

FinScope
Malawi
2019

Micro, Small and Medium Enterprise (MSME) Survey



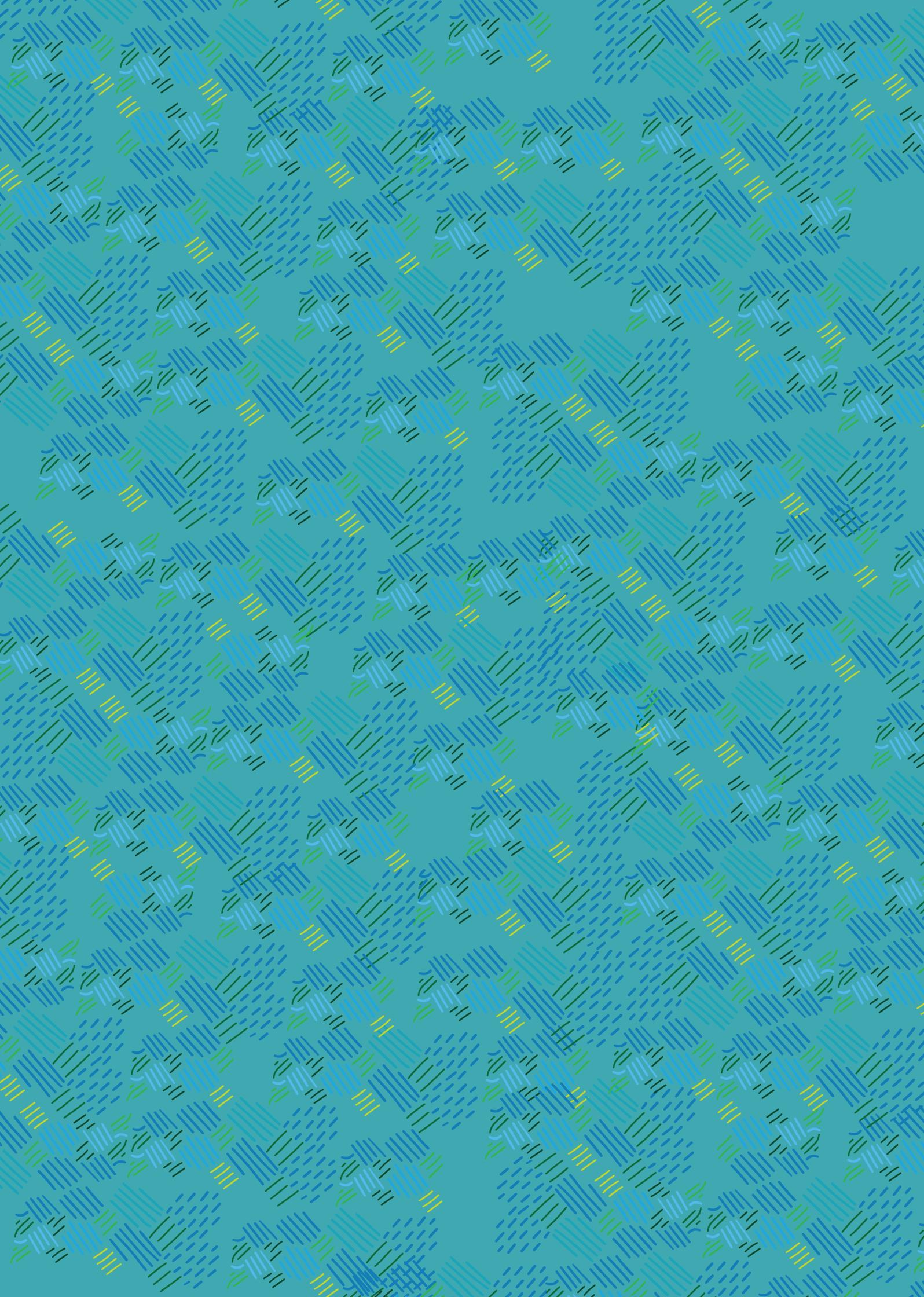


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ACRONYMS AND ABBREVIATIONS

BAM	Bankers Association of Malawi
COMESA	Common Market for Eastern and Southern Africa
COMSIP	Community Savings and Investment Promotion
DEMAT	Development of Malawian Enterprises Trust
DFID	Department for International Development
EA	Enumeration Area
EUD	European Union Delegation
GDP	Gross Domestic Product
HDI	Human Development Index
IFAD	International Fund for Agricultural Development
ILO	International Labour Organisation
MBS	Malawi Bureau of Standards
MCCCI	Malawi Confederation of Chambers of Commerce and Industry
MEDI	Malawi Entrepreneurs Development Institute
MITT	Ministry of Industry, Trade and Tourism
MITC	Malawi Investment and Trade Centre
MoFEPD	Ministry of Finance, Economic Planning and Development
MSME	Micro, Small and Medium Enterprises
MRA	Malawi Revenue Authority
MMFIN	Malawi Microfinance Network
MUSCCO	Malawi Union of Savings and Credit Cooperatives,
NASME	National Association of Small and Medium Enterprise
NSO	National Statistics Office
PPS	Probability Proportional to Household Size
PSU	Primary Sampling Units
RG	Reference Group
RBM	Reserve Bank of Malawi
SEDOM	Small Enterprises Development Organisation of Malawi
SMEDI	Small and Medium Enterprise Development Institute
SME	Small and Medium Enterprise
SC	Steering Committee
TEVETA	Technical and Vocational Educational Training Authority
UNDP	United Nations Development Programme
UNDAF	United Nations Development Assistance Framework
WBG	World Bank Group

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FinScope MSME Malawi 2019 was designed to involve a range of stakeholders, engaging in a comprehensive consultative process, thereby enriching the survey and ensuring appropriateness and buy-in. We would like to thank all parties who participated in this project in their personal or institutional capacity. Without them, the project would not have been successful. The survey was carried out under the auspices of the Ministry of Finance, Economic Planning and Development (MoFEPD) and funded by the European Union, Department for International Development (DFID), United Nations Development Programme (UNDP) and the World Bank Group (WB).

The assignment was overseen by a steering committee, referred to as the Reference Group (RG), as part of the broader Making Access Possible MSME Malawi 2019 study.

The RG comprised representatives from various Government of Malawi ministries, donors, and other relevant institutions working with the MSME sector. The RG was chaired by the MoFEPD. Other members included the Reserve Bank of Malawi, National Statistical Office (NSO), National Association of Small and Medium Enterprise (NASME), Bankers Association, Malawi Microfinance Network, Ministry of Industry, Trade and Tourism, Malawi Union of Savings and Credit Cooperatives, Malawi Confederation of Chambers of Commerce and Industry (MCCCI), United Nations Development Programme, European Union, World Bank Group and the Department for International Development and Community Savings and Investment Promotion (COMSIP). The RG's mandate was to provide oversight and guidance for the duration of the survey. The UNCDF (MAP) also provided technical input and direction for the overall implementation of the study.

The National Statistical Office provided statistical oversight and quality control in data collection. FinMark Trust was responsible for overall project management and expert technical assistance throughout the many phases of the project. Imani Development was mandated to implement the fieldwork and data processing for the demand side FinScope MSME survey 2019. We thank their staff, including supervisors, coordinators and enumerators, as well as the office staff who worked tirelessly on this survey.

Last, but not least, we would like to acknowledge the MSME owners who availed their precious time and took part in the survey to give us insights into their businesses.

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GLOSSARY OF TERMS

TERM	DEFINITION
Access Strand	A measurement of financial inclusion across the formal-informal institutional provider continuum.
Adults	Those people aged 18 years or older.
Banked	Individuals using one or more traditional financial products supplied by commercial banks.
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	Demand-side barriers to access financial services relate to characteristics inherent to individuals that prevent them from using financial services such as perceived insufficient income, low levels of financial literacy and lack of trust in financial institutions.
Enumeration Area (EA)	An enumeration area (EA) is a well identified territorial unit containing the prescribed population size (usually about 80 to 120 households) in which enumeration is to be carried out by a single enumerator within a specified period of enumeration.
Other formal	Financial products/services supplied by formal financial institutions, which are not banks.
Formal products	Products provided by government regulated financial institutions such as 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.
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	MSME owners using one or more formal and/or informal financial products/services.
Financially excluded	MSME owners who are not using any formal or informal financial products/services.
Financially inclusion	The extent to which the MSME owners in the country engages with financial products and services, such as savings, transaction banking, credit and insurance, whether formal or informal.
Informal products	Financial services provided by individuals and/or associations, which are not regulated by government such as savings clubs and private moneylenders.
Informally only served	MSME owners who are not using any formal financial products but who are using one or more financial products/services supplied from an informal source, such as a savings club or informal moneylender.
Informally served	MSME owners who make use of informal financial products (regardless of whether or not they use formal financial services and products).
MSME	Micro, Small and Medium Enterprises (MSME) are defined by the number of employees (according to the Malawi MSME Policy of 2019) who employ less than 100 employees and an annual turnover of up to K500 million. For the purposes of the study, number of employees and turnover were used to segment the sector from micro, small and medium.
Insurance	Payment of a premium for risk of an event happening, where pay-out is made if or when the event occurs.
Supply-side barriers	Supply-side barriers to access to financial services relate to factors inherent to financial service providers that prevent individuals from using their services such as location of access points and the cost of using their services. Supply-side barriers could also relate to macroeconomic factors such as legal systems and policy.
Transactional	Financial services that use cash or other means (such as cheques, credit cards, debit cards or other electronic means) to send, make or receive payments.
Formal MSME	MSME owners that have either registered their business with an authority such as the Ministry of Industry Trade and Tourism or have a license to operate from an authority such as the District Council, City Council and municipality.



EXECUTIVE SUMMARY

The Government of Malawi (GoM) has been working towards the development of the Micro, Small and Medium Enterprises (MSME) sector. In a bid to boost economic growth, reduce poverty, and support decent job creation, the GoM has designated the private sector as an engine for the country's economic growth and poverty alleviation. This is evident in all GoM economic policy documents, such as the Malawi Growth and Development Strategy (MGDS III) 2017-2022, the Micro, Small and Medium Enterprises (MSME) Policy 2019, the National Industrial Policy, the National Trade Policy, the National Export Strategy, and the National Employment and Labour Policy. It is also apparent in sectoral policies, such as the National Agricultural Policy, the Financial Sector Development Strategy and the National Financial Inclusion Strategy, amongst others. In 2019, in an attempt to spur access to finance for MSMEs, the GoM launched the Malawi Agriculture and Industrial Investment Corporation (MAIIC) as a development bank.

Thus, in trying to understand and unlock the full potential of the sector, a FinScope MSME survey was conducted between March and May of 2019. The main objective was to size and scope the MSMEs in Malawi while describing their levels of access to financial products and services (both formal and informal). The study also attempted to identify the most binding constraints to MSME development with a focus on access to financial markets. The study segmented the MSME sector into different categories, primarily the high-impact small and medium enterprises (SMEs), to identify the needs of key segments and develop recommendations for the promotion of growth and employment.

This report is prepared to provide insight into the Malawi MSME sector using the FinScope Malawi MSME 2019 survey. This will aid stakeholders in understanding the characteristics of MSMEs and serve as a tracking study to the FinScope MSME 2012 survey. The report used graphical analysis to profile MSME owners, the characteristics of their businesses and the operational challenges they face, and provide a comparison to the 2012 survey. Although a myriad of studies exist concerning the sector, few, if any, have been developed to accurately capture the informal businesses that dominate the MSME sector nor to size the universe of the MSME sector in a globally recognised manner.

The following useful insights have been gained:

- MSME owners and livelihoods:** The overall Malawi MSME sector is estimated to consist of 1,141,784 business owners, marking an increase of around 50 per cent from 758,118 in 2012. There are slightly more male business owners 583,694 (51 per cent) than female business owners 558,090 (49 per cent) showing a 3-percentage point increase in females from 2012. About 11 per cent of the population own MSMEs and employ approximately 1,825,219 people from 1,260,530 in 2012. This shows growth in not only full-time employment but a 68 per cent overall growth of the sector in providing employment compared to 2012. The analysis shows that MSMEs in Malawi contribute a significant share of employment within the total labour force (24 per cent). Looking at livelihoods, about 21 per cent of the Malawian adult population derives their livelihood from the MSME sector.

MSMEs in Malawi contribute a significant share of employment within the country's total labour force (24 per cent).

- **About 42 per cent of MSME business owners in Malawi are below 35 years of age.** The large majority of MSMEs (78 per cent) are in rural areas, with Central Region (50 per cent) holding more MSMEs than Southern Region (38 per cent) and Northern Region (12 per cent). Expectedly, more small and medium enterprises are located in Southern Region. About 59 per cent derive their main income from their businesses. The educational attainments of Malawi MSME business owners are mostly low, with 37 per cent having a secondary education qualification or higher. Looking at business abilities, 48 per cent taught themselves the skills required to manage a business, with 29 per cent indicating they were trained by family (other than a spouse) or advisors before venturing into the trade.

- **The MSME sector: Findings indicate that in 2019 there were almost 1.6 million MSMEs in Malawi (1,600,739).** The fact that there are far fewer business owners (1,141,784) indicates that some own more than one business. The average number of people employed per enterprise in the sector is two adults, equating to 367,457 full-time employees. When adding part-time and seasonal employees as well as entrepreneurs, nearly two million in total (1,825,219) are employed by the sector. The findings show that, although a lower proportion of MSME owners are employers in 2019 (12 per cent compared to 41 per cent in 2012) this is likely attributed to improvements in the methodology. A higher number of employees have been absorbed by the sector since 2012 (135,000 full-time, up by around 170%). This implies fewer employer MSMEs in 2019 but a higher employment rate.

- **The majority of MSMEs in Malawi are very small.** About three in four enterprises (74 per cent) are micro-enterprises, 23 per cent are small enterprises and only 3 per cent are medium enterprises. Women own the largest proportion of micro-enterprises at 84 per cent. Given that the majority of MSMEs are micro-businesses, the turnover is relatively low with 32 per cent of MSMEs falling into the micro-turnover category (less than K5 million per year) with a yearly average of USD5,957. On average, micro-enterprises are making a loss annually. However, using just turnover to segment between micro to medium enterprises, 60 per cent of MSMEs in Malawi would fall into the micro turnover category with an average of USD2,034.

- **The sector generates revenue of approximately USD15.8 billion (2019).** Considering this cumulative of revenue of all MSMEs a deduction of expenses is required to understand value addition. This translated to about USD6.8 billion in value addition, which can loosely be coined as a contribution to Gross Domestic Product (GDP). With 11 per cent formal businesses in 2019, the contribution of formal MSMEs (likely already included in overall GDP) is USD3.6 billion (53 per cent of total MSME contribution) while the informal MSME contribution is USD3.2 billion (47 per cent of total MSME contribution). This indicates that informal MSMEs contribute significantly to the economy overall if formalised and added to the national GDP. According to 2019 estimates by the Ministry of Finance, this would equate to an additional 40 per cent

per cent of the estimated GDP of USD8.1 billion. Therefore, including informal MSMEs would increase the value of Malawi's economy to USD11.5 billion as of 2019.

- **The largest proportion of MSME business owners operate in the wholesale and retail sectors (64 per cent), i.e. they sell something, particularly agricultural outputs or fast-moving commodity goods.** Furthermore, 23 per cent conduct primary agricultural activities and 4 per cent render business services, e.g. professional services (accountant, lawyer, consultants) and 5 per cent offer community or household business, e.g. skilled services (hair salon, plumber, and gardening). The most common place of MSME business operations are either from a trading centre/market (25 per cent) or from their residential premises (24 per cent). The notable changes with 2012 within sectors, which may be attributed to the improvements in the sampling methodology since 2012.

Two thirds of MSME owners are women but most of them run independent enterprises (no employees).

- **Many of those businesses are in the start-up phase (3-5 years of existence).** The analysis implies that MSME firms are growing, not only through the expansion of existing firms but also via the birth of new firms. This is evident in the larger proportion of start-ups in 2019. There has been an increase of 11 percentage points in the proportion of start-ups compared to 2012, up to 34 per cent in 2019. The trend also shows a higher and more significant death rate of MSMEs as the proportion between two and five years old has dropped from 38 per cent to 27 per cent. This can, however, also be explained by more enterprises reaching the established-to-mature phases, up ten-percentage points from 2012 to 49 per cent in 2019. The start-up and growth phases require special attention with regards to expansion and support.

- **89 per cent of MSMEs trade informally, being neither registered nor licensed with the remaining 11 per cent being formal.** However, this is on a positive trajectory compared to 2012 when just 3 per cent were considered formal businesses. Only 7 per cent of MSMEs are registered by the Registrar of Companies and 10 per cent are licensed. Those surveyed cited their main reason for not registering as the business being too small. About 11 per cent of MSMEs are in compliance with income tax, 22 per cent municipality tax and 40 per cent Value Added Tax (VAT). Other studies suggest that the cost of registration is not the only barrier as MSMEs need to be told the benefits of registration, which include the ability to open a business account, obtain a loan and other business support services.

- **Nearly 80 per cent of MSME owners started a new business using their own savings.** While MSME owners primarily rely on their own capital, including salaries, the assistance of family and friends and the sale of assets are also a common source of funds. 10 per cent of MSMEs manage to access both formal and informal credit from other channels to start their businesses, including village savings and loan groups (VSLs) also known as Bank Mkhonde. This provides ground for the Government to strengthen financial inclusion initiatives.
- **Around 2 in 5 (42 per cent) MSMEs owners are classed as youth.** Young entrepreneurs below 35 years constitute 42 per cent of MSME business owners in Malawi, which shows the potential of the sector in job creation and alleviating youth unemployment. It also contributes to the Government's effort in promoting the economic empowerment of young people in Malawi. Young entrepreneurs may have limited business experience, leaving a gap for the Government to expand business support services to this group, particularly through incubation programmes. There is still a higher proportion of youth across the start-up and growth business life cycle stages compared to more senior business owners.
- **Women are more likely to own micro-enterprises and less likely to own small and medium firms.** Two-thirds of MSME owners are women but most of them run independent enterprises (no employees) and proportionately fewer women own high-impact SMEs (10 per cent). High-impact SMEs are a segment of the small and medium-size business category, using a group median income as a cut-off, and must be an employer. A higher proportion of women are likely to own a business in the start-up phase (61 per cent) rather than established (41 per cent) or mature (35 per cent). Proportionally, women entrepreneurs are more likely to have started a business as additional income and to provide for their families compared to men entrepreneurs. Their motivation is less about seeing an opportunity or being their own boss compared to men entrepreneurs. This calls for the provision of training programmes tailored to women MSME owners to assist them in growing their businesses, particularly in the start-up phase.
- **Recommendations include policy revision with a focus on industrialisation and a deeper understanding of the business environment.** It is recommended that an awareness strategy should be developed linking the importance of formalisation with other benefits such as access to financial institutions. The BESTAP World Bank project study found that registration on its own delivers no measurable benefits to firms as MSMEs do not experience smoother operations, nor does it increase their trust in government (and other) institutions. There seems to be another compounding issue at hand: imperfect information. Qualitative research found that the reason more women-owned businesses were classed as micro-enterprises is that many women entrepreneurs chose businesses that hold more certainty requiring minimal funds and low or no employees but with the caveat of lower returns. One in five employers is a women-owned enterprise. Thus, it indicates an aversion to formalisation and the possibility that compliance issues deter business growth rather than promoting it.
- **Business registration should provide value to businesses in the form of tangible and clearly evident benefits.** Some business owners do not see value in formalisation as it becomes a tedious task to access and the benefits are not made clear. Likewise, formal businesses should not view informal outfits as 'better-off'. The advantages of formalisation, such as access to business support, markets and finance, should sell formalisation as a platform to growth and sustainability of the business. Governments seeking to increase economic growth should aim to reduce costs associated with registration and couple it with interventions that increase direct contact with formal financial institutions.
- **The MSME sector is constrained by a number of factors that are a part of the economic environment.** These include supply-side and infrastructural constraints, such as energy and water supplies, that limit the potential of growth in the economy. Additionally, essentials such as better transport infrastructure (roads, railway and air transport) and logistics, tax incentives to MSMEs, knowledge networks, supportive financing and banking facilities, and more investments in mechanised farming and agro-processing are needed. Increasing the growth rate will require a combination of deep structural reforms and a number of medium-term investments to lower the cost of doing business in Malawi.
- **Businesses in the MSME sector that enjoy financial inclusion increased by 33 percentage points, with formal access up by 23 points since 2012.** The main drivers of access to financial products, particularly formal, were mobile money, SACCOs and MFIs. While banking access grew by just 2 percentage points, from 22 per cent to 24 per cent, there was an increase in absolute banked MSMEs, from 170,000 in 2012 to 276,000 in 2019. There was notable growth in businesses using informal financial services.
- **The main barriers to financial service inclusion are high transaction expenses** (particularly banking and mobile money fees), low financial literacy, cost of travel to financial services providers, lack of identification, ill-suited financial product offerings, limited income, and unavailability or insufficient loan collateral, amongst others. The current service provision and need present a gap in accessibility, which makes financial services expensive, if accessed at all.
- **Other recommendations include value chain analyses and improving awareness of the business support and infrastructure available to MSMEs.** Developing innovative products that are tailored to the predominantly cash-driven economy within which MSMEs operate also promotes the transition to the digitisation of value chains.

SECTION 1

INTRODUCTION

The Government of Malawi has placed considerable emphasis on the Micro, Small and Medium Enterprises (MSME) sector, recognising its crucial contribution towards economic growth, job creation and poverty alleviation. The Government has recently developed the MSME Policy (2019) to replace the 1998 policy. This MSME policy aims to create a modern and effective framework that will guide the development of vibrant, competitive and sustainable MSMEs in Malawi. A thorough analysis of the country's MSME sector was conducted in 2011 and 2012 and involved a series of broad and in-depth consultations with key stakeholders, including government ministries, departments and parastatals, business associations, civil society, development and cooperating partners, as well as entrepreneurs across the country. That analysis will be used to inform the framework. The policy review was based on a comprehensive analysis of government, private sector and development partner initiatives. It also examined the latest MSME policies in several developing countries within the Southern Africa Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA) regions.

The new MSME Policy is intended to guide government and private sector interventions in enterprise development, acting as a springboard for the economic advancement of the country. The policy has been designed to provide opportunities to MSMEs in accessing of markets, affordable finance, business support services and other assistance services to develop a more competitive and diversified MSME sector. Development of the sector is an essential

part of the MSME Policy and facilitating small business access to finance (using alternative financing schemes) forms part of the Micro Finance Policy, Financial Sector Development Implementation Plan and National Strategy for Financial Inclusion. To understand and unlock the full potential of the sector, a 2019 FinScope MSME survey was conducted. That survey was integral to verifying the size and scope of the MSME landscape in Malawi and the levels of access to financial products and services (formal and informal).

This study also attempted to find the most binding constraints to MSME development. The focus here was on access to financial markets as well as sectioning the MSME sector into different segments to identify the needs of each segment and form recommendations for their development. This allows targeted interventions to be created with each segment's needs in mind.

This report presents the Malawi MSME sector by reviewing its function in economic growth and poverty reduction through its role as a livelihood source and contributor to the broader economy. The legal and institutional framework required to ensure a sustainable MSME sector has been highlighted based on a review of strategic documents prepared by various government departments. The demographic profile of MSME owners, as well as the profile of businesses and financial access, are presented based on the 2019 FinScope MSME survey.

This report places particular emphasis on well-established SMEs to draw policy attention to a category that can transform the broader sector if given the necessary

support. These have been referred to as high-impact SMEs. The study also attempts to identify the most binding constraints to MSME development with a focus on access to financial markets.

1.1 Methodology

The FinScope MSME Survey is a nationally representative study developed by FinMark Trust focusing on MSME owners and their financial service needs. The specific objectives of the survey are to:

- assess the size and scope of micro, small, and medium enterprises (MSMEs) in Malawi;
- describe the levels and landscape of access to financial products and services (both formal and informal), as well as track the level of financial access since 2012;
- identify the drivers and barriers to financial access for MSMEs;
- identify the most binding constraints to MSME development and growth with a focus on access to financial markets; and
- structure the MSME sector into market segments and identify the needs of each to stimulate related product innovation.

