic diversification, job creation and greater economic opportunities for the poor in Malawi. As part of this mandate, the MICF provides grant finance and technical assistance to businesses, with a view to supporting agriculture, and manufacturing value chains to work better for the poor.

MICF co-funds innovative business ideas that have the potential for significant social impact. The fund has launched four competitive rounds spread across the agriculture, manufacturing, agribusiness, logistics and irrigation sectors since 2014. The fund is worth USD 24 million (i.e. MWK 17,281 billion) and is supported by multiple donors agencies including DFID, IFAD and KfW.

In 2019 MICF launched an Innovative Finance Window that sought to catalyse the development of new profitable models for FSPs to better serve MSMEs. This included the development of new products and services and delivery channels. It required the FSP and its potential funders to match funds of at least 50 per cent of the total cost through a combination of in-kind and cash contributions. The grant fund ranged between USD 200,000 and USD 700,000 (i.e. MWK 144 million and 504 million).

MICF
Malawi Innovation Challenge Fund

134. Global Impact Investing Network, The Landscape For Impact Investing in Southern Africa, Malawi 2016 | Note: Currency figures are inflation adjusted and presented as at 2013

135. WBG, Malawi Agricultural Commercialisation project, 2017

136. All Africa, Malawi: FDH Bank, Africa Guarantee Fund in K 2.25bn partnership to fund SMEs, 2018

- USAID Development Credit Authority Activity: As at 2019 there were two active loan portfolio guarantee programmes in partnership with First Capital Bank. The first, launched in 2013 worth USD 4.25 million (i.e. MWK 3 billion), focused on MSMEs in the agriculture sector, while the second, launched in 2016, worth USD 15 million (i.e. MWK 10.8 billion), focused on women- and youth-led MSMEs in agriculture[137].

A review of current donor-funded accelerator and challenge-fund programmes identifies that up to MWK 4.9 billion (i.e. USD 6 million), was directly provided to finance MSMEs in 2018[138]. This is likely understated, as not all programmes were sampled, and the impact of credit guarantee schemes is not included in the calculations.

Financing is often coupled with technical assistance (covered in Section 4.1.6), which provides useful business skills for MSMEs.

Some challenges faced by donor agencies in providing financing to MSMEs include:

- Financing is linked to specific programmes which run the risk of being discontinued should funders' objectives change. This affects the sustainability of the model. However, efforts to ensure businesses match financing, and to catalyse the development of new products within FSPs, serve to try and address this.
- Donor financing develops 'donor darling' businesses that win multiple rounds of financing by continually adapting their business models to suit the specific financing window requirements. This runs the risk of concentrating financing within a few businesses, limiting the overall impact.
- There are a limited number of staff members to provide the technical assistance offered which limits the ability to scale coverage.

POTENTIAL ACTIONABLE AREAS

1. Donor agencies may continue to offer direct forms of financing tailored to SMEs that would ordinarily not have access to finance. These should include start-up and growing businesses as well as businesses owned by women and youth. Efforts should be made to limit the concentration of funding to few businesses, i.e. 'donor darlings'.
2. Innovative efforts to galvanise FSPs to extend financing to currently underserved or excluded business segments should be continued such as with the challenge fund and risk-sharing products. Caution needs to be taken to limit the moral-hazard potential of both FSPs and end consumers, around these initiatives. Potential options could include limiting the visibility of donor support to end beneficiaries, and developing more rigorous targets and measurement frameworks for implementing partners[139].
3. Donors may explore the use of second loss partial credit guarantees (SLPCG) to promote the uptake of movable asset-based lending. In this approach, FSPs would accept the first loss in the loan covered by movable collateral that has been executed (i.e. liquidated to pay off the outstanding balance) and the SLPCG would cover the remaining losses. SLPCG's would cover the difference between the risk that movable collateral does not cover on the outstanding loan amount, and could also increase the use of and amount of data in the collateral registry[140].

4.1.3. Payments overview

OVERVIEW OF PAYMENT PROVIDERS

Ninety-five per cent of adults indicate that they use cash to purchase food and clothing, while 40 per cent use cash to purchase large household items.[141] This indicates that cash remains the predominant form of payment. FinScope 2019 indicates that within the MSME context, 97 per cent of payments to businesses are through cash, while DFS accounts for only 8 per cent of total payments.[142]

The retail economy relies heavily on cash as credit and debit cards are not common in Malawi. However, there has been growth in digital payments following a concerted effort of regulations such as the Electronic Payments and Cyber Security Act of 2016.

Banks and MMOs are the dominant players in the Malawian payment industry. According to Figure 20, it is evident that MMOs have the highest share of payment volumes with a total of 184 million payments recorded in 2018. However, banks have the highest share, in terms of value, traded through internet banking at MWK 922 billion (USD 1.2 billion), in 2018.[143]

The Malawi Interbank Transfer and Settlement System (MITASS) is the major payment and clearing system and the

137. USAID, Development Credit Authority, Data set, 2019
138. Stakeholder consultations, 2019 | Note: Assumed the MICF USD 24 million funds were equally distributed from 2014 to 2019 and Growth Accelerator Malawi had an annual distribution of USD 2 million
139. Stakeholder consultations, 2019 | Note: Assumed the MICF USD 24 million funds were equally distributed from 2014 to 2019 and Growth Accelerator Malawi had an annual distribution of USD 2 million
140. OECD, EU, Facilitating access to finance, Discussion Paper on Credit Guarantee Schemes, n.d. | World Bank, Task Force for the design, implementation and evaluation of public credit guarantee schemes for SMEs, n.d.
141. World Bank, Second Loss Partial Credit Guarantee, n.d.
142. FinScope Malawi, 2014
143. FinScope SME Malawi, 2019

Figure 20: Volume and value of retail DFS

Source: RBM Bank supervision annual reports, 2014-2018

Note: Currency figures are inflation-adjusted and presented as at 2013 MWK

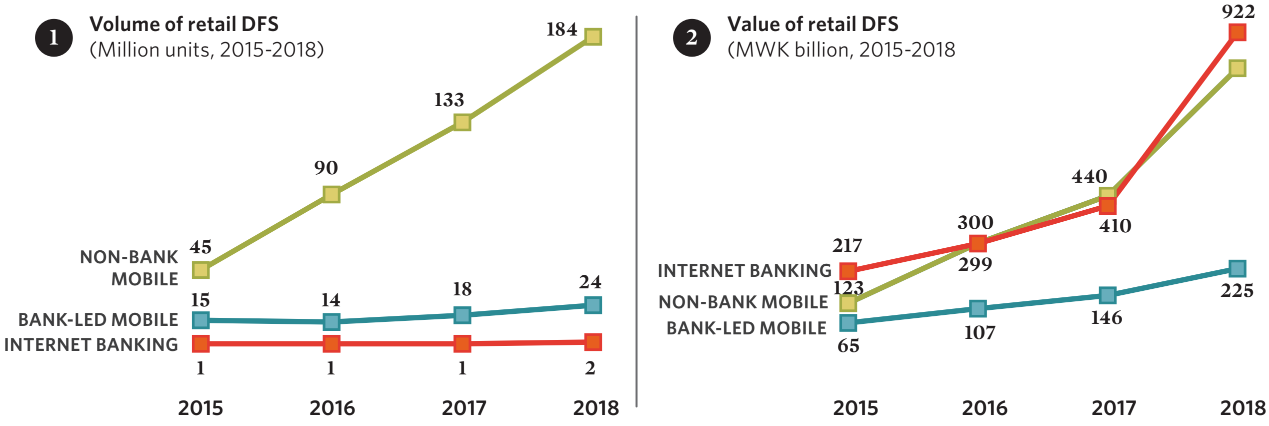
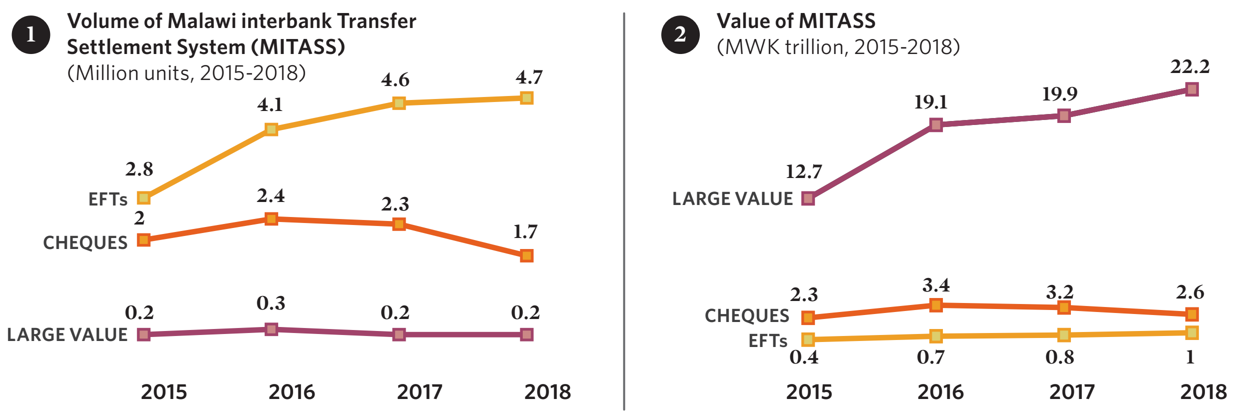


FIGURE 21: Volume and value of MITASS

Source: RBM Bank supervision annual reports, 2014-2018

Note: Currency figures are inflation-adjusted and presented as at 2013 MWK



country's only settlement system.[144] Figure 21 shows EFTs and cheques have stagnated over the period 2015 to 2018. However large value payments continue to dominate the total value of payments processed via the MITASS.

Insights from FGDs show that even though cash dominates the payment landscape, the use of digital channels such as POS have benefited customers who may not have cash on hand. Additionally, mobile money has assisted in reducing the incidence of cash robbery, and improved convenience of business transactions. That said, there are still reservations among MSMEs around the fear of fraud and high costs of digitisation.[145] This implies that despite high growth witnessed in the digitisation of payments, there is still room to grow around sensitisation and scaling of digital payment methods.

MOBILE MONEY OPERATORS

The bulk of the volume of mobile money transactions is comprised of airtime top-ups (42%) and cash-in cash-out transactions (41%). In terms of value, cash-in cash-out transactions are 57 per cent of the total value of mobile money transactions. Additionally, Business-to-business (23%) and person-to-person (8%) payments are the second and third largest items by value, respectively. This indicates that there is traction and potential use case for mobile money for MSMEs. Insights from stakeholder consultations noted that a challenge with mobile money is that the high proportion of cash-out transactions mean agents would need additional cash float to manage liquidity over and above their day-to-day business needs.

144. Note: Using the exchange rate at 31 December 2018 from Oanda.com

145. RBM, National Payment System, Q4 report, 2018

Given the growth in mobile money transactions, there is an opportunity to leverage the MSME payments solution to make better use of the expansion of the mobile money payment channel. An added benefit of digital-based payment system over cash is the enhanced business record-keeping which comes with each transaction. However, the current flow of mobile money payments suggests that merchant payments via mobile money is in its infancy and requires further consideration from providers and users.

Key challenges to MMOs when it comes to providing payment solutions to MSMEs are as follows:

- Mobile money presents liquidity challenges to agents.
- Low literacy levels among agents inhibit the growth of mobile money.[146]
- Malawians in rural areas, many of whom have never used banks, do not have sufficient trust in financial services to take up mobile money.[147]

POTENTIAL ACTIONABLE AREAS

1. MMOs expand the geographical reach of financial services far wider than traditional FSPs. Partnerships which leverage the MMO agent network are therefore potential opportunities for FSPs to expand their reach. For example, MMO (e.g. Kutchova by Airtel and Mpamba by TNM) and microcredit agencies (e.g. GetBucks) have started developing mobile-based credit and investment products.
2. As in other markets, merchant and bill payments have a high potential for the digitisation of retail payments. The GoM could leverage the reach of mobile money payments in order to supplement the existing e-government portal through use of the mobile channels.
3. The National Switch Limited (NSL) launched in 2015 ensures interoperability of ATM and POS devices. The RBM may explore adding MMOs to the switch in pursuit of full interoperability between banks and MMOs. Careful examination of interchange pricing would need to be carried out to ensure prices are affordable enough to motivate use by consumers, but not too low to distort incentives for FSPs to build out their networks further.

4.1.4. Insurance overview

The insurance industry is still nascent, with total assets of MWK 41.3 billion (i.e. USD 57.3 million) as at 2018, having grown from MWK 18.9 billion (i.e. USD 26.3 million) in 2013, (i.e. CAGR of 17%). Total gross premiums grew at a CAGR of 15 per cent from MWK 20.2 (i.e. USD 28 million) to MWK 41 billion (i.e. USD 56.9 million) over the same period as depicted below. The top three firms by market share accounted for 68 per cent of total assets and 61 per cent of gross premiums in 2018.

The main insurance products offered by general insurance to businesses are fire, motor and all risks (including insurance against theft) insurance. Motor insurance continues to be the dominant class of business, on average accounting for 61 per cent of gross premiums and 80 per cent of net claims incurred from 2013 to 2018. This was followed by miscellaneous at 15 per cent of gross premiums and 7 per cent of net claims; and fire insurance at 15 per cent and 5 per cent, respectively. Fire insurance has exhibited the fastest growth over the last six years and suggests there is an increasing number of businesses taking up insurance.

Stakeholder interviews and FGD discussions identified that the product offerings remain limited, and the current products are too expensive for businesses.

The majority of general insurance assets are placed in safe assets such as fixed deposits (30%), the Government and other securities (11%) and cash (6%), as with the banking industry. Only 11 per cent of assets are utilised for equity investments.

The key barriers to serving small and medium sized businesses include:

- Insurance firms lack adequate capacity to build suitable products to meet the specific needs for businesses. Product gaps mentioned include products that cover against climate and weather changes, disease outbreaks for livestock, theft and fraud.

- There are limited partnerships in key areas where external data is required such as weather insurance.

- Limited number of automated weather stations in Malawi are restricting policy-holders from making claims, as they are unable to use data to prove the damage caused.

- There is a lack of skilled insurance sales teams in rural areas to ensure businesses can match their main risks to existing insurance products

POTENTIAL ACTIONABLE AREAS

1. Similar to other FSPs dependent on brick-and-mortar infrastructure, insurance firms could seek partnerships with MMOs in order to extend their reach. This could include the exploration of bundled products such as automatic insurance or funeral cover with certain prepaid top-ups.
2. There is a need to increase the tailoring of insurance products to mitigate the main risks faced by businesses. This includes enhancements to the Weather Index Insurance (WII).
3. Insurance providers could explore how to leverage satellite imagery to circumvent the lack of weather stations.
4. The GoM could seek to develop minimum asset investment quotas of general insurance providers that go towards investing in Malawian businesses or FSPs that support Malawian businesses.

146. Buckley et al, The Regulation of Mobile Money in Malawi, 2017
147. Ibid.

BOX 7: Weather Index Insurance | *Source: Ephias M Makaudze, Malawi's experience with weather index insurance as an agricultural risk mitigation strategy against extreme drought events, 2018 | WBG, Weather Index-based crop insurance in Malawi, 2012*

Weather Index Insurance (WII) in Malawi

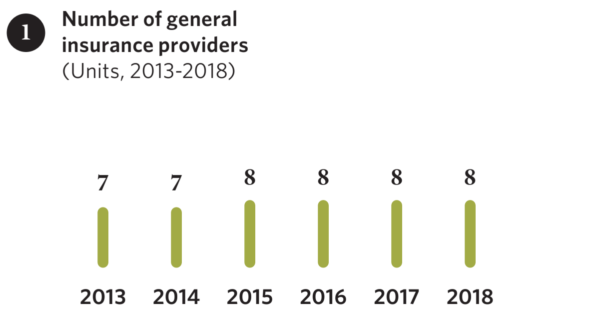
Extreme weather events constitute a large risk for Malawi as the economy is dependent on climate-sensitive agriculture. It was estimated that Malawi loses 1.7 per cent of GDP every year due to an extreme drought event[148].

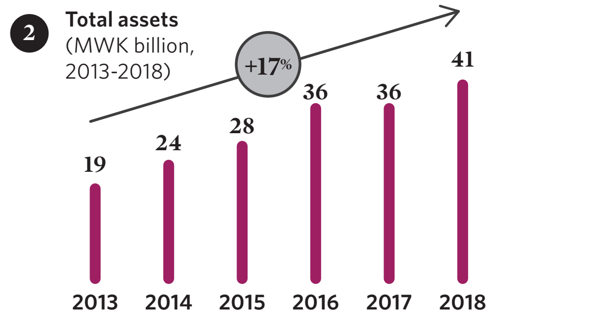
In response to the challenges imposed by extreme weather, the Government, in partnership with the WBG and other development partners, initiated a WII scheme in 2005. This sought to address the limited provision of agriculture insurance and was intended to provide commercialisation opportunities to transform rural agriculture.

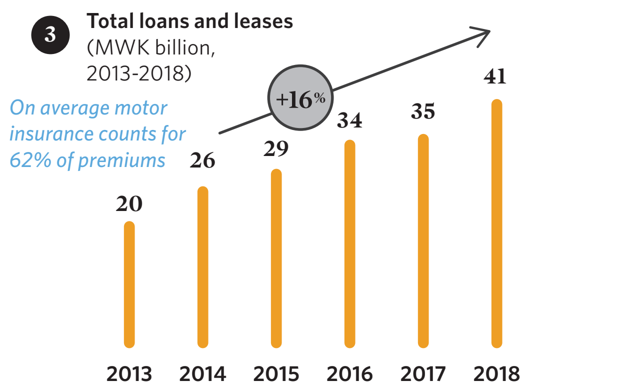
WII initially began focusing on small scale groundnut producers with two locally-based MFIs providing financial support. Within a few years, the programme expanded to include maize and tobacco crops. However, by 2014 most of the lending institutions had discontinued any form of direct crop insurance coverage to smallholder farmers.

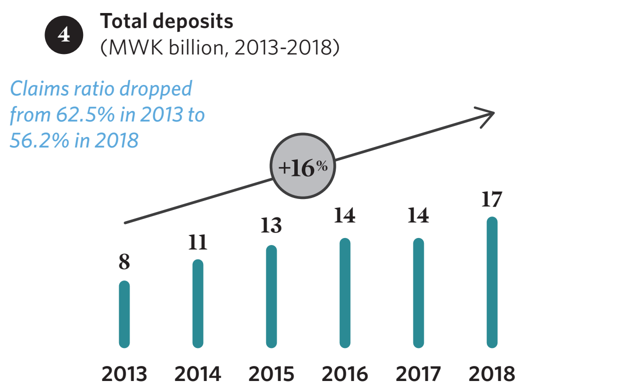
A review of the impact of WII identified the following challenges faced by WII:

- There was insufficient demand for WII due to the high cost of the insurance. Studies suggest that WII should have been bundled with key farm inputs or loans. Additional benefits of this approach would include reducing default risk; could be designed to cover portfolios; could lower transaction costs and could be a strategy to spread the reach. This is, however, complicated by the existing farm-input subsidy programme (FISP) that smallholder farmers have already got used to. Furthermore, smallholder farmers are poor and are unable to afford the premiums.
- Localised risks such as pests, disease outbreak and fire destruction would be devastating to individual farmers, but not be widespread enough across all insured farmers to trigger the index to justify indemnity payments, i.e. the basis risk. This caused dissatisfaction in farmers who rather opted to withdraw from the cover.
- Poor understanding of education around insurance meant that farmers perceive insurance premiums as financial investments and expect a financial return on their investment. The risk mitigation element is not well understood, resulting in dissatisfaction with the WII.
- Effective index-based weather-insurance contracts require reliable, timely and high-quality data weather station networks. In Malawi, there are a limited number of automated weather stations to provide this level of data.
- There is a lack of required expertise at local insurance firms to aid product design, product marketing and customer service.
- There was a disparity between cash and food crops. While financial institutions are willing to offer cover for cash crops, the Government has vested interest in providing insurance coverage for food crops.









