



FinScope

Malawi 2019

Micro, Small and Medium Enterprise (MSME) Survey



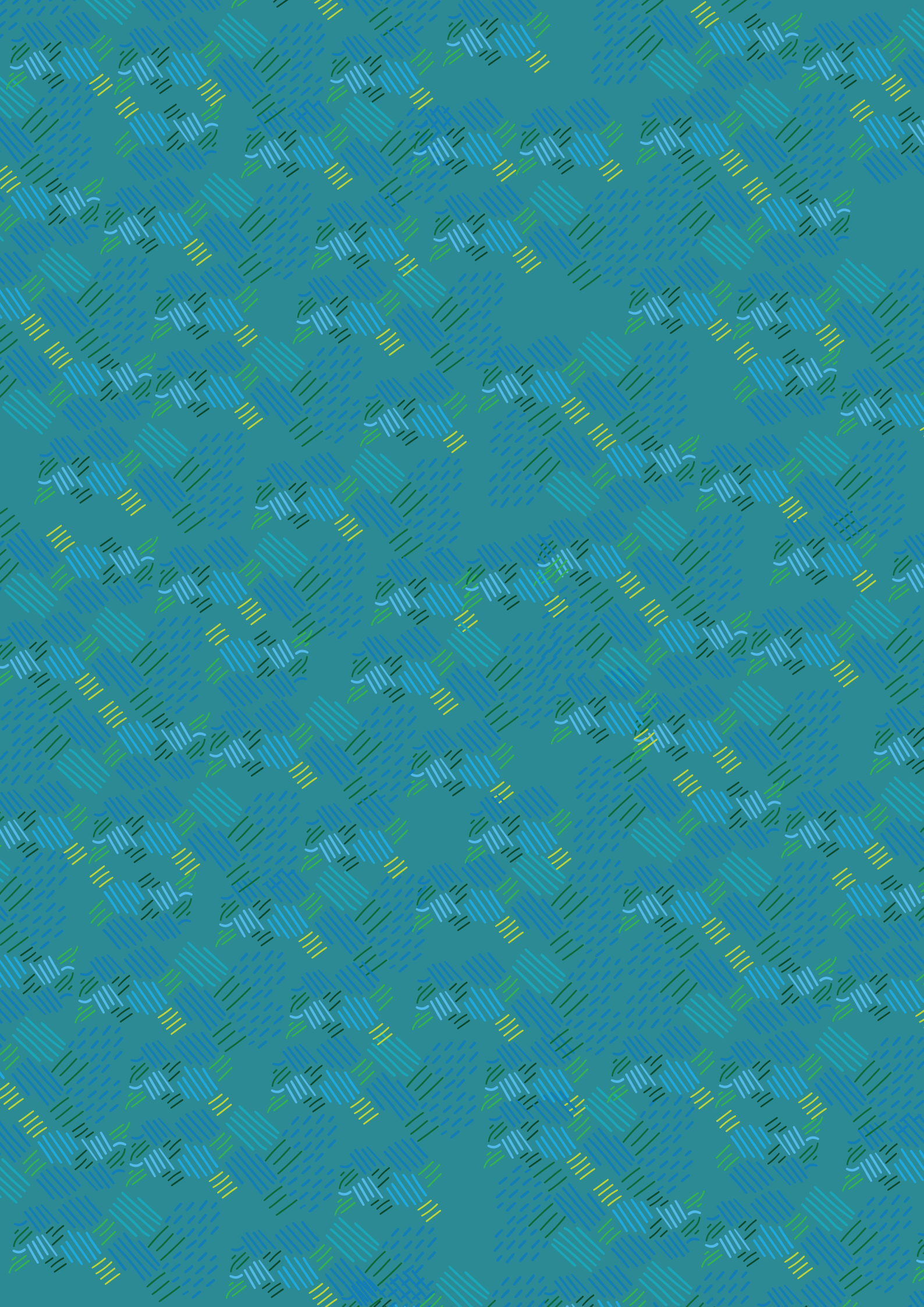


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ACRONYMS AND ABBREVIATIONS

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 & 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 (NASME),
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 individuals who participated in this project in their personal and institutional capacity, without which the project would not have been successful. The survey was carried out under the auspices of the Ministry of Finance and Economic Planning and Development 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 was made up of representatives from various government of Malawi ministries, donors, and other relevant institutions working with the MSME sector. The RG was chaired by the Ministry of Finance, Economic Planning and Development. Other members included were 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, Department for International Development and Community Savings and Investment Promotion (COMSIP). The RG's mandate was to provide oversight and guidance throughout the implementation of the survey. The UNCDF (MAP) also provided technical input and direction to

the overall implementation of the MAP MSME Malawi study.

The National Statistical Office provided statistical oversight and quality control on the data collection. FinMark Trust was responsible for overall project management and technical assistance through the different phases of the project. Imani Development was mandated to implement the field work and data processing for the demand side FinScope MSME survey 2019. We thank their staff including their 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 responded to 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.



***MSMEs in Malawi
contribute a significant
share of employment
within the Malawi
total labour force
(24 percent)***

EXECUTIVE SUMMARY

The Government of Malawi (GOM) has been working towards 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 private sector as the engine for the country's economic growth and poverty alleviation. This is evident in all GOM's 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, the National Employment and Labour Policy as well as in sectoral policies such as the National Agricultural Policy, the Financial Sector Development Strategy and the National Financial Inclusion Strategy amongst others. In a bid to spur access to finance for MSMEs, the GOM has recently launched the Malawi Agriculture and Industrial Investment Corporation (MAIIC) as a development Bank in 2019.