The FinScope MSME Malawi survey was designed to engage a broad range of stakeholders in a comprehensive and intensive consultative process. This aimed to enhance the survey

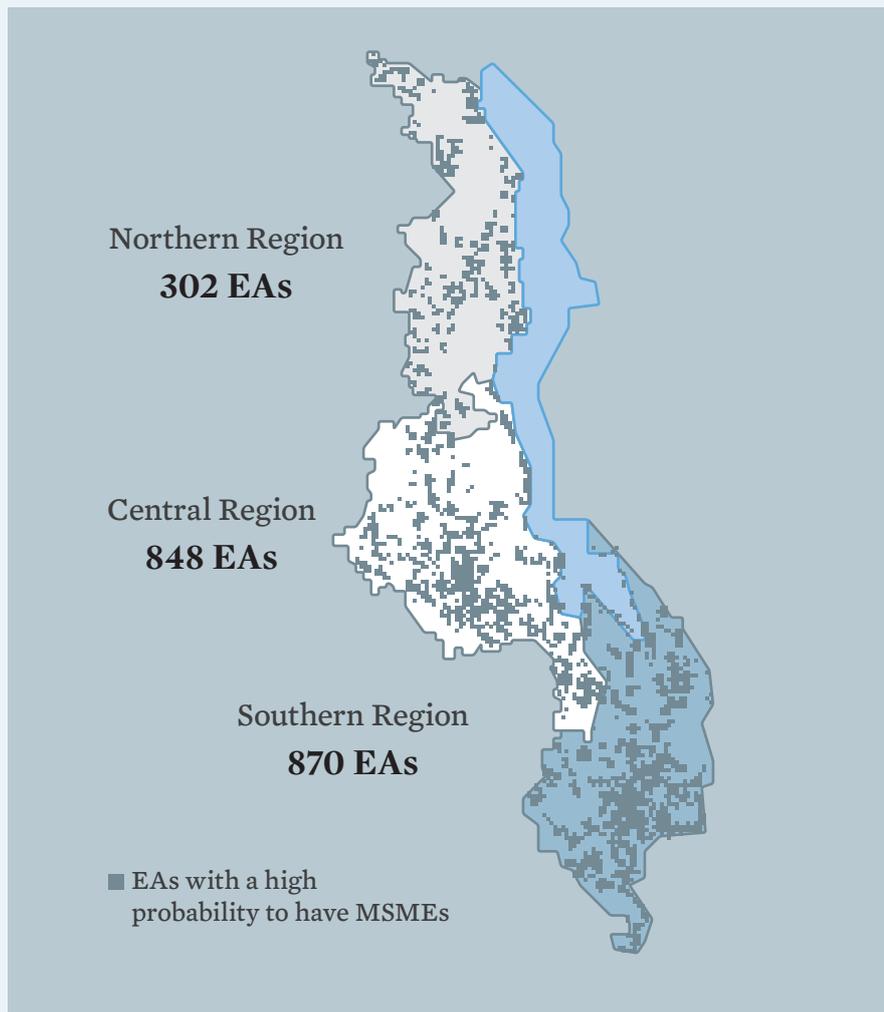
and ensure that the results contributed meaningfully to members who have a common interest in developing the sector. A Steering Committee (SC), referred to as the Reference Group (RG), was set up and chaired by the Ministry of Finance, Economic Planning and Development through the Pensions and Financial Sector Policy Division. The RG comprised representatives from FinMark Trust, Reserve Bank of Malawi, National Statistical Office (NSO), Malawi Microfinance Network, Community Savings and Investment Promotion (COMSIP), Ministry of Industry, Trade and Tourism (MoITT), Malawi Union of Savings and Credit Cooperatives (MUSCCO), United Nations Development Programme (UNDP), European Union (EU), World Bank Group (WBG), Department for International Development (DFID), among others. All stakeholders played an integral role in the design of the survey instruments and provided valuable insight into the sector and unpacking of the results.

The study further enjoyed a complementary qualitative research component of 6 focus groups following an analysis of the findings. These focus groups were women-led enterprises, youth, manufacturing, agro-processing, agriculture, high-impact SMEs and business support groups. These insights are incorporated into the report but a separate note is available from the focus group discussion findings.

1.2 Sampling

The initial FinScope MSME Malawi survey, conducted in 2012, was based on the first generation of FinScope methodology that relied largely on household sampling. With developments in Information Technology (IT) and geospatial data, newly available techniques employed globally enable us to sample a fragmented population group with no nationally known populations. This allowed the development of a third-generation sampling methodology, improving on that first applied in 2012. Most of the criteria used in sampling did not change but the basis for enumeration areas

FIGURE 1: Enumeration areas (EAs) with high probability to have MSMEs



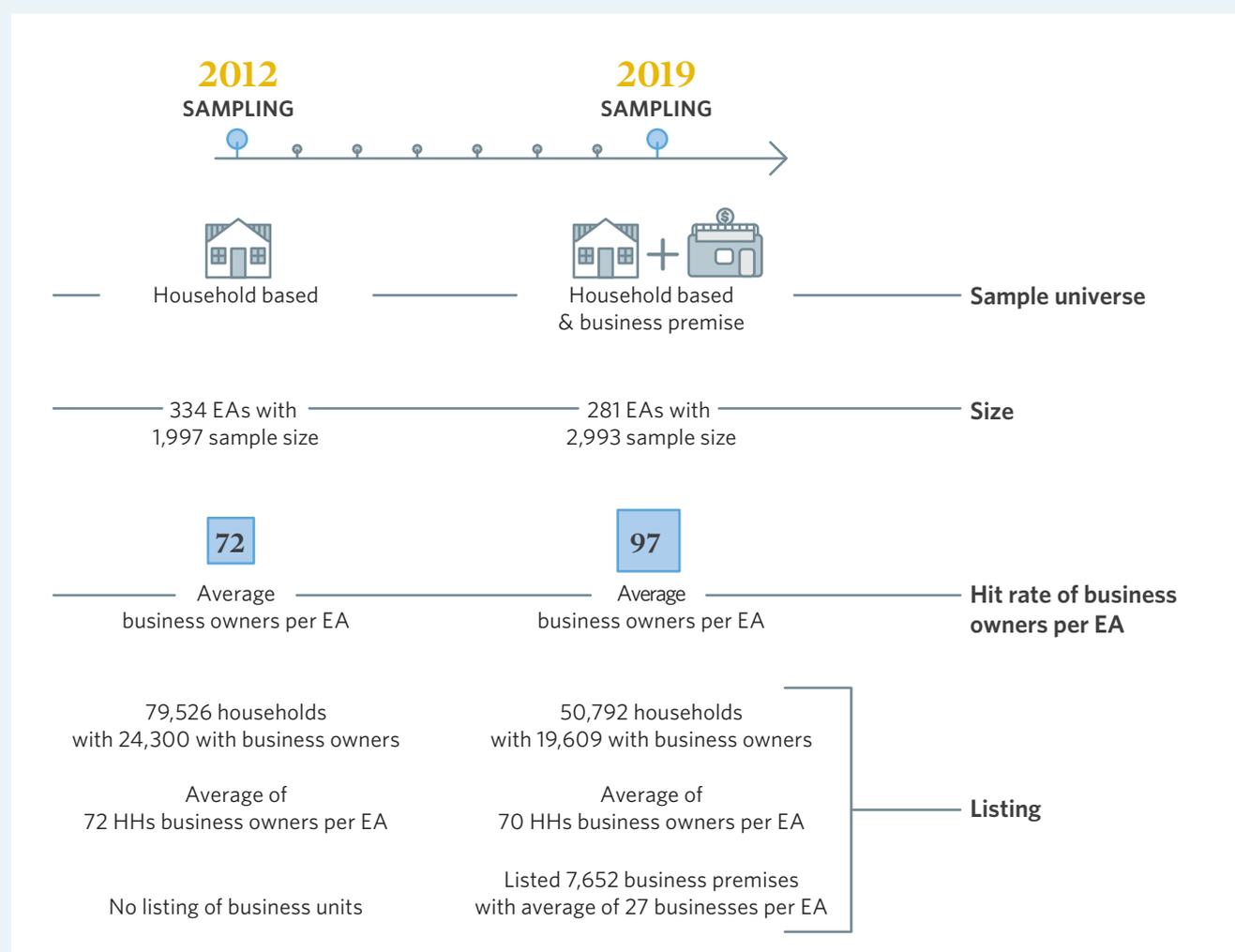
(EAs) that informed the sampling was derived from geospatial modelling. Hence, the modelling screened all EAs in Malawi, identifying and categorising them into three main clusters; none to low probability, medium probability and high probability of possessing MSMEs. An example of the plotting of high probability EAs is shown in Figure 1.

The survey sample was derived from all adults in Malawi who perceive themselves as being an MSME owner. Unlike the 2012 survey that defined MSMEs by the number of employees, this latest study took into account turnover as well, as per the MSME Policy of 2019. The 2012 study categorised MSMEs as independent entrepreneurs (no employees), micro businesses (1 to 4 employees), small businesses (5 to 20 employees) and medium businesses (21 to 99 employees). In the 2019 study, however, micro, small

and medium business were categorised based on both the number of employees and/or turnover. Hence, a nationally representative sample of MSME owners was drawn from the Malawi adult population, including those business owners who are:

- 18 years or older;
- perceive themselves to be business owners/generating an income through business activities; and
- employing 99 people or fewer (this includes independent entrepreneurs without any employees).

The FinScope MSME Survey Malawi 2019 is based on a nationally representative sample of business owners across all the districts in the country. The NSO provided the sample frame based on the 2018 population census and validated the

TABLE 1: 2019 versus 2012 Sampling Methodology

data to represent the current population estimate of Malawi. It is important to note that, due to differences in the sampling regimes, not all EAs have the same number of MSMEs. This was aligned based on modelling, which results in more accurate estimates and inferences of the MSME population in Malawi in 2019.

Sampling strategy: A multi-stage sampling approach was used, including an initial listing phase. The listing exercise was performed at each of the 281 Enumeration areas (EAs) to identify all business owner(s), including where they operate or reside, to create the sampling frame. Once a sample frame of the business owner(s) is established, these would then be randomly selected, taking into consideration the size of the business.

Each of the micro, small and medium-sized business owners had different criteria for selection with a bias towards

small and medium enterprises to allow a fair analysis of these groups in the data. As fewer businesses tend to be medium-sized when selecting randomly, a minimum of 12 medium-sized businesses (where applicable) would be pre-selected to enable representation. The same sampling approach was applied to small enterprises. All other micro-businesses were open to random selection as they had a higher probability of occurring. To balance between categories, randomisation within a sector was applied based on the observed sector in which the business sits (for micro-enterprises). This was done after research from other markets showed under-representation in the data of small and medium enterprises. A similar call was made to the selection of rural versus urban households. As urban centres generally have a higher proportion of MSMEs that are diverse in nature, 12 business owners

were selected in urban EAs while 6 were selected in rural EAs. A step-by-step process of the sampling regime is available in the technical report.

Sampling units: A total of 281 EAs were sampled using probability proportional to household size (PPS) based on the 2018 Malawi Population and Housing Census. EAs were the primary sampling units (PSU), qualifying business premises or households with business owners were secondary sampling units (SSU), and individuals, selected by the Kish Grid from eligible respondents (business owners) at every chosen qualifying business premises or household, were tertiary and ultimate sampling units.

These EAs included 188 urban and 93 rural areas. A summary of the listing is detailed in Table 1, showing on average 97 business owners listed per EA in 2019 versus 72 in 2012.

The selection process used for households with more than one business owner included the use of a Kish Grid to randomly select the qualifying household member. Fieldwork was conducted by Imani Development from the 8th of April to the 17th of May 2019.

1.3 Questionnaire design

A revised questionnaire was developed by Finmark Trust for the 2019 FinScope MSME survey, taking into account the development of the tool over the years. The questionnaire was reviewed by members of the RG to ensure that all sections used during the 2012 FinScope Survey were captured and updated to reflect the current status of the MSME sector. The updated questionnaire was reviewed by the technical team to ensure all input was met and local context was taken into consideration when developing the draft questionnaire.

The final questionnaire was approved by the chair as well as broader members of the RG. It was developed in English and then translated into the local languages of Chichewa and Tumbuka. A local translator evaluated each question for ease of interpretation and made recommendations accordingly. The translated questionnaire was then presented to the steering committee, which provided final approval prior to the initiation of fieldwork. The questionnaire was pre-tested in the field by conducting a few pilot face-to-face interviews as a final evaluation of the translation quality.

The FinScope MSME questionnaire was scripted with the CS-Pro Android application for use on tablets. Once programmed, the scripted version of the questionnaire was tested to ensure that all questions were correctly routed. More information on the methodology is available in the technical report. The data was analysed using SPSS and STATA.

TABLE 2: Overview of the methodology

Description	Details
Methodology	Computer Assisted Personal Interviews (CAPI)
Definition of MSME owners	<p>Survey of MSME owners, defined as individuals who are:</p> <ul style="list-style-type: none"> 18 years or older; Perceiving themselves to be business owners/generating an income through some business activities; Employing 99 people or fewer, including independent entrepreneurs without any employees
Sample size	n=2,993 nationally representative sample including both urban and rural areas. The sample was drawn by the NSO based on the 2018 census
Sampling frame	Listing phase, population stratified by location (urban/rural)
Household qualification	<p>6 households were selected from rural EAs</p> <p>12 households were selected from urban EAs</p>
Questionnaire Length	67 minutes on average
Fieldwork	8th of April- 17th of May 2019
Data Management	Weighting was done by the NSO and FMT

1.4 Organisation of the report

The rest of the report is organised as follows:

SECTION 2

Presents the overview of Malawi economy by emphasising the role of MSMEs in economic development. It also presents the legal and institutional framework in place to promote MSME development in the country;

SECTION 3

Presents the Business Owners profile;

SECTION 4

Provides the MSME sector in Malawi;

SECTION 5

Presents the Financial Inclusion of MSMEs;

SECTION 6

Presents the High-impact MSMEs: Focusing Effort for Growth and Employment; and

SECTION 7

Presents conclusions and implications for Stakeholders.

SECTION 2

BACKGROUND ON MSMEs AND THE MALAWI ECONOMY

Malawi is a low-income country, with comparatively moderate levels of development, ranking 166 out of 184 countries in 2019, a small shift from its 2016 level of 170 out of 188 (UNDP Human Development Index). Covering an area of 118,500 square kilometres, it is one of the most densely populated countries in the region with a density of 186 people per square kilometre in 2018, against a sub-Saharan average of 44.¹ The country has a population of approximately 18 million people, of which 50.7 per cent live below the poverty line and 70.9 per cent survive on less than USD1.90 a day. It presents a relatively high Gini coefficient, which increased from 39.9 in 2004 to 46.1² in 2018, indicating high levels of inequality.

The population growth rate stands at around 3.1 per cent and projections estimate the total population will reach 43 million by 2050³. This projected high population growth is expected to complicate the vulnerability of the population with high poverty levels, inequality, unemployment, and limited access to essential social services. Agriculture is the backbone of Malawi's economy and accounts for 64 per cent⁴ of employment, 80 per cent of foreign exchange earnings and about 30 per cent of GDP. The sector is, however, hampered by a lack of diversification, with maize and tobacco dominating as staple and export crops respectively. There is also an over-reliance upon rain-fed agriculture, rendering the economy vulnerable to weather, climate change, and international price shocks.

The economy has registered significant GDP growth in recent years, averaging 4.3 per cent between 2010 and 2016. This growth has largely been attributed to capital-intensive, rather than labour-intensive, industries and has thus failed to produce the much-needed employment growth. The GDP growth rate declined in 2016, reaching 2.7 per cent, down from 3.3 per cent in 2015 and 6.2 per cent in 2014. The growth rate was projected to jump to 6.1 per cent in 2017, mainly due to a good farming season and bumper yields in the 2016/17 farming period. However, in March 2018 the Government announced a downward revision of the projected growth from 6.1 per cent to 4 per cent, attributing this to high production costs. Overall, the reduced GDP growth rate is largely connected to negative and stagnated growth in the agriculture and manufacturing sectors.

In a bid to boost economic growth, reduce poverty, and support decent job creation, the GoM has targeted the private sector as the engine for economic growth and poverty alleviation. This is evident in all the GoM's economic policy documents, such as the National Industrial Policy, the National Trade Policy, the National Export Strategy⁵, the Malawi Growth and Development Strategy, the National Employment and Labour Policy, as well as in sectoral policies like the National Agricultural Policy (launched 2016). The country registered a significant improvement in the Doing Business Index (DBI) rankings, jumping from 133 out of 190 countries in the 2017 Doing Business Report (DBR), to position 110 in 2018. However, the ideal business environment for the private sector to deliver on its potential is not present, and the sector's growth is hampered by a number of factors.

Malawi's MSME sector faces a lot of challenges that hinder its growth and development in the areas of access to finance and markets, infrastructure, policy and regulatory environment, bureaucracy, capacity for doing business and meeting quality standards, among others. The recently launched Financial Sector Development Strategy II (2017-2022) recognises that inclusive finance is essential to increasing agricultural productivity and production, starting or expanding micro and small enterprises, creating employment, increasing household income and smooth consumption. The National Strategy for Financial Inclusion (2016-2020), among its priority areas, calls for targeted finance for MSMEs and farmers.

2.1 Private sector development in Malawi

Although private investment has grown to be at the centre of all economic activities in Malawi, it still faces several challenges that affect its growth. It remains negatively constrained by poor transport infrastructure, an erratic energy supply, the weak use of information technology, and low investment in the areas of research, science and technology in Malawi. From policy perspectives, these findings imply that the Government should consolidate on the adopted market economy by: (1) addressing the challenges that inhibit private sector investment growth; and (2) increasing public sector investment in the private sector's complementary economic activities.

The MSME sector can play a crucial role in building a vibrant private sector. This can be achieved with interventions to promote MSME progression as part of the entrepreneurship development programme, where MSMEs play a role in job

1. UN Population Division, 2015 revision, <http://esa.un.org/unpd/wpp/>

2. World Bank Estimate (<https://data.worldbank.org/indicator/si.pov.gini>)

3. UN Population Division, 2015 revision, <http://esa.un.org/unpd/wpp/>

3. Malawi Labour Force Survey 2014

5. Government has also developed a draft Micro, Small, and Medium Enterprises (MSME) Policy and Bill, awaiting cabinet approval.

creation and urbanisation. Expansion of credit to the private sector is also part of the strategy with the introduction of innovative financing schemes considered an important measure toward easing MSME access.

2.2 The role of MSMEs in economic development

MSMEs play a crucial role in the economic growth and industrial development of a country. They make important contributions to the enhancement of economic and social sectors of a country through invigorating large-scale employment, investment, development of local skills and technology, entrepreneurship and innovation, exports, and building industrial bases at different scales. A competitive and innovative MSME sector holds tremendous promise, particularly for developing countries like Malawi, in terms of:

- Optimal employment of domestic resources;
- Higher income growth;
- More gainful integration through regional trade and investment; and
- Greater equity in access, distribution and development.

The contributions of micro, small and medium-scale businesses to socio-economic growth and development of nations take many forms, including boosting public revenue through taxation, provision of goods and services to the general public and, more importantly, poverty alleviation created through the employment and economic empowerment of citizens. This is not an exception in Malawi as, going by the definition in the Micro, Small and Medium Enterprises Policy, the private sector is dominated by MSMEs.

These enterprises have the flexibility to quickly adapt and adjust to brisk changes in the environment. Contrary to the long-held belief that MSMEs were meant to serve local demand, the recent emergence has brought developments favourable to both demands and investment structures. As a result, MSMEs are not only key ingredients of the global production networks across countries but are also actively involved in the systems of innovation. The presence of MSMEs is found across industries and sectors, in rural, urban and peri-urban areas. In addition, they are an important channel for poverty alleviation through economic empowerment and participation, particularly for women, the youth and the marginalised sections of society.

As with Malawi, MSMEs in most countries have not received the necessary attention to help them start, grow and diversify, leaving them facing a myriad of challenges. MSMEs are generally founded, owned, and operated by individual entrepreneurs, often without much support from public or private sector sources. It is important to realise that many of the corporations existing today had humble beginnings as MSMEs several decades ago.

It is worthwhile acknowledging that the private sector is a critical player in employment creation, growth and development of any country, and MSMEs form the largest and most critical component of that, making them the bedrock of the sector.

The FinScope MSME 2019 survey showed that 74 per cent of MSMEs are involved mostly in the general wholesale and retail of agricultural products. Further, 16 per cent of MSME businesses are associated with the selling of agricultural products as most MSME are linked in some way to the agricultural sector. Of much concern to policymakers and the economy is the broad finding that a majority of MSMEs are necessity driven or referred to as survivalists. Owners venture into business merely to supplement off-farm income rather than responding to opportunities in the economic environment or creating a strategy to grow their businesses into sustainable ventures. As a result, most businesses are seasonal and tend to follow the cycle of demise and revival any time there is a need or a shortfall from agricultural income.

Subsequently, one in three business owners were found to be very willing to abandon their enterprise and move into formal employment whenever that possibility becomes available (FinScope 2019). This area is largely comprised of women and youth. This area should undoubtedly be addressed by state institutions and agencies involved in championing the growth and vibrancy of the Malawi private sector. Rather than moving into businesses as a temporary stepping stone whilst waiting for employment opportunities, there is a need to change the mindset towards creating businesses as the ultimate goal and formal employment as temporary.

2.3 Institutional framework to promote MSME development

MSMEs are recognised as a cornerstone of economic development, with the potential to enhance the industrialisation process if their entrepreneurial spirit is nurtured. Among the managerial requirements for MSMEs to thrive, there are many challenges that thwart the entrepreneurial vision, such as marketing, accounting, finance, training and development, and difficult business climate.

Cognisant of the need to promote MSMEs in Malawi, both the Government and the private sector established initiatives, interventions and institutions to promote these businesses and have continued to do so. One notable effort in this regard is the institutional changes that occurred in the period 2012–2014. This saw the disbanding of Development of Malawian Enterprises Trust (DEMAT), Small Enterprises Development Organisation of Malawi (SEDOM) and Malawi Entrepreneurs Development Institute (MEDI), and the emergence of the Small and Medium Enterprises Development Institute (SMEDI). The merger of these organisations was undertaken to eliminate overlaps in delivery of MSME support services and to bring efficiency and effectiveness to the promotion and development of MSMEs.

Additionally, the Government established organisations such as the Malawi Investment and Trade Centre (MITC) and the Malawi Bureau of Standards (MBS), which promotes quality measures and the implementation of Malawi Standards. This is performed through conformity assessments and via the Technical Education, Vocational and Entrepreneurship Training Authority (TEVETA). The institution promotes and regulates the sustainable provision of quality technical, entrepreneurial and vocational education and training within existing institutions, both state and non-state. The Government, non-governmental institutions, financial institutions and other international organisations have all increased efforts to provide support to MSMEs. The agencies taking an active role in the development of Malawi's MSMEs include the Small and Medium Enterprises Development Institute (SMEDI), Malawi Investment and Trade Centre (MITC), the Malawi Bureau of Standards (MBS), and the Malawi Confederation of Chambers of Commerce and Industry (MCCCI).

2.3.1 The Small and Medium Enterprise Development Institute (SMEDI)

The institution was created to provide business development support services such as business training, business advisory services, and links to markets and financial institutions.

2.3.2 The Malawi Investment and Trade Centre (MITC)

The institution's mission is to promote and facilitate sustainable, inclusive and transformative investment and trade in Malawi. MITC's main objectives are to provide specialised support to foreign and local investors in all prioritised sectors for industrialising Malawi and to promote and facilitate export products and services to international markets. MITC plays an advisory role to the government on policies that influence the business environment.

2.3.3 The Malawi Bureau of Standards (MBS)

The Bureau has a mandate to promote metrology, standardisation and quality assurance of commodities and of the manufacture, production, processing or treatment thereof; and further to provide for matters incidental to or connected with standardisation.

2.3.4 The Malawi Confederation of Chambers of Commerce and Industry (MCCCI)

MCCCI carries out business facilitation services, which including the following: providing business and economic information for decision making; issuing certificates of origin; organising trade promotion events, providing business management training; representing the business community at national, regional and international fora and offering business premises to small enterprises. The chamber researches and analyses policies and regulations to identify obstacles to doing business in the country and to ensure a conducive environment for private sector development. The research and analysis provide MCCCI with a basis to lobby on issues that need to be addressed by the Government.

One in three business owners were found to be very willing to abandon their enterprise and move into formal employment whenever that possibility becomes available.



SECTION 3

MSME OWNER PROFILE

The profile of MSME owners was analysed based on age, gender, level of education, motivation for starting a business and location. This is useful in understanding entrepreneurial concentration across these categories.



1-4

Employees

up to K5,000,000

Turnover

K1 million

Value of assets
(excluding land & buildings)



5-20

Employees

K5,000,001-K50,000,000

Turnover

K20m

Value of assets
(excluding land & buildings)



21-99

Employees

K50,000,001-K500,000,000

Turnover

K250m

Value of assets
(excluding land & buildings)

Source: Malawi MSME Policy, 2019

Definition of MSMEs

According to the Malawi Micro, Small and Medium Enterprises (MSME) Policy (2019), MSMEs are defined based on the total number of employees, total investment and sales turnover. Accordingly, businesses that employ up to 99 workers, generate an annualised turnover of up to K500 million or with maximum assets [exclude land and building in the case of manufacturing enterprises] of K250 million.