148. Pauw K, Thurlow J, Seventer D, Droughts and Floods in Malawi - Assessing the economic-wide effects. IFPRO Discussion Paper, 2010

4.1.5. Pension overivew

OVERVIEW OF PENSION SCHEMES

In 2017, the proportion of total individuals who were contributing to Malawian pension funds was 3 per cent; which is considerably low given that contribution towards the national pension fund is mandatory for businesses who employ five or more people. A substantial number of employers have not joined the mandatory pension system yet.[149] The Malawian pension sector is comprised of 32 funds as at 2018. This includes 13 standalone funds, two self-administered funds, 13 unrestricted funds, one umbrella fund and three restricted umbrella funds. The Pensions Amendment Bill passed in 2014 aided the setting up and management of pension funds. The National Pension Scheme membership has grown at a CAGR of 16 per cent over the period 2013 to 2018.

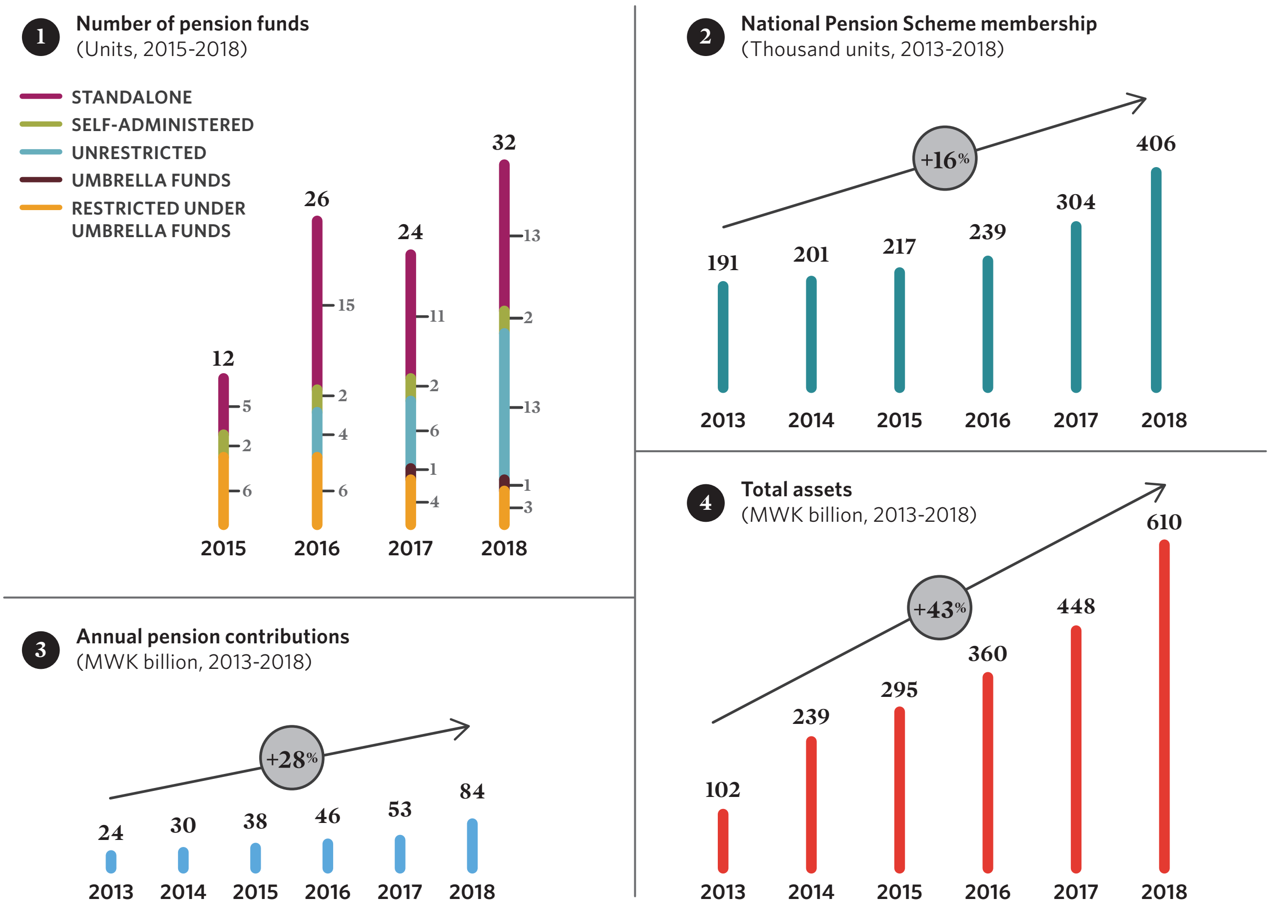
Annual Malawian pension contributions have grown at a CAGR of 28 per cent over the period 2013 to 2018. This is despite challenges such as knowledge gaps, pension remittances and enforcement issues that are facing labour officers responsible for ensuring compliance with the mandatory National Pension Fund.[150]

The composition of pension portfolios has shown a marked increase in government securities, increasing to 33 per cent in 2018 from 21 per cent in 2013. The composition of the pension fund by asset class also indicates that there is a decline in the share of equities over the same period. This shows that pension funds have opted to invest in safer asset classes such as government securities as opposed to investing in businesses (i.e. with listed equities reducing from 44% to 38% and unlisted equities at 9%). The Pension benefits have increased at a CAGR of 38 per cent over the period 2013 to 2018. Retirement and early withdrawals comprise 49 per cent and 43 per cent of benefit payouts, respectively.

FIGURE 23: Pension fund sector overview

Source: RBM Bank supervision annual reports, 2014-2018

Note: Currency figures are inflation-adjusted and presented as at 2013 MWK



149. OECD, Pension Markets in Focus, 2018

150. Malema, Factor Analysis of Challenges Experienced with regards to Implementation of the Pension Act of 2011 in Malawi, 2019

Key challenges facing pension fund in relation to MSMEs are as follows:

- Stakeholder engagements revealed that contribution arrears and slow registration of employees into pension funds are inhibiting the growth of the sector.[151] FGDs also noted that a lack of appropriate credit products has resulted in business owners utilising savings and pension funds to satisfy their capital needs.

- A key challenge facing pension fund administration is the failure to access pension benefits due to non-remittance of pension contributions by employers. This indicates that there is a need for improved enforcement and oversight in order to ensure pension funds are being adequately administered.[152]

POTENTIAL ACTIONABLE AREAS

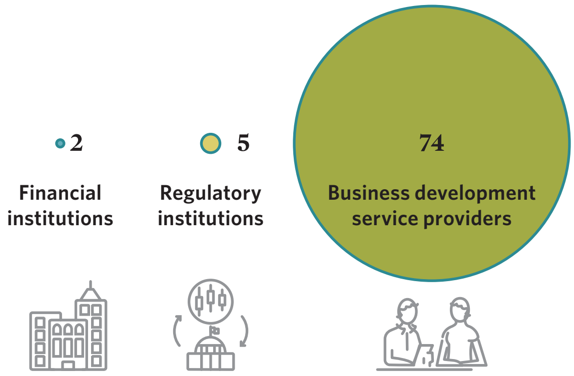
1. Efforts are currently underway under the authority of the Registrar of Financial Institutions to develop a centralised national pension database to enhance enforcement of the Pension Act, maintenance of pension data analysis and policy development. The system endeavours to register all pension members and integrate data from all pension fund administrators across the country.[153] This will be beneficial from a collections point of view.
2. There is potential to limit investments in government securities in favour of vehicles that fund SMEs. This could be achieved through the regulatory changes which raise the profile of MSMEs as an asset class of choice. For example, Zambia has instituted an amendment to their pension laws which stipulates that a minimum of 2 per cent of pension funds need to be deployed into unlisted equities.[154] A similar approach in Malawi has the potential to unlock longer-term capital funding to MSMEs.

4.1.6. Business development services overview

The WBG defines BDS as non-financial services and products offered to entrepreneurs at various stages of their business.[155] BDS is particularly important in developing MSMEs as it acts as an enhancer of access to finance and assists businesses in running their operations more sustainably.[156] In particular, this makes reference to the ability for BDS to ensure MSMEs are building core capabilities so that they are able to take full advantage of financial support.

FIGURE 24: Split of MSME support providers (Count, 2015)

Source: Ministry of Industry and Trade, Directory of Micro, Small and Medium Enterprises (MSME) Support Providers, 2015



The Malawian BDS landscape is comprised of over 80 providers stemming from private, public, and donor sectors. A few examples of the services provided include the provision of training, market access, technical assistance, and research and development.[157] Regulatory institutions' primary contribution is through the creation of regulatory frameworks. However, there is increased expansion into the support of MSMEs. A few examples are the provision of oversight, licensing and certification. The MBS is responsible for the development of standards, inspections and certification of products and testing and verification of compliance to standards. Stakeholder consultations revealed that it would be beneficial if the MBS could offer more hands-on BDS to MSMEs who are looking to grade their products by way of developing capacity within MSMEs to obtain and maintain standards of production.[158]

Financial institutions primarily offer credit and financial service provision. However, some provide training and technical assistance in partnership with service providers as an ancillary service. During stakeholder consultations, commercial banks stated that they are looking to develop specialised MSME banking departments to cater to the financing and BDS needs of businesses.

151. Stakeholder Consultations, 2019
152. Registrar of Financial Institutions Annual Report, 2018
153. Ibid.
154. OECD, Survey Of Investment Regulation Of Pension Funds, 2018
155. IFC, The Role of Business Development Services, 2006
156. SME Impact Fund, "Business Development Services make SMEs more sustainable", 2018
157. Ministry of Industry and Trade, Directory of Micro, Small and Medium Enterprises (MSME) Support Providers, 2015
158. Stakeholder Consultations, 2019

FIGURE 25: Split of MSME support providers by category (% of BDS service providers, 2015)

Source: Ministry of Industry and Trade, Directory of Micro, Small and Medium Enterprises (MSME) Support Providers, 2015

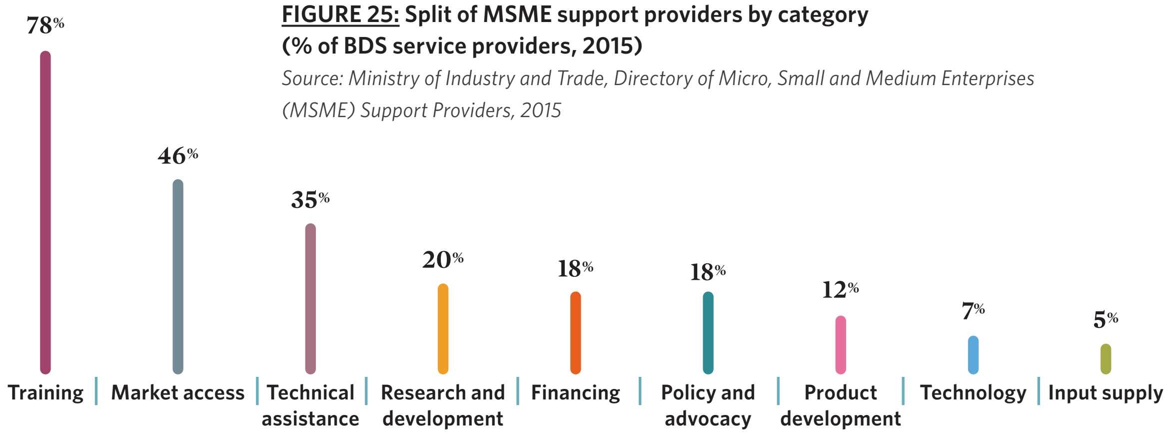


Figure 25 provides a breakdown of the types of support offered. Training is offered by 78 per cent of BDS providers; this is a broad category that encompasses aspects such as support on the operational management of businesses, business planning, accounting, marketing, finance, and administration.

The facilitation of market access is offered by 46 per cent of providers and comprised primarily of market linkages. Technical assistance is offered by 35 per cent of providers and comprises of specialist support and transfer of knowledge for the development of products and services.

Key challenges facing BDS providers in relation to MSMEs are as follows:

- Stakeholder consultations revealed that BDS providers have difficulty grappling with high-illiteracy rates. Additionally, stakeholder consultations revealed that there is limited coordination amongst BDS providers in Malawi and as such scalability has yet to be realised.
- Stakeholder consultations also revealed that BDS providers often offer a one-size-fits-all approach which gives generic solutions to MSMEs. Furthermore, limited-schedule flexibility is offered meaning business owners often must shut their operations to attend the programmes.
- Banks are increasingly recognising the importance of developing MSME focused departments to serve their specific needs. The banks have recognised that lack of financial record keeping is a key limitation of MSMEs which ultimately limit bank-credit extension. In resolving this, there are instances of service providers having MOUs with banks to assist with writing up business plans suggesting leveraging of partnerships in the industry.
- BDS providers cited limited access to technology such as the internet in rural areas as a hindering factor in reaching out to MSMEs. BDS providers can only reach MSME through physical contact with MSME owners. Therefore, geographic constraints may hinder outlying MSMEs from receiving the appropriate BDS.

Insights from FGDs indicate that MSMEs in the agricultural sector are better served with BDS as opposed to MSMEs in manufacturing, tourism and donor-related projects which support BDS. This attests to the challenge of generic BDS and highlights the need for BDS across the board which serve the needs of MSMEs.

The public sector, through the MSME Policy (2018), identifies the promotion and development of MSMEs through coordination of BDS providers and enhancing awareness of BDS providers to MSMEs. This reaffirms the importance of BDS to GoM, given the Ministry of Trade and Industry's role in spearheading a number of initiatives around BDS in the MSME Policy.

A further understanding of BDS is provided in the target market analysis which brings together the key challenges and opportunities around the provision of BDS as well as the key challenges faced by MSMEs. Finally, this analysis provides the groundwork to display key gaps in the BDS sector which is essential for devising interventions which will ultimately benefit MSME development.

POTENTIAL ACTIONABLE AREAS

1. A few banks are investing in SME focused departments to serve the needs of SMEs and improve access to finance. Banks that are able to offer BDS would stand to benefit from providing training as they would be able to co-create bankable deals and ultimately provide a full suite of financial products along the business cycle.
2. The partnership models between BDS providers and banks to assist MSMEs in writing business plans, has the potential to be an integral part of stress testing the operational feasibility of the business idea, and ultimately providing much needed early guidance to start-up businesses.
3. BDS delivery can benefit from a more coordinated effort to help make them more effective. This would require an update or developing of a BDS provider registry which details sectors, value chains, and regions which are being served by specific BDS providers. This would require close collaboration by the different market players.
4. There is a need to incorporate basic accounting and financial management training in schools, nationally, and TEVETs, to ensure future entrepreneurs have adequate understanding.

Summary of findings

Findings from the prior analysis can be summarised in Table 11

TABLE 11: Summary of supply-side findings

Topic	Gaps	Potential actionable areas
Distribution of financial services	• Network expansions are limited by infrastructure gaps. • Reporting of FSP network distribution is limited to banks.	• The Government could extend road, electricity and internet infrastructure. • Enhance RBM reporting of non-bank FSPs.
Credit	• FSPs lack robust lending models and therefore rely on traditional forms of collateral and manual processes to lend to MSMEs. • Credit information sharing remains in its infancy, with poor quality data and not all FSPs reporting to CRBs. • No obvious bank lending product gaps exist. However, MSMEs still find difficulty matching products accurately to their needs, find bank lending expensive and turnaround times too long. • MFIs have weak capital bases affecting their ability to on-lend. • Government delays in remitting loan repayments to MFIs impede MFI operations. • A directive from RBM has in effect created interest rate cap for MFIs. • SACCOs and MFIs are not tailored to focus on SMEs as they rely on individual savings/shares. • SACCOs and MFIs face governance challenges that negatively impact public perceptions. • VSLAs currently charge ~20% interest per month, which limits the potential impact for MSME. • High capital and stringent requirements prior to and post listing on the MSE Alternative Capital Market have prevented MSME listings. • Donor financing develops 'donor darling' businesses that win multiple rounds of funding.	• Enhancing the user experience of the PPSR to increase uptake by FSPs. Public awareness campaigns are also required to increase knowledge of it. • Explore efforts to merge the ACE and AHCX and develop a single WRS to increase usage of collateral financing for the agriculture sector. • Further technical assistance for FSPs could be provided to help banks develop new risk management and lending models. • The Government may consider developing a wholesale lending model for MFIs through an apex institution. • Additional government and donor support can be considered to aid the initial running of the MFI Hub, with a move to sustainability in the medium term. • FSPs can explore partnerships with MMOs to extend their reach. • MUSCCO could continue efforts to develop a triangular cooperative model and guarantor-based lending approach. • The MSE may re-evaluate the listing requirements of the Alternative Capital Market Exchange. • MSE could consider providing additional value-added services to assist prospective and listed SMEs. • Impact investors could work closely with business incubators to source potential MSMEs. • Donors could continue to explore innovative instruments that serve to galvanise FSPs to extend financing to the underserved.
Payments	• Mobile money agents face liquidity challenges. • Low-literacy levels among mobile money agents inhibit the growth. • Individuals in rural areas do not sufficiently trust FSPs.	• MMOs could leverage partnerships with other FSPs to extend the reach. • Merchant and bill payments have a high potential for the digitisation of retail payments. • The RBM may explore the inclusion of MMO into the NSL.

Topic	Gaps	Potential actionable areas
Insurance	• Firms lack adequate capacity to build suitable products to meet the specific needs of businesses. • There are limited partnerships in key areas where external data is required. • A limited number of automated weather stations restricts policy-holders from proving the damage caused. • There is a lack of skilled insurance sales teams in rural areas to match products to business risks.	• Seek partnerships with MMO providers in order to extend their reach. • There is a need to increase the tailoring of insurance products to mitigate the main risks faced by businesses. • Insurance providers could explore how to leverage satellite imagery to circumvent the lack of weather stations. • The GoM could seek to develop minimum asset investment quotas of general insurance providers that can be directed towards investing in Malawian businesses or FSP supporting MSMEs.
Pensions	• Contribution arrears and slow registration of employees into pension funds are inhibiting the growth. • Failure to access pension benefits due to non-remittance of pension contributions by employers.	• Efforts are underway to develop a centralised national pension database to enhance enforcement of the Pension Act, maintenance of pension data and analysis policy development. • There is potential to limit investments in government securities in favour of vehicles that fund SMEs.
BDS	• BDS providers have difficulty grappling with high illiteracy rates. • BDS providers often offer a one-size-fits-all approach which gives generic solutions to MSMEs. • BDS providers cited limited access to technology hinders reaching out to MSMEs.	• A few banks are investing in SME focused departments to serve their needs. • BDS providers in partnership with banks to assist with writing up business plans. • BDS delivery can benefit from a more coordinated effort to help make them more effective. • There is a need to incorporate basic accounting and financial management training in schools nationally, and TEVETs.

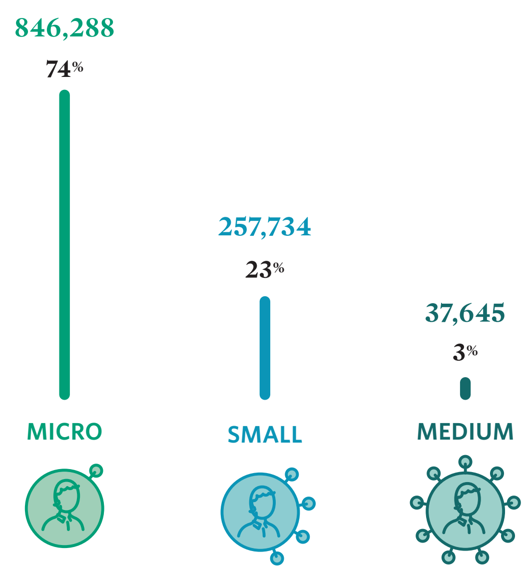
SECTION 5

OVERVIEW OF MSMES AND TARGET MARKET ANALYSIS

The target market section provides an analysis of the demand-side characteristics of Malawian MSMEs.[159] The analysis uses quantitative insights from the FinScope MSME Malawi 2019 Survey as well as insights derived from FGDs.