Thus, in trying to understand and unlock the full potential of the sector, a FinScope MSME survey was conducted between March 2019 and May 2019. The main objective was to size and scope the MSMEs in Malawi while describing the 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), in an effort to identify the needs of key segments and come up with recommendations for promotion for growth and employment.

This report is prepared to provide insight into the Malawi MSME sector using FinScope Malawi MSME 2019 survey with the aim of allowing stakeholders to understand the characteristics of MSMEs as well as to serve as a tracking study to the FinScope MSME 2012 survey. The report used graphical analysis to profile MSME owners, characteristics of the businesses they own and the challenges they face in running their businesses in comparison to 2012. Although a myriad of studies exists concerning the sector, few, if any, have been developed to accurately capture the informal businesses that dominate the MSME sector or size the universe of the MSME sector in a globally recognised approach.

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

- **About 42 percent of MSME business owners in Malawi are youth aged below 35 years old.** The large majority of MSMEs (78 percent) are in rural areas with the Central region (50 percent) having the more MSME than the Southern Region (38 percent) and Northern region (12 percent). About 59 percent derive their main income from their businesses. The educational attainments of Malawi MSME business owners is for most low, with 37 percent having a secondary education qualification or higher. Looking at the business skills, 48 percent taught themselves the skills required to manage a business, with 29 percent indicating they were trained by family (other than spouse) or advisors before venturing into their own business.

- **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 less business owners (1,141,784) indicate that some people own more than one business. The average number of people employed by the sector per enterprise is two adults and employs 367,457 full-time employees. When adding part time and seasonal employees as well as the entrepreneurs, nearly two million people 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%) compared to 41% in 2012, which may likely be attributed to improvements in the methodology, a higher number of employees are absorbed by the sector from 2012 i.e. 135,000 fulltime up by about 170%. This implies fewer but high employment MSMEs in 2019.

- **The majority of MSMEs in Malawi are very small.** About three in four enterprises (74 percent) are micro enterprises, 23 percent are small enterprises and only 3 percent are medium enterprises. Women own the largest proportion of micro enterprises (84 percent). Given the fact that the majority of MSMEs are micro businesses, the turnover of many businesses is relatively low with 32 percent of MSMEs falling into the micro- turnover category (<K5 million per year) with a yearly average of USD 5,957. However, using only turnover to segment the between micro to medium enterprises, 75 percent of MSMEs in Malawi would fall into the micro turnover category with an average of USD 2,034.

- **The sector generates a revenue of approximately USD15.8 billion (2019).** Considering this cumulative of revenue of all MSMEs a deduction of expenses is required to deduce value addition. This translated to about USD6.8 billion in value addition which can loosely be coined as contribution to Gross domestic Product (GDP). With 11 percent formal businesses in 2019, the contribution of formal MSMEs (likely already included in overall GDP) is USD3.6 billion (53 percent of total MSME contribution) while the informal MSME contribution is USD 3.2 billion (47 percent of total MSME contribution). This indicates that informal MSMEs have a significant contribution to the economy overall as if formalised and added to national GDP i.e. 40% percent (estimated GDP for Malawi in 2019 is about USD8.1billion according to the 2019 estimates of

the Ministry of Finance) which would add to the Malawian economy to be valued at about USD 11.5 billion at 2019 including the informal MSME sector.

- **The largest proportion of MSME business owners operate in the wholesale and retail sectors (64 percent),** i.e. they sell something, particularly agricultural outputs or fast-moving commodity goods. Furthermore, 23 percent conduct primary agricultural activities and 4 percent render business services, e.g. professional services (accountant, lawyer, consultants) and 5 percent 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 percent) or from their residential premises (24 percent). There 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 expansion of existing firms but also through birth of new firms seen by the larger proportion of start-ups in 2019. There has been an increase in the proportion of start-ups compared to 2012 by 11 percentage points to 34 percent in 2019. The trend also shows a higher and more significant death rate of MSMEs beyond as almost two thirds of the MSMEs are between two and five years old – drop from 38 percent to 27 percent. However, this can also be explained by more enterprises growing into the established to mature phases with a ten-percentage point increase from 2012 to make it 49 percentage in 2019. The start-up and growth phases require special attention with regards to expansion and support.

- **The majority of MSMEs trade informally (89 percent) being neither registered nor licensed with 11 percent being formal and 89 percent being informal.** However, this is on a positive trajectory compared to 3 percent that were formal in 2012. Only 7 percent of MSMEs are registered by the Registrar of Companies and 10 percent are licenced- those surveyed cited their business being too small as the main reason for not registering. About 11 percent of MSMEs are in compliance with income tax , 22 percent municipality tax and 40 percent Value Added Tax (VAT) compliant. Other studies recommends that cost of registration is not the only barrier but MSMEs need to be told the benefits of registration, which include being able to open a business account, obtaining a loan and other business support services.

▪ **Nearly (80 percent) of MSME owners started a new business used own savings to start-up their businesses.**

While the MSME owners primarily rely on their own savings including salaries, the selling of assets and family and friends are common source of funds. Ten percent 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 and other financial institutions. This provides ground for government to strengthen financial inclusion initiatives.

▪ **Almost every 2 in 5 (42 percent) of the MSMEs owners are the youth:** Young entrepreneurs aged below 35 years constitute 42 percent of MSME business owners in Malawi which shows the potential of the MSME sector in job creation and alleviating youth unemployment problem. It also contributes to the government's effort of promoting economic empowerment of young people in Malawi. The young entrepreneurs may have limited business experience and this provides opportunity for the government to expand business support services to these group of MSME owners particularly through incubation programmes. There still are higher proportions of youth across the start-up and growth business lifecycle 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 also proportionately fewer women own high impact SMEs (10 percent). High impact SMEs are segmented businesses from the small and medium size business using a group median income as cut-off and must be an employer. A higher proportion of women are likely to own business in the start-up phase (61 percent) than in the established (41 percent) or mature phase (35 percent). A larger proportion of women entrepreneurs have started a business to make more money and provide for their families than men entrepreneurs. The drive is less of seeing an opportunity or being their own boss compared to men entrepreneurs. This calls for provision of training programs tailored to women MSME owners to enable them to grow their businesses particularly at the start-up phase.