Businesses within the MSME sector are classified using the same set of criteria. Accordingly, micro-enterprises are those engaging up to four people, or operating capital under K1 million and a turnover of up to K5,000,000.00. The majority of micro-enterprises fall under the

informal sector. Small enterprises are mostly formalised activities engaging between 5 to 20 people or with a capital investment of K20 million and turnover of up to K50 million. Medium enterprises employ between 21 to 99 people or use capital investment of K250 million and a turnover of up to K500 million.

By this definition, any two of the criteria can be used to determine whether the enterprise is micro, small or medium-sized. Employment size and annual turnover are the most important measures and were used in the classification for this study. Because Malawi's economy is labour-intensive, being agriculture-based, with over 75 per cent of the population engaged in that sector, employment criteria are the principal parameter used in the determination. The definition excludes seasonal workers. Additionally, this may not apply to high tech enterprises where

annual revenue and value of assets are the key variables applied.

The maximum assets criterion is only applicable to manufacturers, where asset accumulation is a central dynamic for manufacturing enterprises, especially in high-growth sub sectors. In the case of manufacturing, the estimated asset value by enterprise size is indicative and may be used as a proxy to measure whether the enterprise is micro, small or medium-sized. However, this is a guideline rather than a prescribed rule. This criterion also applies to high-tech businesses where employment numbers can be downplayed. Due to the low accuracy [or ownership] of the value of assets, and in line with MSME policy, this report measures business size using a combination of employees and turnover. These classifications are used throughout the report.

3.1 Youth and senior entrepreneurs

Analysis of MSME owners by age allows us to understand the distribution across age groups and provide insight into which particular age category ownership is concentrated. It also proves useful when looking at youth development and their role in the entrepreneurial sector. As shown in Figure 2, over half the MSME owners are adults aged above 35 years. Participation of the youth (age between 18 to 34 years) is encouraging, with 42 per cent of the MSMEs owned by this age group. This shows the potential of the MSME sector in alleviating the problem of youth unemployment and contributing to government efforts of promoting economic empowerment amongst Malawi's youth.

It also suggests that most MSME owners are young entrepreneurs with limited business experience, which provides an opportunity for the Government to expand business support services to MSMEs. This also has an implication on the financial strength of the enterprises. Most MSME owners finance start-up and grow themselves and young owners may not have enough resources to invest in their businesses, placing a greater burden on the Government to introduce innovative financing schemes for MSMEs.

FIGURE 2: Age distribution of MSME owners and by business life cycle (%)

Source: FinScope MSME Malawi 2019 Survey

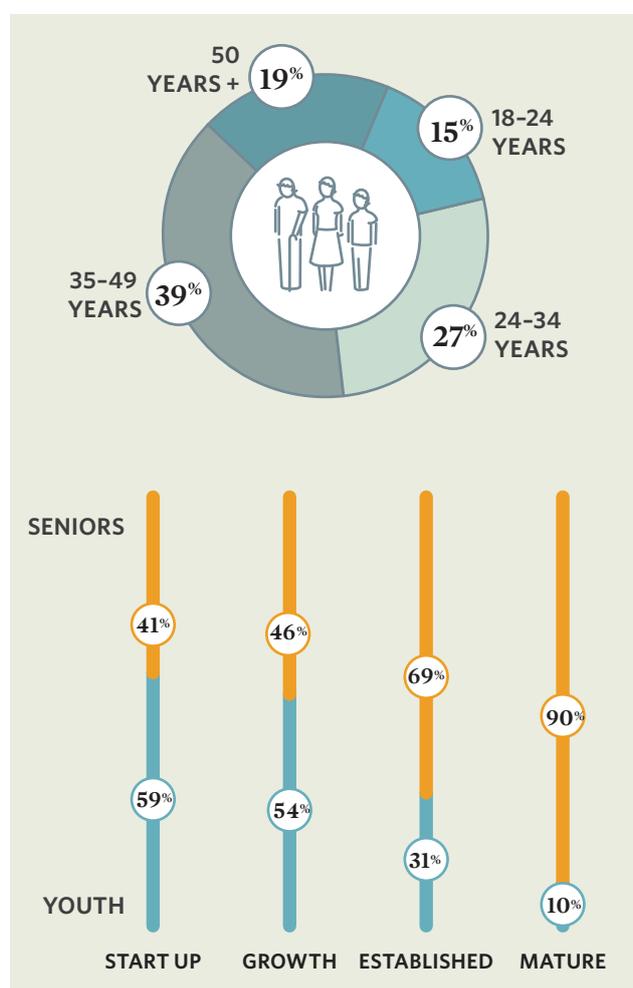


Figure 2 also shows that there is a higher proportion of youth at start-up phases, further supporting the aforementioned points. Finance, business type (formal or informal), growth and success are different attributes of any business. The age of the business owner seems to have a significant correlation with the extent of these attributes.

Youth development programmes aimed at start-up and growth phase entrepreneurs will serve a broader population of youth in these phases of the MSME life cycle. Whilst both the youth and senior business owners are aware of business support organisations (97 per cent each) usage of these platforms is lower amongst youth, at 14 per cent compared to seniors at 20 per cent. Despite most of the youth being aware of formalisation, a lower proportion of them are classed as formal (9 per cent as per FinScope survey). This expanded on the qualitative study stating reasons such as their business being too small or fear of exposure to tax (FinScope Malawi FGDs 2019).

3.2 Gender of business owners

Comparison of MSME ownership across gender shows that 49 per cent of Malawi's individual MSME owners are females while 51 per cent are males (see Figure 3). Given that the gender split of the adult population in Malawi is 51 per cent females and 49 per cent males, according to the Malawi Population Census 2018, females have a lower propensity to own an MSME.

Business size comparison by gender shows that most females surveyed own micro-enterprises (84 per cent) compared to males (64 per cent). Males own a higher proportion of small enterprises (30 per cent) compared to 15 per cent of females, and 6 per cent of medium enterprises compared to just 1 per cent for females. As business size grows, the proportion of females lowers while that of men increases. This suggests that women are likely to be the owners of less mature, under-developed enterprises. Medium enterprises are largely owned by males, which indicates that the sector is still largely male-dominated in developed enterprises. Specific interventions are required to address this gender gap and promote the growth of female-owned businesses to small and medium enterprises.

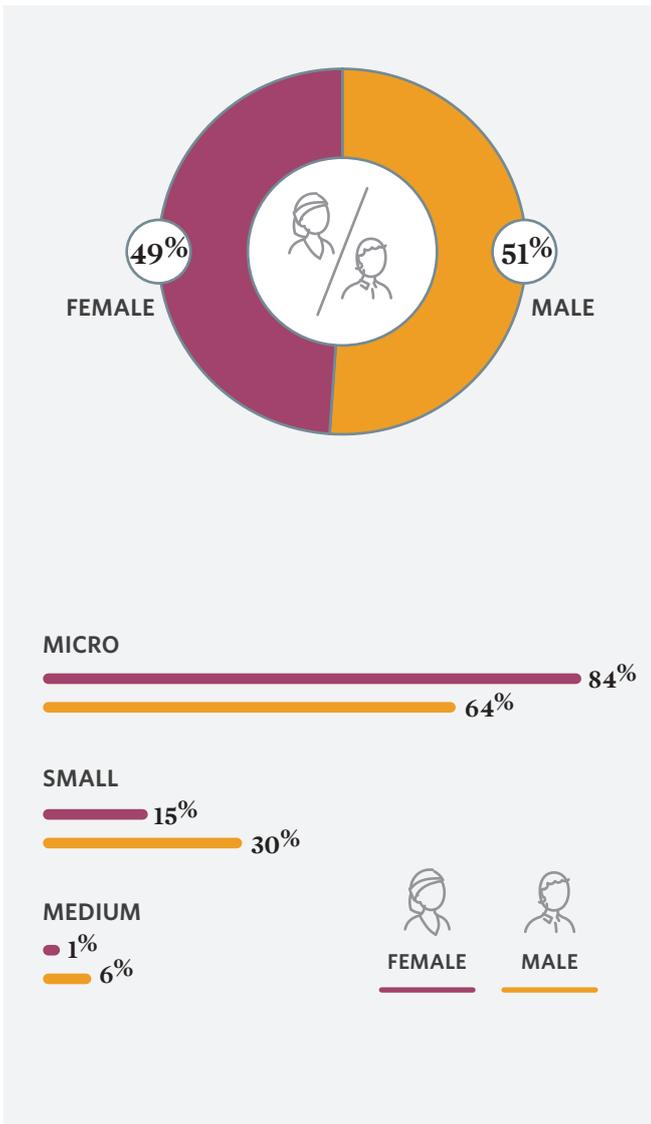
This implies that female entrepreneurs need to be given targeted attention in specific areas and phases of their business life cycle so that they can grow their enterprises. A contributing factor for the higher proportion of female-owned micro-businesses is inherent in the bulk of women holding lower educational attainments and therefore lower formal employment prospects. As such, women tend to move into self-employment as a means of survival rather than entrepreneurial motivation. When they do, they largely invest in risk-averse sectors like wholesale and retail, and community and household, seldom employing other people. Business development is a critical tool in developing women-led enterprises.

“I think BDS, including business planning, business management, financial management, marketing, managing staff, networking, mentoring is a must for anyone starting up a business. BDS is a requirement for any MSME. I was also someone who was very shy when it came to networking but through mentoring programs and training, I am now managing to network. I am now confident, knowing how to do financials is a requirement for anyone doing business. I would suggest different packages for MSMEs; those at start up level, those at medium level and those at maturity stage. The BDS should be provided continuously to MSME based on the growth stage of the business.

FGD Participant – Women-led Tourism.

FIGURE 3: Distribution of individual MSMEs owners by gender

Source: FinScope MSME Malawi 2019 Survey



3.3 Level of education amongst MSME owners

People can have an innate drive towards entrepreneurship but to successfully run a business in the modern, technologically-advanced environment requires business management skills. These skills can be acquired through either formal education or specialised pieces of training. Entrepreneurs with education are better positioned to maximise opportunities and avoid threats. Research indicates a significant and substantial effect of an added year of education for a business owner towards the profitability of their business.

As shown in Figure 4, about 53 per cent of MSME owners in Malawi have at least a primary education. About 32 per cent of MSME owners have completed secondary education and 9 per cent have no education, while the inclination to own a small business is low among those with vocational education or a university degree. The lower entrepreneurial inclination from those with a higher level of education may be driven by their greater access to employment opportunities and their concomitant loss of interest in running their own business due to the comfort of their work income, the high risk of failure and opportunity cost. In contrast, those with a lower level of education might be compelled to start a business as the only way of generating income. Such a trend would lead to MSME ownership being dominated by entrepreneurs with a lower level of education, often lacking aspiration to grow their business by introducing new products and services. This calls for the provision of business support services to MSME owners with no formal education or primary education to help them acquire the skills necessary for running a successful business. The latter being aimed at sustaining livelihoods.

Almost all business owners without education operate micro-enterprises (96 per cent). That amount lowers by category as more small and medium enterprises business owners hold a secondary education or higher.

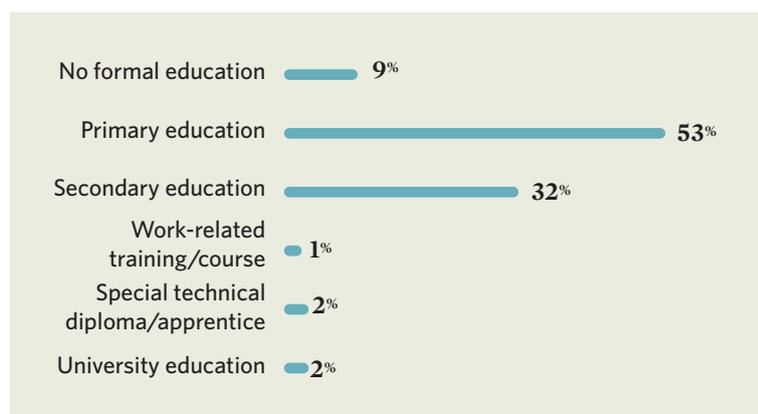
3.4 Location (urban/rural and regions)

MSME development may be affected by geographic location due to differences in the availability of infrastructural facilities and markets. Businesses tend to concentrate in urban areas where they can readily access the market for their products and services. As shown in Figure 5, the majority of MSME owners are based in urban areas (78 per cent) whilst just 22 per cent are located in rural areas. A further look at the sectoral distribution of MSMEs shows that most in the agricultural/farming, wholesale and retail sector are rural-based.

Figure 5 also shows the distribution of business size across regions in Malawi. MSME owners are concentrated in the urban areas of Blantyre, Lilongwe and Mzuzu and urbanised areas within the districts. Across regions, half of the MSMEs are located in Central Region, 38 per cent in Southern and 12 per cent in Northern. Most of the MSMEs belong to micro-

FIGURE 4: Level of education of MSME owners (%)

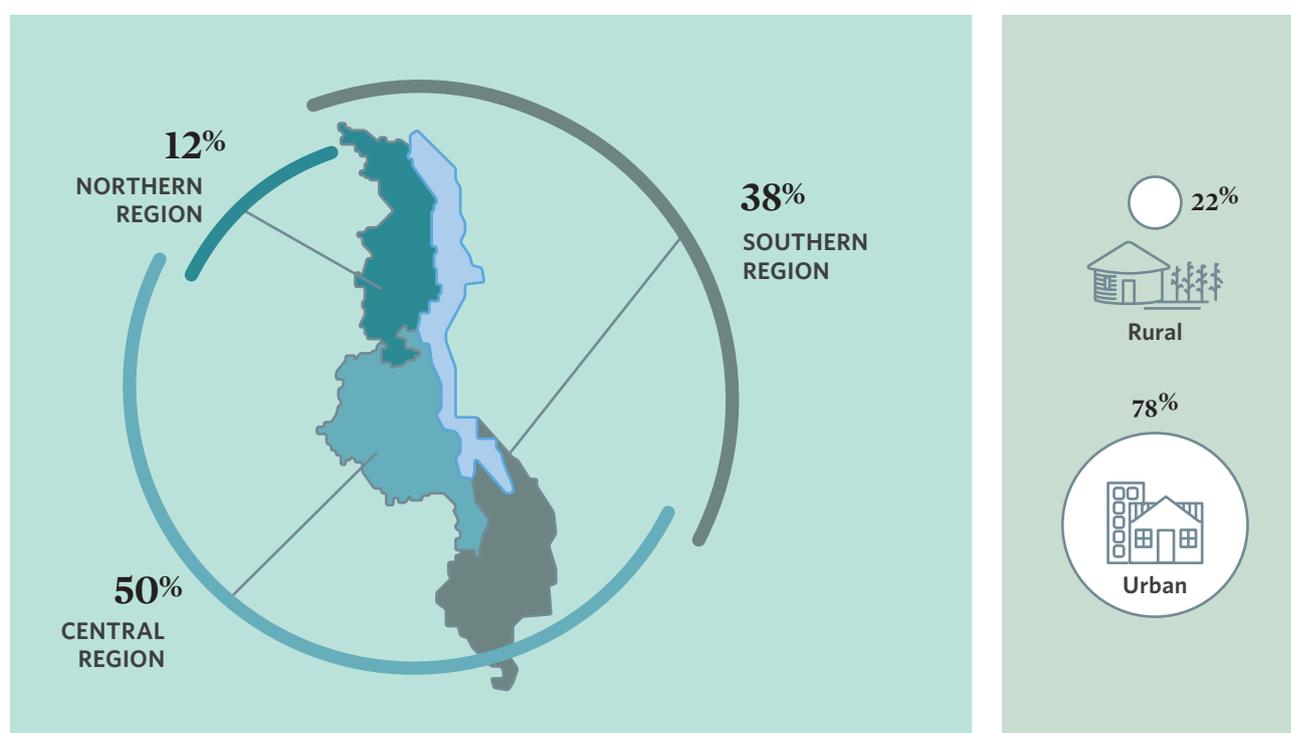
Source: Finscope MSME Malawi 2019 Survey



Research studies report a significant and substantial effect of an added year of education of a business owner on business profitability.

FIGURE 5: Location of MSME owners (%)

Source: FinScope MSME Malawi 2019 Survey



entrepreneurs followed by small then medium enterprises. The high concentration of MSMEs in cities is due to a greater proportion of the adult population living there (urbanisation) and more economic activity in urban areas. Urban areas also produce higher disposable incomes per household.

3.5 Motivation for starting a business

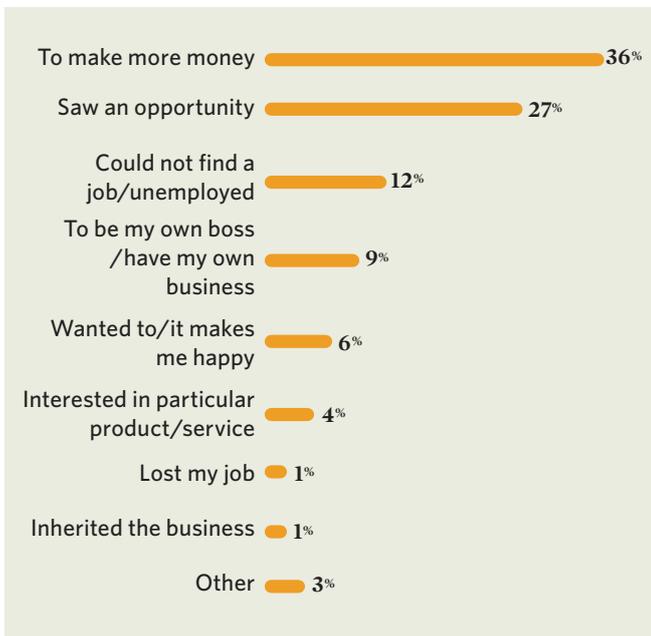
Research has shown that entrepreneurial inclination plays an important role in small business survival and growth. Studies show that small businesses founded by those with an entrepreneurial mindset are stronger than those established by people who simply wanted to make a living from their own business. The study, therefore, analysed the motivation

of small business owners in starting their enterprise. The reasons for starting a business are classified into three categories: entrepreneurial, desperate and others.

Entrepreneurial category owners are individuals who started a business because they saw an opportunity, were interested in a product or desired to use their skills. Desperate category comprised those that started a business due to either loss of work or inability to find employment. These are different from the first group because they were compelled into running a small business through exclusion from the job market. The 'others' category includes scenarios such as owners who inherited their business from family, started their business to make more money, wanted to be their own boss, or were pressurised by their family.

FIGURE 6: Reasons for starting a business (% of MSME owners)

Source: FinScope MSME Malawi 2019 Survey



As shown in Figure 6, 36 per cent of MSME owners started a business because they were motivated by a need to make more money, either for entrepreneurial reasons or to provide for their family. 27 per cent identified an opportunity in MSMEs and 12 per cent started a business out of desperation due to a lack of employment. The indication that 63 per cent of MSME owners have entrepreneurial drive is good for the growth of the MSME sector.

3.6 Business Turnover

Aside from the contribution to job creation, development of the MSME sector is needed because of its potential to boost national output. Turnover is an indicator that only takes into account the volume of sales but does not acknowledge expenses. Income and turnover are inexact measures as they are prone to under- or overstatement but they can provide an indicative performance of the business and overall sector. The income of the business owner, assumed to be derived mainly from the business, reflects the fluidity of the enterprise.

The analysis of Malawian business turnover in Table 3 estimates the volume of business within the MSME sector at about 11.5 Trillion Malawian Kwacha, or USD15.8 billion. The comparison of turnover across sectors shows that a large portion is obtained from the wholesale and retail sectors, contributing 74 per cent of total turnover, followed by manufacturing, agriculture, and community and household activities with less than 10 per cent each. The lowest contribution comes from the construction, natural resources and mining sectors, which is still underdeveloped and relatively small at this level of enterprise in Malawi. These sectors are usually dominated by large firms.

The combined proportion of the wholesale and retail sectors is considered to reflect the buying power of consumers, which in turn reflects the value of the currency. As the sector is driven by household commodities, the expenditure component of GDP reflects the consumption power of the economy. It is therefore not surprising that the bulk of the turnover stems from the wholesale and retail sectors. Looking at the average and median turnover tells us the contribution of a single enterprise per sector. Tourism has the highest turnover of all sectors, followed by manufacturing, construction, and community and household. It shows that focusing on these sectors for growth will have far-reaching effects per enterprise.

The turnover to business size distribution demonstrates that as a business expands from micro to medium-sized, so does its turnover. Medium-sized enterprises contribute 39 per cent of total turnover and have the highest average turnover, making them the largest contributors within the MSME sector. But it is worth noting that micro-enterprises are a major force, contributing to 32 per cent of total turnover in the MSME sector. The average annual turnover of micro-enterprises is USD5,957 whereas that of medium enterprises sits at USD163,770. Due to outliers, it may be best to use the median turnover, which compares sectors and size.

3.7 MSME sector contribution to GDP

It is strongly contended that the sector contributes significantly to the Malawian GDP. According to the 2019 Annual Economic report by the MFEPD, the estimated GDP for that year was about USD8,2 billion (as of June 2019). To highlight the contribution of the sector, the survey summed up the total turnover generated by MSMEs at an estimated USD15,8 billion. As shown in Table 3, the total expenses of the sector are calculated at USD8,9 billion giving a profit of USD6,8 billion. This can be loosely interpreted as the value added to the economy by the MSME sector.

It is important to note that of the USD6,8 billion profit, about USD3,6 billion (53 per cent) is likely already captured in the total GDP figure of USD8,2 billion. This is because 11 per cent of MSMEs are formal enterprises (only 125,000 businesses) and it can be assumed that their contribution is already included in the total GDP figure. Therefore, the unseen, or grey sector (informal), contributes USD3,2 billion (47 per cent of the MSME sector). This is generated by 89 per cent of the MSMEs (1 million enterprises). This estimate justifies the need to understand informal enterprises in order to capture their contribution to national output. Given these estimates, the potential of the informal MSME economy is about 40 per cent of current GDP output. Understanding drivers and barriers to formalisation, particularly of informal businesses, is identified as an important consideration for policymakers. Due to their high number and fragmented nature, informal enterprises are likely micro (78 per cent), rural (82 per cent), or in their start-up and growth phases (61 per cent). Targeted interventions are needed in the effort of formalising these enterprises, taking into account the low business survival rate associated with them.

TABLE 3: Annual turnover by sector and business size

Source: FinScope MSME Malawi 2019 Survey

	% Share of total MSME turnover	Total annual turnover (\$)	Average annual turnover (\$)	Median annual turnover (\$)	
Wholesale /retail	73.7%	11,656,776,122	14,797	5,343	
Manufacturing	9.4%	1,485,163,872	34,621	7,890	
Agriculture /farming	6.1%	967,085,553	5,119	753	
Community & household	4.4%	699,737,961	13,700	7,124	
Business services	2.3%	355,901,718	36,359	1,972	
Tourism	1.6%	254,821,984	58,022	65,753	
Natural resources & mining	1.5%	230,021,441	6,064	1,246	
Agro-processing	0.6%	88,414,218	5,608	3,764	
Construction	0.5%	71,549,734	24,335	8,219	
 MICRO	32%	5,023,768,221	5,957	1,972	
 SMALL	29%	4,543,254,764	17,478	9,863	
 MEDIUM	39%	6,242,449,621	163,770	123,287	
TOTAL	100%	15,809,472,606			

3.8 Usage of technology by MSMEs

The impact of technology as a critical enabler in business is well researched, particularly in the streamlining of production up to distribution and sales. Numbu (2019) describes industry 4.0 as “the combination of industry, automation, digitalisation and the current Internet of Things (IoT) technology.” The participation of modern businesses, and in particular MSMEs, relates to their ability to adapt and utilise technology in their day-to-day operations. The potential for Malawian MSMEs to participate in global industrialisation depends on a myriad of issues and so the report looks at the current ownership of technological equipment by MSMEs.

As stated earlier, only 12 per cent of MSMEs are employers. Of these, 27 per cent require their employees to have specialised skills, with just 11 per cent of them requiring information and technology (IT) or computing abilities. One in four businesses demanding specialised skills requires

equipment maintenance, with 48 per cent requiring marketing and sales skills from their staff. The usage of technology and IT skills in the sector is still in its infancy according to the survey findings. With regard to computer literacy or IT-related skills, none of the MSMEs had received training or assistance in this field.