This section intends to provide a brief overview of the Malawian MSME sector with specific reference to providing a descriptive overview. This overview will include characteristics such as key demographic indicators, number of MSMEs, and split of MSMEs by category. The overview of the Malawian MSME landscape will provide necessary context ahead of defining the key high-impact target markets which focus on high-potential small and medium enterprises. The creation of the high-impact SME target market is useful in gaining more granular insights and understanding of the high-growth potential Malawian MSMEs. Thereafter, insights will be drawn from the target-market segments with a view to understanding key operational considerations, issues pertaining to the take-up of BDS, and the take-up of financial services.

FIGURE 26: Malawian MSME sector by size (Number of SMEs; % of total MSME, 2019)
Source: FMT, Malawi FinScope MSME Survey report, 2019



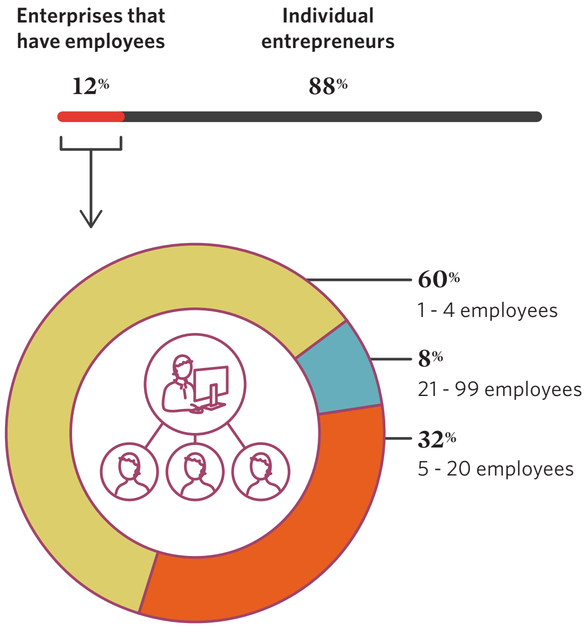
5.1. Overall MSME landscape

FinScope MSME Malawi 2019 reports that there is a total count of 1.1 million businesses classified as MSMEs. Figure 26 provides a breakdown of the MSME sector split by size. Micro enterprises comprise the majority of total MSMEs with 846,288 businesses (74%), followed by 257,734small businesses (23%), and 37,645 medium businesses (3%). The sector provides employment to 683,551 employees which are comprised of full-time (367,457), part-time (97,453), and seasonal workers (218,640).

Figure 27 outlines the MSME employment levels split by MSME size. Only 12 per cent of enterprises have employees and the vast majority (88%) of the market is comprised of individually run businesses. Sixty per cent of businesses employ between 1 and 4 individuals; 32 per cent employ between 5 and 20 individuals; and 8 per cent employ between 21 and 99 individuals.

Figure 28 outlines the view of MSMEs split by sector, which indicates that 69 per cent of MSMEs report that wholesale and retail is their main activity or service. Thereafter, 16.5 per cent of MSMEs are situated in the primary agriculture and farming sector, and the remaining MSMEs are split between manufacturing, mining, agro-processing, business services, tourism and construction.

FIGURE 27: Breakdown of employee numbers by size
Source: FMT, Malawi FinScope MSME Survey report, 2019



159. FMT, FinScope SME Malawi, 2019

This split of MSMEs by sector echoes the findings in the context section that agriculture and trade are the two largest sectors of economic activity. Although the other sectors constitute small proportions of the whole SME market, they also command an important contribution to GDP growth and employment which will be discussed in Section 5.3 (Descriptive characteristics of the target market).

Table 12 provides a breakdown of MSMEs by size. All sectors except manufacturing and tourism are comprised mostly of microenterprises. The macroeconomic context section indicated that tourism and business services offered the largest contribution to GDP, surpassed only by the agricultural sector. In the context of segmentation split by sector, small enterprises comprise 86 per cent of the share of the tourism sector and medium enterprises comprise 15 per cent of the share of the business services sector. Although these two sectors only contribute 1.4 per cent of the total MSME sector, they remain important contributors to economic growth and employment opportunities.

The split of the number of MSMEs by business maturity is an important descriptor of the sector as MSMEs of different business maturity require different BDS and financial products. Thirty-four per cent (391,377) of Malawian MSMEs are situated in the start-up phase; 27 per cent (310,769) are situated in the growth phase; 16 per cent (181,883) in the established phase and 23 per cent (257,639) in the mature phase.

FIGURE 29: MSME breakdown by business maturity

Source: FMT, FinScope MSME Malawi, 2019

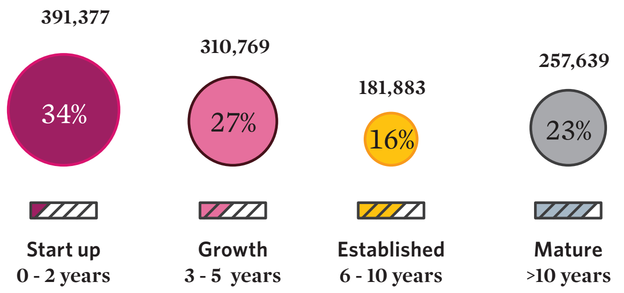
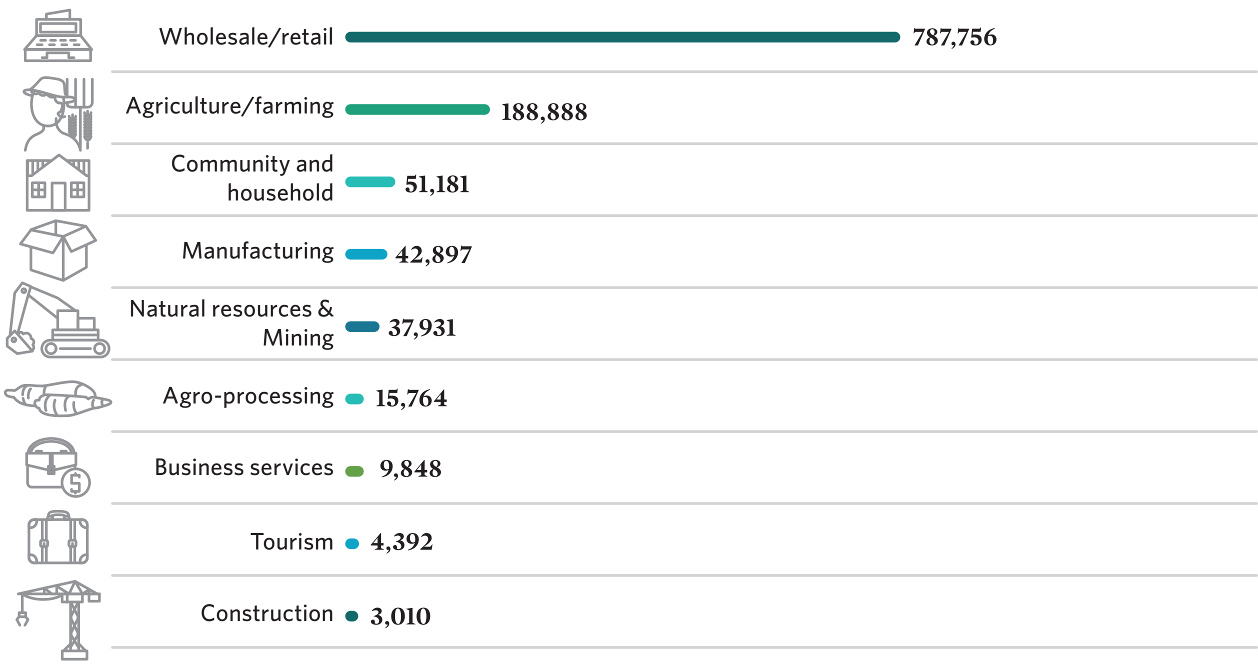


Figure 30 outlines the state of financial inclusion among MSME owners in Malawi. A notable finding is that 74 per cent of MSME owners are financially included. This means that business owners have use of financial products and services for business services through formal or informal channels. Twenty-six per cent of MSME owners are financially excluded, which is a marked improvement from 59 per cent who were financially excluded in 2012. The key drivers for the improvement of financial inclusion are growth in mobile money account ownership and insurance uptake.[160]

Financial access split by sector indicates that construction, business services, and tourism are the most financially included with these three sectors reporting a 90 per cent and greater

FIGURE 28: MSME split by sector

Source: FMT, Malawi FinScope MSME Survey report, 2019

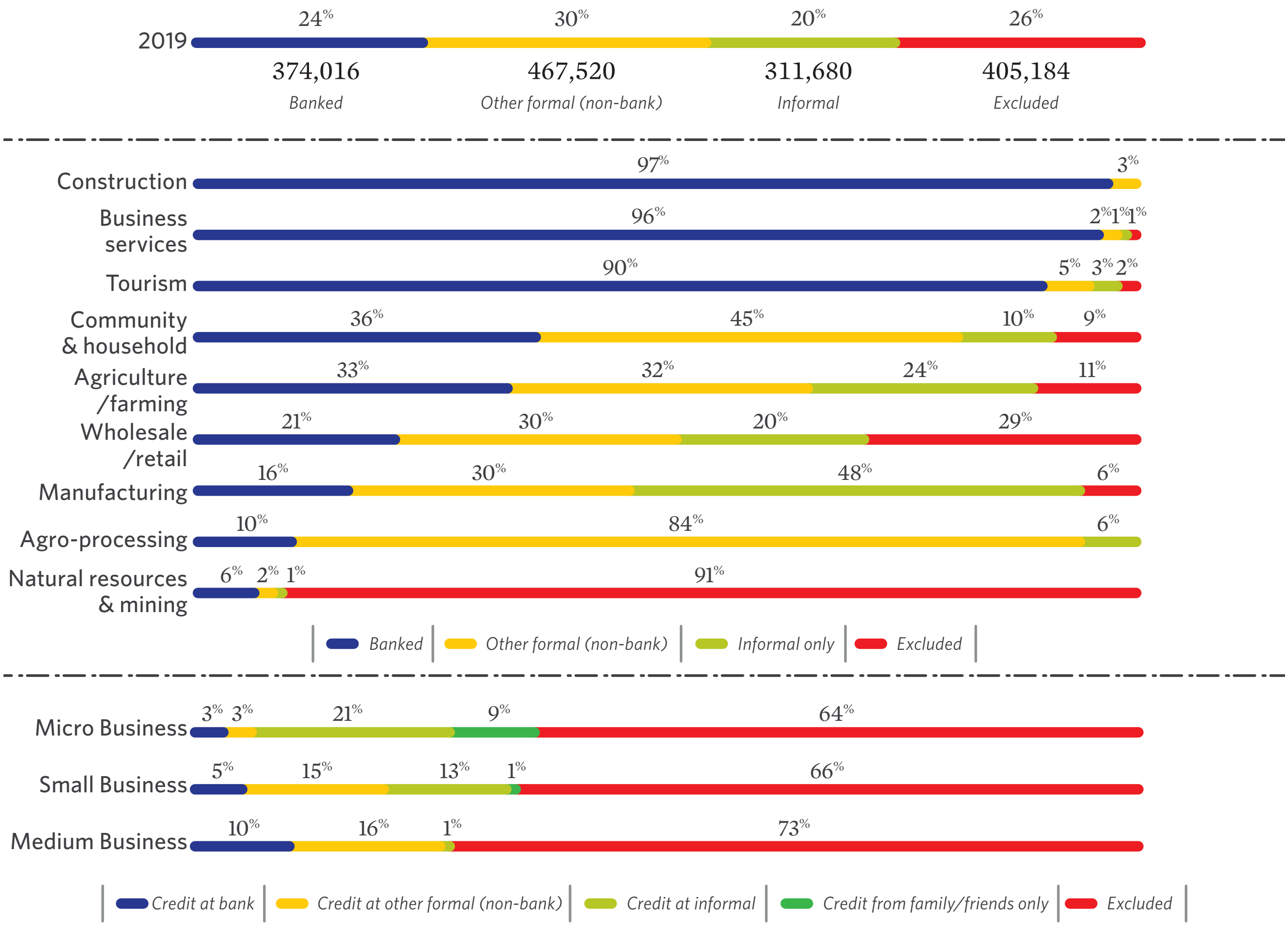


160. FMT, Malawi FinScope MSME Survey report, 2019

TABLE 12: MSME segments split by sector | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

	% Micro (Number)	% Small (Number)	% Medium (Number)	%Total (Number)
Wholesale/retail	73 (575,062)	23 (181,184)	4 (31,510)	100% (787,756)
Agriculture/farming	89 (168,110)	10 (18,889)	1 (1,889)	100% (188,888)
Community and household	52 (26,614)	46 (23,543)	2 (1,024)	100% (51,181)
Manufacturing	44 (18,875)	55 (23,593)	1 (429)	100% (42,897)
Natural resources & Mining	93 (35,276)	5 (1,897)	2 (759)	100% (37,931)
Agro-processing	86 (13,557)	13 (2,049)	1 (158)	100% (15,764)
Business services	70 (6,894)	15 (1,477)	15 (1,477)	100% (9,848)
Tourism	9 (395)	86 (3,777)	5 (220)	100% (4,392)
Construction	50 (1,505)	44 (1,324)	6 (181)	100% (3,010)
% TOTAL (NUMBER)	**100% (846,288)**	**100% (257,734)**	**100% (37,645)**	

FIGURE 30: Financial access strand in MSMEs | *Source: FMT, Malawi FinScope MSME Survey report, 2019*



banked proportion. Micro enterprises reported that 3 per cent have access to credit at a bank; small enterprises reported 5 per cent have access to credit at a bank and 10 per cent of medium enterprises reported having credit at a bank. This supports the supply-side findings that as businesses grow in size there is greater access to credit, especially formal credit. Conversely, as firms grow in size, there is a decline in firms accessing credit via informal mechanisms because they find it easier to access formal credit.

It is evident that microenterprises contribute a significant share of employment in Malawi and are an integral part of the economy. However, not all MSMEs will have a notable and sustainable impact on employment, let alone economic growth. It is therefore important to strategically focus resources on those MSME segments that have high growth prospects and potential to contribute to employment and national output. This enables the selection of clear priorities and actionable areas.

5.2. Segmenting the market

Market segmentation is a critical aspect of understanding the key characteristics of MSMEs to ultimately inform the key target group interventions. In particular, it provides an improved understanding of each segment's interaction with BDS providers and financial institutions and helps identify gaps and crafts more targeted interventions.

Table 13 outlines the official Malawian definition of enterprises as per the 2018 MSME Policy. According to this definition, SMEs are classified as businesses with employment between 5 and 99 employees, a turnover of MWK 5 million to MWK 50 million, and a value of assets between MWK 20 million and MWK 250 million. The FinScope Malawi SME Survey 2019 opts to use the number of employees, individual business income relative to the median in group and perceptions of business growth. A more detailed justification for this is provided later in the section.

The primary segmentation tools are individual business, income, number of employees, and perceptions of business growth. These four metrics will be used to identify MSMEs with the highest potential for contribution to the Malawian economy.

The following set of criteria is used for establishing high growth segments:

1. **Small and medium enterprises (SMES) -** dropping micro enterprises which have a high proportion of survivalist businesses
2. **Personal income is above the median of the segment[162] –** this measure is correlated to business performance and provides a useful benchmark for showing businesses who are performing slightly above average.
3. **The business has employees –** all businesses who have employees other than the owner. This is done on the basis that businesses who employ are able to contribute to economic growth as well as employment.
4. **The business views itself to be growing or stable in the past year -** this provides insight around business perception and in conjunction with the previous two indicators, provides a rounded view of high impact businesses. The total number of high impact SMEs are 34,855 which represents approximately 3 per cent of total MSME market.

TABLE 13: Definitions of MSMEs in Malawi | *Source: GoM, MSME Policy, 2018*

MICRO	SMALL	MEDIUM
1–4 Employees	5–20 Employees	21–99 Employees
up to K5,000,000 Turnover	K5,000,001-K50,000,000 Turnover	K50,000,001-K500,000,000 Turnover
K1 million Maximum assets MWK[161]	K20m Maximum assets MWK[161]	K250m Maximum assets MWK[161]

161. Note: Maximum assets exclude land and buildings for manufacturing enterprises
162. Note: For small enterprises above MWK 480k p/m and medium above MWK 600k p/m

The high impact segments are further subdivided by sector into aggressive growth and employment generation to develop a more nuanced understanding of the underlying SMEs. The criteria used for each target group is described below:

- **Aggressive growth -** these are businesses in agriculture or farming, manufacturing, construction and business services sectors. This target group is identified to be key in industrialising the SME economy and purported to grow substantially in its contribution to economic growth.
- **Employment generation -** this comprises wholesale or retail, community and households, tourism, agro-processing and natural resources and mining.

Figure 31 provides a conceptual view of the segmentation. The key takeaway is that the aggressive- and employment-generation target groups are subsets of total high-impact SMEs. The descriptive characteristics in the following section will provide a clearer understanding of the differences in the segments.

Placing the segmentation into the context of the overall MSME market, the high-growth target segments make up 3 per cent of the overall MSME market. Within the target segments, aggressive growth SMEs comprise 16 per cent of total high-impact growth SMEs and employment generation SMEs comprise 84 per cent of total high impact growth SMEs.

5.3. Descriptive characteristics of the target market

A large proportion of the high-impact target group is found within the wholesale and/or retail sector at 49 per cent followed by the community and household sector at 21 per cent.

Aggressive-growth MSMEs have a higher proportion of businesses with employees between 5 - 20 (57%) and 21 - 99 (5%) while 66 per cent of employment creation businesses employ between 1 and 4 individuals. Men dominate the ownership of both target groups as depicted in Figure 33. This is in contrast to overall MSME ownership where 49 per cent of businesses (the majority of which are micro-businesses) are female-led. This identifies a large gender imbalance in the high impact target segments.