▪ **Recommendations include policy revision with an industrialisation focus and further understanding of the business environment.** On formalisation it is recommended that an awareness strategy should be developed that links the importance of formalisation with other benefits such as financial institutions access, 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 does it increase their trust in government (and other) institutions. There seems to be another, compounding, issue at hand: imperfect information. Factors discovered from qualitative research found that the reason more women owned businesses were micro is that women entrepreneurs

chose more certain businesses likely with low returns and requiring minimal funds and low or no employees. One in five employers are women-owned enterprises. Thus, it indicates an aversion from formalisation and compliance issues deterring business growth than promoting it.

▪ **Business registration should push value to businesses that is realisable and benefits to the firm are evident.** Some business owners do not see value of formalisation as it becomes a tedious task to access and the benefits are not apparent to the business itself. Likewise, those formal should not view the informal as 'better-off'. The merits of formalisation such as access to business support, markets, access to finance should in themselves sell formalisation as a platform to growth and sustainability of the business. Therefore, governments seeking to increase economic growth, should aim at reducing the costs of registration and coupling it with interventions that increase direct contact with formal financial institution.

▪ **The MSME sector is constrained by a manifold of factors that are a part of the economic environment** – these include supply-side and infrastructural constraints that limit the potential of growth in the economy such as energy and water supplies. In addition, constraints from essentials such as better transport infrastructure (roads, railway and air transport) and logistics, tax incentives to SMEs, and knowledge networks, supportive financing and banking facilities and more investments in mechanized 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 that would reduce the cost of doing business in Malawi.

▪ **Financially included businesses in the MSME sector 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 through mobile money, SACCOs and MFIs. While banking access grew by 2 percentage points from 22 percent to 24 percent, there was an increase in the absolute banked MSMEs from 170,000 in 2012 to 276,000 in 2019. There was notable growth in businesses using informal financial service

▪ **The main barriers to financial service inclusion** include high transaction costs including relatively high banking and mobile money costs, low financial literacy, and cost of travel to financial services providers, lack of identification, ill-suited financial products retrofitting retail banking, limited income, unavailability or insufficient loan collateral amongst others. The current service provision and need shows a gap which makes financial services expensive if they are accessed at all.

▪ **Other recommendations include** value chain analyses, improving awareness of business support and infrastructure available to MSMEs. Developing innovative products that are tailored to highly cash-driven economy that the MSMEs operate in also improves the transition to digitisation of value chains.

SECTION 1

INTRODUCTION

The Government of Malawi has placed a considerable emphasis on the Micro, Small and Medium Enterprises (MSME) sector recognising the crucial contribution the sector can make towards economic growth, job creation and poverty alleviation. The Government has recently developed the Micro, Small and Medium Enterprise (MSME) Policy (2019) this replaces the 1998 Micro, Small and Medium Enterprise (MSME) 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 based on a thorough analysis of the MSME sector in Malawi conducted in 2011 and 2012, including a series of broad and in-depth consultations with key stakeholders including Government Ministries, Departments and Parastatals, Business Associations, Civil Society Organisations, Development and Cooperating Partners, and entrepreneurs across the country. The policy review was also based on a comprehensive review of Government, private sector and development partner initiatives, and an examination of the latest MSME policies in a number of 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 meant to guide government and private sector interventions in enterprise development as a springboard for the economic advancement of the country. The new policy has been designed to provide opportunities to MSMEs in areas of accessing markets, affordable finance, business support services and other support services and develop a more competitive and diversified MSME

sector. Development of the MSME sector is an essential element of Small, Micro and Medium Enterprises Policy and facilitating small business access to finance using alternative financing schemes is 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 with the aim to size and scope the MSMEs landscape in Malawi while defining the levels of access to financial products and services (both formal and informal).

This study also attempted to find the most binding constraints to MSMEs development with a focus on access to financial markets as well as segmenting the MSME sector into different segments in an effort to identify the needs of each segment and come up with recommendations for their development. This allows targeted interventions to be developed with each segments needs in mind.

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

This report places special importance on well-established SMEs with the goal to draw policy attention to a group of SMEs that can transform the MSME sector if accorded the necessary support. These have been referred to as the high impact SMEs. The study also attempted to identify the most binding constraints to MSMEs development with a focus on access to financial markets.

1.1 Methodology

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

- To assess the size and scope of micro, small, and medium enterprises (MSMEs) in Malawi
- To 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
- To identify the most binding constraints to MSMEs development and growth with a focus on access to financial markets
- Segment the MSME sector into market segments and identify the needs of different segments to stimulate related product innovation.