The study further explored the extent to which MSMEs used technology in their business operations. About two in three MSMEs used and owned business technology equipment such as a mobile phone, fax machine or website. 65 per cent used a computerised record-keeping system. The single attribute for this high usage was the mobile phone, with 99 per cent of these MSMEs engaging with technology through using, or having used, a mobile phone. Other business technology, such as a printer (1 per cent), computer (3 per cent), email address (2 per cent) or cash register/till (2 per cent) registered low usage. Additionally, only 2 per cent had engaged in marketing through television or online. Surprisingly, only 2 per cent of

When looking at technology usage in business outside of mobile phone ownership the picture skews towards other technology equipment such as the internet, computerised record keeping or switchboards.



MSMEs employing technology accessed the internet for business despite nearly all of them owning a mobile phone. When looking at the usage by business size, the medium enterprises recorded about triple the usage on average compared to micro and small enterprises. 6 per cent of medium-sized enterprises listed internet usage, email addresses or a website and 9 per cent used computerised record keeping.

Looking at the usage of technology for business marketing by sector brought some interesting findings. While an unexpectedly low proportion of enterprises in wholesale/retail, manufacturing, and community and household sectors used some form of technology to market their businesses (2, 2 and 4 per cent respectively), other sectors showed far higher usage. Construction (38 per cent), business services (16 per cent) and tourism (12 per cent) revealed greater usage of marketing technology. Natural resources and mining, agriculture/farming and agro-processing all recorded less than 1 per cent, which is atypical.

Overall engagement of technology by sector is mainly driven by mobile phone usage, with high levels across construction, tourism and business services at close to 100 per cent (refer to Table 4). When excluding mobile phone ownership, the picture skews towards other technology equipment such as the internet, computerised record-keeping or switchboards. Tourism was mainly defined by the use of computers while business services and construction mostly used printers, switchboards, or computers and the internet to aid their businesses. A survey limited to measuring actual usage of technology in production or services can be explored further in other research. Considering the usage of machinery in various enterprises, the extent to which technology is used will need to be a consideration of future studies on the MSME sector.

Commonly, the use of technology in the broader sector is low, linked to a generally high proportion of entrepreneurs having secondary or lower education, and almost none having received training in technology or computers.

TABLE 4: Usage of technology tools on business (%)

Source: FinScope MSME Malawi 2019 Survey

	Technology usage	Technology usage without mobile phone	
Wholesale /retail	69	6	
Manufacturing	47	7	
Agriculture /farming	57	3	
Natural resources & mining	9	1	
Business services	98	26	
Community & household	74	11	
Construction	98	46	
Tourism	100	83	
Agro-processing	90	1	

The scope of using digital financial services to aid commercial transactions is explored in section five. There is a need to examine the readiness and impact of MSMEs in embracing technology in day-to-day business operations and the digitisation of value chains within and across sectors. It should also be noted that the environment for technology to play a role in business needs to be created by exposing more MSMEs to technological advancements related to their business. These include alternative energy, modern equipment, and investment in IT and communications infrastructure at a national level as well as basic access to stable and reliable electricity, network coverage and improved educational attainments.

SECTION 4

THE MSME SECTOR IN MALAWI

This section presents characteristics of MSMEs by focusing on the source of start-up capital, awareness and use of support infrastructure, and employment across business sectors. The relative importance of education level on the category of a business is highlighted by comparing business sizes across different levels of owner education.

As presented in Table 4, compared against other countries within the region, MSME ownership in Malawi is lower than Zimbabwe, South Africa, and Mozambique but higher than Eswatini and Lesotho. With just 11 per cent registered, Malawi's MSME sector is less formal than those of Eswatini, Lesotho, Zimbabwe, Mozambique and South Africa at 25, 18, 15, 14 and 17 per cent respectively. The employment capacity of Malawian MSMEs is only better than Mozambique in the SADC region where FinScope MSME surveys have been conducted.

The SADC territory has largely commodity-driven and very similar economies engaged in agriculture and with highly commercialised foreign-owned enterprises and public entities. The structure of the economy is very much driven by primary and secondary sectors as discussed in chapter 2 and this gives rise to informal business owners who seek a living by meeting a demand for basic services. The phenomenon of highly informal MSME sectors across some of the SADC countries in which an MSME study has been conducted is shown in Table 4 below. Zimbabwe and Mozambique have the highest proportions of MSME ownership amongst their adult population, largely due to political and economic instability and high unemployment rates. However, their MSME sectors also contribute positively towards employment.

The employment aspect of the MSME sector in 2019 is explored further in section 4.4 of this report.

TABLE 5: Cross country comparison of MSMEs in Malawi vs other countries | Source: FinScope MSME Surveys

Indicator	Malawi (2012)	Malawi (2019)	Lesotho (2016)	Zimbabwe (2012)	South Africa (2010)	Mozambique (2012)	Eswatini (2017)
Business owners	18 years and older 100 employees or less	18 years and older 100 employees or less	18 years and older 49 employees or less	18 years and older 75 employees or less	18 years and older 200 employees or less	18 years and older 100 employees or less	18 years and older 50 employees or less
Estimated adult population	6,1 million	8,7 million	1,1 million	5,9 million	33.5 million	10,8 million	600,000
Estimated % of adult population that owns MSMEs	13%	13%	7%	46%	17%	42%	10%
Number of MSME owners	760,000	1,1 million	76,000	2,8 million	5.6 million	4,5 million	59,000
Number of MSMEs they own	1 million	1,6 million	85,000	2,8 million	6 million	4,9 million	68,000
% of MSME owners with registered/licensed businesses	3%	11%	18%	15%	17%	14%	25%
Number of employees (including MSME owners)	1,2 million	1,8 million	118,000	2,9 million	6 million	5,3 million	93,000
% of independent entrepreneurs	59%	88%	83%	71%	67%	93%	75%
% of businesses with employees	41%	12%	17%	29%	33%	7%	25%
Average number of employees per MSME	1.2	1.1	1.4	1	1	1	1.4

4.1 Business Sector

The economic role of MSMEs becomes even more valuable when they operate in sectors of the economy considered strategically important. However, capital constraints and accessibility of markets may lead to a concentration of small businesses in sectors of the economy that are not considered a strategic priority. Another factor is the skills and education levels of individuals entering into specific sub-sectors, leading to the export of cheaper raw goods and the import of more expensive finished goods.

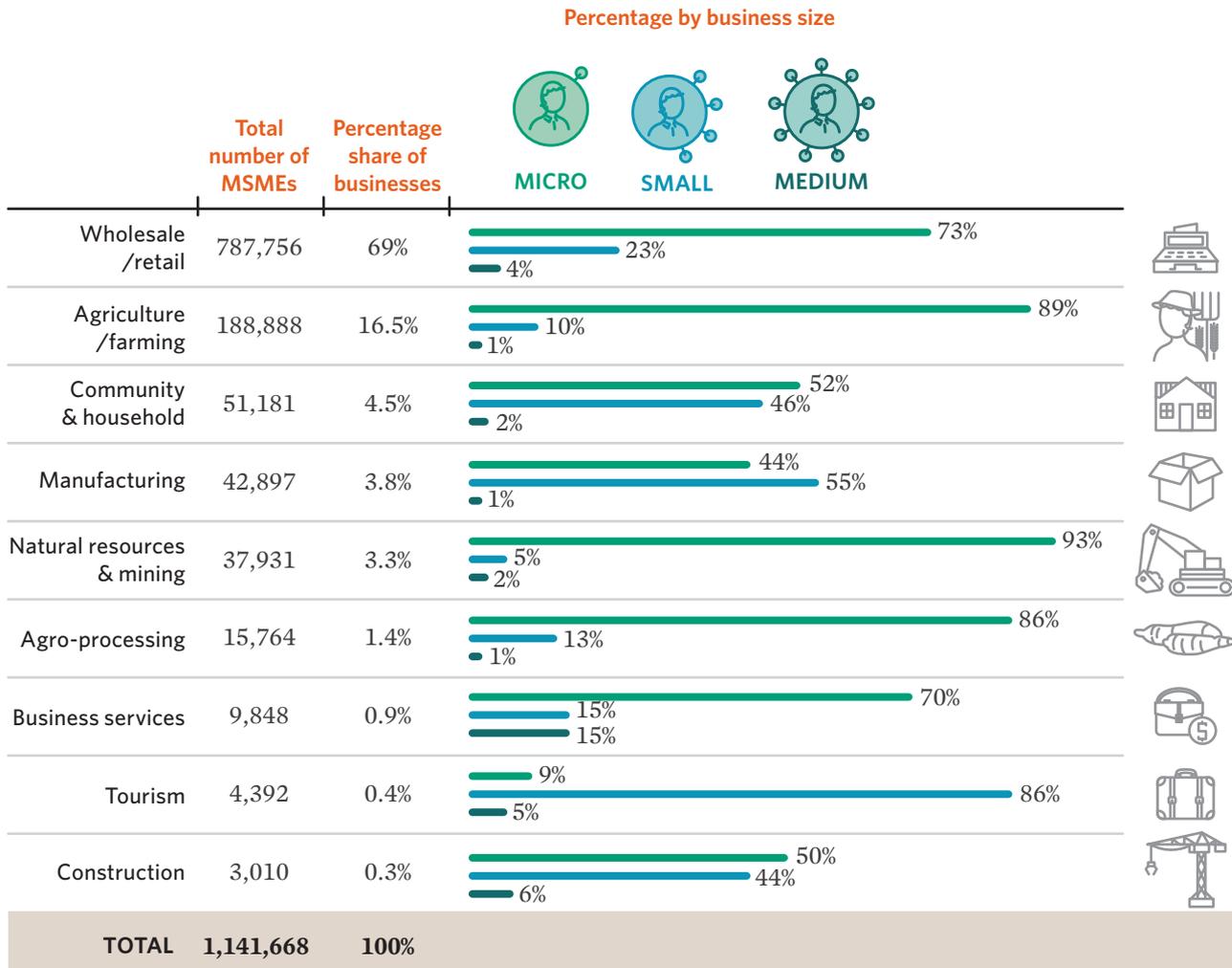
As shown in Table 5, MSMEs operate predominantly in the wholesale and retail, or agricultural sector. The wholesale and retail sector accounts for about two-thirds of MSME business activities at 69 per cent, followed by the agricultural sector with 17 per cent. The fact that around 6 per cent of MSMEs operate in the manufacturing sector (when combined with agro-processing) shows that the sector’s contribution to the Government’s industrialisation efforts is marginal. This indicates that manufacturing, as a whole, comprises mostly large scale enterprises.

Small enterprises have the largest proportion of businesses in tourism (86 per cent) and manufacturing sectors (55 per cent), which in turn produce higher average turnovers per business. Tourism is a high growth sector and has the potential to increase rural job creation. Construction also records a high proportion of small and medium-sized businesses, with 50 per cent of those falling across these two bands. This calls for a concerted effort by the Government to help MSME owners identify opportunities in the small and medium-sized manufacturing sectors and provide incentive packages to attract more entrepreneurs to the category. Import substitution and local procurement may be ways to increase local production.

A high proportion of micro-enterprises operate in the agriculture/farming and natural resources and mining sectors, which score report lower revenues than specialised sectors such as manufacturing. This indicates that these sectors are predominantly primary sectors with natural resources and mining showing rudimentary enterprise levels.

TABLE 6: Business sector in which MSMEs operate (number and %)

Source: FinScope MSME Malawi 2019 Survey



4.2 Business Size

Businesses within the MSME sector are classified using the same set of criteria outlined in the Malawi Micro, Small and Medium Enterprises Policy (2019) as mentioned earlier. The majority of micro-enterprises fall under the informal sector whilst small enterprises are mostly formalised activities engaging 5 to 20 people or with a capital investment of K20 million and turnover up to K50 million. Medium enterprises employ 21 to 100 staff or have a capital investment of K250 million and turnover up to K500 million.

In this report, the study classified businesses using a combination of employee numbers and annual turnover. These were separated into the size categories defined in the Malawi MSME Policy (2019), which prescribes these indicators but opts not to use asset worth due to bias in valuation. Three categories were created to incorporate micro-enterprises. The first category covers micro-enterprises, which employ 0 to 5 workers or produce a turnover of less than MK5 million. The second category, small enterprises, consists of businesses employing 5 to 20 workers or a turnover up to K50 million. The third category is medium enterprises, which employ 21 to 100 workers or produce a turnover up to K500 million.

As shown in Figure 7, more than two-thirds of Malawian MSMEs are micro-enterprises, 23 per cent are small enterprises and only 3 per cent are medium enterprises. Overall, micro and small enterprises account for 97 per cent of the MSME sector. Analysis of the findings indicates that

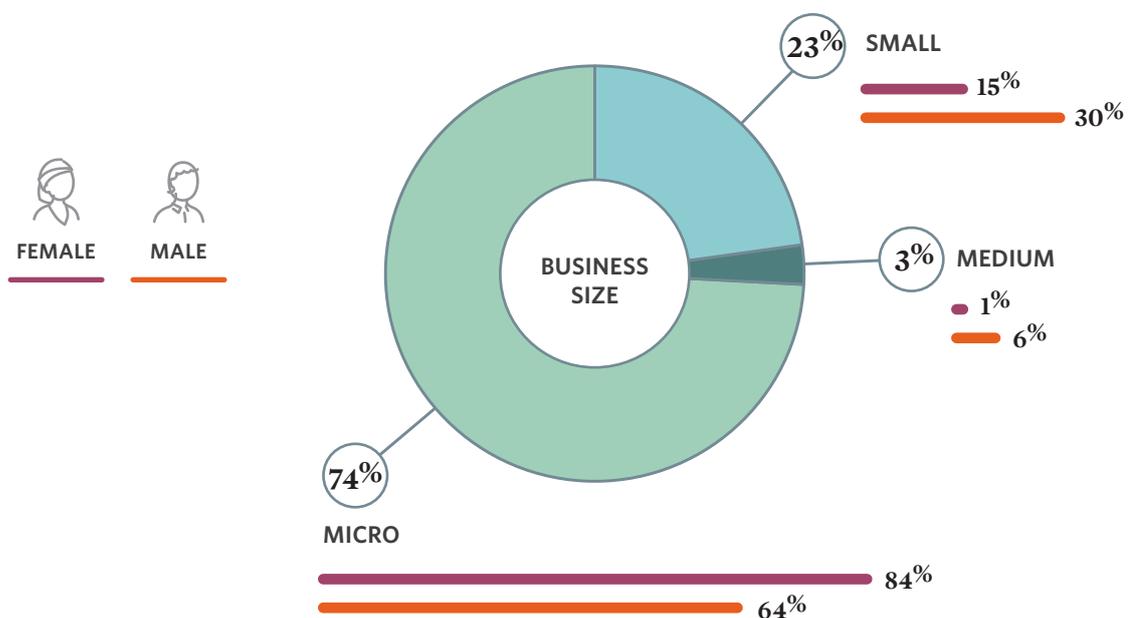
as a business grows in size, the participation of women in those businesses declines. For instance, female business owners make up the majority of micro-enterprises owners (84 per cent compared to 64 per cent male). But only 15 per cent of females own small enterprises compared to 30 per cent males and a mere 1 per cent of medium-sized enterprises are owned by females, compared to 6 per cent males. The same applies to business life cycle where a higher proportion of females operate in the start-up phase (61 per cent), lowering to 49 and 41 per cent in the growth and established phases respectively. Fewer female-owned enterprises are recorded in the mature phase with 35 per cent. The fact that most MSMEs are either micro or small enterprises implies limited employment potential of that sector in Malawi.

Analysis of business size by owner education provides expected results in that the size of an MSME correlates with education level. As shown in Figure 8, ownership of a micro-enterprise decreases as one moves up the ladder from formal to tertiary education. A larger proportion of micro-enterprises are operated by owners who have not schooled beyond primary education, limiting their opportunities and access to formal, salaried employment.

Interestingly, nearly half of small and medium-sized enterprises are more likely to be owned by those with secondary education. Those with work-related training and special technical education also represent a good share across all business sizes. The most prominent educational attainment for MSME owners is secondary schooling.

FIGURE 7: Business size and gender of business owner (%)

Source: FinScope MSME Malawi 2019 Survey



4.3 Sources of start-up capital

Starting a business often requires funding and other resources to ensure value is created and transferred. The lack of funding has been cited in many SME studies as the major obstacle for starting a new business with the issue of survivalist businesses being borne from adults that source small capital to set up a business as a form of survival. This blurs the notion of start-up capital as the main resource at their disposal is time rather than finance, which is usually sourced from within the household. Most studies have opted to filter these enterprises from the scope due to their survivalist nature as opposed to entrepreneurship.

Figure 9 shows that over 80 per cent of MSME owners start a new business using money from their saving, salaries, selling

of assets and family and friends. Only 10 per cent manage to access formal credit from other channels, including village savings and loan groups (VSLs), also known as Bank Nkhonde, and other financial institutions. A general reliance on savings and money from family and friends or informal lenders poses a significant challenge to the MSME sector. This is because it takes time for individuals to accumulate the savings required to finance a start-up. It may also result in many micro-enterprises starting with low seed funds and remaining unchanged for a long period. This may explain the observation of a majority of MSME owners citing a source of funds as being a major challenge to start-up, growth and operations. At the same time, it is noted that a 'barrier' to credit is a common claim that they do not need to borrow money. This conflicting observation requires further examination around the perception of sourcing funds and the role of credit in business.

FIGURE 8: Business size by level of education (%)

Source: FinScope MSME Malawi 2019 Survey

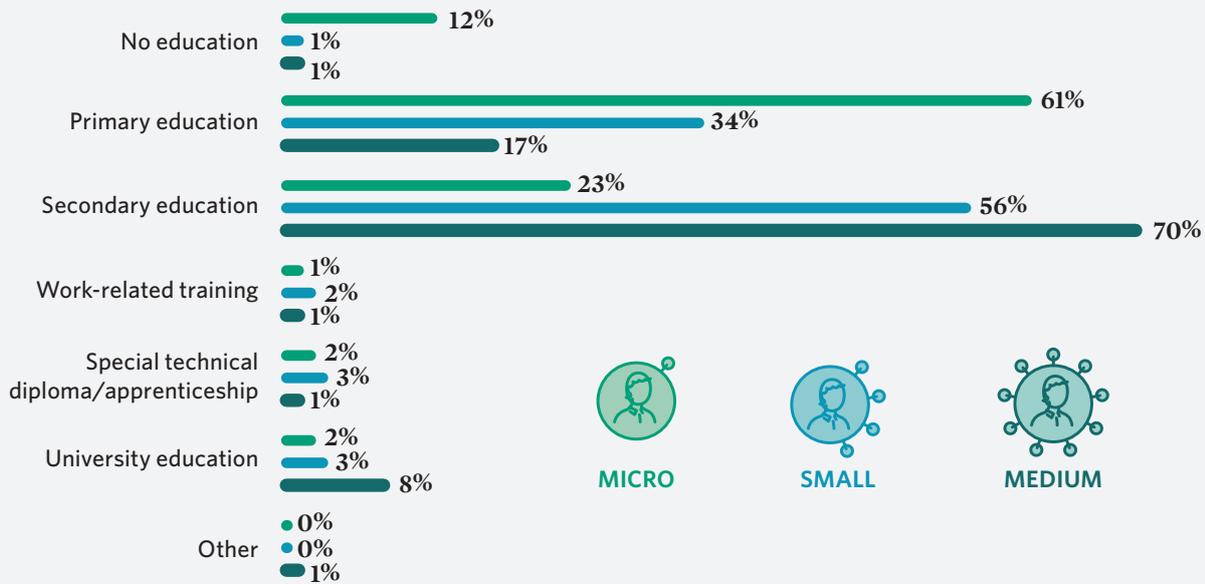


FIGURE 9: Source of start-up capital (%)

Source: FinScope MSME Malawi 2019 Survey



4.4 Employment creation by MSMEs

Employment creation is one of the main drivers of economic growth. The analysis shows that MSMEs in Malawi contribute a significant share of employment within the total labour force (24 per cent). Findings, as indicated in Table 7 below, show that a total of 1.8 million persons are employed within MSMEs. A total number of about 1.1 million are self-employed, with 12 per cent of them employing other people, amounting to an additional 680,000. Based on the category of employment, 367,000 (22 per cent) of these are full-time employees yet about 98,000 (6 per cent) were employed part-time and 218,000 (13 per cent) were classified as seasonal employees.

According to the Malawi Labour Force Survey Report (2014), Malawi's unemployment (both formal and informal) figure sits

at 20.4 per cent. Urban unemployment, at 28.4 per cent, is higher than rural unemployment, which sits at 19.2 per cent. Unemployment is higher amongst females than males, at 25.7 and 14.3 per cent respectively. The youth unemployment rate was 26.8 per cent and was found to be higher in urban areas (47 per cent) compared to rural (24 per cent) in (MLFS, 2014).

Table 6 shows that amongst all MSMEs in Malawi, excluding owners, there is an average of 0.4 employees per business. Urban, male-owned, small and medium enterprises have a ratio of 1 employee or more per business. In interventions aimed at driving employment, it can be taken that focusing on medium-sized businesses would see the greatest results.

TABLE 7: Total and average number of employees in MSMEs by gender, location and business size

Source: FinScope MSME Malawi 2019 Survey

	Total number of MSMEs	Full-time Employees	Part-time Employees	Seasonal Employees	Total Employees (full-time, part-time & seasonal)	Average No. of Workers per MSME
	No. of MSMEs	No. of Workers	No. of Workers	No. of Workers	No. of Workers	No. of Workers per MSME
TOTAL	1,600,739	367,457	97,453	218,640	683,551	0.4
 Urban	347,360	200,734	51,363	20,154	272,250	1
 Rural	1,253,379	166,724	46,090	198,486	411,301	0.3
 Female	781,160	85,581	21,849	13,373	120,444	0.2
 Male	819,578	281,876	75,964	205,267	563,107	1
 MICRO	1,182,946	116,739	49,382	118,474	284,594	0.2
 SMALL	364,969	178,652	31,101	32,151	241,904	1
 MEDIUM	52,824	72,067	16,971	68,016	157,053	3

4.5 Employment by sector

Analysis of MSME characteristics shows that most small business employees work in either the wholesale or retail sectors, which employ about 710,000 people (42 per cent) as individual proprietors. On average, the tourism and business services sectors account for greater employment while wholesale and, surprisingly, manufacturing and agro-processing provide the lowest employability. Therefore, it is the service sector that provides the most job opportunities in Malawi. Notably, a very small percentage of MSMEs operate in the manufacturing and agro-processing sectors, with most lacking the development needed to absorb a significant labour force. Promotion of the services sector shows significant growth prospects for the MSME sector as a whole. With 95 per cent of MSMEs employing 3 workers at most, the job-creating capacity of MSMEs is marginal. Therefore, government policies are encouraged to target MSMEs with growth potential and higher employment capacity instead of casting a wider net on the whole MSME sector.

Employment potential differs across sectors due to differences in labour intensity of the respective businesses.

As shown in Figure 10, MSMEs in small-scale mining and natural resources, manufacturing, wholesale and retail, and agro-processing are dominated by businesses where the owner is the only employee. Micro enterprises that employ less than 5 people are dominant in the construction, agriculture and farming, and community and household sectors, account for 55, 42 and 28 per cent respectively. Over three-quarters of the tourism sector and 17 per cent of MSMEs in the business services sectors employ between 5 and 20 workers. Medium-sized enterprises that employ over 20 staff are well represented in the business services sector. This implies that growth in the services sector (business service and tourism), as well as agriculture and farming, construction, and community and household sectors, holds a greater capacity for job expansion than the other sectors.

Analysis of the findings above tells us there is a need for the Government to find sustainable ways of reducing unemployment, potentially through incentives to micro and small enterprises, which boast a greater number of employees. Box 2 indicates some of the programmes in place to promote business development and employment in Malawi.

TABLE 8: Total and average number of employees by type and sector

Source: *FinScope MSME Malawi 2019 Survey*

	Total number of MSMEs	Full-time Employees	Part-time Employees	Seasonal Employees	Total Employees (full-time, part-time & seasonal)		
	No. of owners	No. of Workers	No. of Workers	No. of Workers	No. of Workers	Average No. of Workers	
TOTAL	1,141,668	367,457	97,453	218,640	683,551	1	
Wholesale /retail	787,756	158,128	31,240	74,116	263,484	0.3	
Manufacturing	42,897	7,950	9,677	1,047	18,674	0.44	
Agriculture /farming	188,888	66,952	31,974	136,975	235,900	1	
Natural resources & mining	37,931	6,354	4,412		10,766	0.3	
Business services	9,848	26,524	8,336	247	35,107	4	
Community & household	51,181	57,944	11,021	6,120	75,085	2	
Construction	3,010	5,305	315	136	5756	2	
Tourism	4,392	31,818	417		32,235	7	
Agro-processing	15,764	6,483	62		6,544	0.4	



Business support projects in Malawi

Some business opportunities and initiatives are being implemented to address the challenges.