FIGURE 31: Conceptual diagram of SME target segmentation

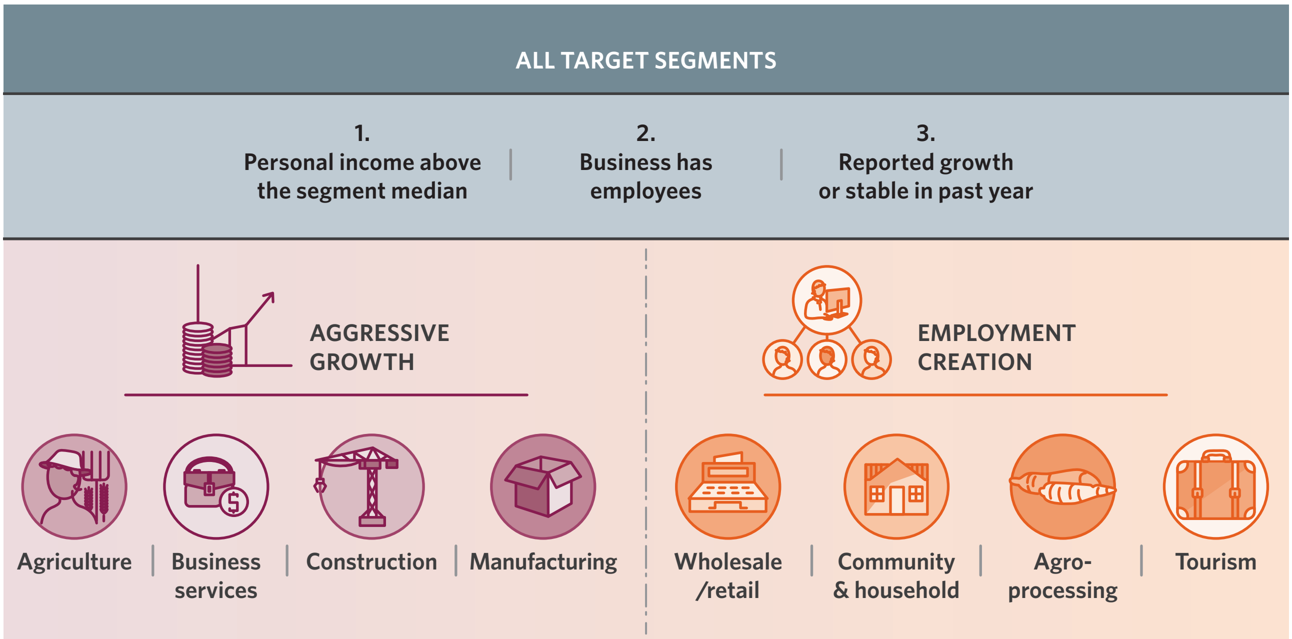
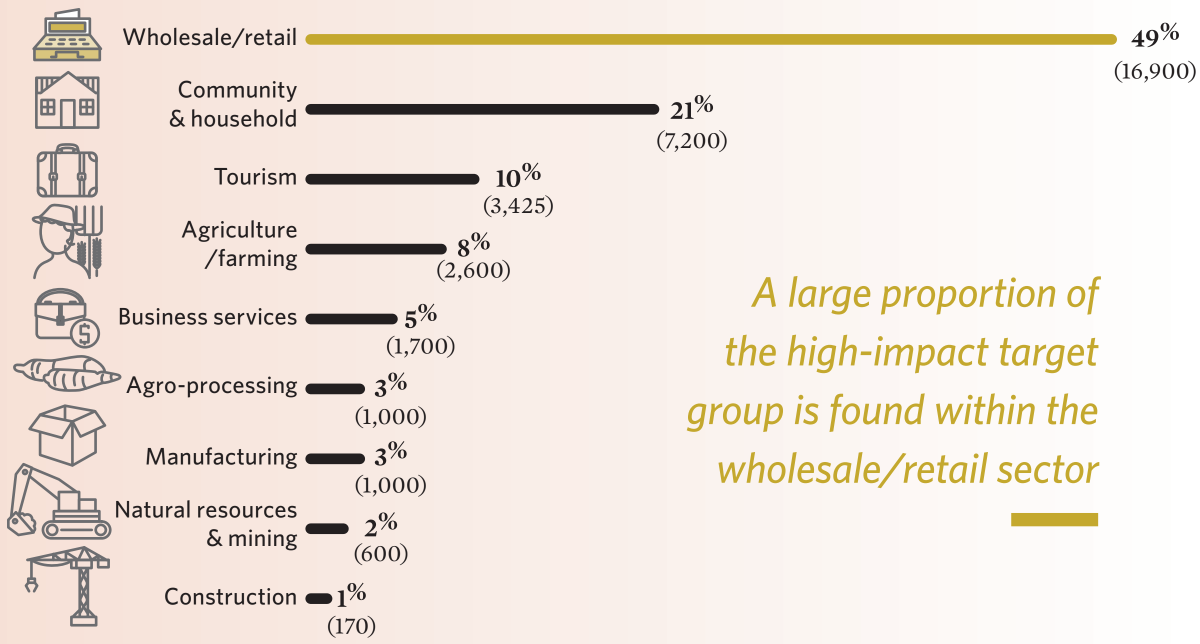


FIGURE 32: Target market SMEs vs Non-target market MSME | (% count, 2019)

Source: FMT, Malawi FinScope MSME Survey report, 2019

TABLE 14: Number of businesses per sector

Source: FMT, Malawi FinScope MSME Survey report, 2019



A large proportion of the high-impact target group is found within the wholesale/retail sector

Nineteen per cent of aggressive growth and 24 per cent of employment-generation business owners are aged 35 years and younger. Of overall MSMEs, 42 per cent are run by youth. This shows that the target segments are mainly led by older entrepreneurs, suggesting that the youth-owned businesses may be facing challenges in growing from micro to small and medium enterprises. Forty-one per cent of aggressive-growth business owners had attained higher than secondary school education, against only 25 per cent of employment generation business owners.

Businesses from both target groups are primarily located in Central and South Regions (i.e. over 80%) as per the overall distribution of MSMEs. Fifty-one per cent of aggressive-growth businesses are located in the Central region, while 59 per cent of employment generation businesses are located in the South. Aggressive-growth businesses are almost evenly distributed between rural and urban locations, likely reflecting the large composition of agriculture businesses in rural areas. Seventy-eight per cent of employment-generation MSMEs operate in urban areas as would be expected with primarily trade sectors in busier cities.

The majority of both high-impact segments are formally registered or licensed compared to only 1 in 5 (i.e. 20%) businesses from the overall MSME population being formally registered. This suggests that SMEs see a greater need to formalise as they grow in size. FGDs identified that most women- and youth-led entrepreneurs are not aware of the process or the importance of formalising, which is expected, given that they mainly operate as a micro and small business.

The sole proprietor was the most utilised business ownership structure of both segments. Aggressive-growth businesses also had a number of partnerships and cooperatives and/or trusts which are aligned to the businesses having a larger size of employees as described above.

Sixty-five per cent of aggressive-growth businesses and 63 per cent of employment-generation businesses are established or mature businesses. This exceeds the average 39% of overall MSMEs. This confirms that the target-market segment is more experienced relative to other MSMEs.

Over 30 per cent of aggressive-growth MSMEs began their operations to be their own boss and to make more money, followed by 29 per cent who saw an opportunity in the market. Together, these reflect the owners' inherent desire for entrepreneurship rather than getting into business ownership out of circumstance. These trends are exhibited across most business life-cycles save for the growth phase that reported having lost their jobs or being unable to find a job as a motivation.

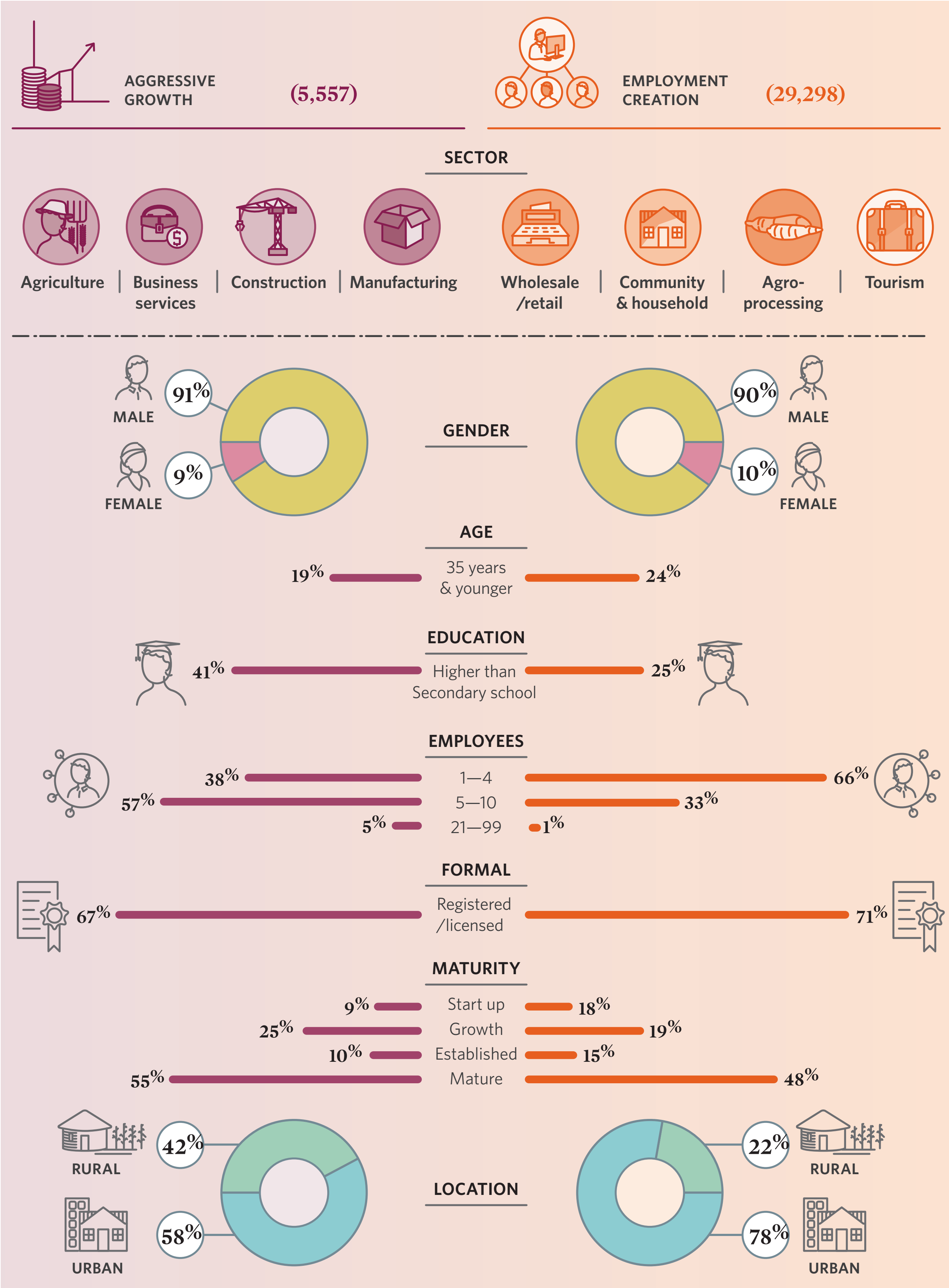
A more detailed breakdown of the target SME descriptive analysis can be found in the FinScope MSME Malawi Report 2019.

Entrepreneurship was also the motivation for employment generation MSMEs, with 61 per cent stating they did it to make money, 46 per cent saying they saw an opportunity and 39 per cent reporting they wanted to be their own boss (see Table 16). These views were held across all business life cycles.

Aggressive-growth businesses are generally more pessimistic about their business prospects. Fifty-five per cent of them felt that they do not have the same opportunities as other people,

FIGURE 33: Descriptive overview of Aggressive-growth and Employment-generation SMEs

Source: FMT, Malawi FinScope MSME Survey report, 2019



Green reflects more than 30% of businesses per business cycle or overall

Orange reflects between 15%and 30% t of businesses per business cycle or overall

Respondents were allowed to provide multiple responses and therefore percentage responses do not add up to 100%

TABLE 15: Main motivation for starting a business for aggressive-growth businesses

Source: FMT, Malawi FinScope MSME Survey report, 2019

The motivation of starting a business	Overall aggressive growth	Start-up	Growth	Established	Mature
Lost my job	9% (500)		20% (281)		8% (246)
Could not find a job/unemployed	14% (778)	9% (45)	44% (618)	7% (40)	3% (92)
Saw an opportunity	29% (1,612)	23% (115)	25% (351)	51% (294)	27% (831)
Interested in a particular product or service	7% (389)	17% (85)	4% (56)		8% (246)
Wanted it, makes me happy	15% (834)	6% (30)	18% (253)		17% (523)
To be my own boss /have my own business	39% (2,168)	11% (55)	39% (548)	11% (63)	48% (1,478)
To make more money /provide for my family	32% (1,779)	67% (334)	13% (183)	61% (352)	30% (924)
Took over from previous owner/manager	7% (389)				12% (369)
Inherited the business	1% (56)				2% (62)

TABLE 16: Main motivation for starting a business for employment-generation businesses

Source: FMT, Malawi FinScope MSME Survey report, 2019

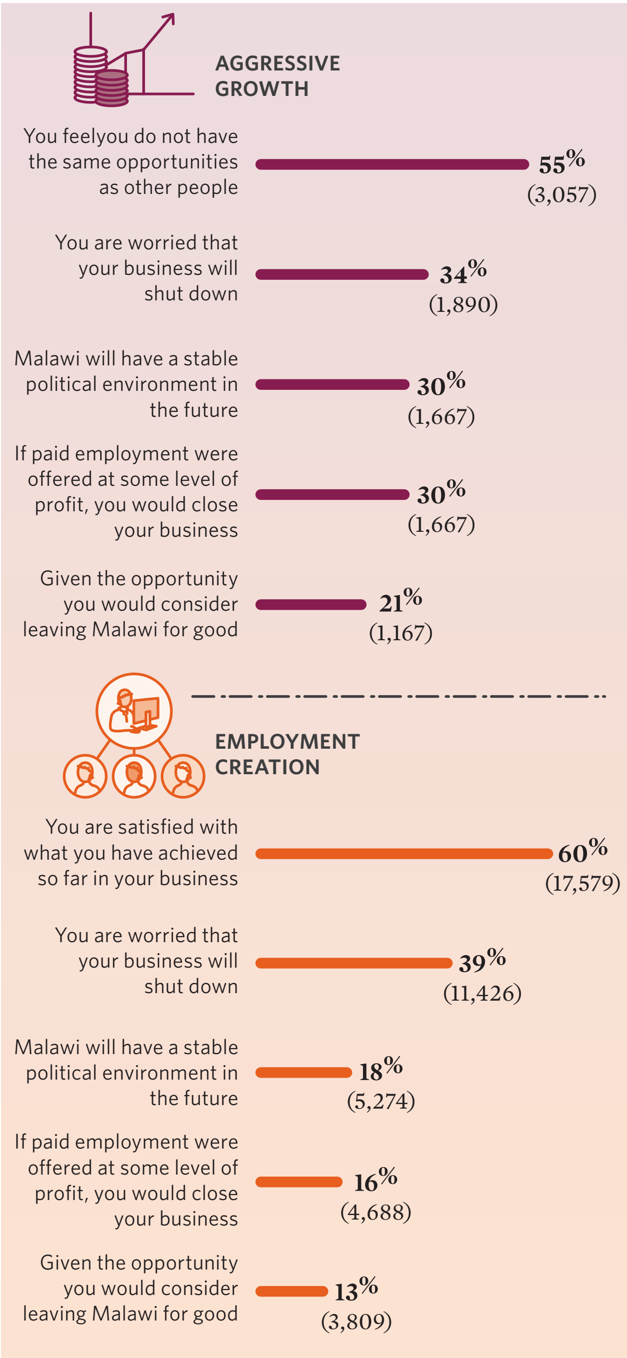
The motivation of starting a business	Overall employment generation	Start-up	Growth	Established	Mature
Lost my job	2% (586)	1% (53)	3% (169)	9% (391)	
Could not find a job/unemployed	6% (1,758)	6% (315)	5% (282)	13% (565)	4% (562)
Saw an opportunity	46% (13,477)	41% (2,153)	50% (2,824)	66% (2,870)	41% (5,761)
Interested in a particular product or service	8% (2,344)	8% (420)	9% (508)	15% (652)	5% (703)
Wanted it, makes me happy	12% (3,516)	18% (945)	12% (678)	19% (826)	7% (984)
To be my own boss /have my own business	39% (11,426)	26% (1,366)	30% (1,694)	18% (783)	53% (7,447)
To make more money /provide for my family	61% (17,872)	85% (4,464)	53% (2,993)	48% (2,087)	59% (8,290)
Took over from previous owner/manager	2% (586)	1% (53)			3% (422)
Inherited the business					1% (141)
Other	2% (586)		1% (56)	8% (348)	

and 34 per cent were worried that their business would shut down. Similarly, 30 per cent stated that if paid the same level of profits they would consider closing their businesses and moving into employment. Together, this suggests the difficulties faced to industrialise in Malawi and the need for better support mechanisms for SMEs to better navigate their operating environments

Employment-generation businesses were more optimistic with 60 per cent recording they were satisfied with what they had achieved and only 16 per cent saying they would shut their businesses if offered employment at the same level of profits.

FIGURE 34: Perceptions of business | (% split, count, 2019)

Source: FMT, Malawi FinScope MSME Survey report, 2019



Key takeaways

1. There is a high gender imbalance in the high-impact target segments as female-led businesses account for only 10 per cent.
2. The target segments are mainly led by older entrepreneurs, i.e. about 35 years old.
3. Aggressive-growth business owners are generally more educated than the employment-generation business owners.
4. Aggressive-growth businesses are almost equally distributed in urban and rural areas. This makes them potential instruments for the development of rural areas.
5. Majority of target-segment businesses are registered or licenced, suggesting businesses may benefit from increased formalisation.
6. Target-segment businesses are established and mature businesses highlighting the need to ensure sufficient support is provided to start-up businesses.
7. Entrepreneurship is one of the main motivators for business owners of the target market.
8. Difficulties are faced within the industrialisation target segment which suggests added BDS is required to support the business operations.

Employment-generation businesses were more optimistic with 60 per cent recording they were satisfied with what they had achieved

5.4. Target market insights

5.4.1. Operational considerations

This section outlines some of the key operational characteristics of the target segment. The areas explored in this section provide a comparative view of the operational dynamics that show similarity or show differences between the aggressive-growth and employment-generation target groups.

The problems faced by businesses when starting a business indicates that sourcing money is an issue for 62 per cent of both aggressive-growth and employment-generation SMEs. Thereafter, tax compliances is the second biggest issue for aggressive-growth SMEs cited by 24 per cent of SMEs, and lack of customers for employment-generation SMEs at 32 per cent.

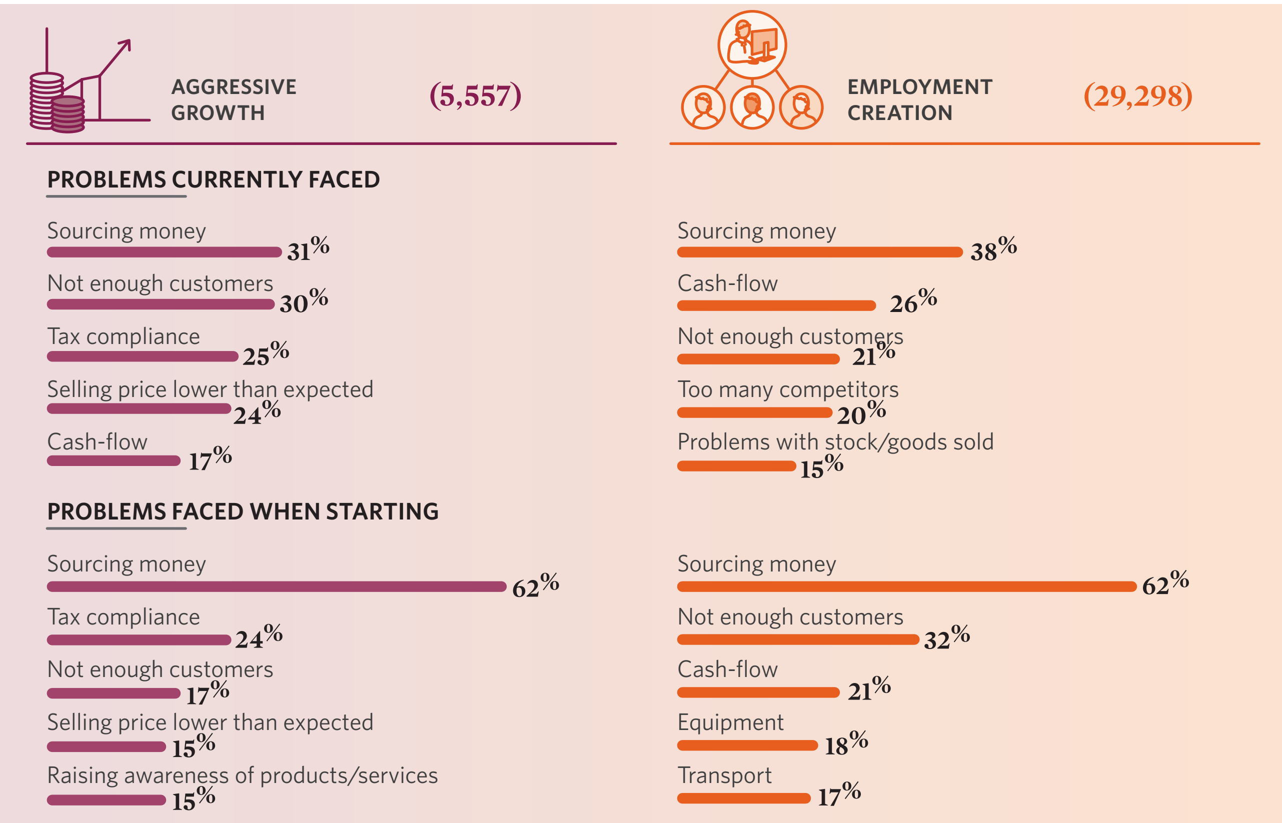
The access to amenities reported across the two segments indicates that there is high access to cell phones. This may prove promising for the dissemination of financial products as there has been significant uptake in mobile money usage. Similarly, access to electricity is cited at 73 per cent in aggressive growth and 80 per cent in employment-generation target groups which suggests that there is wide electricity coverage within these segments. However, findings from the FGDs with MSMEs, stakeholder interviews, and those highlighted in the context section indicate that frequent load-shedding and high commercial cost of electricity continue to plague both target groups.[163]

Fifty-two per cent of the aggressive SMEs operate out of residential premises and 28 per cent of aggressive SMEs operate out of stalls in designated trading areas. The employment-generation SMEs operate predominantly out of stalls in designated trading areas (49%), followed by those operating on streets and pavements (21%). The type of premises has implications for and is also a driver of the nature of the business. For example, aggressive-growth SMEs predominantly operate in residential premises where they can have more stable access to electricity as opposed to employment-generation SMEs which operate in stalls and on the streets where they are closer to buyers but depend less on electricity.