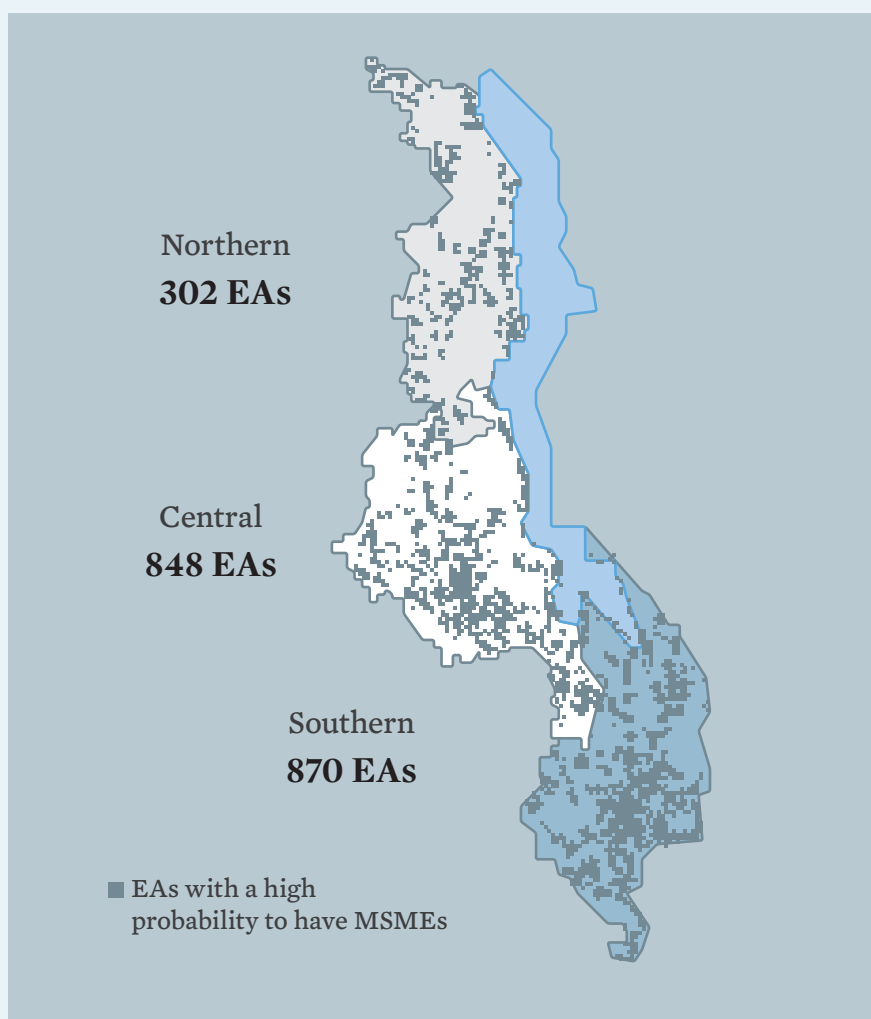
The FinScope MSME Malawi survey was designed to engage a broad range of stakeholders in a comprehensive and intensive consultative process. This process aimed to enrich the survey and ensure that the results contributed meaningfully to members who have a common interest in developing the sector. A Steering 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 and comprised of 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 involved 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 also enjoyed a complementary qualitative research component of 6 focus groups following 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 first FinScope MSME Malawi in 2012 was based on the first generation of FinScope methodology that relied mainly on household sampling. With developments in information technology (IT) and geospatial data, new techniques are available and globally used to sample fragmented population group with no nationally known populations. This allowed the third-generation sampling methodology to be developed improving

FIGURE 1: EAs with high probability to have MSMEs



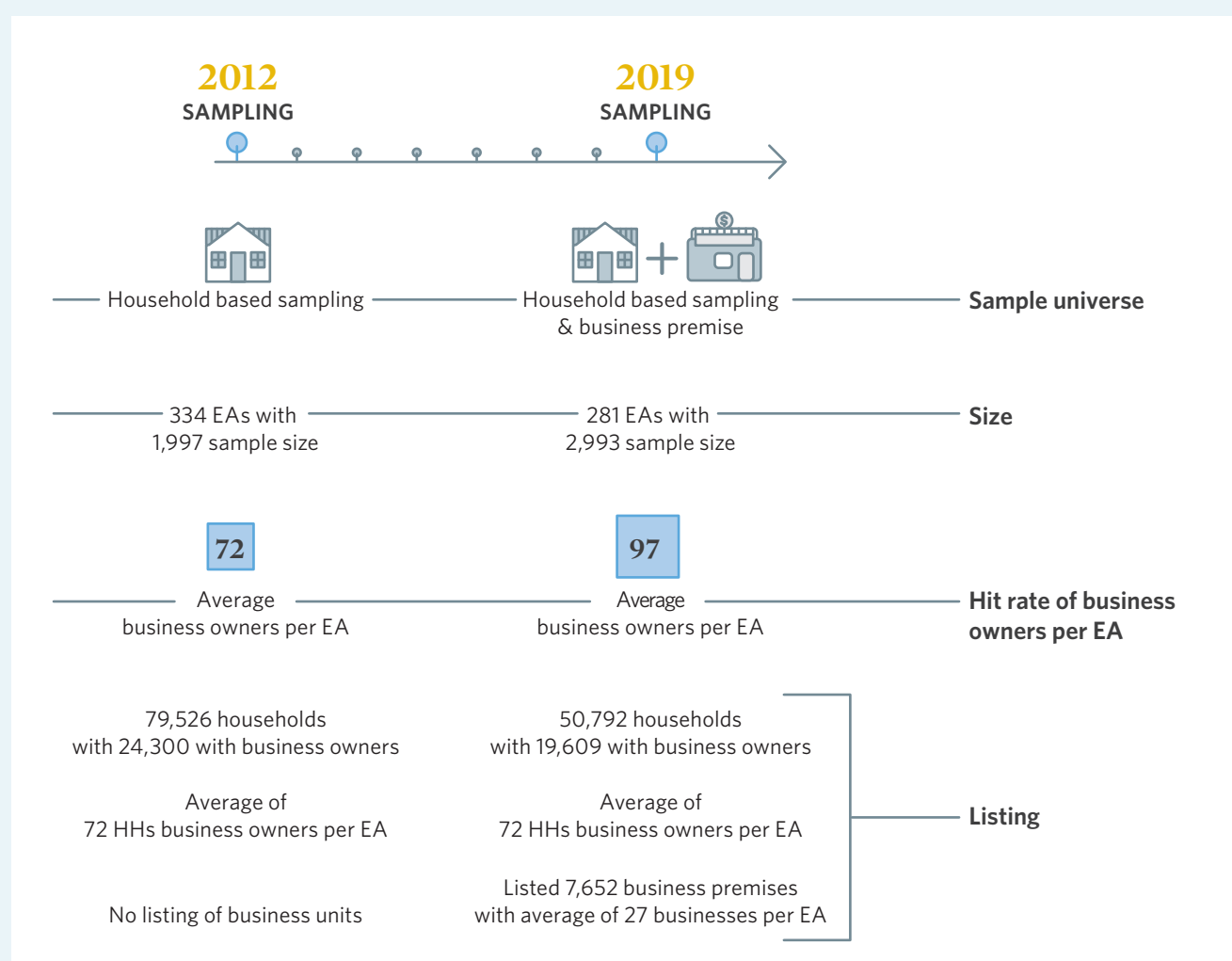
the first applied in 2012. Most of the criteria used in sampling did not change but the basis for enumeration areas (EAs) that informed the sampling were derived from geospatial modelling. Hence, the modelling sieved all EAs in Malawi identifying and categorising them into three main clusters i.e. none-low probability of having MSMEs, medium and then high probability to have MSMEs. An example of the plotting of high probability EAs is shown in figure 1.