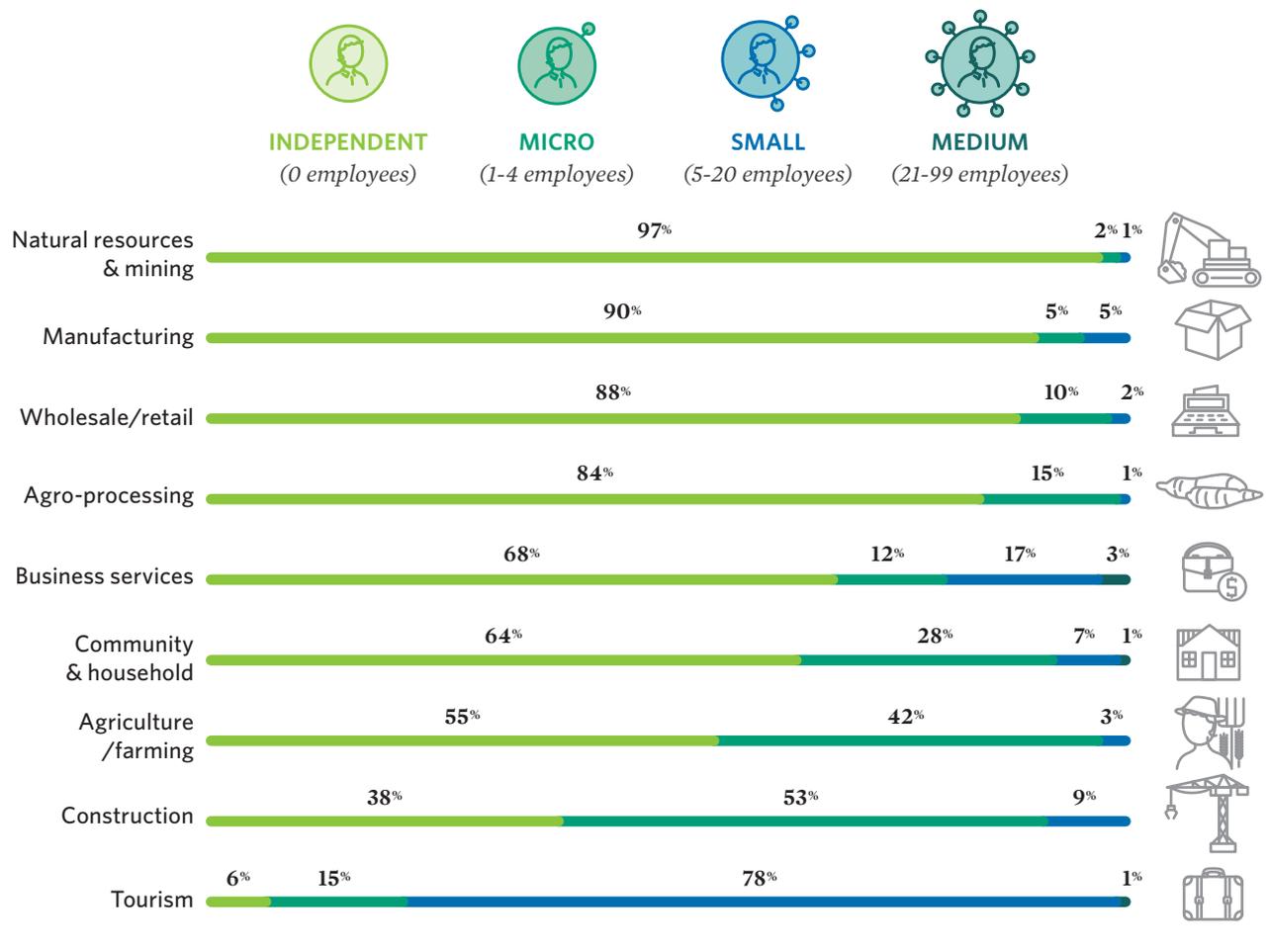
The United Nations Development Programme (UNDP), Royal Norwegian Embassy, mHub and Growth Africa launched the Growth Accelerator Market Test Programme in May 2018, aimed at accelerating youth-led, innovative, business ideas for Malawian enterprises.

DFID Malawi has been delivering a Private Sector Development programme with activities to support individual firms with high growth potential, grow key sectors and improve the general environment for business. DFID projects that have targeted MSME development to date include the Malawi Innovation Challenge Fund and the Malawi Oilseeds Sector Transformation Programme.

The AfDB is implementing the Jobs for Youth Project, which seeks to economically empower young women and men for improved employability in suitable jobs and sustainable entrepreneurship in Malawi.

Source: Ministry of Industry and Trade and Tourism, 2018

FIGURE 10: Employment by sector and size (%) | Source: FinScope MSME Malawi 2019 Survey



There are 89 per cent informal enterprises and 11 per cent formal enterprises in the MSME sector.

4.6 Formalisation (business registration/licensing) amongst MSMEs

The majority of firms in Malawi formalise by registering as a “Business Name”⁶. The three keys to registration for small enterprises are: 1) business registration at the Department of the Registrar’s General (DRG) to obtain a Business Registration Certificate (BRC); 2) tax registration at the Malawian Revenue Authority (MRA) to obtain a Tax Payer Identification Number (TPIN); and 3) registration at the local City Council (CC) to obtain a business license. The three institutions that provide these documents operate independently and do not share information on registered firms and taxpayers, although a BRC is a pre-requisite for obtaining a TPIN. As a result, business registration and tax registration can be separated, as is the norm in Africa, and businesses can choose which aspects of formality, if any, to obtain.

The findings from the 2019 Finscope Survey in Figure 11 indicate that there are more sole traders (86 per cent) and private companies (8 per cent) and partnerships (3 per cent). Overall the findings imply that the MSME sector consists of 89 per cent informal and 11 per cent formal enterprises. This is an improvement from the figure of 3 per cent formal enterprises in 2012.

According to the Ministry of Trade, as part of the Business Environment Strengthening Technical Assistance Project (BESTAP) supported by the World Bank, the Government introduced a new Business Registration Bill. This sought to enforce the registration of informal enterprises; draft a new Business Licensing Bill; and transition to an online-based electronic system of business registration, thus reducing the time to register firms. The goal was to reduce turnaround time from 14 days to less than five.⁷

The findings further indicate that formality differs across the three segments, as represented in Figure 12. The Registrar of Companies shows a figure of 7 per cent registered enterprises and 10 per cent licensed enterprises. In the medium sector, a far larger number of businesses are registered or licensed, at 20 and 35 per cent respectively. Business licensing and registration is highest among most developed businesses and low among least-developed and emerging businesses.

4.7 Barriers to business registration

Some of the reasons for not registering include the small size of the businesses (47 per cent), a lack of information regarding registration (19 per cent), and the costs, which amount to MWK 2,000 (USD4 in 2019).

The findings reveal the perceptions of MSMEs around the advantages of formalisation. About 21 per cent of MSMEs see the benefit of registering as compliance with the law, 12 per cent stated access to finance and government assistance, 10 per cent reported that they didn’t see any benefits and 4 per cent felt that registration would help avoid fines. This is most common where city authorities perform inspections of business premises.

On the other hand, the BESTAP World Bank project study found that registration on its own delivers no measurable benefits to firms. MSMEs do not experience smoother operations, nor do they increase their trust in government (and other) institutions. There seems to be another, compounding issue at hand: imperfect information.

Recent business reforms in Malawi have led to some improvements in the Global Competitive Index (GCI). The 2018 GCI report, defined as the set of institutions, policies and factors that determine the level of productivity, ranks Malawi’s infrastructure 129th out of 140 economies. This was up from 135 out of 138 economies in 2016 but lower than other SADC countries⁸.

The number of reforms has led Malawi to record a significant improvement in the Doing Business Index (DBI) rankings, from position 133 out of 190 countries in 2016 to position 109 in the 2019 report. The MGDS III target for the DBI is to reach position 100 or better. The initiatives undertaken include reforms to corporate tax, investments in innovation, science, telecommunications and transport infrastructure, the streamlining of business regulatory processes, and advances in competition laws. However, the necessary business environment for the MSME sector to deliver on its potential has not yet been created and private sector growth is hampered by many factors detailed in the section that follows.

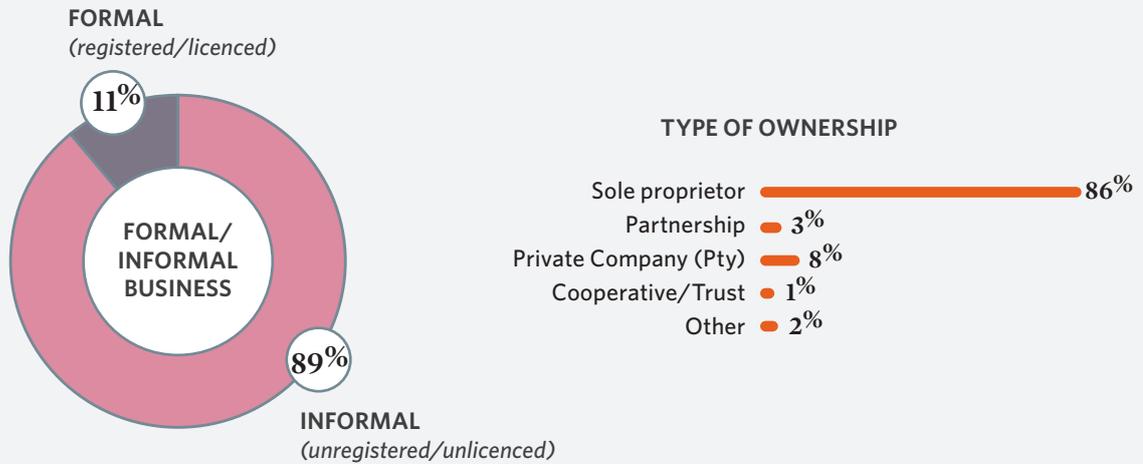
6. Approximately 135,000 firms are registered as “Business Names” vs 11,000 as limited liability firms, 2018.

7. The effects of these reforms have only partly been recognised by the 2018 Doing Business Report

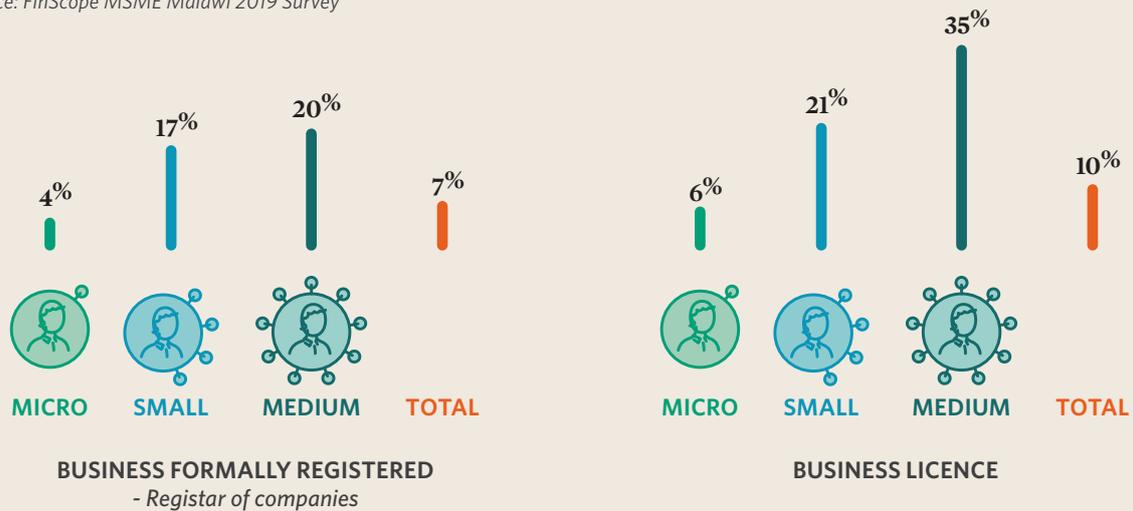
8. Mozambique ranks 124, South Africa ranks 64, Zambia ranks 125 and Zimbabwe ranks 123

FIGURE 11: Formal and informal businesses and type of ownership

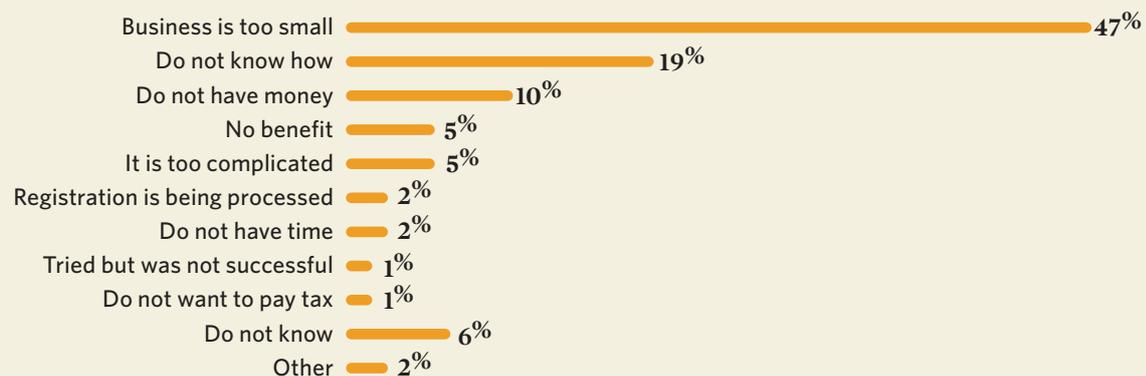
Source: FinScope MSME Malawi 2019 Survey

**FIGURE 12: Business licensing and registration**

Source: FinScope MSME Malawi 2019 Survey

**FIGURE 13: Reasons for not registering**

Source: FinScope MSME Malawi 2019 Survey



4.8 Age profile of MSMEs business and general outlook

The average business age of Malawian MSMEs stands at 7.5 years. Figure 14 indicates that about a third of Malawi’s MSMEs are less than 3 years old, 27 per cent in the growth stage, 16 per cent are established and 23 per cent are mature. There is a perception of growth, with most start-ups claiming they are progressing (45 per cent) and some declaring they are in stagnation (29 per cent). Growth-established MSMEs showed a lower outlook at an average of 30 per cent, with more micro-businesses operating for less than 5 years (64 per cent). Two in five small enterprises are established or mature compared to 32 per cent of medium enterprises classed as established and 46 per cent as mature. More female entrepreneurs are found in the in start-ups (61 per cent).

The analysis implies that MSME firms are growing, not only through the expansion of existing firms but also the birth of new enterprises seen by the larger proportion of start-ups. The trend also shows a lower survival rate of MSMEs as only two-thirds below 5 years and 39 per cent older than 6 years remain in business.

MSMEs may fail due to the lack of skills that are key to running a successful business. This is over and above those businesses that become obsolete through their value offering or simply turn out to be bad investments. Support provided to MSMEs would thus alleviate this problem and assist these firms to survive and grow.

The benefit of business support infrastructure depends largely on enterprises being informed of its existence and so the report explored the extent to which MSME owners are aware of the support or take advantage of it. The research shows that almost 97 per cent of MSME owners know of the availability of business support services but, disappointingly, only 18 per cent actually make use of it. This tells us that whilst business support infrastructure exists and almost all MSMEs are conscious of its availability, there is a lack of information on how to use it. Encouragingly, almost all (95 per cent) of MSME owners that used the support facility found it useful. Conversely, most MSMEs were not aware of the appropriate business institution offerings as shown in Figure 15. About 14 per cent are aware of the MoFEPD, 13 per cent are aware of both the Ministry of Industry and Trade or TEVET, 6 per cent are aware of other organisations, such as the Chamber of Commerce, and 5 per

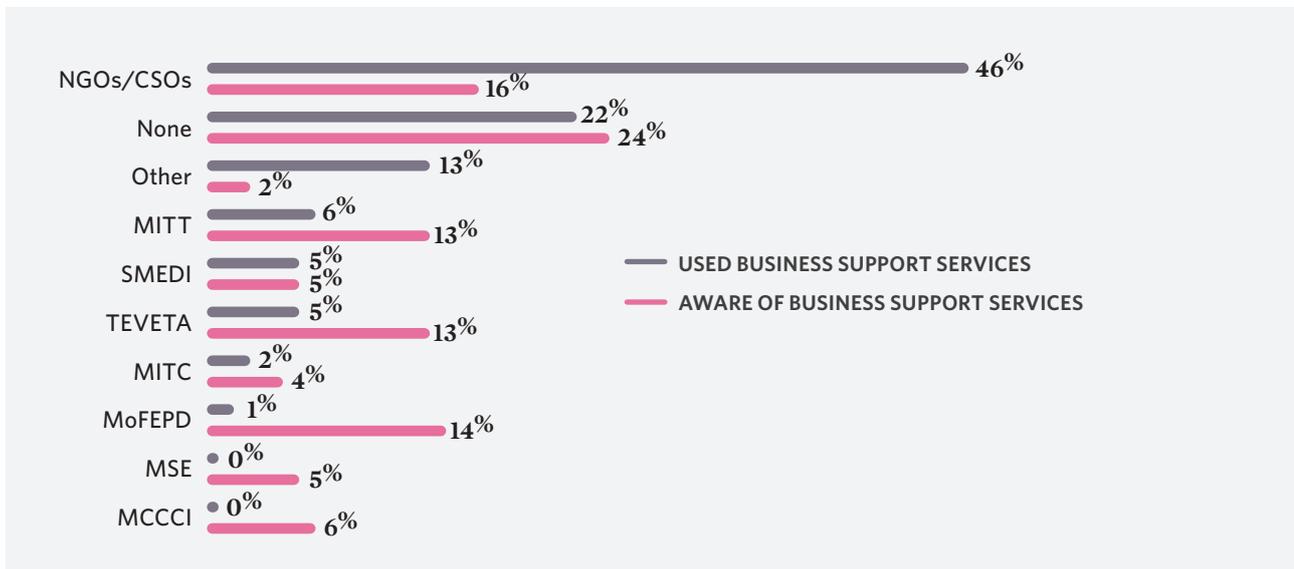
FIGURE 14: Business cycle of MSMEs

Source: FinScope MSME Malawi 2019 Survey



FIGURE 15: Awareness and usage of business support Institutions

Source: FinScope MSME Malawi 2019 Survey



cent were aware of SMEDI. Additionally, 49 per cent used NGO or CSO services, 14 per cent used other organisations, and 6 per cent used support from the Ministry of Trade or SMEDI.

Awareness and use (as well as the usefulness) of support service differs across sectors. The take out is that, while awareness is better among MSMEs owners in the service sector, usage is higher within those in the agricultural sector. Usage of support infrastructure is low within MSMEs in the wholesale and service category. Analysis suggests that increasing awareness of the support infrastructure and encouraging MSME owners to use the services will likely benefit the sector in the country. This may also have a spillover to formalisation.

4.9 Access to markets and business linkages

Almost two-thirds of MSMEs sell their products directly to individual consumers (68 per cent) and 22 per cent show forward linkages by selling to other enterprises. However, very few MSMEs sell to government. The findings note that only 3 per cent of MSMEs were able to tender for government procurements and, of those, 79 per cent were successful. The low forward business linkages suggest the need for deliberate efforts to ensuring MSME participation in government procurement of goods and services. Only 2 per cent of MSMEs export commodities while 6 per cent import some of their inputs. This already shows the trade imbalance between imports and exports against the Malawian MSME sector. The major destinations for exports included Tanzania and Zambia and the main sources of imports were China, South Africa and Zambia.

FIGURE 16: Awareness and usage of business support Institutions by sector

Source: FinScope MSME Malawi 2019 Survey

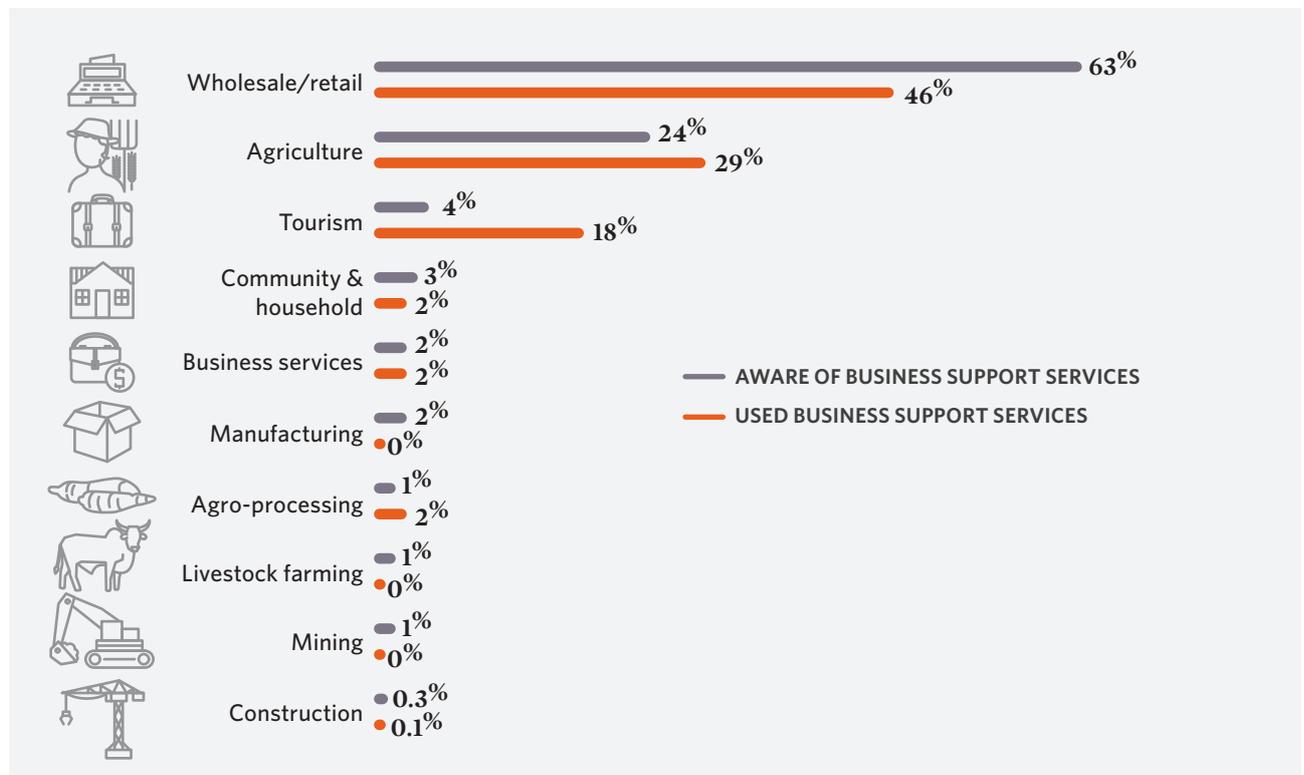
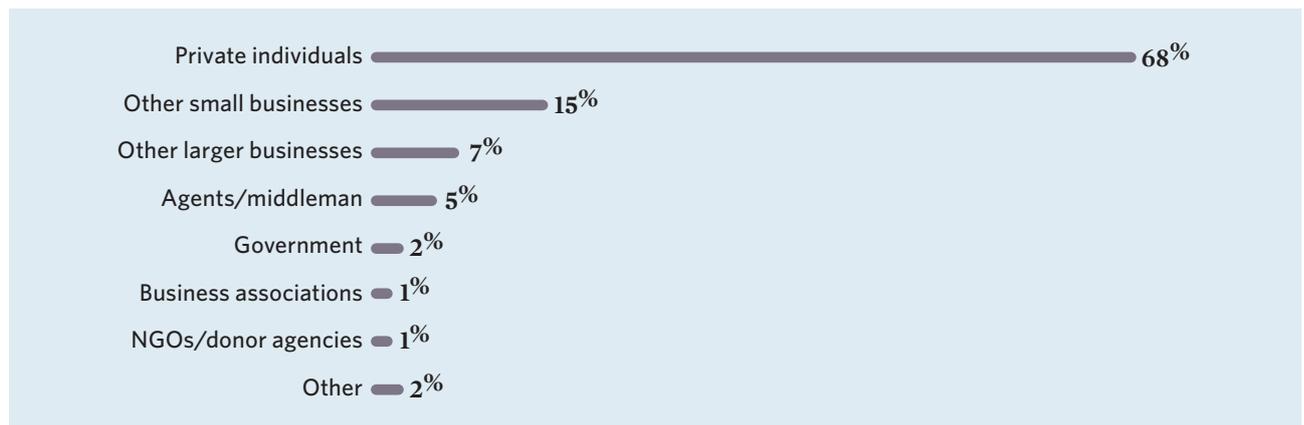


FIGURE 17: Access to markets (%)

Source: FinScope MSME Malawi 2019 Survey



4.10 Agriculture and farming sector

About 189,000 farmers (16.5 per cent of the MSME sector) operate in the primary agriculture sector, the major commodities being tobacco (35 per cent) followed by edible nuts. This is in line with the high-value cash crop system in Malawi since the farming of maize and corn is usually for household consumption rather than profit. The research found that the main source of capital for funding agricultural businesses was through selling crops or livestock (24 per cent), borrowing from an agric-supplier or using personal savings (13 per cent). The average landholding size is 5 hectares and the main market for agriculture production includes collection centres (41 per cent), retailers (31 per cent), and directly to the consumer (27 per cent). This shows some backward linkages as most of these commodities are sold unprocessed.