A key operational consideration for small businesses is the source of customers as this has an impact on the stability and future growth prospects of the business. For example, relying primarily on private individuals and walk-in customers could be a less reliable source of customers compared to other small businesses or large businesses where contracts are more likely to be set in place. The aggressive-target group has a more diversified customer base as evidenced by 54 per cent of businesses citing other small businesses as customers, as well as 49 per cent of larger businesses as customers.

FIGURE 35: Problems faced by business split by target group

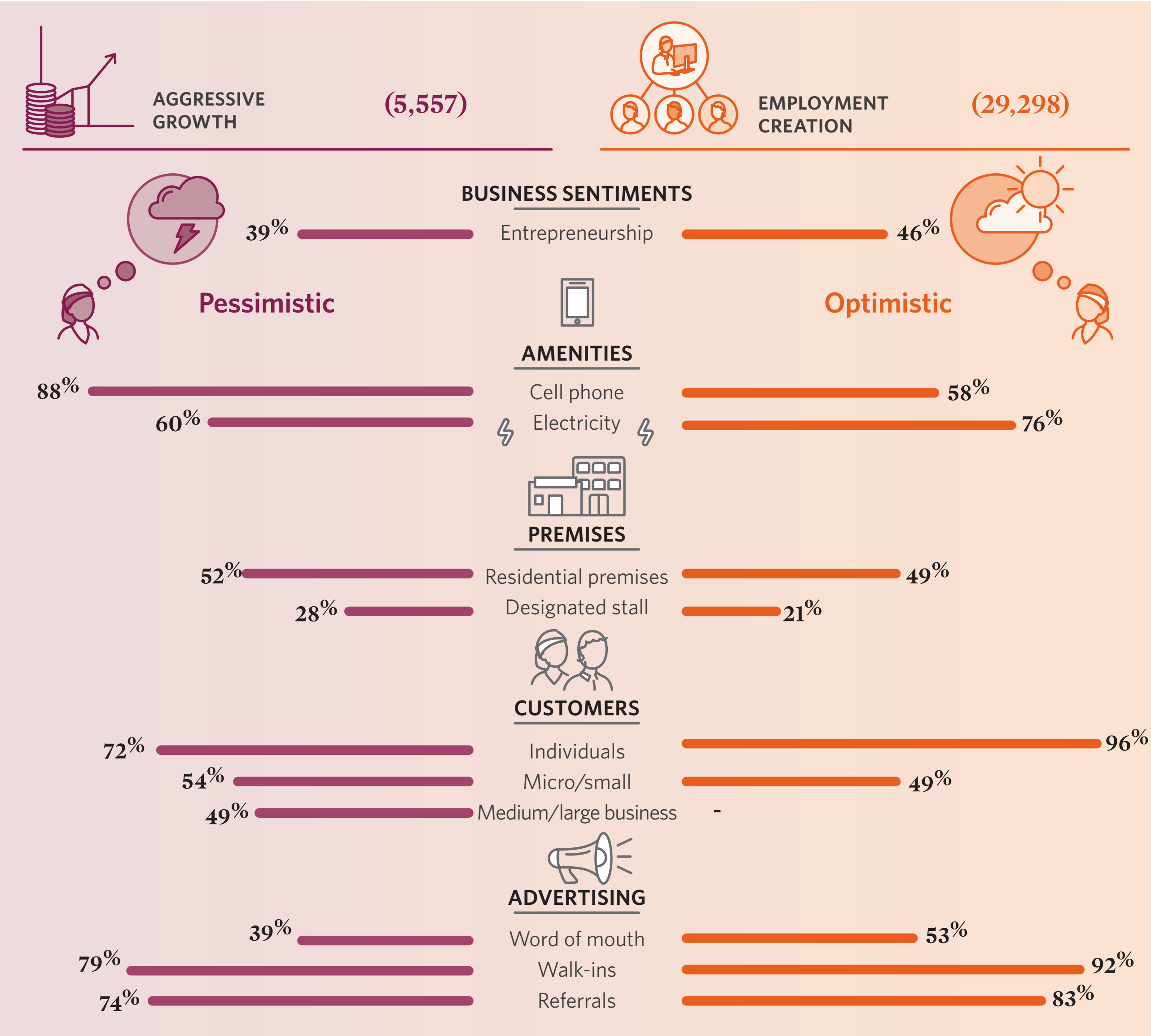
Source: FMT, Malawi FinScope MSME Survey report, 2019



163. FMT, Malawi FinScope MSME Survey report, 2019

FIGURE 36: Operational considerations split by target group

Source: FMT, Malawi FinScope MSME Survey report, 2019



A review of businesses offering credit within the target groups shows that aggressive-growth SMEs (81%) report offering credit slightly more than the employment-generation SMEs (71%). The FGD highlight that the concern around offering customers credit is that it often places strain on cash-flow due to customers taking a long time to repay businesses.[164] This is a gap that affordable working capital or even invoice-discounting solutions could be well placed to serve.

Aggressive-growth (79%) and employment-generation (92%) SMEs rely on walk-ins as their primary source of customers. A review of methods of marketing across both target groups indicates that word of mouth is the primary form of marketing for aggressive-growth (39%) and employment-generation growth (53%) segments. This speaks to the gap SMEs face in marketing their goods to new markets. One solution that could address this gap could be the use of technology and social media platforms, but the adoption and usage of this are limited as shown in the context section.

In reference to Table 17 and 18, a review of major business expenses by maturity reveals that employee wages and inputs are a major expense throughout the maturity cycle for both aggressive and employment-generation target groups. An interesting insight is that rental costs are greater for employment-generation SMEs as opposed to aggressive-growth SMEs.

A review of source of capital across target segments shows that employment-generation SMEs are driven by money from other businesses (62%) and aggressive growth is driven by savings (39%), followed by money from other business (37%), salary (37%) and family and friends (35%). The

164. FMT, Malawi FinScope MSME Survey report, 2019

FGDs revealed that access to start-up capital and working capital are limited and evidently this is received from business owners' networks of other businesses, family or savings as opposed to formal financial networks.[165]

Key takeaways

1. High-impact SMEs have extensive access to cell phones. This indicates potential to develop different financial and non-financial solutions in partnership with mobile network operators and other technology firms.
2. Aggressive-growth SMEs have a diversified source of customers across private individuals, other small businesses and other large businesses. Conversely, employment-generation SMEs' customer base is primarily driven by private individuals.
3. Businesses offering goods and services on credit indicate that slow-paying customers place strain on cash flow. This highlights the need for working capital and other finance solutions such as invoice discounting to reduce the strain on SMEs.
4. Most high-impact SMEs rely on word of mouth as a primary form of getting new customers, which limits their reach to customers in different geographies.
5. Because of the difficulties in sourcing bank finance, SMEs mainly fund themselves through own savings, salary, or money from other businesses.

Green reflects more than 80% of businesses per business cycle or overall

Orange reflects between 50% and 80% of businesses per business cycle or overall

Respondents were allowed to provide multiple responses and therefore percentage responses do not add up to 100%

TABLE 17: Major business expenses by maturity for the aggressive target group

Source: FMT, Malawi FinScope MSME Survey report, 2019

Major business expenses by maturity	Overall aggressive growth	Start-up	Growth	Established	Mature
Rental costs including lighting and water	26% (1,445)	20% (100)	39% (548)	17% (98)	23% (708)
Employee wages/salaries	81% (4,501)	75% (374)	90% (1,264)	85% (490)	77% (2,371)
Licencing and permits	14% (778)		17% (239)		17% (523)
Inputs such as raw materials and equipment	74% (4,112)	70% (349)	77% (1,081)	88% (508)	70% (2,155)
Transportation (of product or staff)	41% (2,278)	64% (319)	52% (730)	43% (248)	31% (954)

TABLE 18: Major business expenses by maturity for employment-generation target group

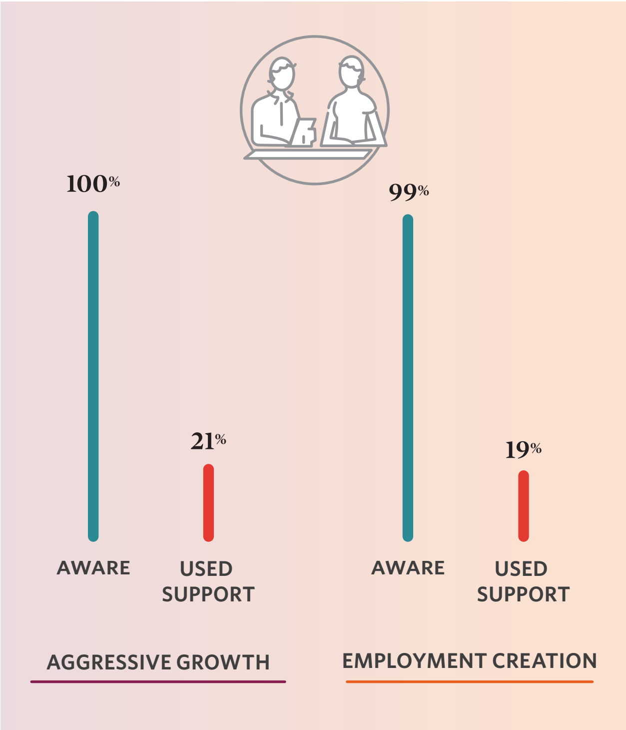
Source: FMT, Malawi FinScope MSME Survey report, 2019

Major business expenses by maturity	Overall employment generation	Start-up	Growth	Established	Mature
Rental costs including lighting and water	50% (14,649)	56% (2,941)	71% (4,009)	60% (2,609)	36% (5,085)
Employee wages/salaries	82% (24,024))	76% (3,992)	81% (4,574)	81% (3,522)	84% (11,803)
Licencing and permits	7% (293)	28% (1,471)	8% (452)	1% (43)	1% (141)
Inputs such as raw materials and equipment	74% (21,681)	69% (3,624)	50% (2,824)	59% (2,565)	90% (12,646)
Transportation (of product or staff)	34% (9,961)	17% (893)	43% (2,428)	40% (1,739)	35% (4,918)

165. FMT, Malawi FinScope MSME Survey report, 2019

FIGURE 37: Awareness and use of BDS split by target group | (% split, 2019)

Source: FMT, Malawi FinScope MSME Survey report, 2019



5.4.2. Take-up of business development services

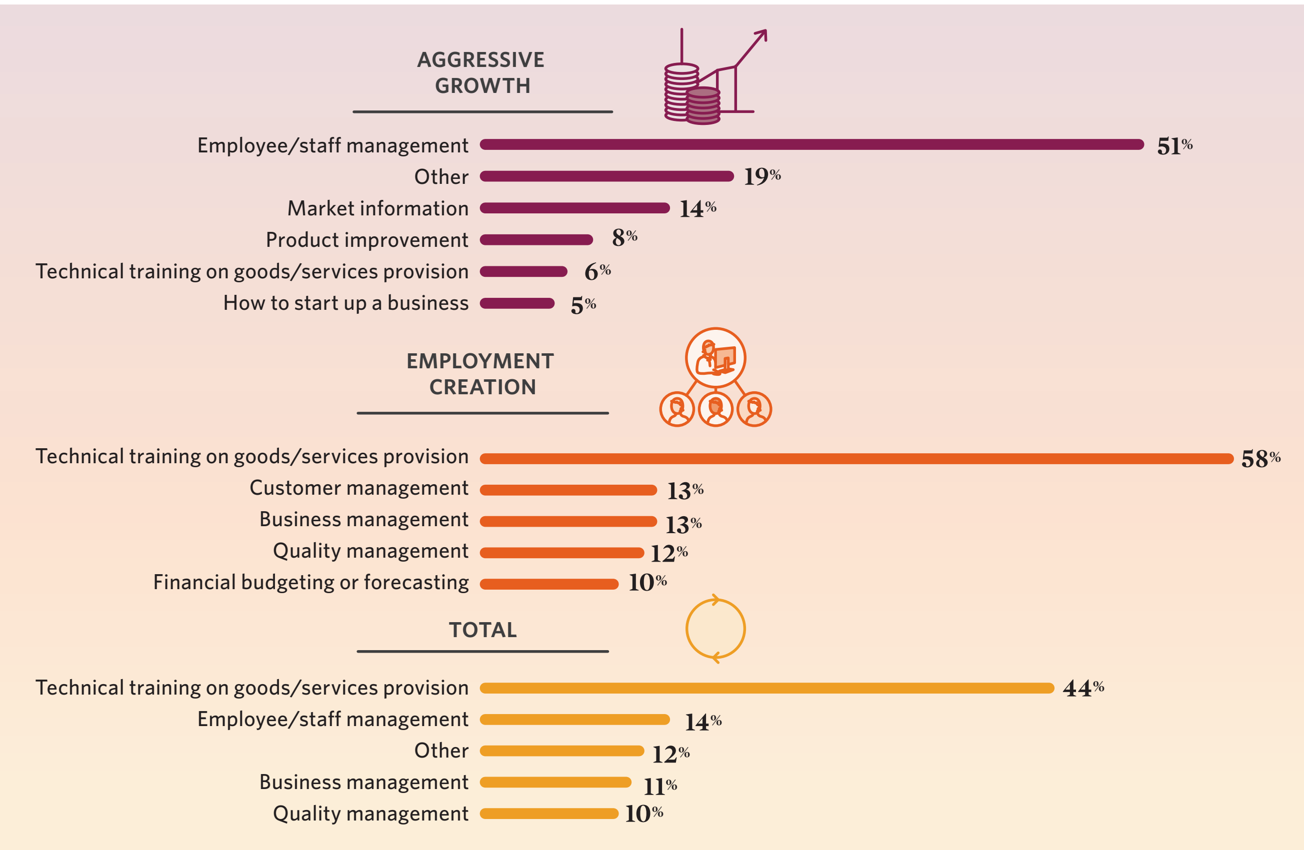
BDS support is an important mechanism to help SMEs grow into businesses that not only operate more efficiently but are also viable for financial institutions to finance. FinScope data, FGDs, literature, and stakeholder consultation, all paint a picture of an SME population that is characterised by low levels of financial and business management skills, which makes BDS one of the most important needs in Malawi.

According to FinScope, both high impact SME segments are aware of BDS, but only 1 in 5 SMEs are making use of the services. Qualitative insights from the FGD report revealed that the availability of BDS services is relatively better in the agriculture MSMEs than in other sectors such as manufacturing and tourism because of donor-funded programmes that support BDS.

A review of the target segments' main reasons for using BDS shows that employee and staff management is the main type of support received under aggressive growth (51%) and technical training on goods and services provision (58%) for the employment-generation segment. Given that aggressive-growth target segments are comprised of sectors that have significant employment such as agriculture, manufacturing, and business services, it is likely that SMEs in these sectors would require employee and staff management related BDS.

FIGURE 38: Top 5 reasons for using BDS split by target group | (% split, 2019)

Source: FMT, Malawi FinScope MSME Survey report, 2019



Ninety-two per cent of aggressive-growth SMEs and 80 per cent of employment-generation SMEs report that they keep financial records. Similar to access to electricity, there is a high reporting for record-keeping but stakeholder interviews and FGDs suggest that the quality is low and many are not kept up to date. Among SMEs in the target group who did not keep records, it is interesting to note that aggressive SMEs reported not seeing the value (54%) and employment-generation SMEs reported that they do not need to keep records (63%).

Approximately two-thirds of the total target-group SMEs are registered with the registrar. However, this means that 1 in 3 businesses within the target group is not registered. The main reasons for aggressive-growth SMEs not being registered were that they were either currently in the process of registering their business, their business was too small, or they did not know how to register. The employment-generation target group reports that the main barrier to registration is that their business is too small to feel the need to register.

A review of compliance across both target SME segments suggests that there is a low level of income tax compliance amongst SMEs. Forty-seven per cent of the aggressive-growth target group and 35 per cent of the employment-generation target group have registration certification.

The aggressive-growth SMEs reported highly on workman's compensation (61%), whereas the employment-generation target group reported VAT as the main area of compliance (78%). The National Pension Fund held the lowest level of compliance across both target groups at 6 per cent.