The survey sample was of all adults in Malawi who perceived themselves to own an MSME. MSME's are defined by the number of employees and turnover only for this study as per the MSME Policy of 2019. This is a difference to the 2012 study that defined MSMEs only by the number of employees. The 2012 study categorised independent entrepreneurs (without any employees), micro businesses (1 to 4 employees),

small businesses (5 to 20 employees) and medium businesses (21 to 99 employees) whereas in 2019, the study aligns with policy in defining them as micro, small and medium based on both 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

TABLE 1: 2019 versus 2012 Sampling Methodology

districts in Malawi. The NSO provided the sample frame based on the 2018 population census and validated the data to represent the current population estimate of Malawi. It is important to note that due to difference in the sampling regimes, not all EAs have the same number of MSMEs which was aligned based on the modelling which resulted 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 make the sampling frame. Once a sample frame of business owner(s) is established, these would then be randomly selected taking into consideration the size of the business they own.

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 fair analysis of these groups in the data. As generally fewer businesses are medium sized, when selecting randomly, a minimum of 12 medium, where applicable, would be pre-selected to allow representation of medium enterprises. The same sampling approach was applied to small enterprises. All other micro businesses were open to random selection as their probability to selection was very high. However, to balance between sectors, randomisation within sector was applied based on the observed sector the business falls in (for micro enterprises). This was done after learnings from other markets showed under-representativeness 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 being highly heterogeneous in nature, 12 households were selected in urban EAs while 6 households were selected in rural EAs. A step-by-step process of 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 & Housing Census EAs were the primary sampling units (PSU), while qualifier business premises or households (those with business owners) were secondary sampling units (SSU), and individuals selected by the Kish Grid from a list of eligible respondents (business owners) at every selected qualifier business premise 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 for the 2019 FinScope MSME survey was developed by FinMark Trust taking into account the development of the tool over the years. The questionnaire was reviewed by members of the Reference Group to ensure that all sections used during the 2012 FinScope Survey were captured and updated to reflect the current situation of the MSME sector. The revised questionnaire was managed by the technical team to update the draft questionnaire to ensure that all input was met and local context was taken into consideration.

The final questionnaire was approved by the chair as well as broader members of the Reference Group. It was developed in English and then translated into local languages of Chichewa and Tumbuka. A local translator evaluated each question for ease of translation and made recommendations to guide proper translation. The steering committee was then consulted regarding the translated questionnaire, and they gave their final approval prior to fieldwork. The questionnaire was pre-tested in field by conducting a few pilot face-to-face interviews as a final check of the translation quality.

The FinScope MSME questionnaire was scripted on the CS-Pro Android application on the 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	Survey of MSME owners, defined as individuals who are: <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	6 households were selected from rural EAs 12 households were selected from urban EAs
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, least developed country, and ranks 166 out of 184 countries in 2019 from position 170 out of 188 countries in 2016 (UNDP Human Development Index). Covering an area of 118,500 square kilometres, Malawi is one of the most densely populated countries in sub-Saharan Africa with a population density of 186 people per square kilometre in 2018, against a sub-Saharan Africa average of 44.3¹. The country has a population of approximately 18 million people of which 50.7 percent live below the poverty line and 70.9 percent live on less than US\$1.90 a day, and a relatively high Gini coefficient, which increased from 39.9 in 2004 to 46.1 in 2010, entailing high inequality levels.

The population growth rate stands at about 3.1 percent and projections estimate the population to reach 43 million by 2050². This projected high population growth is expected to perpetuate 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 the sector accounts for 64 percent³ of employment, 80 percent of foreign exchange earnings, and about 30 percent of GDP. The sector is however hampered by lack of diversification, with maize and tobacco dominating as staple and export crops respectively. There is also an overreliance on the rain-fed agriculture, rendering the economy susceptible to weather, climate change, and international price shocks.

The economy has registered significant GDP growth in recent years, averaging 4.3 percent between 2010 and 2016. This growth, has largely been attributed to capital intensive industries as opposed to labour intensive industries, and has hence failed to create the much-needed employment. The GDP growth rate declined in 2016, registering 2.7 percent from 3.3 percent and 6.2 percent in 2015 and 2014 respectively. The growth rate was projected to jump to 6.1 percent in 2017, mainly ascribed to a good farming season and bumper yields in the 2016/17 farming season. However, in March 2018, the Government announced a downward revision of the projected growth from the projected 6.1 percent to 4 percent, attributed to high production costs.