4.11 Agro-processing segment

The MSME survey also examined sector-specific issues within manufacturing with regards to agro-processing as an emerging high-growth segment. The findings show that the agro-processing sector has about 40,000 owners (4 per cent of all MSMEs), of which 85 per cent fall under micro-enterprises, 14 per cent under small enterprises and 1 per cent in the medium enterprise category. The figure differs from the aforementioned 15,000 due to perception as more business owners believed to be agro-processors including millers. The sector employs about 6,500 people and is reliant on the use of local inputs (95 per cent). The domestic market accounts for 99 per cent of sales. Figure 19 shows that at 34 per cent, fruit and vegetable processing forms the largest sub-sector within agro-processing followed by 'other' at 28 per cent, nuts and animal oils at 25 per cent, and grain milling contributing 9 per cent to the sector.

An analysis of bottlenecks within the agro-processing sector shows that some of the main obstacles include marketing (8 per cent), procurement of material inputs (6 per cent) and other logistical problems such as a lack of storage facilities (44 per cent), lack of transportation (28 per cent), bad road conditions (20 per cent) and high fuel cost (7 per cent). Insights from focus group discussions shed more light on the challenges faced. Energy was the most common problem to agro-processors.

FIGURE 18: Agriculture and farming

Source: FinScope MSME Malawi 2019 Survey (%)

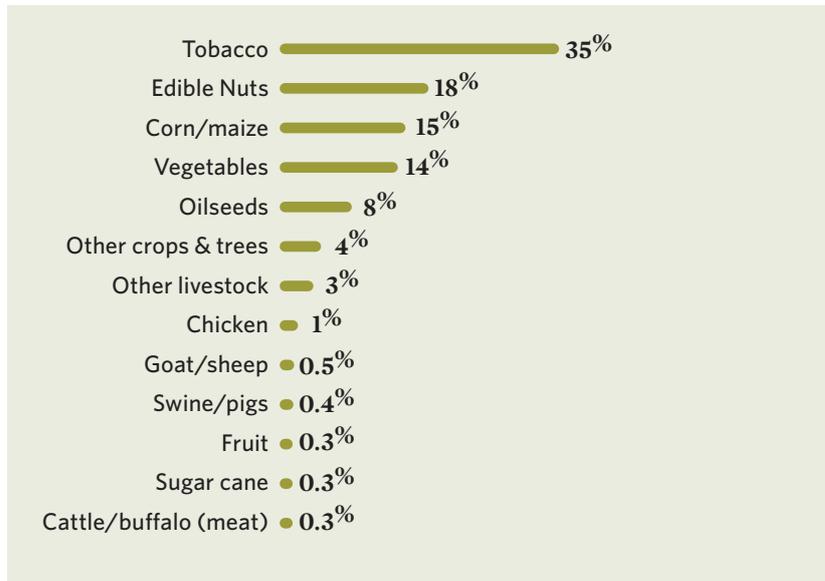


FIGURE 19: Agro-processing distribution (%)

Source: FinScope MSME Malawi 2019 Survey

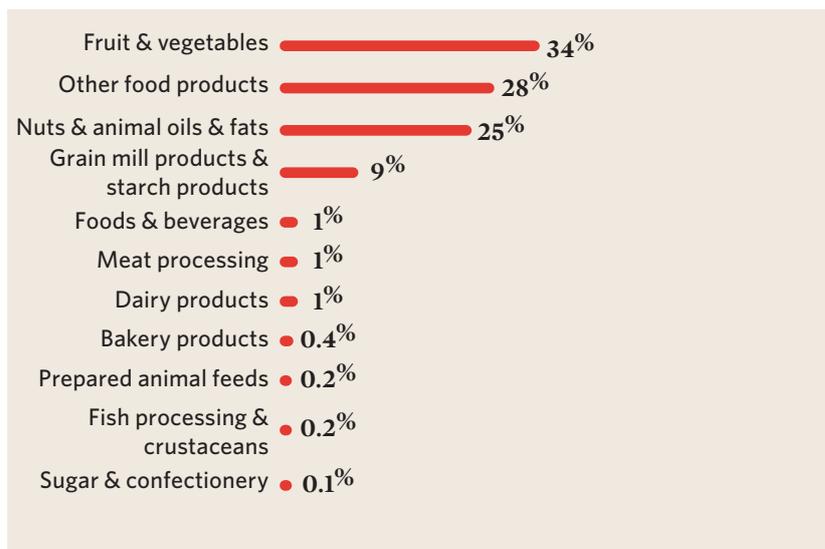


FIGURE 20: Manufacturing distribution (%)

Source: FinScope MSME Malawi 2019 Survey

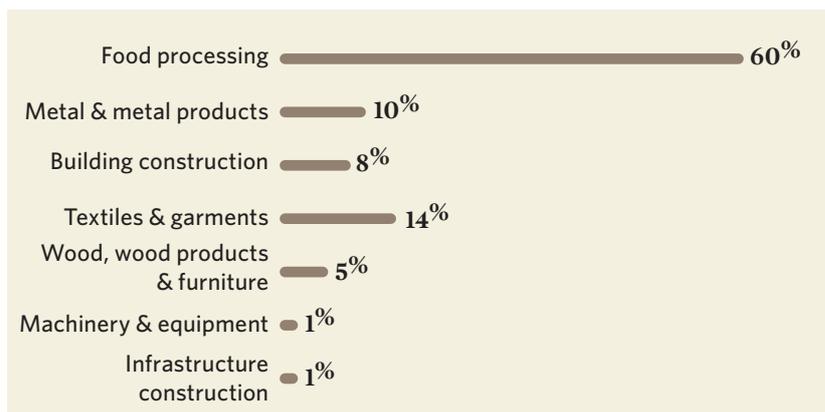


TABLE 9: MSMEs access to amenities by location, size and sector

Source: FinScope MSME Malawi 2019 Survey

Background characteristics	 % MSMEs with access to water	 % MSMEs with piped water	 % MSMEs with electricity
TOTAL	63	24	26
 Urban	65	56	54
 Rural	63	15	18
 MICRO	60	20	20
 SMALL	73	30	43
 MEDIUM	78	67	44
 Wholesale /retail	63	24	28
 Manufacturing	47	15	15
 Agriculture /farming	61	17	16
 Natural resources & mining	100	0	0
 Business services	84	52	52
 Community & household	70	40	51
 Construction	11	11	61
 Tourism	82	40	6
 Livestock farming	28	19	16
 Agro-processing	66	52	88

4.12 Manufacturing sector

The industrial structure has shown from earlier findings and analysis that the majority of the MSMEs in Malawi are operating in the wholesale and retail, and services sectors. Only 2 per cent operate in manufacturing. The MSME survey conducted a manufacturing-specific module to explore the makeup of the sub sector. The findings in Figure 20 show that Malawi's MSME sector mostly operates in food processing (60 per cent) and this includes items such as fruit and beverages, edible oils and so forth. About 14 per cent is contributed via the textiles and garments industry. This has been one of Malawi's traditional industry but has seen a decline due to falling cotton prices. The sector now involves mostly tailoring, fabric printing and the manufacture of apparel and garments.

Challenges in manufacturing include a lack of strong markets (26 per cent), electricity (18 per cent), access to finance—both the availability and cost—(17 per cent), inability to obtain loans or the lack of funds (14 per cent), crime, theft and disorder (8 per cent), corruption (8 per cent), and transportation (4 per cent). These findings were echoed in the desk reviews, which found that the industrial production index has stagnated. This is evidenced by the closing of several manufacturing firms in the last decade, citing a lack of profitability due to the high costs of operations. Whilst reforms are being implemented there are still some gaps in terms of coordination amongst institutions. These continue to act as a burden on competitiveness as businesses ended up paying numerous license fees and levies to multiple institutions, e.g. business registrations, council business licenses, council food licenses, beverages licenses, MBS levies, TEVET levy, etc.

4.13 Access to amenities

Water and electricity supply difficulties pose a threat to the country's industrialisation drive and trade and infrastructure development. The risk of low returns limits diversification into non-traditional exports and particularly undermines manufacturing output and investment.

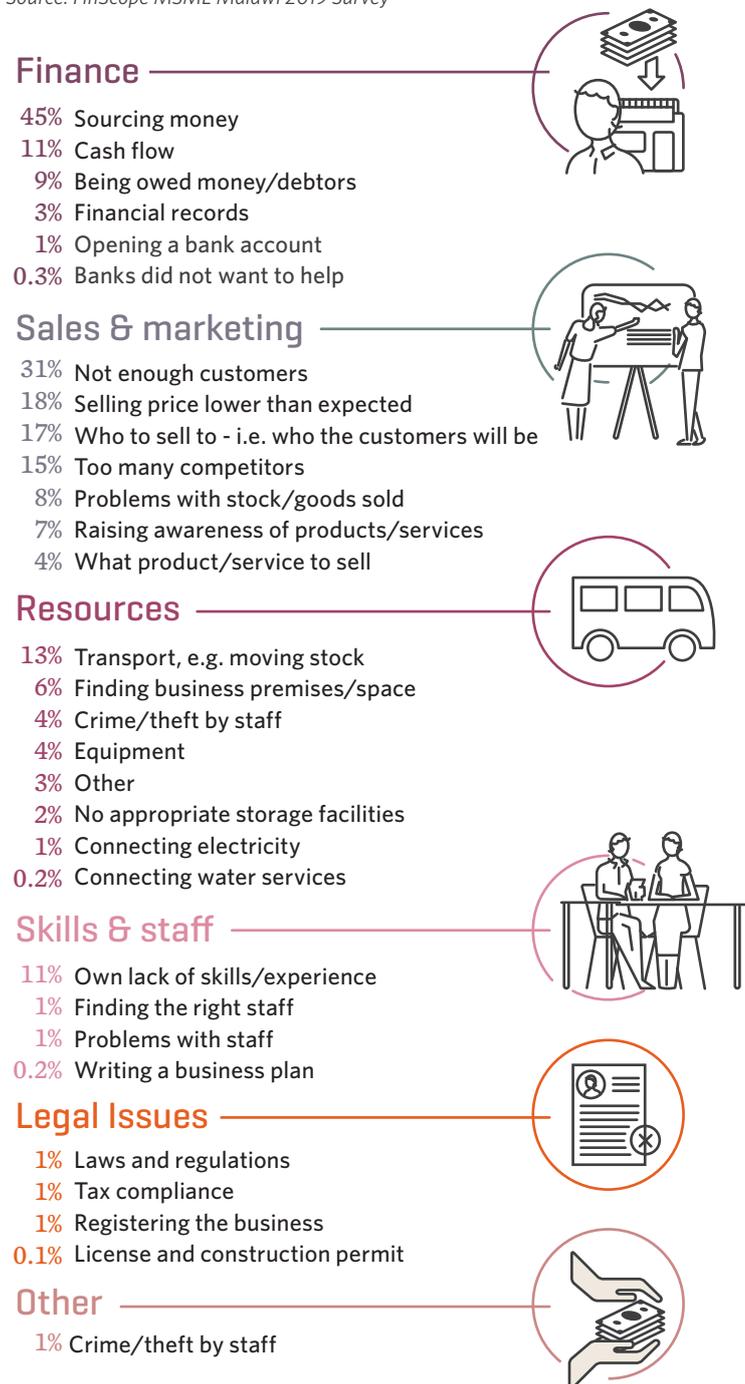
4.14 Challenges when starting a business

Malawi’s MSME sector faces a lot of challenges to growth and development in the areas of access to finance, access to markets, infrastructure, policy and regulatory environment, bureaucracy, capacity in doing business, and meeting quality standards, among others. Access to finance is the primary challenge faced by owners when starting a business. The rest of the barriers faced are listed in the box below. The main obstacles to financial services include transaction costs (high banking fees), low financial literacy, cost of travel to financial providers, lack of identification, ill-suited financial products, limited income, and the unavailability or insufficiency of loan collateral.



TABLE 10: Challenges at start up

Source: *FinScope MSME Malawi 2019 Survey*



Access to finance is a convoluted term that needs better understanding from the needs of the business.

Access to markets requires more work invested in addressing market asymmetries and information dissemination.

SECTION 5

FINANCIAL SERVICES PRODUCT UPTAKE AND USAGE

Access to finance is one of the most common factors contributing to or impeding MSME growth at various levels of their development. Finance is crucial to business start-up, operation and growth. Figure 21 shows how the analysis of financial inclusion was conducted under the FinScope methodology. The framework categorises the business owner population in different segments based on the financial products that they have or use.

FIGURE 21: Financial inclusion framework

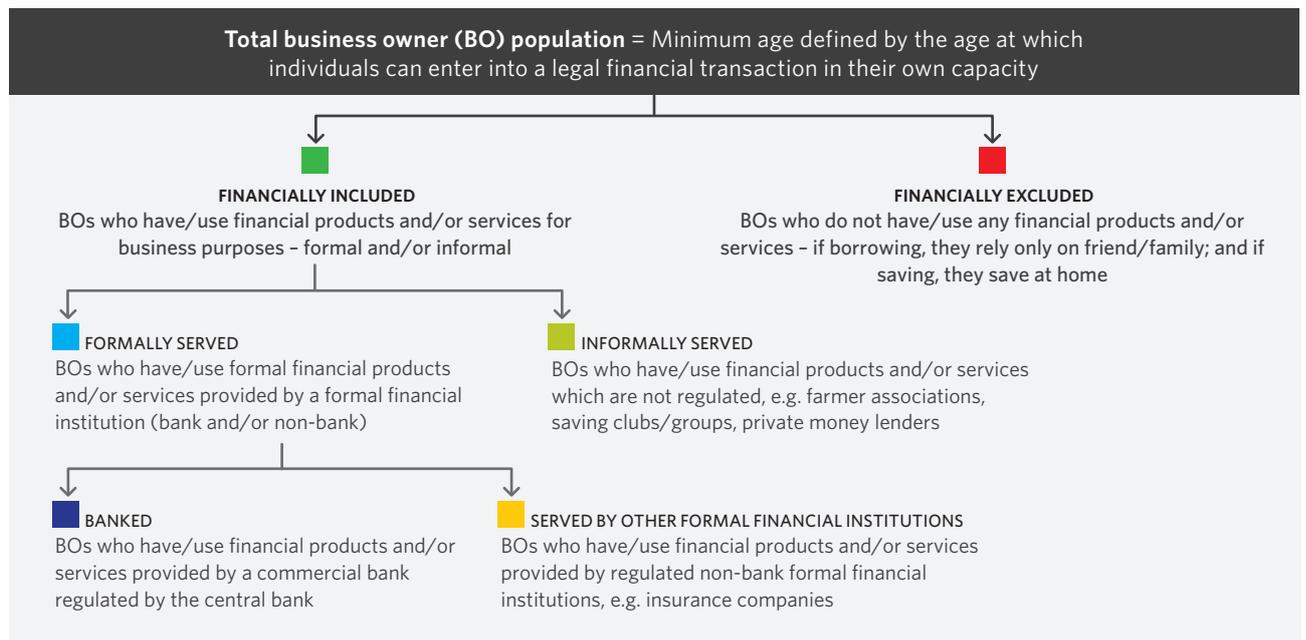
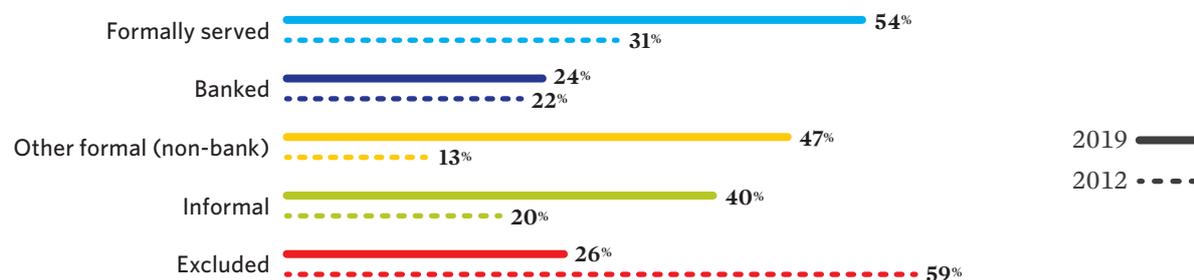


FIGURE 22: Overview of financial product use (with overlaps)

Source: FinScope MSME Malawi 2019 Survey



MSMEs use different mechanisms to finance their day-to-day operations, expand or even downsize. The FinScope financial inclusion framework allows for the various mechanisms accessed by business owners to be identified and used in combination. This allows a deeper understanding of what access to finance entails in the daily needs of the business, ranging from payments to risk mitigation mechanisms. Figure 22 shows an overview of financial product use across the categories comparing 2012 and 2019.

Figure 22 shows a notable increase of 23 per cent in the proportion of business owners with access to formal financial services or products from 2012 to 2019. This is largely driven by mobile money account ownership and SACCOs. Bank access has increased marginally in terms of the proportion of banked business owners but a significant increase is noted in terms of absolute numbers, jumping from 169,000 in 2012 to 270,000 in 2019.

5.1 Overlaps and the financial access strand

As mentioned earlier, businesses use a myriad of financial services offered by various providers ranging from informal to formal. Hence, there may be overlaps when looking at the ownership and usage of financial services and products by MSME owners. A further look at the overlaps shown in Figure 23 reveals their usage of financial services via multiple sources such as banks, other formal institutions and informal operators. This may be driven by a difference in the accessibility of financial services offered by each sector, the cycle phase of the business, location, or other intrinsic factors such as demographics. Issues surrounding collateral, Know-Your-Customer requirements and arduous procedures may impede the uptake of formal products and services.

There have been significant shifts in financial product uptake between 2012 and 2019, which can be explained through processes like payments where mobile money has played a role in the growth of non-bank formal services. Access to credit from informal mechanisms such as VSLAs has also become available. The report will explore these in detail and explain the decline in the proportion of excluded business owners.

FIGURE 23: Overlaps and Financial Access Strand (%)

Source: FinScope MSME Malawi 2019 Survey

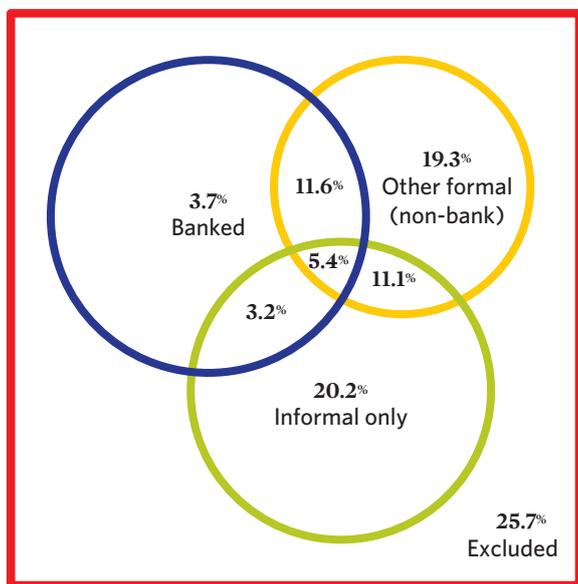
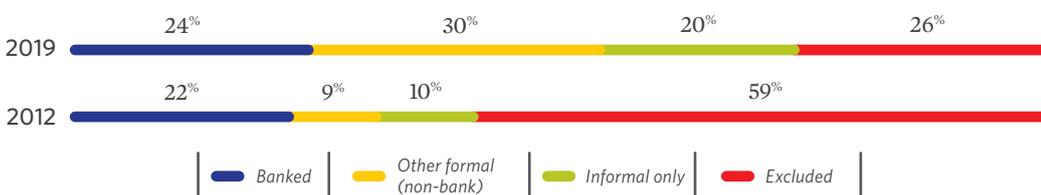


FIGURE 24: Access Strand 2019 (%)

Source: FinScope MSME Malawi 2019 Survey



5.2 Financial access and usage

Conventionally, the driving institution of formal services and products was banks. The landscape significantly changed with the introduction of mobile money in 2012, and microfinance institutions at the beginning of the century. As cited in the National Strategy for Financial Inclusion 2016-2020, 'There is potential to support MFIs as the primary formal providers of MSME and agricultural finance, and to further extend credit to farmers through existing value chains.' In such endeavour, an increase in MSME formal access from 31 per cent in 2012 to 54 per cent in 2019 indicates market stimulation to increase the breadth of formal access points and products that cater to MSME needs. Cross use of products by business owners between banks and other formal, non-bank providers is evident as shown in Figure 23 earlier.

There are definite drivers to the increase in formal product access, mainly attributed to mobile money. This can be identified easily as Malawi had no mobile money offering in 2012 and there has been a rapid uptake since its introduction to the market since then. Another driver of formal financial access has been the banks themselves. The prevalence of business owners making use of bank products increased from 22 per cent in 2012 to 24 per cent in 2019 (see Figure 24). This was mostly due to transactional products since savings levels with banks dropped proportionally yet overall there was an increase in the number of business owners accessing transactional products.

The level of financial access varies by sector as the demands for financial services differ according to the complexity of the business (due to intrinsic factors such as the development of the sector and the business life cycle phase). As shown in Figure 25, more developed sectors such as business services, tourism and construction have a higher number of banked enterprises. Less developed sectors, such as farming, and wholesale and retail sectors, have lower levels of formal access. Interestingly with lower bank penetration, there is a higher uptake of other formal, non-bank services and products. This can be credited to higher uptake of mobile money and SACCOs. A high degree of informal enterprises and low turnover, as discussed in section 3, may discourage business owners from using formal products due to cost and convenience. The most common drawback is the perceived lack of need for bank products.

Formal product access and usage depend largely on the business ecosystem. If clients and input suppliers mostly operate on a cash system, the use of formal platforms like

Point of Sale (POS) may be more costly to the business. Understanding the ecosystem of the business will help create products that improve how owners collect and make payments and enhance their cash flow management and security.

The business life cycle stages present different financial needs. The capital mix for a start-up may look completely different from that of an established or mature business. Looking at the access to finance for each business stage allows financial tools better tailored to each phase to be deployed into the market. The large variations between sectors make life cycles difficult to ascribe to businesses. So for simplicity, this report uses the business age as a life cycle indicator to look at financial usage at each phase.

Figure 26 shows that access to formal products increases with progression through the life cycle of a business. It is interesting to note that other formal, non-bank uptake increases steadily with each life cycle stage. Whilst the overall figure sits at 42 per cent for both mature and start-up phases, that equates respectively to a high of 58 per cent and a low of 35 per cent overall. The use of informal mechanisms is also similar across all stages in the business cycle, with the largest proportion stemming from growth and established phases at 31 per cent each (44 per cent overall for the growth phase, which also comprises an additional 23 per cent of owners entirely dependent on informal mechanisms for their financial needs).