FIGURE 39: **Financial record-keeping and reason for no financial records | (% split, 2019)**

Source: FMT, Malawi FinScope MSME Survey report, 2019

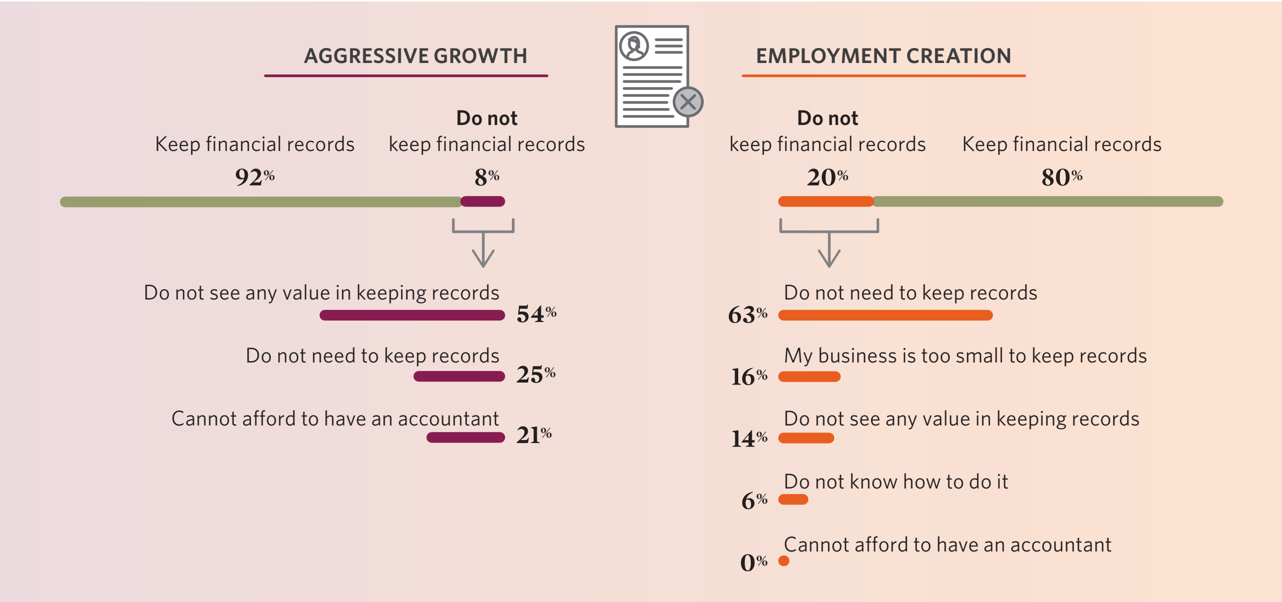
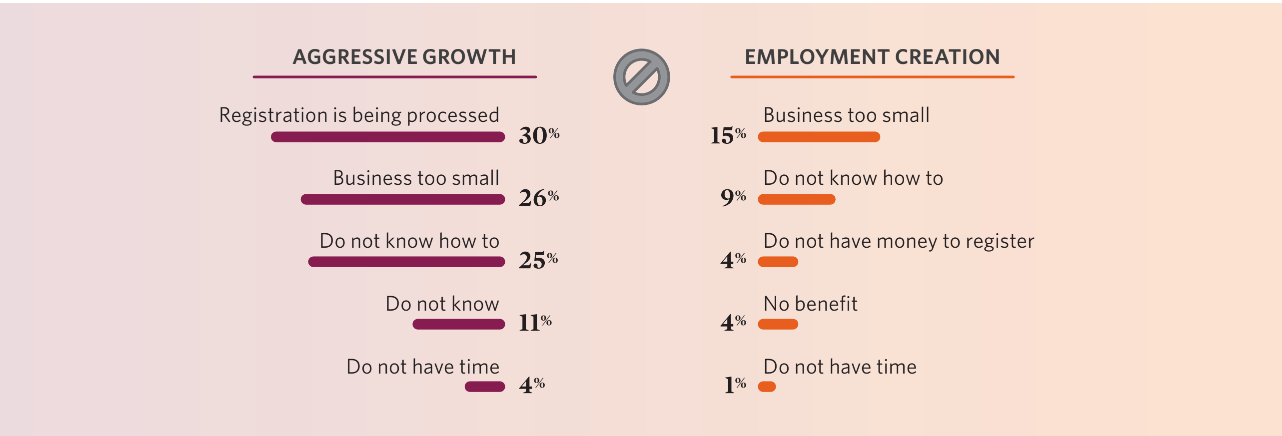


FIGURE 40: **Top 5 reasons cited for barriers to registration | (% split, 2019)**

Source: FMT, Malawi FinScope MSME Survey report, 2019



Following this review of BDS among the target group, it would be useful to revisit some of the key barriers faced by BDS providers. An overarching theme from BDS providers is that high illiteracy rates make it difficult to provide services and training. Additionally, the BDS providers have limited coordination and as such, scalable BDS has yet to be attained. Limitations in ICT infrastructure, internet access in particular, restrict BDS provision of face-to-face contact with SMEs. Furthermore, business registration is limited due to poor accessibility of registration offices, coupled with a lack of awareness of the benefits of registration.

Limitations in ICT infrastructure, internet access in particular, restrict BDS provision of face-to-face contact with SMEs

Key takeaways

1. Although the target-growth segments are fully aware of BDS, only 1 in 5 make use of them.
2. The key driver for low uptake of BDS is perceived lack of availability in non-agricultural sectors.
3. More than 80 per cent of target-growth groups keep financial records. However 86 per cent of target-growth segments keep financial records manually, while 21 per cent keep financial records through computerised systems.
4. Businesses in target-growth segments who do not keep financial records cite that they 'do not need to' and 'do not see the value' as their primary reasons.
5. Two-thirds of the high impact SMEs are registered. However, of businesses not registered, the main reason cited by businesses was that they were too small to justify registration.
6. BDS services that are most in demand include capacity building, business planning, financial management, identification of market and mentoring.
7. Limited internet access in rural areas hinders the ability to provide BDS at scale in different geographies. This results in BDS providers requiring costly face-to-face interaction as the main channel of BDS.
8. The type of BDS received and the type demanded suggest a mismatch between BDS provision and the actual BDS needs of the target segments.

FIGURE 41: Business licencing compliance split by target group | (% split, 2019)
Source: FMT, Malawi FinScope MSME Survey report, 2019

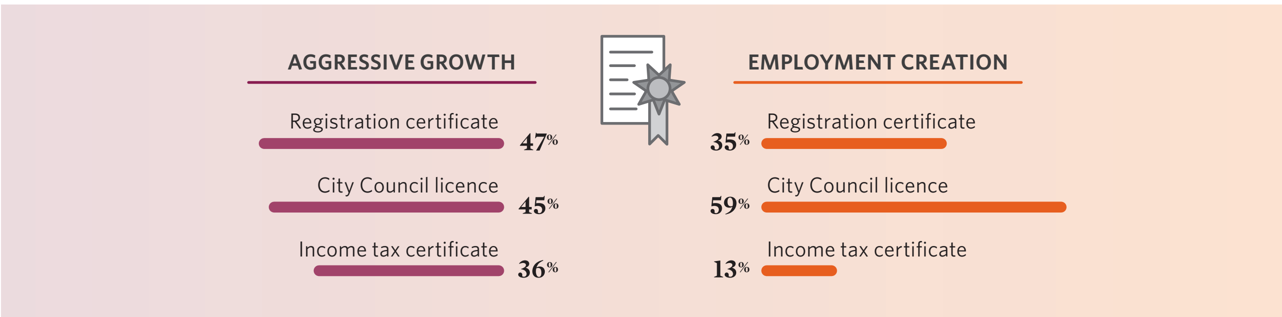
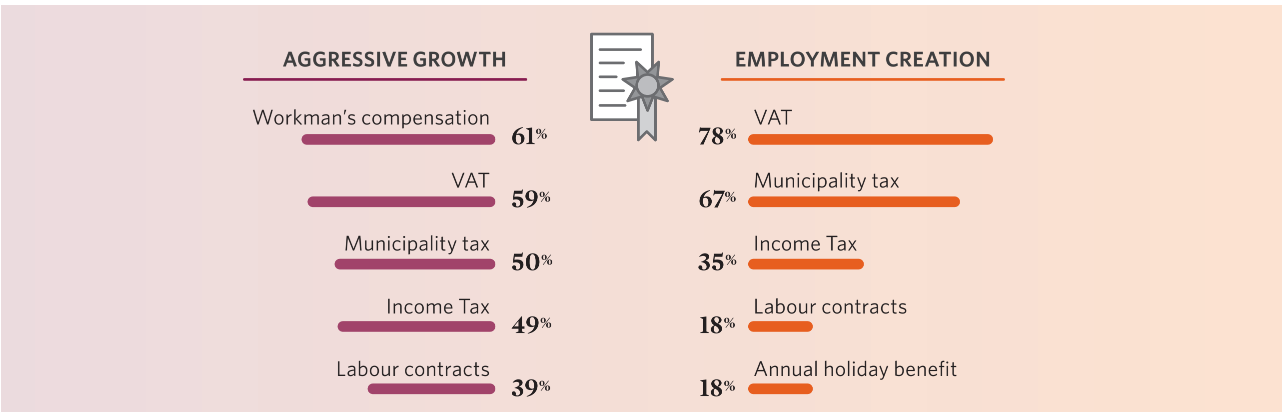


FIGURE 42: Top 5 compliance areas split by target group | (% split, 2019)
Source: FMT, Malawi FinScope MSME Survey report, 2019



5.4.3. Take-up of financial products and services

FINANCIAL ACCESS STRAND

Most high-impact SMEs in Malawi are banked (73% - 24,444), with the remainder also largely served by non-bank formal institutions. As a result, only 3 per cent (1,046) of high-impact SMEs are excluded from any financial services. Employment-generation SMEs are less banked than aggressive-growth SMEs (71% vs 83%), and therefore have a higher reliance on non-bank formal institutions (91% vs 86%). Despite having a lower share of banked SMEs, because of its larger relative size, the job creation segment has a significantly larger number of banked SMEs (4,612 vs 20,802).

The proportional level of financial inclusion within the high-impact SME segments is in stark contrast to the overall MSME population where only 24 per cent of MSMEs are banked, 54 per cent with formal access. This suggests that high impact SMEs generally find it relatively easier to open accounts with formal financial institutions.

Formal non-bank financial products were the most widely used by the target segments. This is largely driven by mobile money usage where 74 per cent of aggressive-growth businesses and 66 per cent of employment-generation businesses reported using MMO services. Informal financial access stood at 40 per cent for aggressive-growth businesses (which is identical to overall MSME access) and 16 per cent for employment-generation businesses. This may suggest that aggressive-growth businesses are able to utilise agriculture networks in rural areas for finance, in a way that urban retail businesses of employment-generation segment are not able to create.

Of the 17 per cent (i.e. 939) aggressive-growth businesses that are not currently banked, the two main inhibitors cited include that businesses do not need a bank account and that the business does not have to have a business address. Focus group discussions (FGDs) highlighted that businesses would rather seek finance from alternative sources before going to a bank because they perceive that they will not meet the eligibility requirements to be served[166]. Businesses were further of the impression that they are too small or were too informal to be banked. This was particularly a deterrent for both women- and youth-led businesses.

Twenty-nine per cent (i.e. 8,467) of the employment-generation SMEs without bank accounts reported that they were planning to have one in the future, suggesting that a number of businesses are still interested in opening bank accounts even though they do not currently have one (see Figure 45).

FIGURE 43: Financial access strand | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

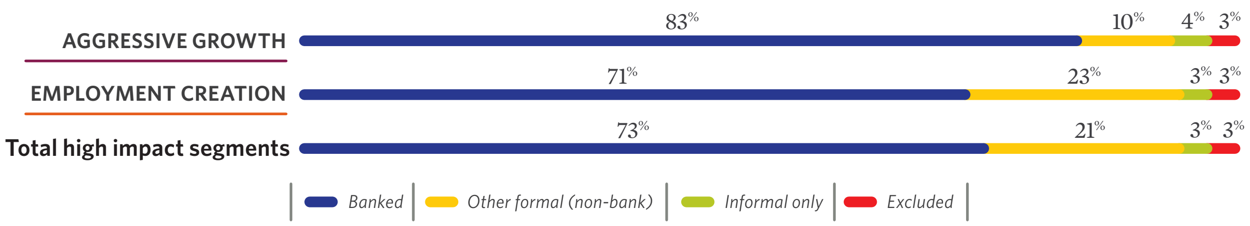


FIGURE 44: Overall financial access strand | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

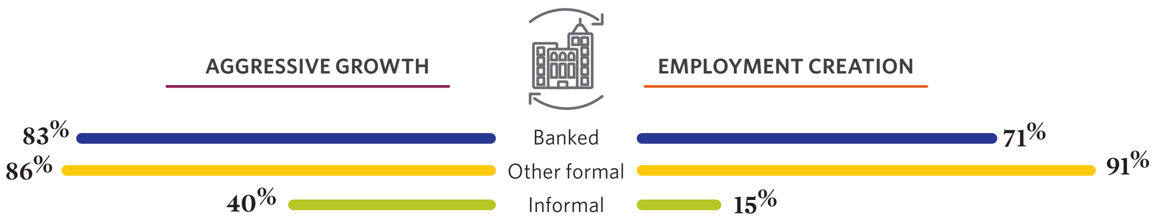
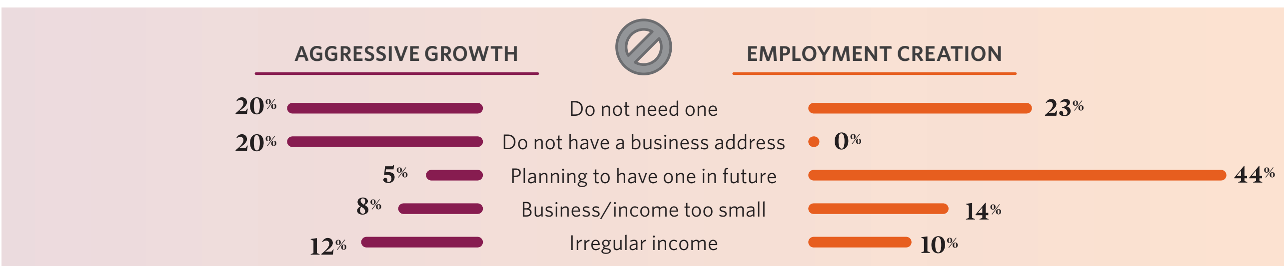


FIGURE 45: Barriers to banking | *Source: FMT, Malawi FinScope MSME Survey report, 2019*



165. FMT, Malawi FinScope MSME Survey report, 2019

CREDIT OR FINANCE

Fifty-four per cent (2,973) of aggressive-growth and 68 per cent (19,776) of employment-generation businesses do not borrow, compared to 64 per cent of all MSMEs. Of those that borrow, both target segments have a larger proportion borrowing from banks (i.e. 33% - 1,828 for aggressive growth and 21% - 6,065 for employment generation) in comparison to all MSMEs at only 4 per cent.

Aggressive-growth businesses show that as businesses mature in their life cycle they tend to consume more credit. This general trend shows an increase of bank-based lending from 13 per cent as a start-up to 42 per cent as a mature business, save for established businesses that reported 42 per cent of informal credit. Employment-generation businesses depicted a general rise in the uptake of formal bank credit, but the percentage of businesses not borrowing remained largely unchanged.

Credit was mainly used to grow all high-impact businesses or to meet their day-to-day needs. In addition, employment-generation businesses used credit to purchase land, while aggressive-growth businesses used it to purchase machinery and to upgrade business facilities. This supports the data on business premise and shows the difference in business focuses, i.e. aggressive-growth businesses being focused on industrialisation, and employment-generation businesses is focused on securing a premise for trade. These were, however, a small proportion of businesses suggesting a potential underutilisation of asset finance and mortgage products.

The majority of businesses reported sourcing their start-up capital from other businesses (though it was not clear whether these were businesses owned by the same owner or separate entities), their savings, salaries, and family and friends. FGDs reiterated the perception that start-ups, as well as women- and youth-led businesses, found it exceptionally

FIGURE 46: Credit strand | *Source: FinScope MSME Malawi 2019 Survey*

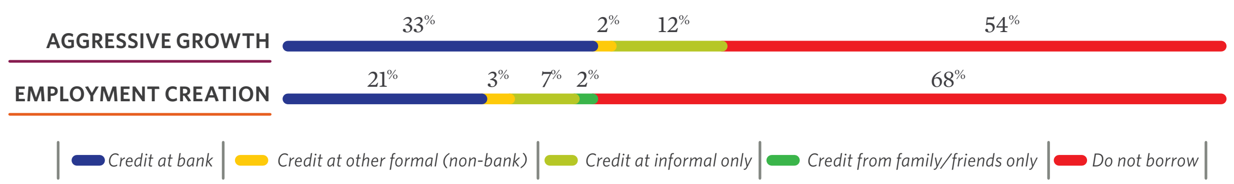


FIGURE 47: Credit strand by business life cycles | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

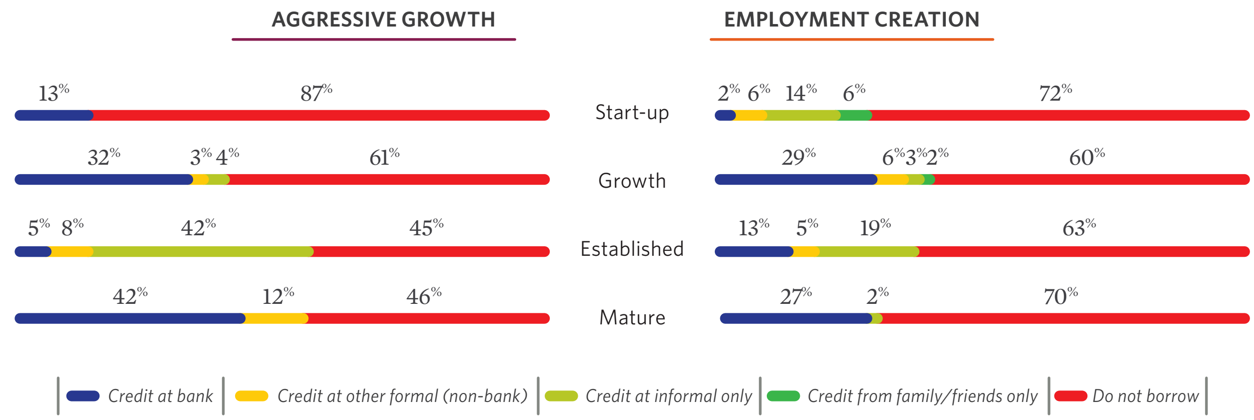
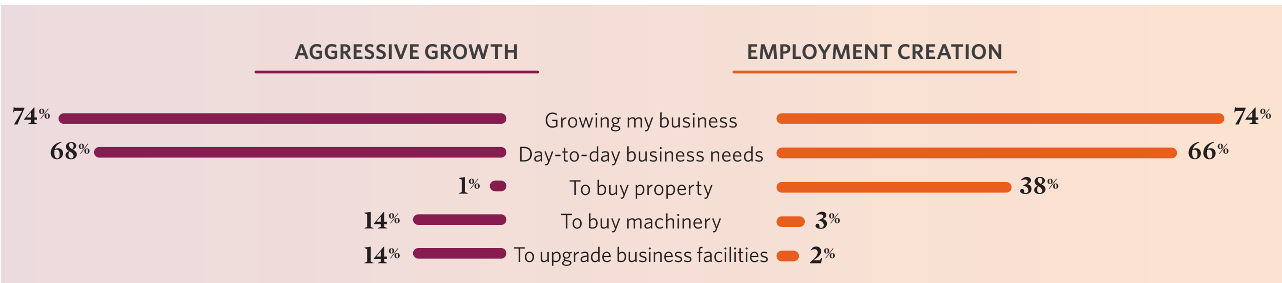


FIGURE 48: Drivers for borrowing | *Source: FMT, Malawi FinScope MSME Survey report, 2019*



difficult to gain access to finance from banks because of eligibility issues, thus requiring them to seek this from primarily informal sources[167]. This lack of eligibility was as a result of said MSMEs having poor credit histories, lacking proper financial records and written business plans, as well as lacking sufficient collateral. This supports the need to build the financial and business management capacities of SMEs through BDS.

SACCOs and VSLAs were identified in FGDs, and also shown in the supply-side findings, as providing easier access to finance as they had more flexible requirements. SACCOs and VSLAs were, therefore, a significant source of finance to women- and youth-led businesses. They, in addition, enjoyed the benefit of receiving interest from accrued savings. The main limitation identified with this source of financing was that the loan tenures were short, and borrowing amounts were limited in value and to individuals, and not businesses. The FGDs further revealed that access to start-up capital and working capital are limited for businesses[168]. As a result, they are evidently received from business owners' networks of other businesses, family or savings, as opposed to formal financial networks.

None of the target segments reported sourcing start-up capital from either the Government or donor agencies or non-governmental organisations (NGOs). Considering these institutions are able to take higher risks and thus are better suited to support start-ups, does not explain the limited scale that these offerings have achieved. FGD interviews, however, identified that some businesses had been successful with donor grants namely the United Nations Development Programme Growth Accelerator Programme. However, these were tailored only for asset finance and not working capital, similarly limiting the use case for businesses.

FGDs identified that MSMEs have low knowledge of understanding of alternative forms of finance such as the Malawi Stock Exchange (MSE), equity financing from private equity (PE) or venture capital (VC) firms and equipment leasing. Similarly, there was limited knowledge of the CRBS and the PPSR (i.e. the movable collateral registry). Together, this suggests the need for the different providers to invest in further consumer awareness campaigns, coupled with financial management training.