Overall, the reduced GDP growth rate is largely attributed 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 designated private sector as the engine for the country's economic growth and poverty alleviation. This is evident in all GOM's economic policy documents, such as the National Industrial Policy, the National Trade Policy, the National Export Strategy⁴, the Malawi Growth and Development Strategy, the National Employment and Labour Policy as well as in sectoral policies such as the National Agricultural Policy⁵. Despite the country registering a significant improvement in the Doing Business Index (DBI) rankings, from position 133 out of 190 countries in the 2017 Doing Business Report (DBR), to position 110 in the 2018 report, the necessary business environment for private sector to deliver on its potential is not created, and private sector 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, access to markets, infrastructure, policy and regulatory environment, bureaucracy, capacity in doing business and meeting quality standards, among others. The recently launched Financial Sector Development Strategy II (2017-2022) recognizes that inclusive finance is essential for 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 MSME 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 is still negatively constrained by the poor transport infrastructure, an erratic energy supply, the weak use of information technology, and the low investment in the areas of research, science and technology in Malawi. From the policy perspectives, these findings imply that the Malawian government should consolidate on the adopted market economy through: (1) addressing the challenges that inhibit private sector investment growth; and (2) increasing public sector investment in the private sector's complementary economic activities.

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

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

3. Malawi Labour Force Survey 2014

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

5. Launched in 2016



The MSME sector can play a crucial role in building a vibrant private sector and hence, interventions are needed to promote MSME development as part of entrepreneurship development programme where the role of MSMEs is in job creation and urbanisation. Expansion of credit to the private sector is also part of the strategy in which introducing innovative financing schemes is considered as an important measure to ease MSME access to finance.

2.2 The role of MSMEs in economic development

MSMEs play a crucial role in economic growth and industrial development of a country. MSMEs make important contributions in enhancing economic and social sectors of a country through invigorating large-scale employment, investment, development of indigenous skills and technology, promoting entrepreneurship and innovativeness, enhancing exports, and also building an industrial base at different scales. A competitive and innovative MSME sector holds out huge 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 contribution of micro, small and medium scale businesses to socio-economic growth and development of nations takes many forms including boosting public revenue collections through various forms of taxation, provision of goods and services to the general public and, more importantly, poverty alleviation through creation of employment and economic empowerment of citizens. This is not an exception in Malawi considering that the private sector is dominated by MSMEs, going by the definition in the Micro, Small and Medium Enterprises Policy.

MSMEs have the flexibility to quickly adapt and adjust to rapid changes in the environment. Contrary to the long-held belief that MSMEs were meant to serve the local demand, the newly emerged situation has brought changes favourable to demands and investment structures. As a result, MSMEs are not only key

ingredients to the global production networks across countries but they are also actively involved in innovation systems. The presence of MSMEs is also 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.

Since MSMEs in most countries, as the case is for Malawi, have not received the necessary attention to enable them to start, grow and diversify, they face a myriad of challenges. MSMEs are generally founded, owned, and operated by individual entrepreneurs, often without much support from public or any other 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 worthy to realise that the private sector is a critical player for employment creation, growth and development of any country, and MSMEs make up a critical and largest component and hence the bedrock of the private sector.

The FinScope MSME 2019 survey also showed that 74 percent are involved in general wholesale and retail of mostly agricultural products. Further, 16 percent of MSME businesses are involved in the selling of agricultural products as most MSME are linked in some way to the agricultural sector. Of much concern to policy makers and the economy is the general finding that most MSMEs are necessity driven or also referred to as survivalists. Owners venture into business just to supplement off-farm income not as a result of responding to opportunities in the economic environment or with a strategy to see their businesses grow into sustainable ventures. As a result, most businesses are seasonal and tend to follow the cycle of demise and resurrection any time there is need or a shortfall from agricultural income. Resultantly, one in three business owners were found to be very much willing to abandon businesses and go into formal employment whenever that opportunity is available (FinScope 2019). This area is largely comprised by women and youth. Undoubtedly, this should be an area that requires addressing by state institutions and agencies involved in championing the growth and vibrancy of Malawi private sector. Rather than going into businesses as a temporary stepping stone waiting for employment opportunities, there is need to change the mind-set towards venturing into businesses as the ultimate goal and formal employment as temporary.



...one in three business owners were found to be very much willing to abandon businesses and go into formal employment whenever that opportunity is available.

2.3 Institutional framework to promote MSME development

MSMEs are recognised as cornerstone for economic development with the potential to enhance the industrialisation process if their entrepreneurial spirit is nurtured. However, there are many factors identified that hamper the entrepreneurial spirit which include: marketing; accounting; finance; limitations in training and development; business climate; are among other managerial constraints for MSME businesses to thrive.

Cognisant of the need to promote MSMEs in Malawi, both the Government of Malawi and the private sector have and continue to put in place initiatives, interventions and institutions to promote these businesses. Some of the notable efforts that the government has taken include taking institutional changes that occurred in the period 2012 – 2014, which resulted in 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 was undertaken to eliminate overlaps in delivery of MSME support services and to bring in efficiency and effectiveness in promoting the development of MSMEs.

The government also established organisations such as the Malawi Investment and Trade Centre (MITC), the Malawi Bureau of Standards (MBS) which promotes standards and quality and implementation of Malawi Standards. This is done through conformity assessments; and the Technical Education, Vocational and Entrepreneurship Training Authority (TEVETA) which promotes and regulates sustainable provision of quality technical, entrepreneurial and vocational education and trainings and existing institutions, both state and non-state. The government, non-governmental institutions, financial institutions and other international organisations have made attempts to provide support to MSMEs. The main agencies that are active in developing MSMEs in the country include: Small and Medium Enterprises Development Institute (SMEDI), Malawi Investment and Trade Centre (MITC), the Malawi Bureau of Standards (MBS), Malawi Confederation of Chambers of Commerce and Industry (MCCCI).