FIGURE 25: Financial Access Strand by sector (%)

Source: FinScope MSME Malawi 2019 Survey

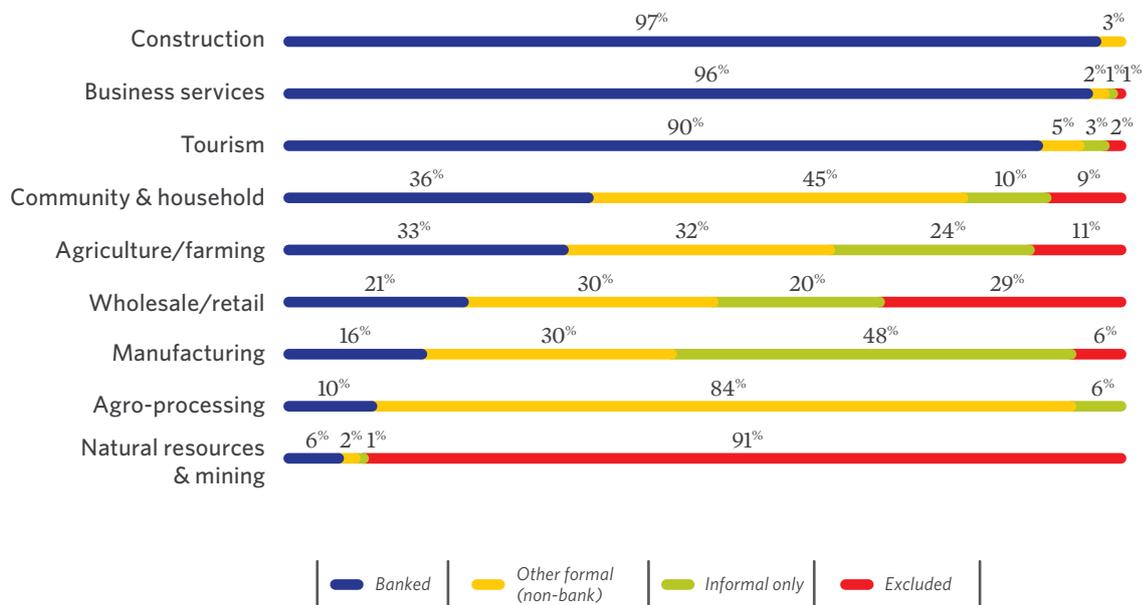
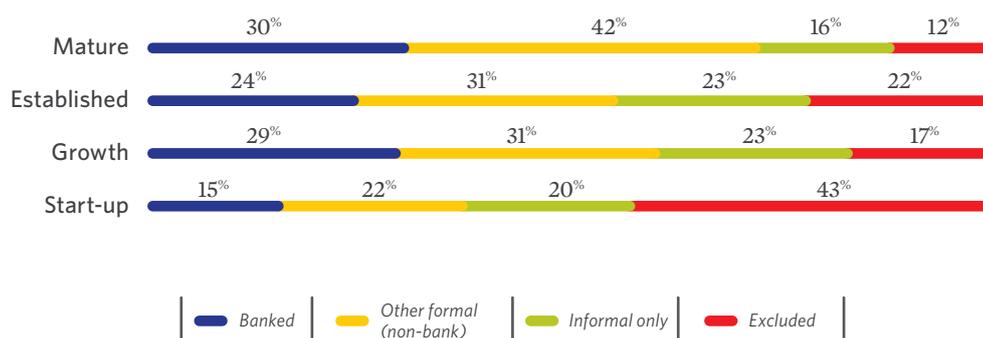


FIGURE 26: Financial Access Strand by business life cycle (%)

Source: FinScope MSME Malawi 2019 Survey

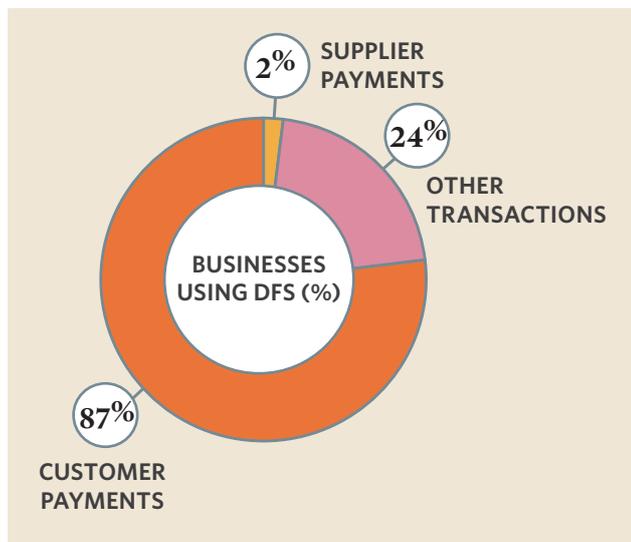


5.3 Digital financial services

Digital financial service (DFS) tools have seen a rapid increase in adoption, particularly in developing economies with increasing ownership of mobile phones and cheaper, more accessible, mobile-based financial services. This allows financial offerings to reach more businesses across distant geographic areas in real-time. With the introduction of mobile money and its high uptake, this broadens the financial landscape across the digital ecosystem.

FIGURE 27: DFS universe

Source: FinScope MSME Malawi 2019 Survey



MSMEs in Malawi have a 40 per cent adoption rate (uptake) of mobile money services. Unexpectedly, only 9 per cent of businesses use DFS and this may be attributed to high use of cash-in, cash-out transactions and low usage of digital platforms to transact with suppliers (2 per cent) or receive customer payments (87 per cent) as shown in Figure 26. Business owners typically using DFS are banked (67 per cent) and have mobile money accounts (67 per cent), showing a crossover in use between banks and mobile money. The contribution of DFS to these figures lies in the interoperability between banks and mobile money wallets. The advent of mobile money cards also increased its footprint in the digital ecosystem. Interoperability between bank accounts and mobile wallets, as well as across mobile wallets, may increase DFS usage. It would also raise awareness of those platforms among those who already access formal services and products.

With two-thirds using the technology, usage of digital payments (for both customers and suppliers) is more prominent amongst the youth. This is despite senior owners showing higher ownership of bank, mobile money and MFI accounts.

5.4 Access to credit

As revealed in the FinScope MSME 2012 survey and NSFI 2016-2020, credit is one of the most important factors for growth in the MSME sector. The 2012 report showed that 34 per cent of MSMEs cited access to finance as their biggest obstacle to growth while in 2019, 36 per cent felt the same. Looking at the Credit Strand in Figure 28, there is no improvement in access to formal finance (11 per cent in both 2012 and 2019), although absolute numbers increased from 86,500 in 2012 to 114,000 in 2019.

It is expected that the larger the enterprise the more access to formal and overall credit it will have, as reflected in Figure 27. Micro-enterprises commonly depend on informal credit mechanisms as well as family and friends, who become critical for business cash flow and working capital.

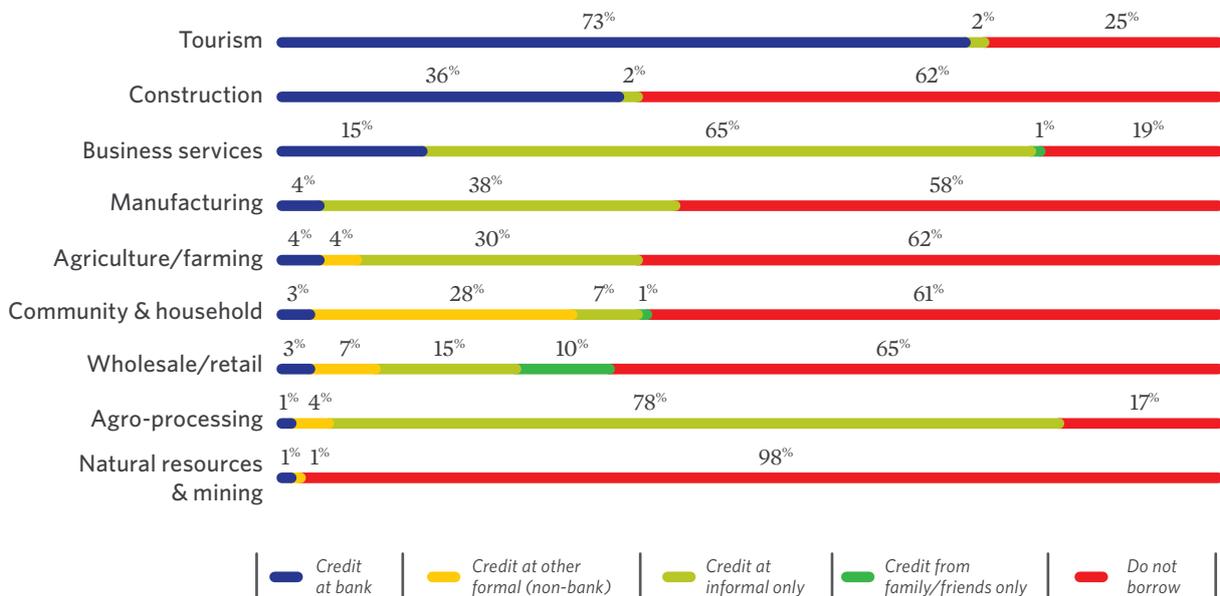
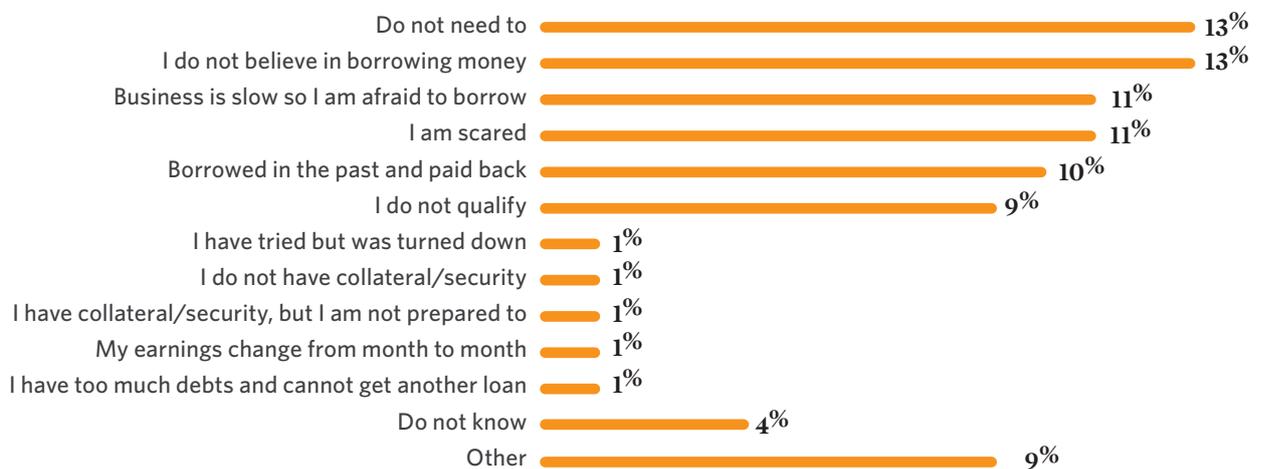
The most significant barrier to entry for MSMEs in any market is start-up capital and as the business grows, various financial tools are introduced but credit remains an important fund-raising source. Access to formal credit, particularly for tourism, construction and business services is high and the three sectors do not borrow from other formal, non-bank institutions (see Figure 29). With the exception of the business services sector (at 65 per cent), the tourism and construction sectors also borrow minimally from informal providers (less than 5 per cent overall with 2 per cent borrowing only from informal sources). The remaining sectors have lower formal credit access, particularly manufacturing and agro-processing, both deemed to be industrial drivers within the MSME sector. There is a high dependence informal sector mechanisms such as VSLAs, ROSCAs and money lenders. While access to credit has improved, the challenge remains in providing credit to the most critical sectors of the economy.

A total of 736,000 business owners (64 per cent) are not currently borrowing for their operations. Looking at Figure 30, the top three barriers have not changed from 2012. This is odd given that over 60 per cent of business owners cite access to finance as an issue, one that is not limited to access to credit. Drawing from the focus group discussion to elaborate on this observation, it was found that MSMEs may have access to credit (contributing to the overall 60 per cent) but found it cumbersome to use, insufficient or expensive. Those who did not have access were simply afraid to acquire credit.

Business owners without access are likely to be in a start-up phase (34 per cent), male (51 per cent), aged 35 years or above (52 per cent) and in rural areas (78 per cent).

FIGURE 28: Credit Strand 2019 versus 2012 and by MSME size (%)

Source: FinScope MSME Malawi 2019 Survey

**FIGURE 29: Credit Strand by sector |** Source: FinScope MSME Malawi 2019 Survey**FIGURE 30: Barriers to borrowing |** Source: FinScope MSME Malawi 2019 Survey

5.5 Savings and investment

Access to capital markets and other formal savings and investment platforms, such as SACCOs or the stock exchange, allows higher returns for MSMEs. These can be invested into formal enterprises thereby increasing the funds available for re-investment or credit. However, looking at the Savings Strand, a drop in savings through banks is noted between 2012 and 2019, falling from 16 per cent to 2 per cent. This is largely attributed to the way the accounts are allocated. Accounts broadly classed as savings in 2012 are listed as non-savings transactional products in 2019. The rationale for this was covered in the 2014 FinScope Consumer survey following the banking system transition from savings book or account to transactional cheque account. This was because the products, originally intended for savings, were being used as chequeing accounts, the appeal stemming from the low entry deposit requirement. These have now been replaced with fixed-term deposits, notice accounts and long-term saving accounts.

The drop in overall savings by from 78 per cent to 46 per cent may also be attributed to the refinement of the Finmark MSME survey questionnaire and measurement framework between the first generations in 2012 and the third generations conducted in 2019. The main questionnaire phrasing change

was framing questions around the enterprise, i.e. is the owner saving specifically for business purposes? This was necessary as it may be difficult to separate personal or household savings from those of the business. A tougher economic environment, dependency on retained earnings as a source of capital injection, and having less money to invest in savings may explain the drop in the overall proportion of enterprises saving capital in 2019.

For those not saving (54 per cent), the main reasons given were either all funds being reinvested into the business (21 per cent) or the business was not generating enough capital to save (18 per cent).

5.6 Insurance and risk mitigation

MSMEs face a myriad of risks that contribute to their overall financial services risk profile. The most common risks facing MSMEs are theft of business stock (34 per cent), rain damage (24 per cent), and fire, flood or natural disaster (23 per cent). With the bulk of MSMEs being informal and sole proprietors, risk transfers to the household, further jeopardising the livelihoods of MSME owners. Whilst the bulk of risks facing the sector are insurable, the uptake of insurance cover remains low

FIGURE 31: Savings Strand (%) | Source: FinScope MSME Malawi 2019 Survey

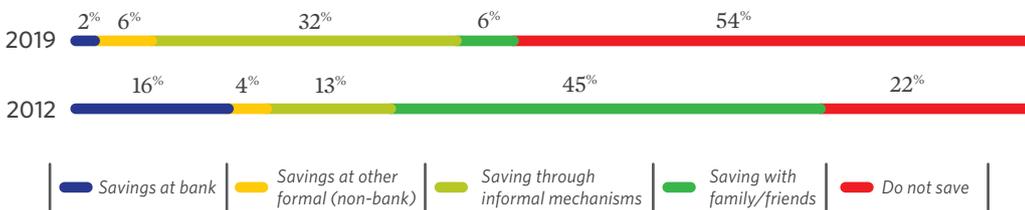


FIGURE 32: Insurance strand (%) | Source: FinScope MSME Malawi 2019 Survey

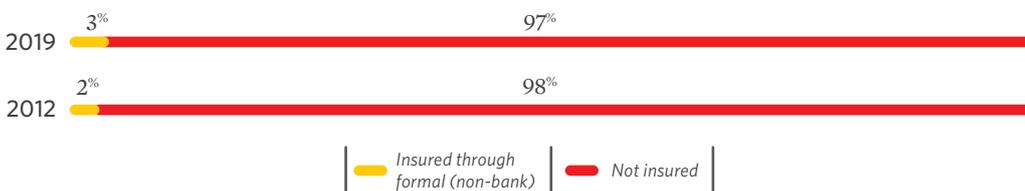
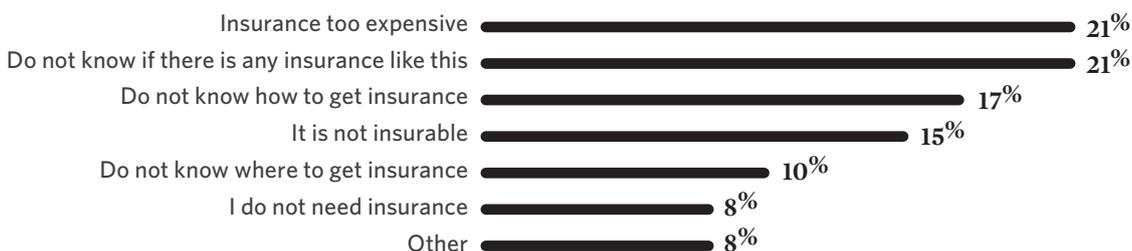


FIGURE 33: Barriers to insurance | Source: FinScope MSME Malawi 2019 Survey



with most owners covering themselves at a personal level and the business remains unprotected. There is a negligible change in the proportion of insured MSMEs between 2012 (2 per cent) and 2019 (3 per cent).

While most MSMEs are uninsured yet face risk, the majority did not take proactive measures. Those that did take action to deal with risk used their personal savings or borrowed capital.

Given the need for insurance and the obstacles to obtaining it, the NFIS proposes wholesale disaster insurance as a viable product targeted primarily at farmers through loan providers such as MFIs. Identifying the most common risks and sizing the market to which an insurable risk applies, allows for a more affordable product. The bundling of products can assist in generating a larger pool of insured agri-business owners and potentially even subsistence farmers. It is equally important that targeted insurance products are coupled with financial education to help business owners understand the concept of insurance and empower them to choose the most suitable policies.

SECTION 6

FOCUSING EFFORT: HIGH-IMPACT SMEs FOR GROWTH AND EMPLOYMENT

The NFIS identifies affordable credit as a priority for MSMEs and farmers possessing both the ability and motivation to grow. While the sector contributes significantly to employment and the broader Malawian economy, not all MSMEs will produce a notable and sustainable impact on those two areas. Governments often cast a wide net in attempting to advance the development of the MSME sector through support to businesses of all sizes. However, such an approach often fails to deliver the expected outcome due to the lack of resources to reach all businesses in the MSME spectrum. Moreover, it is not efficient to spread limited resources attempting to assist every MSME without

adequately understanding the growth, employment and output potential of the respective business types.

It is, therefore, prudent to focus the limited resources when promoting the growth and development of MSMEs. Government investment will have a greater impact when directed toward those with the highest potential to register rapid growth.

As outlined in the box below, segmenting the MSME sector helps to identify those businesses that have the highest potential to grow (defined as high-impact), provide employment, and contribute to the economy.

The segmentation created a group of small and medium enterprises (SMEs) across all sectors using the criterion described earlier. This identified a total of 34,855 enterprises distributed across Malawi and the following sections profile those recognised as high-impact SMEs.

What are high-impact SMEs?

Businesses were grouped into a high-impact category using a battery of criterion that included business size, the owner's perception of business performance, employer status and personal monthly income.

The study used small and medium enterprises (SMEs), dropping micro-enterprises due to their

high balance of survivalist businesses. SMEs had to be a current employer to qualify for this segment and this was coupled with a qualitative measure rating the owner's perception of business performance. That perception was recorded using answers to the following survey question: "Thinking about the last 12 months, would you best describe your business as growing, the same, worse, or just

starting out?". Additionally, as a measure of business performance, the study used the owner's monthly income and applied the median of MK500,000 and above. In summary, the criteria for high-impact SMEs included a growing and stable business with employees and an owner receiving a personal monthly income of MK500,000 or more.

6.1 Who are high-impact SME owners?

Targeting specific SME owners in the high-impact group requires that they be identifiable and quantifiable. There are two main outcomes desired from this segment and so it was split into two target groups, mainly by sector. The first is the aggressive-growth target group, which includes the agriculture and farming, manufacturing, construction, and business services sectors. This target group is identified as a key to industrialising the MSME economy and anticipated to increase substantially in its contribution to economic growth. The second is the employment-generation target group, comprising wholesale and retail, community and household, tourism, agro-processing, and natural resources and mining. While there is scope for agro-processors to develop meaningfully in the sector, the current status within the micro-sector is still in its infancy as most agro-processors in this segment are millers and secondary food processors. The bulk of agro-processing is dominated by large enterprises.

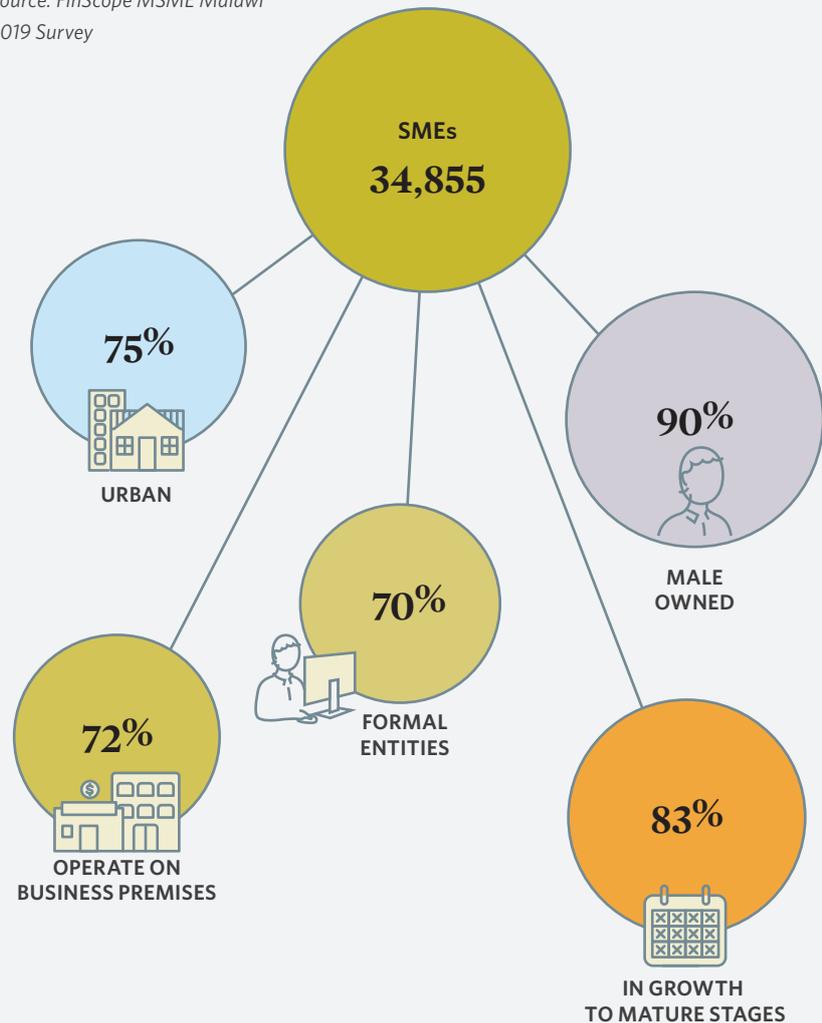
The educational attainments of most SMEs in the high-impact group are slightly higher compared to the overall MSME population. 52 per cent have secondary education, 11 per cent a university degree, and 14 per cent a special technical diploma. Related to education is understanding the importance of maintaining financial records. Around two in three (69 per cent) businesses keep financial records and those are mostly through manual systems (86 per cent) with just 21 per cent using computerised systems. Nine in ten high-impact SME owners are male with most being based in urban areas (75 per cent) and operating from premises such as workshops, stores or markets.

The level of development within the group is clear as most SMEs are in the growth phase or higher. This is indicated by the higher proportion of formal SMEs (70 per cent) and the number of years in business.

While the latter indicator may not be an indicator of enterprise development

FIGURE 34: Overview of high-impact SMEs

Source: FinScope MSME Malawi 2019 Survey



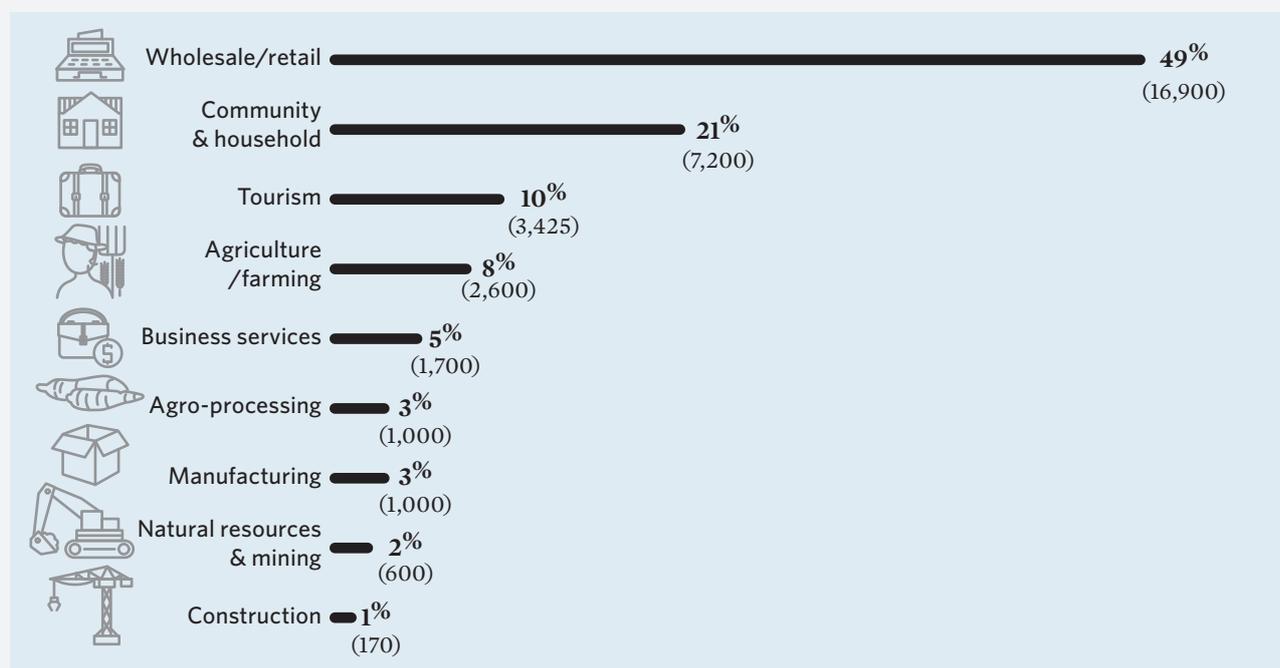
in other sectors, it does give a sense of where the business lies in a typical life cycle. The sectoral split of the high-impact SMEs is shown in Figure 34. As can be expected, the higher proportion of SMEs fall within the wholesale/retail sector (49 per cent, or 17,000 SMEs), and community and household (21 per cent, or 7,200 SMEs). A further breakdown of the high-impact SME category is presented to allow us to delve into growth obstacles, uptake and usage of financial services and products, and the usage and awareness of business support services.