Of those not borrowing, businesses identified that they had no demand for credit (see Figure 50). This could be a result of a number of reasons such as businesses being satisfied with their current state and therefore not seeking additional access to credit, or businesses having given up trying to borrow from formal providers and therefore having resigned to relying on alternative sources of finance.

FIGURE 49: Sources of capital | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

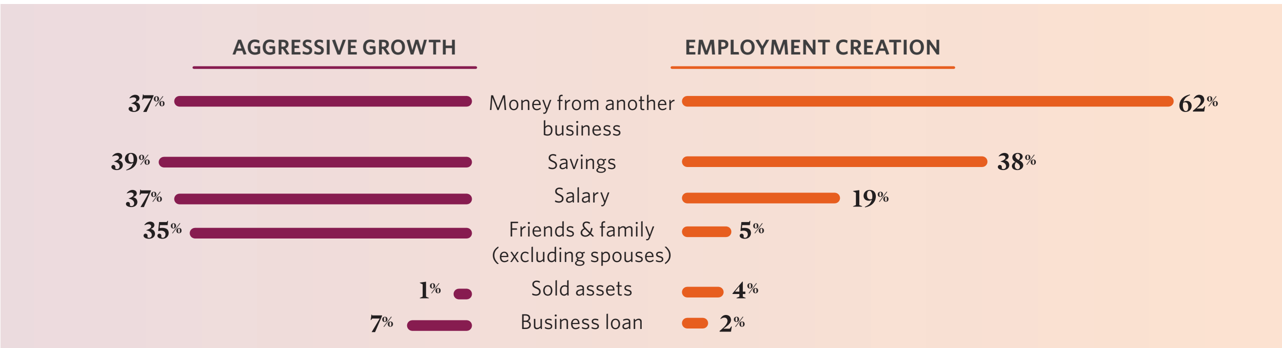
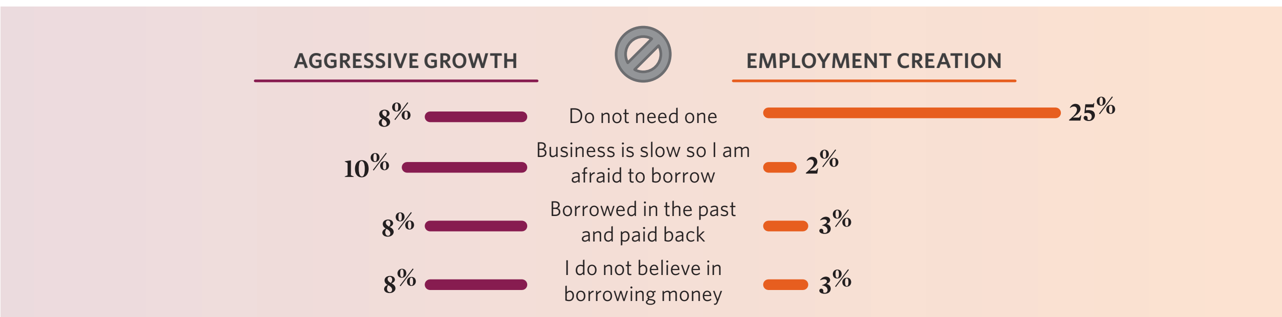


FIGURE 50: Barriers to borrowing (of those not borrowing) | *Source: FMT, Malawi FinScope MSME Survey report, 2019*



167. FMT, Malawi FinScope MSME Survey report, 2019

168. Ibid.

SAVINGS AND INVESTMENTS

As with the credit strand, both target segments have higher percentages of businesses that save formally than overall MSMEs, at 2 per cent. However, both target segments reported having over 50 per cent of businesses not saving at all. This highlights the lack of depth in financial inclusion, for the two target segments operate in above-average formal access, coupled with a majority that does not take up specific product offerings (see Figure 51 below). Aggressive-growth businesses save and invest more than their employment-generation business counterparts, which shows the driving force behind each segment starting a business (e.g. employment-generation SMEs mainly in business to earn additional income to support their families).

Aggressive-growth businesses exhibited a general rise in the use of formal bank savings or investments as the business matured: starting with 0 per cent as a start-up and rising to 34 per cent as a mature business. Employment-generation SMEs exhibited a decrease in the amount of savings used as a business matured. This suggests that the more mature the business become there was less need to save for emergencies, potentially because business owners were more aware of what challenges they might face.

Both aggressive and employment-generation businesses save more using informal mechanisms compared to formal institutions. FGDs identify that this could in part be a result of credit sought from VSLAs against individual savings.

Aggressive-growth businesses primarily utilise their savings and/or investments to expand their businesses, while employment-generation businesses primarily save for emergencies. From this and the above findings, aggressive-growth businesses seem focused on expanding and growing their businesses while employment-generation businesses seem more content to maintain their operations and protect from any emergencies.

The main reasons cited for not saving or investing is that all the money is put back into the business and that businesses do not make enough money to save or invest. This suggests the need for BDS support to help businesses navigate their operating environments.

FIGURE 51: Savings or investment strand | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

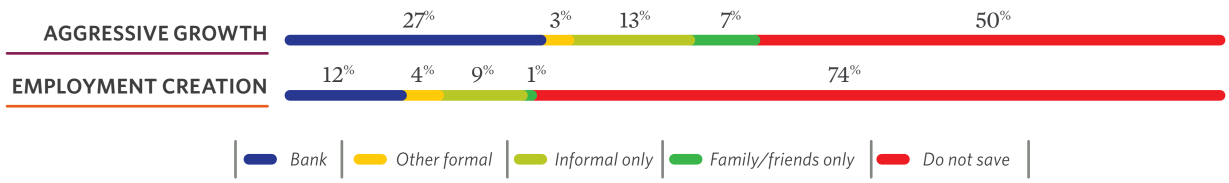


FIGURE 52: Savings or investment strand by business life cycle | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

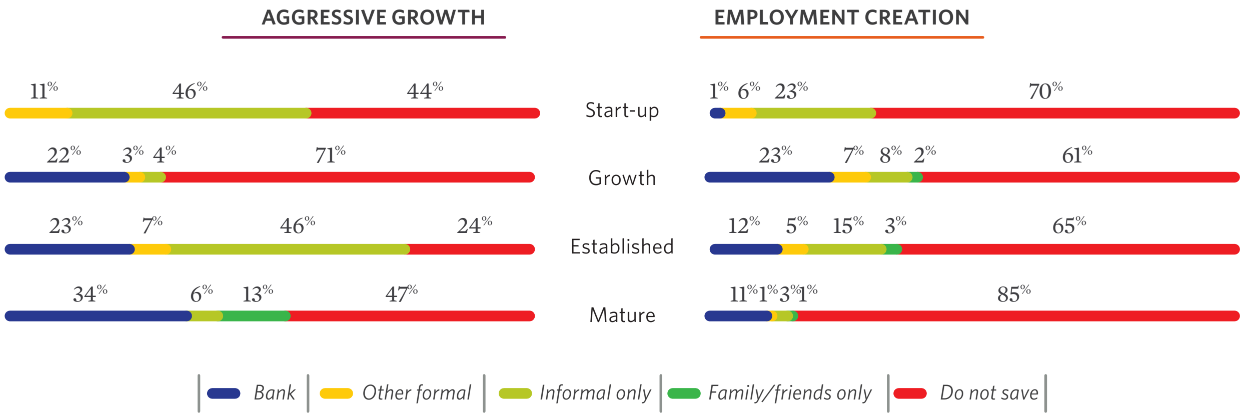


FIGURE 53: Overall savings/investment access strand | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

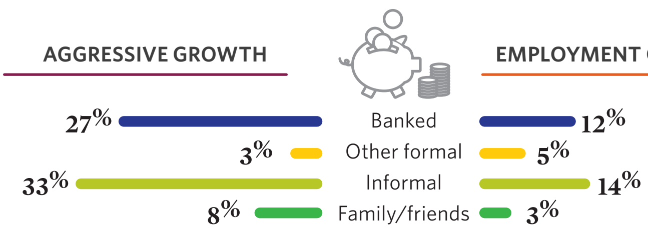


FIGURE 54: Drivers for saving (for those who save) | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

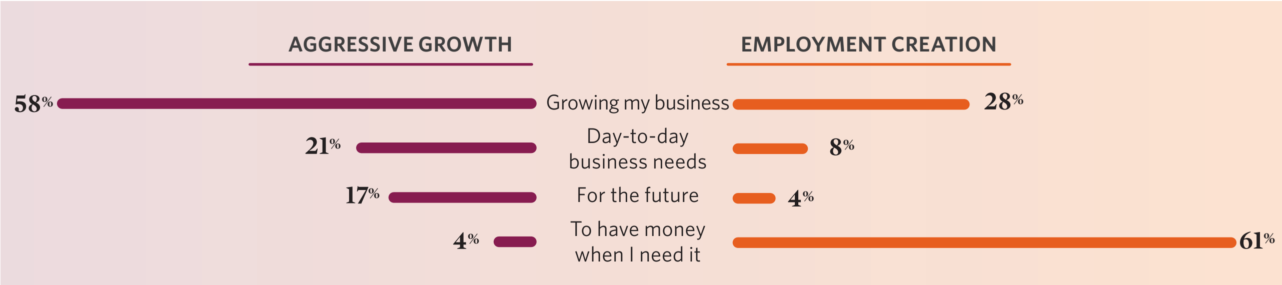


FIGURE 55: Barriers to saving (of those not saving) | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

INSURANCE

Both target groups had over 35 per cent formal insurance uptake, which is markedly higher than that of overall MSMEs at 3 per cent.

Aggressive-growth businesses and employment-generation businesses both registered a rise in uptake of formal insurance as a business matured (see Figure 57).

FGDs identified that businesses have adequate knowledge of the type of insurance products offered by providers. However, the barriers to uptake, relate to the suitability of products to the main risks they face and the high costs of insurance services. FinScope data echoed these findings as depicted in Figure 58.

FGDs further identified the main risks businesses face and for which they would be interested to seek insurance. These include climate and weather change, disease outbreaks for livestock, theft, and fraud. FinScope data identified the main risks faced by aggressive-growth businesses are theft of business stock, competition, and not being paid by creditors.

Employment-generation businesses were also concerned about the theft of business stock, as well as loss of income, and the theft of business equipment. Although insurance against theft of business stock and equipment is currently available from general insurance firms (see Section 4.1.4), the costs are however still restrictive.

PAYMENTS

Usage of digital forms of payment was reportedly 85 per cent (i.e. 4,723) of aggressive-growth businesses, and 68 per cent (i.e. 19,923) of employment-generation businesses. This matched customers' reported usage of digital financial services (DFS) to make payment as 36 per cent of aggressive-growth businesses, compared to employment-generation businesses, which reported 20 per cent. Overall MSME usage of DFS was much lower than the target segments at 8 per cent.

Cash remains the most utilised form of payment with which customers pay the target segments. Aggressive-growth businesses reported a lower cash acceptance at 72 per cent (i.e. 4,001 businesses), than employment-generation

FIGURE 56: Insurance strand | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

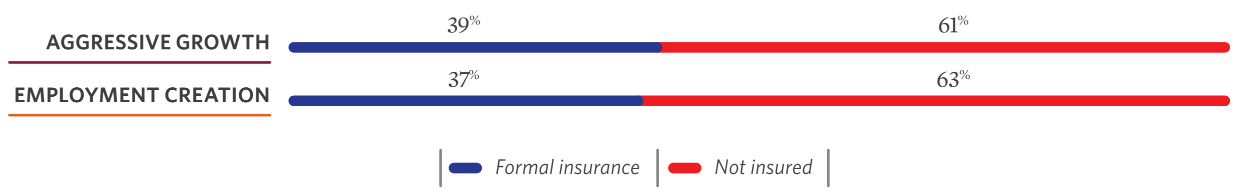


FIGURE 57: Insurance strand | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

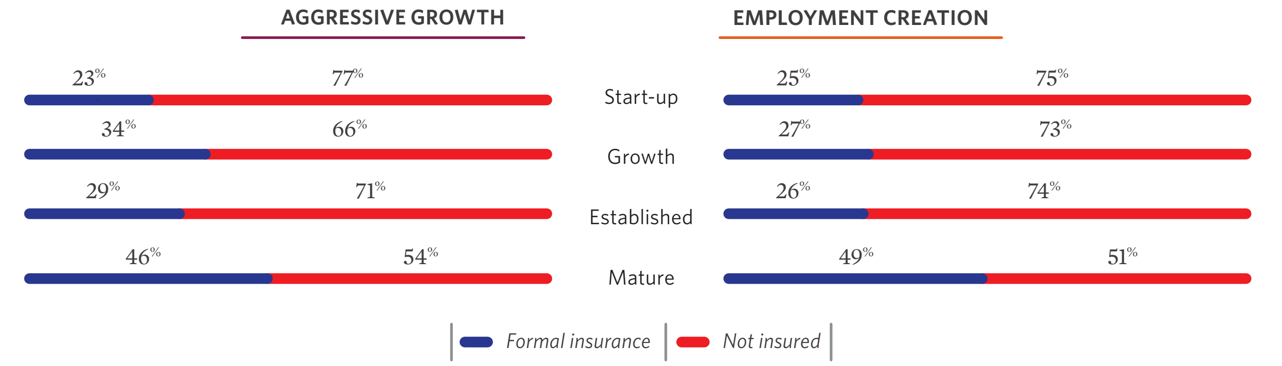


FIGURE 58: Barriers to insurance (of those not insured) | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

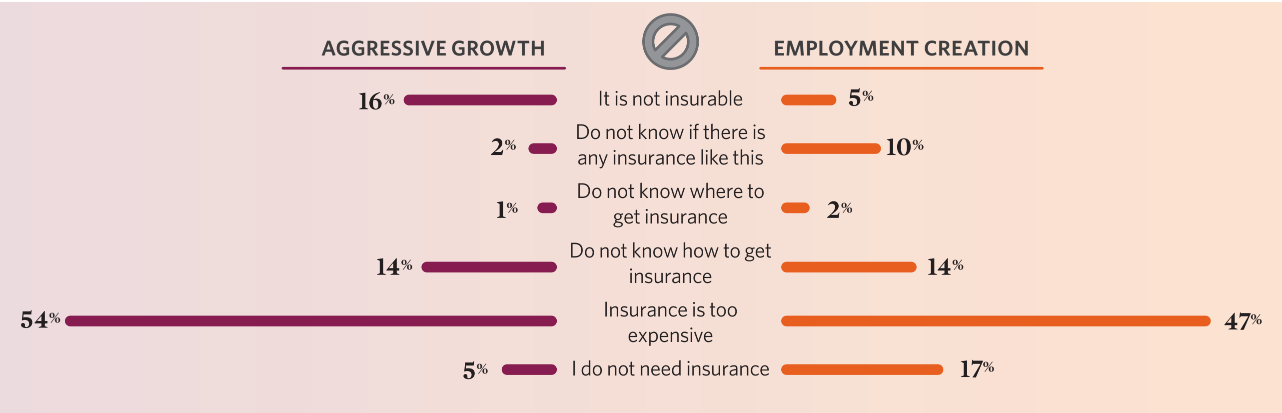


Figure 59: Main risks faced by businesses | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

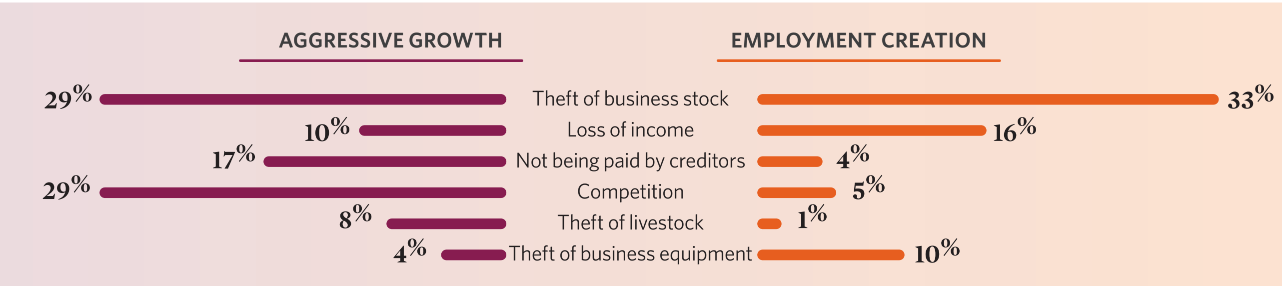


FIGURE 60: Digital payments uptake | *Source: FMT, Malawi FinScope MSME Survey report, 2019*

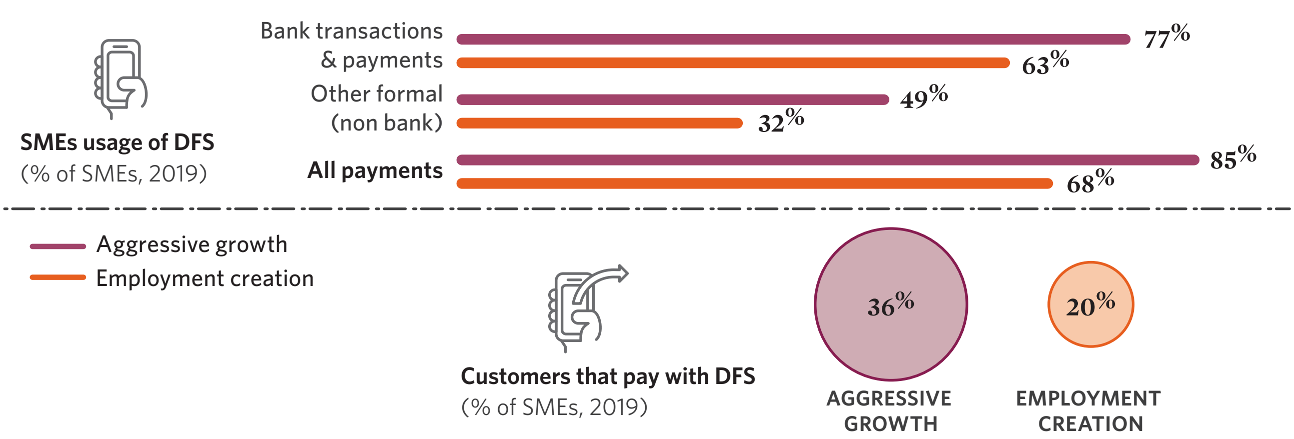
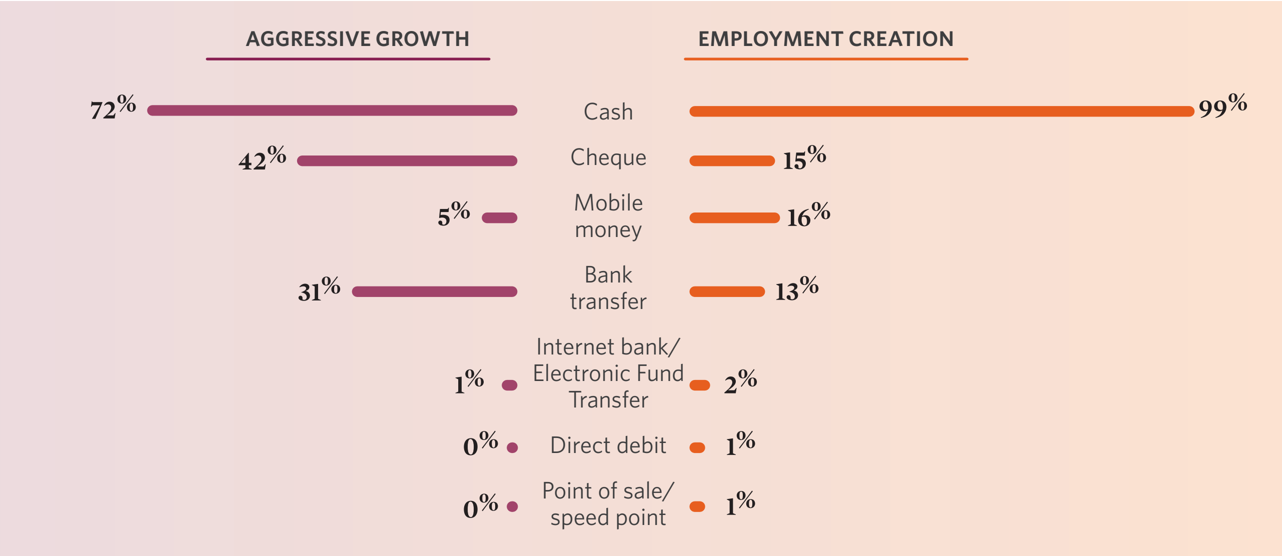


Figure 61: Payment methods used by customers | (% split, 2019) | *Source: FMT, Malawi FinScope MSME Survey report, 2019*



businesses at 99 per cent (i.e. 29,005 businesses). Aggressive-growth businesses further reported that 42 per cent (i.e. 2,334) of businesses received payment in cheque and 31 per cent (i.e. 1,723) of businesses received payment through bank transfer. Employment-generation businesses reported higher acceptance of mobile money payments at 16 per cent (i.e. 4,688). Together, these emphasise the difference in the type of customers that the different segments serve; with aggressive-growth businesses servicing a larger proportion of other businesses as customers and employment-generation businesses having a higher proportion of private individuals (retail), as customers. This suggests there is a need to support the general public in increasing its usage of DFS, which will in turn support businesses increased use of DFS.