2.3.1 Small and Medium Enterprise Development Institute (SMEDI)

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

2.3.2 Malawi Investment and Trade Centre (MITC)

The institution has a mission to promote and facilitate sustainable inclusive and transformative investment and trade in Malawi. The institutions main objectives are to provide specialized support to foreign and local investors in all prioritized sectors for industrializing Malawi, to promote and facilitate export products and services of Malawi to international markets and plays an advisory role to Government on policies with a bearing on 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 standardization.

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

MCCCI carries out business facilitation services 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 also carries out research and analyses policies and regulations to identify obstacles to doing business in the country to ensure a conducive environment for private sector development. The research and analysis provide MCCCI with a basis for lobbying on issues that need to be addressed by the government.

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

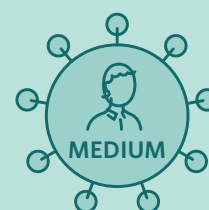
Employees

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 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 at most 99 workers, generate annualised turnover of up to K500 million or with maximum assets [exclude land and building – for 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 employing capital under K1, 000,000.00 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 capital investment of K20,000,000.00 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.

In 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 criteria and were used in the classification for this study. The employment criteria is the principal parameter to be used in the definition, because Malawi's economy is labour-intensive, being agro-based, with over 75 percent of the population employed in the agricultural sector. This criterion may not apply for high tech enterprises, with annual revenue and value of assets being the

key variables applied in such cases. The definition excludes seasonal workers.

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

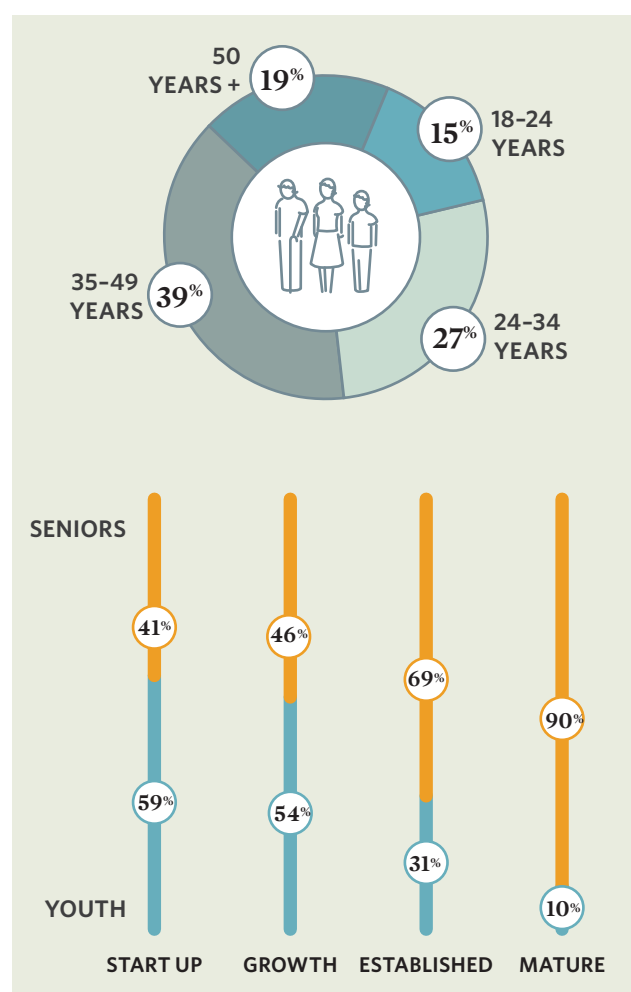
3.1 Youth and senior entrepreneurs

Analysis of MSME owners by age allows us to understand the distribution of MSME ownership across age groups and hence providing insight within which particular age category ownership is concentrated. It also proves useful when looking at the youth development as entrepreneurs and their role in the 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 percent of the MSMEs owned by this age group defined as the youth. This shows the potential of the MSME sector in alleviating youth unemployment problem and its contribution to the government's effort of promoting economic empowerment of the youth in the country.

It also implies that most MSME owners are young entrepreneurs with limited business experience which provides opportunity to the government to expand business support services to MSME owners. This also has an implication on the financial strength of the enterprises. Most MSME owners use their own money to finance start-up and growth and young owners that are at early stage of their life cycle may not have enough resources to invest in their

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

Source: FinScope MSME Malawi 2019 Survey



businesses and this places more burden on the government to introduce innovative financing schemes for the MSMEs. 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 play a significant role on the extent of each of these attributes.

Youth development programmes that are aimed to tackle start-ups and growth phase entrepreneurs will serve a broader population of youth that are in these phases of the MSME sector. While the youth and senior are both aware of business support organisations (97 percent each) usage of these platforms is lower for the youth at 14 percent compared to seniors (20 percent). While most youth are aware of formalisation, a lower proportion of them are formal (9 percent as per FinScope survey) This expanded on the qualitative study stating that their business is 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 percent of the Malawi individual MSME owners are females while 51 percent are males (see Figure 3). Given that the gender split of the adult population in Malawi is 51 percent females and 49 percent males according to Malawi Population Census 2018, females have a lower propensity to own a small business.

However, business size comparison by gender shows that most of the females own micro-enterprises (84 percent) compared to males (64 percent). Males own a higher proportion of the small enterprises (30 percent) compared to 15 percent of females and 6 percent of medium enterprises compared to 1 percent for females. As the business size grows, the proportion of females lowers while that of men grows. 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 the developed enterprises. Specific interventions are required to address this gender gap and to promote female owned enterprises to graduate to small and medium enterprises.