79 per cent of high-impact SMEs have access to electricity while just 53 per cent are connected to piped water. However, consulting with a few of these

enterprises revealed numerous challenges in connecting to the electrical grid, including power cuts and the high cost of electrical connections. ESCOM tariff rates were considered to be high by business owners in this segment. Enterprises also experience challenges with poor transport infrastructure especially roads, which leads to increased transportation costs. They also suffered delays or failed to collect and deliver products in certain areas, particularly during the rainy season. This contributes to the second most common obstacle: access to markets. The infrastructural environment makes it difficult for SMEs to operate and compete. When coupled with low skills or inadequate labour, these challenges contribute to stifled product development and poorer quality products.

FIGURE 35: High-impact SMEs by sector (%)

Source: FinScope MSME Malawi 2019 Survey

**FIGURE 36: Growth obstacles faced by High-impact SMEs (%)**

Source: FinScope MSME Malawi 2019 Survey



Access to finance has been recognised as the most prevalent obstacle in the region, including in the recently conducted FinScope Eswatini 2017 survey. Malawi is no exception, with both 2012 and 2019 surveys identifying it as the major barrier for high-impact enterprise in particular. Unpacking this further, the study found that sourcing funds (37 per cent), cash flow (25 per cent) and high debt books (10 per cent) were the notable issues. This suggests that access to finance is a broad problem and is inadequately provided for in this segment. It is also a largely misconstrued term that bundles in finance-related issues not necessarily linked to access.

“Access to finance is a challenge because banks requirement of collateral, deposits or savings, adequate financial records, written business plans, and credit history. They charge high interest rates and have short loan repayment period. Most of the banks require collateral value to more than one and half the value of the loan”.

High growth SME participant.

As explained earlier, the high growth SMEs were then split into two groups; aggressive-growth and employment-generation segments. The report examines these segments in the next section.

6.2 Aggressive-growth versus employment creation SMEs

The MSME Policy (2009) accurately established that the MSME sector is underdeveloped and uncompetitive. For prosperous transformation to take place, a few segments need to be targeted and supported. This would enhance development in the sector and allow it to compete regionally and globally. As such, the report attempted to identify the sectors most primed to grow aggressively and transform the narrative. The segment is positioned to be industrially-driven with the potential for exports and a broad addition of value. Table 11 shows an overview of this breakdown.

It is equally important to focus on employment creation and higher income to improve the livelihood of Malawians. With increased manufacturing in the sector, smooth and structured value chains and better access to markets become crucial. And so the second segment, which holds higher employment prospects, becomes a critical accessory to the aggressive-growth segment.

One issue raised during qualitative research was the extended time taken by debtors to settle the amount owed to businesses. One-quarter of aggressive-growth SMEs continually offers credit compared to just 6 per cent within the employment-generation group. Best practices should be applied and delivered through business support and other formal financial services. These would include cash flow management and funding to ensure that neither segment is not at risk of overexposure.

Access to markets remains an important factor regardless of sector or business size. Just 5 per cent of the high-impact group sells abroad, showing a low capacity for exports. Value addition sectors need to produce products that meet global quality standards if they are to compete. However, local markets comprise the bulk of the client base for both aggressive-growth and employment-generation segments. A closer look at the value chains in which they participate paints an interesting picture.

TABLE 11: High-impact group segments overview

Source: FinScope MSME Malawi 2019 Survey

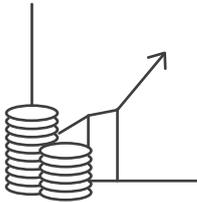
	 Aggressive growth	 Employment creation
Sectors	Agriculture Manufacturing Business services Construction	Wholesale/retail Community & household Agro-processing Tourism
 Urban	58%	78%
 Female	10%	10%
 Electricity access	73%	80%
 Piped water access	61%	52%
 Median annual turnover (USD)	\$26,300	\$24,650
 Formal enterprises	67%	71%
ACCESS TO FINANCE		
Formal financial access	93%	94%
Informal services uptake	40%	15%
Formal credit access	35%	24%
Informal credit access	14%	9%
Mobile money uptake	74%	66%
Digital financial services (using)	49%	37%
VSLA/ROSCA	33%	14%
Insured	39%	37%
Export product	6%	4%
Import input	19%	16%

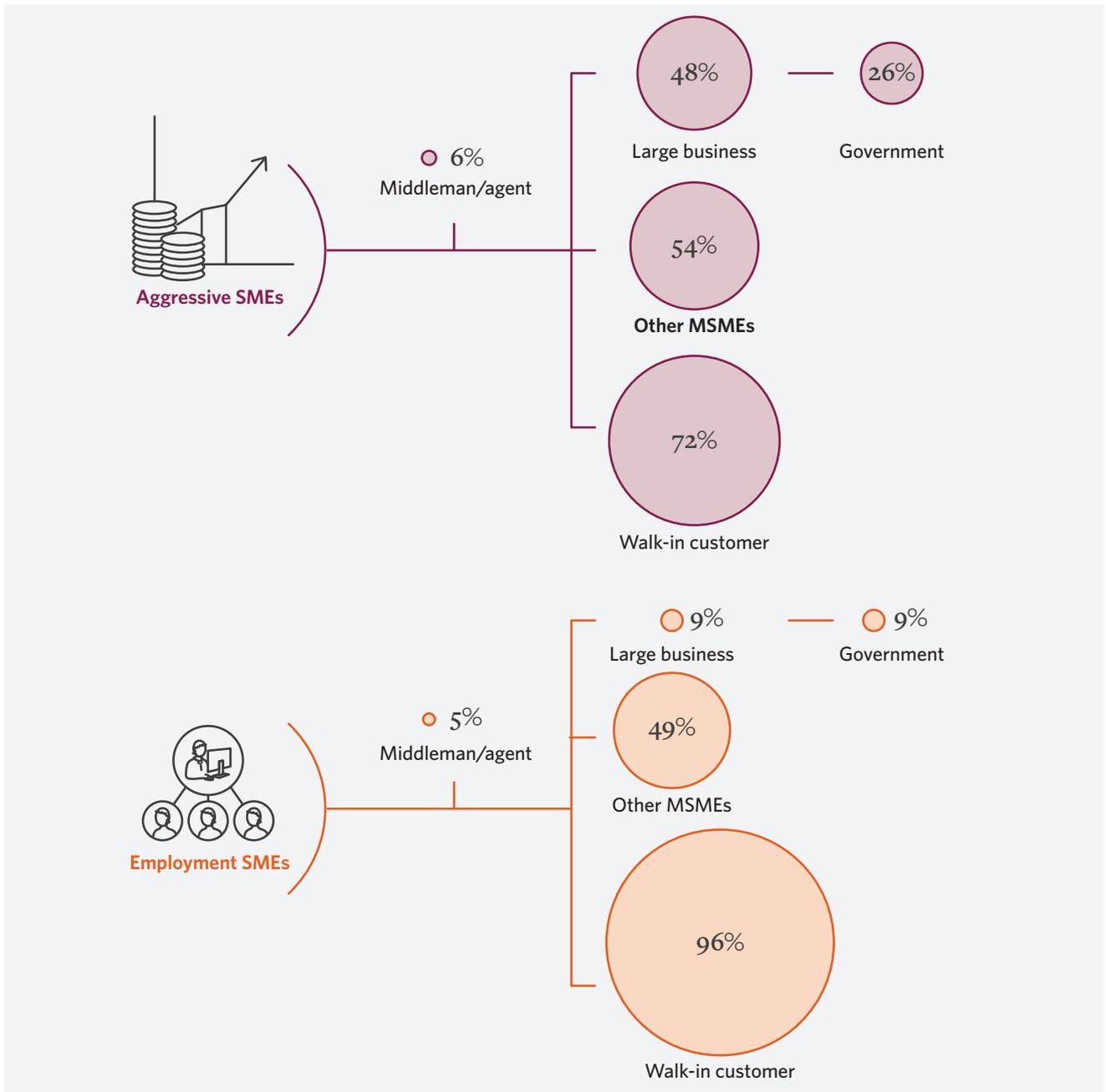
FIGURE 37: Value chains for Aggressive-growth and Employment-generation segments | Source: FinScope MSME Malawi 2019 Survey

Figure 37 above shows the value chains with which the two segments operate. Nearly half of aggressive-growth SMEs (48 per cent) enjoy large businesses and government (26 per cent) as customers. This shows the vertical linkages for aggressive-growth SMEs. Employment-generation SMEs have a lower proportion working with large businesses or government, perhaps due to their sector being predominantly wholesale and retail, and community and household services. However, for both segments,

it shows strong horizontal linkages as one in two (on average) trade with similar enterprises, agriculture and farming being the highest of those (80 per cent). Walk-in customers still form the bulk of clients transacting that way. Few high-growth SMEs use middlemen or agents (less than 5 per cent) while overall medium enterprises utilise them (19 per cent), predominantly amongst medium-sized wholesale and retail enterprises.

Access to formal financial services is high for the two segments, with nine in ten enterprises able to use those services. At 35 per cent, the use of formal credit is higher in the aggressive-growth segment compared to the employment-generation category at 24 per cent. In both cases, this is largely driven by bank credit. Interestingly, two in five aggressive-growth SMEs use informal mechanisms, mainly savings and credit groups such as VSLAs and ROSCAs. This is most common in the business services and agriculture

FIGURE 38: Segment contribution to GDP | Source: FinScope MSME Malawi 2019 Survey

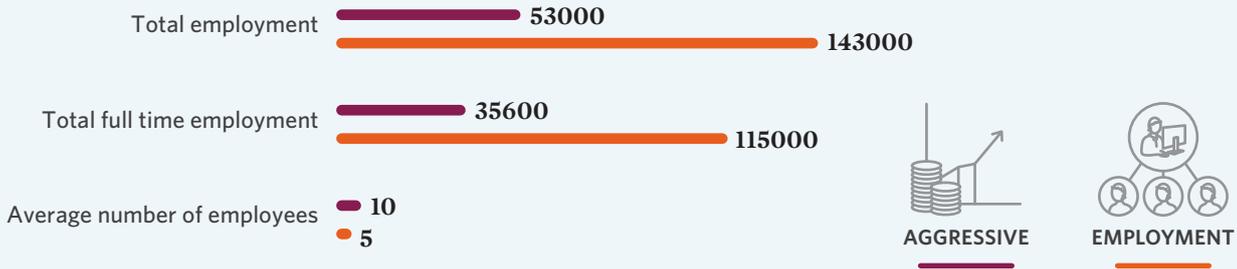


TABLE 12: High-impact segment contribution to GDP | Source: FinScope MSME Malawi 2019 Survey

Segment	Contribution to GDP (value-add)	Percentage of MSME sector contribution
Aggressive	\$468 569 974.56	7%
Employment	\$1 741 251 246.71	25%

sectors. While access to finance may be high, the depth of financial services seems to be inadequate in catering to the business needs. This is reflected in the qualitative study, with a respondent from the high-impact focus group stating, “Informal finance through VSLs is a better option because the requirements to access loans through VSLs are more flexible than formal credit from banks. They benefit from interests charged on loans from VSLs. One can borrow money from VSLs based on their savings”.

6.3 Employment and contribution to GDP

It is important to realise the positioning of these segments concerning the creation of employment and their contribution to GDP. Using the study as a baseline in sizing the target areas as well as their overall performance, Figure 38 shows contribution to employment of each of the segments.

The most pertinent finding is that, while the employment-generation segment is better positioned to absorb more employees than the aggressive-growth segment (143,000 compared to 53,000), the aggressive-growth sector employs more people (on average). This suggests that improving the number of enterprises in this segment will have a greater impact on employment (on average). But there are various factors faced by enterprises with regards to employment as it is an indirect demand factor.

Looking at each segments contribution to GDP shows interesting, though not unexpected, findings. The employment segment has the highest contribution to GDP due to its size and accounts for a quarter of MSMEs in Malawi. However, the contribution per enterprise shows that aggressive-growth SMEs have a higher contribution on average. Looking at the ratio of formalisation between the pair suggests that about two in three enterprises in each segment contributes formally to the economy.

This may already be captured in formal accounts but about one-third of businesses in both segments have the potential to contribute around USD650 million through formal channels. Incentives or benefits of transitioning to formal activities for the SMEs in both segments should be made clearer along with assistance in compliance and reporting accurate turnover. The study found that most high-impact enterprises can adequately account for turnover and business expenses, such as family labour.

To ensure these segments deliver on growth and employment, interventions need to ensure they arise from an intricate knowledge of the SME environment within which they operate. These factors include infrastructure (mainly ICT, energy and road), cost of finance, depth of credit (leading to multiple borrowing), restructuring of tax regimes for simplification, evident advantages of formalisation, taxation and access to markets.

SECTION 7

CONCLUSIONS AND IMPLICATIONS FOR STAKEHOLDERS

The study has drawn the following conclusions by analysing the profile of MSME owners, characteristics of their businesses and the challenges they face:

- **The largest proportion of MSME business owners operate in wholesale and retail** (selling something, particularly agricultural products), conduct agricultural activities, render business services (professional services such as accountants, lawyers and consultants) and skilled services (hair salons, plumbers, and mechanics for example). The most common business premises for MSMEs are either residential (24 per cent) or a trading centre/market.
- **Many of those businesses are in the start-up phase (3 - 5 years of existence).** The analysis implies that MSME firms are growing, not only through the expansion of existing firms but also through the birth of new ones. This can be seen by the larger proportion of start-ups. The trend also shows a higher mortality rate of MSMEs beyond this phase as almost two-thirds of the businesses are below five years old and only 39 per cent survive from 6 years and above. This phase of the business requires special attention with regards to expansion and support.
- **The majority of MSMEs trade informally, being neither registered nor licensed.** Only 7 per cent of MSMEs are listed by the Registrar of Companies and 11 per cent are licensed but the trend is positive as just 3 per cent were formalised in 2012. Those surveyed cited the small size of their business as the main reason for not registering. Other studies advise that the cost of registration is not the only barrier. MSMEs need to be told the benefits of registration, which include being able to open a business account, obtain a loan and take advantage of other business support services.
- **Nearly 80 per cent of MSME owners started a new business using savings.** While MSME owners primarily rely on their own capital, including salaries, selling assets, and help from family and friends, 10 per cent of MSMEs manage to access both formal and informal credit from other channels. These include village savings and credit groups (VSLs), also known as Bank Nkhonde, and other financial institutions. This provides room for the Government to strengthen financial inclusion initiatives.
- **Almost half of MSMEs owners are classed as youth.** Entrepreneurs aged below 35 constitute 42 per cent of MSME business owners in Malawi. This shows the potential of the MSME sector for job creation and alleviating youth unemployment. It also contributes to the Government's effort to promote economic empowerment of young people in Malawi. Young entrepreneurs may have limited business experience and this provides an opportunity for the Government to expand business support services to this category of owners, particularly through incubation programmes.
- **Women are more likely to own micro-enterprises and less likely to own small and medium firms.** Two-thirds of MSME owners are women but most of them run independent enterprises with no employees. Proportionately fewer women own high-impact MSMEs, demonstrating a need for the provision of training programs tailored to women owners, empowering them to grow their business.
- **High-impact SMEs are key to sustainable growth.** These businesses account for about one-third of MSME GDP contribution and have the potential to industrialise the MSME economy, making them a worthwhile prospect for focused interventions. The segmentation revealed that aggressive-growth SMEs, such as construction and agriculture, have a higher propensity to contribute to tax and employment. Formalisation remains a core issue that must be designed to entice informal high-impact SMEs into the formal economy as opposed to a push strategy that ends up growing the informal sector. Tax issues are not always the main reason prominent SMEs don't formalise as the study concluded that high-impact SMEs simply don't see the benefit of formalising.
- **Malawi's MSME sector faces many challenges** to growth and development in the areas of access to finance. These include entry to markets, infrastructure, the policy and regulatory environment, bureaucracy, and capacity in doing business and meeting quality standards, among others.

Implications for stakeholders

Based on conclusions drawn from the analysis, the study presents the recommendations below to policymakers, NGOs and financial service providers

- Recommendations include policy revision with an industrialisation focus and further understanding of the business environment. With formalisation, it is recommended that an awareness strategy be developed linking its importance with other benefits, such as access to formal financial institutions. The BESTAP World Bank project study found that registration on its own delivers no measurable benefits to firms. MSMEs do not experience smoother operations and neither does it increase their trust in government and other institutions. There seems to be another, compounding issue at hand: imperfect information.
- It is therefore recommended that registration includes an information session at commercial banks where evident benefits are presented. For banks, firms opening business bank accounts increase the use of a number of financial services. Therefore, governments seeking to heighten economic growth should aim to reduce the costs of registration and couple it with interventions that increase direct contact with the financial institutions, providing a compelling incentive.
- The MSME sector is constrained by numerous factors not part of the regulatory business environment. These comprise supply-side and infrastructural constraints, such as water and energy supplies, that limit the potential growth of the economy. Indirect needs are better transport infrastructure (roads, railway and air transport), logistics, incentives to SMEs, and knowledge networks whilst direct factors include supportive financing and banking facilities and more investments in mechanised farming and agro-processing. Increasing the potential rate of growth requires a combination of deep structural reforms and medium-term investments to reduce the cost of doing business.
- Value chain analysis is important to understand the case of the agriculture business. The main rationale for this initiative would be to provide an in-depth understanding of sector-specific bottlenecks that hinder the development of an industry considered to be strategically important. As such, unpacking the linkages becomes key. For example, the urban market and export-oriented value chains can be better understood and linked with the development of infrastructures such as quality roads and ports. A clear understanding would allow improved participation of MSMEs if these value chains are identified.

Recommendations for financial service providers [FSPs]

The main barriers to financial service inclusion involve transaction expenses, high banking fees, low financial literacy, the cost of travel to financial providers, lack of identification, ill-suited financial products, limited income, and the unavailability or insufficiency of loan collateral. Financial service providers often view the MSME sector as commercially unviable because of the risk they add to their portfolio. Additionally, MSMEs request small loan amounts which incur a processing cost for the provider that often exceeds the revenue they can generate from it. This is compounded by a lack of competition in the banking market, leading to a tendency for banks to rely more upon established medium and large enterprises. Financial Service Providers need to:

- Develop innovative credit products tailored to the needs and nature of small businesses;
- Set up a dedicated department for MSME financing; and
- Collaborate with other financial service providers to ease MSME financing needs.





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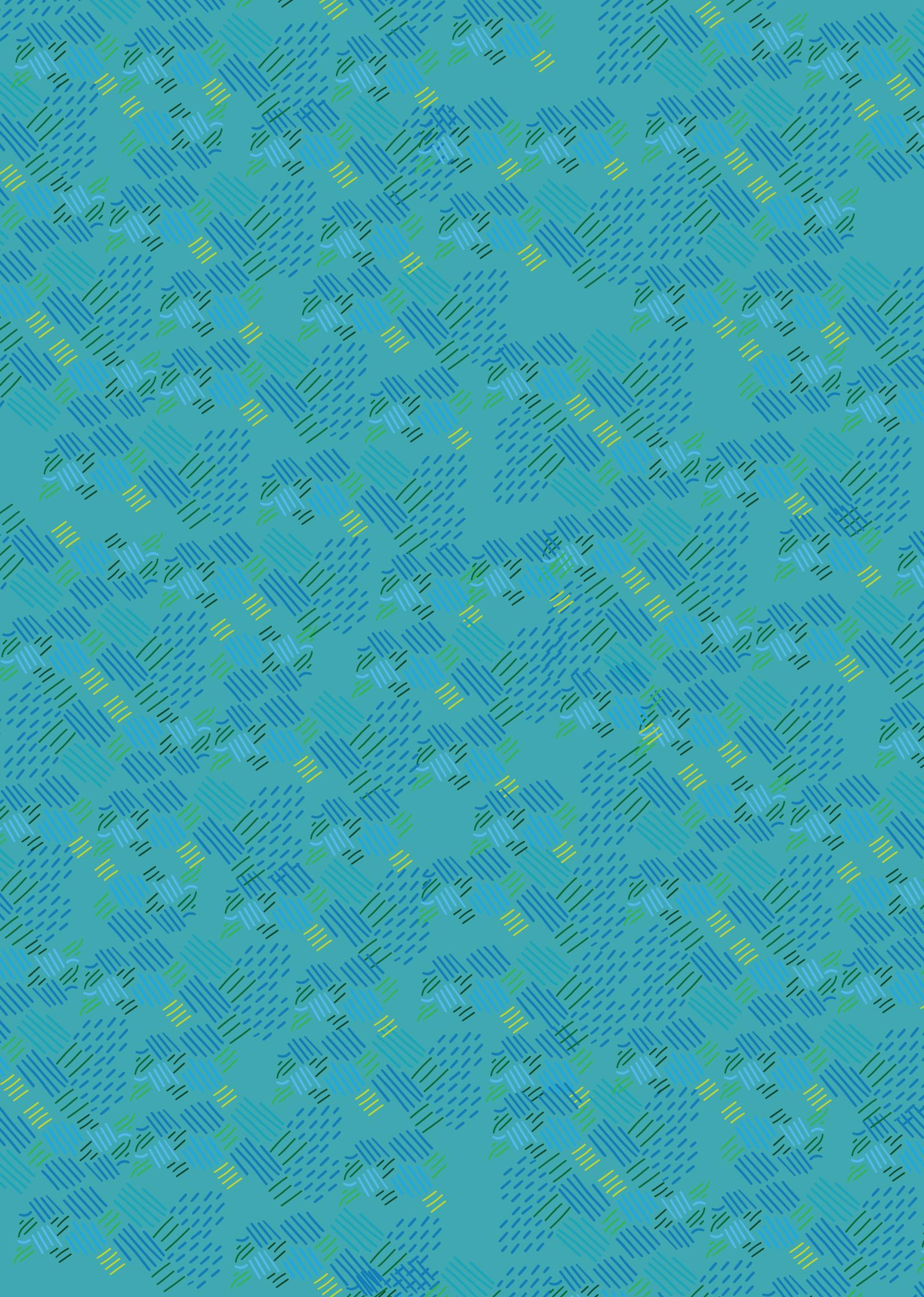
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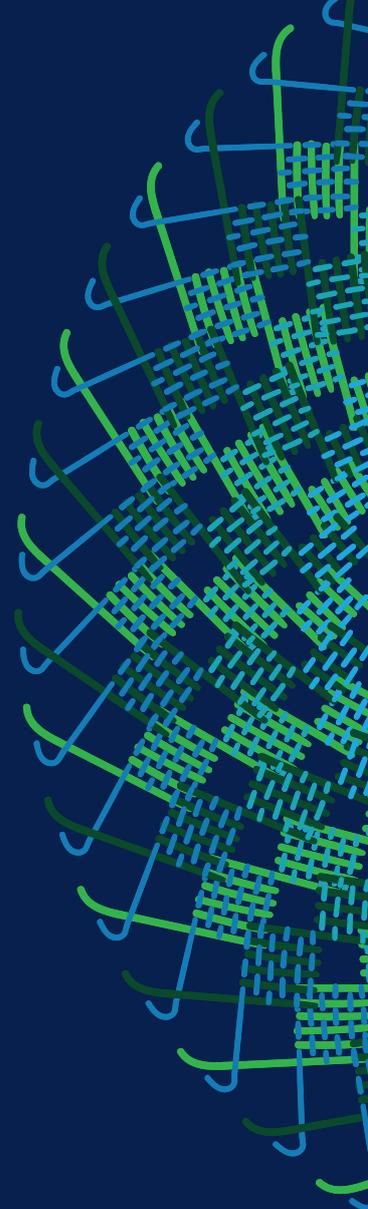
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