Key takeaways

1. Formal financial access to the target group is more than double that of all MSMEs. Formal non-bank providers make up the largest proportion of financial access for the target market.
2. The target segments lack depth in financial inclusion; where a selection of businesses exhibits a higher than average access to formal credit, savings and/or investment and insurance, while the majority of the businesses still face no access.
3. MSMEs have a poor perception of banks, with those not banked perceiving banks as not being interested in extending products and services to them. This is a particular deterrent to women-led and youth-led businesses and start-ups for credit.
4. The businesses also acknowledge they lack adequate credit histories, financial records and business plans, identifying the need for further financial management training.
5. Majority of the credit is used to grow businesses and for day to day needs. Aggressive-growth businesses additionally use credit to purchase equipment and upgrade their business facilities. Employment-generation businesses alternatively, also use credit to purchase property.
6. SACCOs and VSLAs provide easier access to finance, particularly for women- and youth-led businesses. The product offerings are however limited by the tenure of loans and loan amounts.
7. Government and donor agency credit products have limited scale.
8. There is a limited understanding and knowledge of alternative forms of finance, PPSR, and CRBs, among businesses. This suggests the need for each provider to have continued consumer awareness campaigns.
9. Aggressive-growth businesses primarily utilise their savings and/or investments to expand their businesses, while employment-generation businesses primarily save for emergencies.
10. Aggressive-growth businesses primarily utilise their savings and/or investments to expand their businesses, while employment-generation businesses primarily save for emergencies. This suggests aggressive-growth businesses are focused on expanding and growing their businesses while employment-generation businesses are content with maintaining their operations and protecting themselves from any emergencies.
11. The barriers to uptake of insurance relate to the suitability of products, to the main risks faced by businesses, and the high costs of services.
12. Uptake of digital forms of payment among the target segments is higher than that of overall MSMEs.
13. Aggressive-growth businesses reported a higher proportion of customers paying them in DFS and is likely attributed to their higher proportion of other businesses as customers. Employment-generation businesses reported higher acceptance of cash and mobile money, also reflecting their retail clients.

5.4.4. Conclusion – target market overview

A summary of the key characteristics of both target segments are provided in Table 19:

Characteristic	Aggressive-growth	Employment-generation
Segmentation	• Personal income is above the median. • The business has employees. • The business views itself to be growing or stable in the past year.	
	• Industrialisation driving SMEs in sectors such as agriculture, manufacturing, business services and construction.	• Labour-intensive sectors such as tourism, community and household and wholesale and retail trade.
Size	• 5,557 i.e. 0.5% of overall MSMEs.	• 29,298 i.e. 2.6% of overall MSMEs.
Sectoral split	• Agriculture - 48%. • Business services - 31%. • Manufacturing - 18%. • Construction - 3%.	• Wholesale and retail trade - 58%. • Community and household - 25%. • Agro-processing - 4%. • Natural resources and mining - 2%.
Owner characteristics	• There is a high gender imbalance with only 9% of female-led businesses. • 81% of owners are aged 35 years and above. • 41% of owners have attained a higher than secondary school education.	• There is a high gender imbalance with only 10% of female-led businesses. • 76% of owners are aged 35 years and above. • 25% of owners have attained a higher than secondary school education.
Business characteristics	• 58% in urban and 42% rural. • 67% registered or licensed. • 9% are start-ups, 25% growth, 10% established and 55% mature. • Began operations to be their own boss, make more money and saw an opportunity. • More pessimistic about business prospects suggesting this relates to the challenges of industrialisation.	• 78% in urban and 22% rural. • 71% registered or licensed. • 18% are start-ups, 19% growth, 15% established and 48% mature. • Began operations to make more money, saw an opportunity and to be their own boss. • More optimistic about business prospects.
Operational considerations	• High access to cell phones and electricity. • SMEs predominantly operate mainly out of residential premises and designated stalls - reflecting the industrialisation focus. • Have a more diverse customer base ranging from individuals to small and large businesses. • Offers customers credit marginally more than employment generation. • Rely on both walk-ins and references or recommendations. • There is limited use of formal marketing other than word of mouth. • Employee wages and input costs are the main business costs. • The main sources of capital are informal. • Rely on word of mouth as the main form of marketing.	• High access to cell phones and electricity. • SMEs predominantly operate from designated stalls and on streets and pavements - reflecting the retail focus. • Have a more retail and small business customer base. • Offers customers credit marginally less than aggressive growth. • Rely on walk-ins, repeat business and references/recommendations. • Word of mouth and signage are the main forms of marketing used. • Employee wages, input costs and rental costs are the main business costs. • Main sources of capital are informal. • Rely on word of mouth as the main form of marketing.

Characteristic	Aggressive-growth	Employment-generation
BDS	• Aware of BDS offered but limited uptake. • BDS mainly used for employee management. • 92% keep financial records, but some of those do not understand the value in doing so. • A third of non-registered businesses were in the process of registering. Others felt they were either too small or did not know how to register. • Workman's compliance and Value Added Tax (VAT) are the main forms of compliance. • Low compliance for national pension fund. • BDS demanded vs actual uptake implies there is a mismatch in the market.	• Aware of BDS offered but limited uptake. • Mainly used for technical training. • 80% keep financial records, but even those that do believe that that need to. • Businesses not registered felt they were too small. • VAT and municipality tax are the main forms of compliance. • Low compliance for national pension fund. • BDS demanded vs actual uptake implies there is a mismatch in the market.
Overall financial services	• 93% of formal financial access. • Formal non-bank financial services providers were the most used followed by banks. • The moderate use of informal financial service providers suggests the potential use of agriculture networks. • Majority of the non-banked felt they did not need one or did not have a business address.	• 94% of formal financial access. • Formal non-bank financial services providers were the most used followed by banks. • Majority of those not banked were intending to do so in the future.
Credit/finance	• 33% borrow from banks, and 12% from informal sources only. • More mature businesses borrowed more. • Credit is mainly used for growing businesses and day-to-day needs. In addition, it is used for buying machinery and upgrading business facilities - suggesting a desire to grow their businesses. • Source start-up capital from other businesses, savings, salaries and friends. • 54% do not borrow because they felt business was slow, did not need to and had borrowed previously. • Limited knowledge of alternative sources of finance.	• 21% borrow from banks, and 7% from informal sources only. • More mature businesses borrowed less. • Credit is mainly used for growing businesses and day to day needs. In addition, used to purchase property. • Source start-up capital from other businesses, savings and salary. • 68% do not borrow because they reported not needing to. • Limited knowledge of alternative sources of finance.
Savings/ investments	• 27% save at banks, and 13% at informal providers only. • More mature businesses save more. • Save more with informal providers such as VSLAs as they are linked to credit provision. • Primarily utilise savings to expand their businesses. • 50% that do not save because they do not make enough to save and they put back what they make into the business.	• 12% save at banks and 9% at informal providers only. • More mature businesses save less. • Save more with informal providers such as VSLAs as they are linked to credit provision. • Primarily save for emergencies. • 74% that don't save because they put back what they make into the business

Characteristic	Aggressive-growth	Employment-generation
Insurance	• 39% formally insured. • As the business matures the more they are insured. • 61% who are not insured find the costs prohibitive and that the products are not aligned to their risks. • Main risks faced are theft of business stock and competition.	• 37% formally insured. • As the business matures the more they are insured. • 63% who are not insured find the cost prohibitive and do not know how to get insurance. • Main risks faced are theft of business stock and loss of income.
Payments	• 85% use DFS. Attributed to more customers paying with DFS. • Cash, cheque and bank transfers are the main modes through which customers make a payment - aligned to more business customers.	• 68% use DFS. • Cash and mobile money are the main modes through which customers make a payment - aligned to the retail focus of the segment.

Table 20 lists identified needs synthesised from the target market findings.

TABLE 20: Identified needs

Identified need	Motivation	Agg. growth	Empl. gen.	Providers	GoM
BDS on starting a business including financial management training, developing business plans and how to register businesses (basic for start-ups).	Poor financial record keeping and low levels of compliance.				
BDS on advanced business skills such as staff management, quality control, marketing, business management and business innovation (advanced for growing businesses).	Challenges faced in industrialising, limited usage of formal marketing services and a high reliance on walk-ins.				
BDS on technical training.	Challenges faced in industrialising and to remain competitive.				
BDS on technology and social media platforms.	Limited usage of marketing services and a high reliance on walk-ins.				
Awareness of CRBs and PPSR.	Limited knowledge.				
Start-up financing or capital.	Limited uptake of FSP financing for capital and limited knowledge of alternative forms of finance.				
Working capital financing such as trade financing.	Limited usage of working capital financing.				
Asset financing.	Limited usage and knowledge of alternative forms of finance.				
Traditional insurance products.	Low uptake of insurance against fraud.				
Design new forms of insurance products such as weather and climate change.	Current products not aligned to main risks of businesses.				
Formal savings/investment products with potential linkages to credit products.	Relatively low uptake.				
Improve messaging or marketing of relevant products to SMEs (formal FSPs).	Businesses have poor perceptions of their eligibility to be served by formal FSPs.				
Develop more robust risk management and credit scoring capabilities.	Limited uptake of financial products for SMEs.				
Increase scale and awareness of product offerings (for Government and donor providers).	No reported usage of GoM and donor financing products from FinScope.				
Improved coordination of SME support programmes.					
Assessment of the business and tax compliance regime to identify and address gaps that discourage SMEs from formalising.					

SECTION 6

TOWARDS AN SME ROADMAP FOR MALAWI

Based on the preceding analysis of the Malawian context, the regulatory framework, supply-side analysis and target-segment insights, this section of the report develops priorities and recommendations to be developed into
a roadmap.

6.1. Priorities and recommendations

The areas that are likely to have the most impact on the target SME groups given the nature of the identified needs and the country context are as follows:

6.1.1 Enhanced access to finance for SMEs
- Develop tailored products and services for priority sectors

6.1.2 Promote access to markets
- Support value chain linkages and linkages to buyers

6.1.3 Develop SME capacity and support formalisation
- Strengthen BDS
- Streamline formalisation and compliance

6.1.4 Target Government policy towards priority sectors
- Focus the MSME Policy and other Government strategies on priority sectors

The priority areas are:

6.1.1 Enhanced access to finance for SMEs

Develop tailored products and services for priority sectors

RATIONALE

Formal lending to SMEs in Malawi remains limited because FSPs perceive SMEs as too risky. This is attributed to their simplified credit scoring and risk management frameworks that rely on manual processes and traditional collateral to secure credit. Businesses, equally, have come to perceive these biases and opt to refrain from approaching formal FSPs for services, believing they do not meet the eligibility criteria.

FSPs often lack the technical capabilities and appetite to develop suitable frameworks and models. Considering the scale that these formal providers may be able to offer, government agencies and donors may continue to offer capacity building to FSPs in order to nudge them towards enhancing their coverage of the target segments.

OPPORTUNITY

To develop tailored products and services for priority sectors, the following implementation actions could be taken:

- Promote grant, equity, and concessional debt funding to start-up and growing agricultural producers and processors from DFIs, impact investors, private equity and venture capital firms, angel investors, and donor organisations.

- Grow asset financing from banks and MFIs to established and mature agricultural SMEs by de-risking lending through strengthening the PPSR, credit information sharing, WRS, and offering partial credit guarantee schemes. These efforts will require the reviewing of the PPSR to improve customer experience; cleaning the data within CRBs and including non-credit information such as utility providers and government payments to increase the richness of data; and reviewing the efficacy of a single WRS and the potential merging of the two commodity exchanges (comexes).

- Develop an online platform that links SMEs to funders and BDS providers that can help package small ticket-size deals. To achieve this, a refresh of the BDS directory (2015 Directory of Micro Small and Medium Enterprises Support Providers), will need to be carried out to update the list of BDS providers and potential funders. Similarly, adequate market sensitisation will need to be carried out to ensure consumers are aware of the website.

- Grow working capital and revolving credit facilities for wholesale and retail SMEs to shield cash-flow challenges and enable expansion.
- Develop credit scoring models that harness alternative data sources such as mobile money transaction data.
- Digitise SME cashflows by promoting payment interoperability and merchant acquisition.
- Develop weather-index insurance products by leveraging satellite imagery to circumvent the lack of automated weather stations.
- Consider partnerships with SACCOs and farmer groups to leverage the group lending model to extend credit.
- Develop financial products that offer off-grid pay-as-you-go solar solutions.
- Consider developing a wholesale lending model for the MFI sector. This will require a detailed analysis of the current funding gaps experienced by MFIs, and international best practices on the structure of the lending model prior to its roll out.

6.1.2. Promote access to markets

Support value chain linkages and linkages to buyers.

RATIONALE

Access to markets remains a key challenge faced by SMEs in Malawi. This is highlighted by a large number of SMEs identifying that they lack enough customers and have too many competitors.

OPPORTUNITY

In addressing this challenge, both a sectoral focus as well as an overall enhancement of the operating landscape is required:

- Establishing agricultural SME supplier development programmes working with large retailers and large tourism companies
- Supporting certification, packaging, marketing, and market exploration within the priority value chain producers to expand local and international reach. This would involve reviewing the operations of the MBS, identify key pain points and actionable areas to enhance internal capacity of the MBS.
- Donors and Government should support investment in telecommunication infrastructure as a strategic necessity to increase ICT adoption in an effort to grow online marketing and e-commerce in the agriculture, wholesale and retail, and tourism sectors.

6.1.3. Develop SME capacity and support formalisation

Strengthen BDS.

RATIONALE

The vast majority of the high-impact SMEs in Malawi are aware of BDS, but do not make use of their services. This is despite findings that suggest SMEs have a lack of financial management skills, limited access to markets, and a lack of technical training.

The BDS generally offered to SMEs in Malawi did not match their needs. This highlights the need for a more effective and appropriately tailored BDS system in Malawi. It requires coordinated efforts from BDS providers to ensure the right support is being provided and adequate resources are allocated to reach SMEs.

OPPORTUNITY

Opportunities for developing BDS lie in developing more targeted and adequately resourced providers to deliver technical expertise in all areas of provision. In particular, there is an opportunity to develop a more focused service offering which is tailored to delivering support to high-impact SMEs across the maturity spectrum. This can be achieved through:

- Developing training in financial management and reporting, developing business plans and strategies, and assistance with how to formalise for start-up and growing enterprises. Services should also focus on supporting women- and youth-owned businesses, given their challenges in growing from micro and small to larger businesses.
- Developing specialised BDS services to improve productivity in the agricultural sector, and evolution towards agri-processing
- Impacting investors, DFIs, angel investors, banks and MFIs to work closely with BDS providers to source potential SME clients to invest in.

Streamline formalisation and compliance.

RATIONALE

The majority of MSMEs (i.e. 89% of total MSMEs) are informal. Furthermore, most women- and youth-owned businesses are not aware of the process or the importance of formalising. Streamlining of the process of formalisation, and compliance, will work towards easing the process for SMEs and improving the business operating landscape in Malawi.

OPPORTUNITY

Opportunities for streamlining formalisation and compliance include:

- Strengthening the Malawi Investment and Trade Centre's (MITC's), One Stop Service Centre (OSSC) offering on business registration, tax compliance, licencing, and certification for local and international businesses. Carry out market sensitisation on requirements for formalisation and services provided by OSSC
- Developing an online platform for the OSSC to make it more convenient and also easier for remotely located SMEs to access services.

6.1.4. Target Government policy towards priority sectors

Focus the MSME policy and other Government strategies on priority sectors.

RATIONALE

Malawi has 16 different regulations and policies at varying stages of implementation that either directly or indirectly affect MSMEs and their operating landscape. This includes the MSME Policy, 2018. Though these cover a large range of sectors, further focus on priority sectors is required to ensure impact.

OPPORTUNITY

This can be achieved through the following opportunities:

- Reviewing existing data and conducting additional deep dives into the structure and gaps prevailing in the key value chains
- Reviewing input supply models being applied and exploring opportunities for Government's Farm Input Subsidy Programme (FISP) to work with aggregators, processors, and other value chain actors to provide inputs and extension services
- Implementing, monitoring, and reporting on Public Procurement and Disposal of Public Assets policy to ensure 60 per cent of Government procurement is from Malawian SMEs. The policy should be expanded to set specific targets for women- and youth-owned businesses.
- Creating a dashboard to track the implementation of the MSME policy. This is aimed at strengthening the coordination between key implementing stakeholders by providing clear and frequent updates on the status of implementation.

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APPENDIX

List of stakeholders consulted

#	Institution category	Institution
1	Government agencies	Ministry of Finance, Economic Planning and Development
2	Government agencies	Reserve Bank of Malawi (RBM)
3	Government agencies	Ministry of Industry, Trade and Tourism
4	Government agencies	Ministry of Agriculture, Irrigation and Water Development
5	Government agencies	Small and Medium Enterprise Development Institute (SMEDI)
6	Government agencies	Personal Property Security Registry (PPSR)
7	Industry associations	Bankers Association of Malawi (BAM)
8	Industry associations	Malawi Microfinance Network
9	Industry associations	Malawi Confederation of Chambers of Commerce and Industry (MCCCI)
10	Industry associations	National Association of Small and Medium Entrepreneurs (NASME)
11	Industry associations	National Smallholder Farmers' Association of Malawi (NASFAM)
12	Industry associations	Chamber of Small and Medium Enterprises
13	Industry associations	National Cooperative Business Association (NCBA) CLUSA
14	Donor agencies	European Union (EU)
15	Donor agencies	The World Bank Group (WBG)
16	Donor agencies	DFID Malawi
17	Donor agencies	UNDP Malawi
18	Donor agencies	Care International Malawi
19	Donor agencies	Land O Lakes
20	Donor agencies	Microloan Foundation
21	Donor agencies	Feed the Future Agriculture Diversification Activity - USAID
22	Donor agencies	World Relief
23	Financial service provider	Standard Bank Malawi
24	Financial service provider	National Bank of Malawi
25	Financial service provider	FINCA Ltd
26	Financial service provider	Airtel
27	Financial service provider	Credit Data CRB
28	Financial service provider	NICO General Insurance
29	Financial service provider	COMSIP Cooperative Union Limited
30	Financial service provider	Malawi Union of Savings and Credit Cooperatives (MUSCCO)
31	Private sector players	Malawi Mangoes
32	Private sector players	Ilovo Sugar