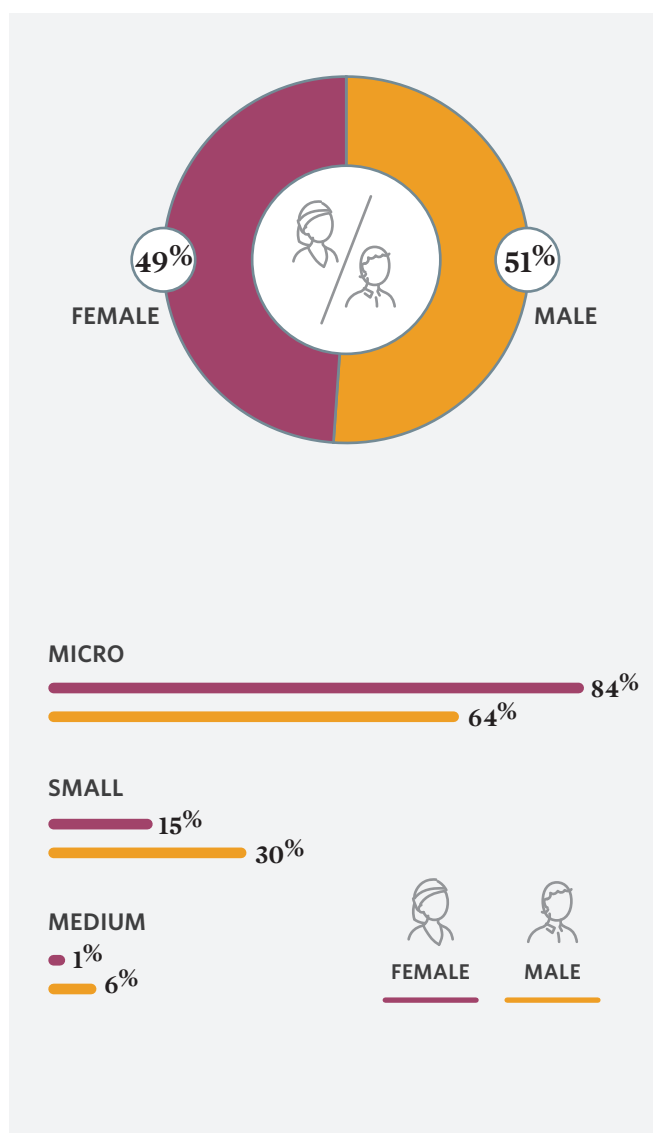
This implies that female entrepreneurs need to be accorded targeted attention at specific areas and phases of business lifecycle, so they can grow their businesses. A contributing reason to the higher proportion of female business owners in the micro- level enterprises is inherent in the bulk of women having lower educational attainments and hence lower formal employment prospects. Women would then engage in self-employment as a means of survival and rarely entrepreneurial motivation. When they do, they largely invest in risk-averse sectors like wholesale and retail and community and household where they often do not employ other people. Business development plays 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 requirement for any one starting up a business. BDS is a requirement for any MSME. I was also someone who was very shy when it comes 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 business in the modern technologically advanced age requires possession of business management skills. These skills can be acquired through either a formal education or through specialised trainings. Entrepreneurs with education are better positioned to maximise opportunities and avoid threats. Research studies report a significant and substantial effect of an added year of education of a business owner on business profitability.

As shown in Figure 4, about 53 percent of MSME owners in Malawi have at least a primary education. About 32 percent of the MSME owners have completed secondary education, 9 percent have no education, while the inclination to own a small business is low among those with vocational education or a university degree. Lower entrepreneurial inclination by those with higher level of education might be driven by availability of employment opportunity for these individuals and a concomitant loss of interest in running own business due to contentment with the employment income and 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 to be dominated by entrepreneurs with lower level of education who often lack the aspiration to grow their business by introducing new products and services. This calls for provision of business support services to MSME owners with no formal education or primary education to enable them to acquire the skills necessary in running a successful business.

Almost all of those without education are micro enterprises (96 percent) lowering by category with more small and medium enterprises having business owners with secondary education and higher.

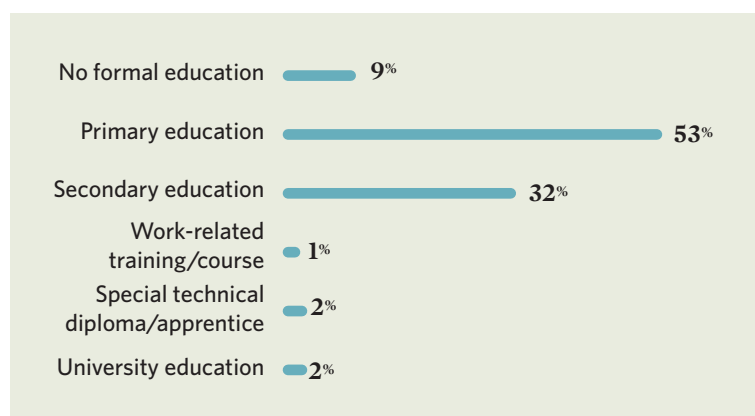
3.4 Location (urban/rural and regions)

MSME development might be affected by geographic location because of differences in the availability of infrastructural facilities and markets. Businesses tend to concentrate in urban areas where they can access market for their products and services. As shown in Figure 5, the majority of MSME owners are based in urban areas (78 percent) whilst 22 percent are located in the rural areas. A further look at sectoral distribution of MSMEs shows that most MSME in the agricultural / farming and 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 urban areas in the districts. Across regions half of the MSMEs are located in the Central region, 38 percent in the South and 12 percent in the North. Most of the MSMEs belong to micro entrepreneurs followed by small enterprises, then medium

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

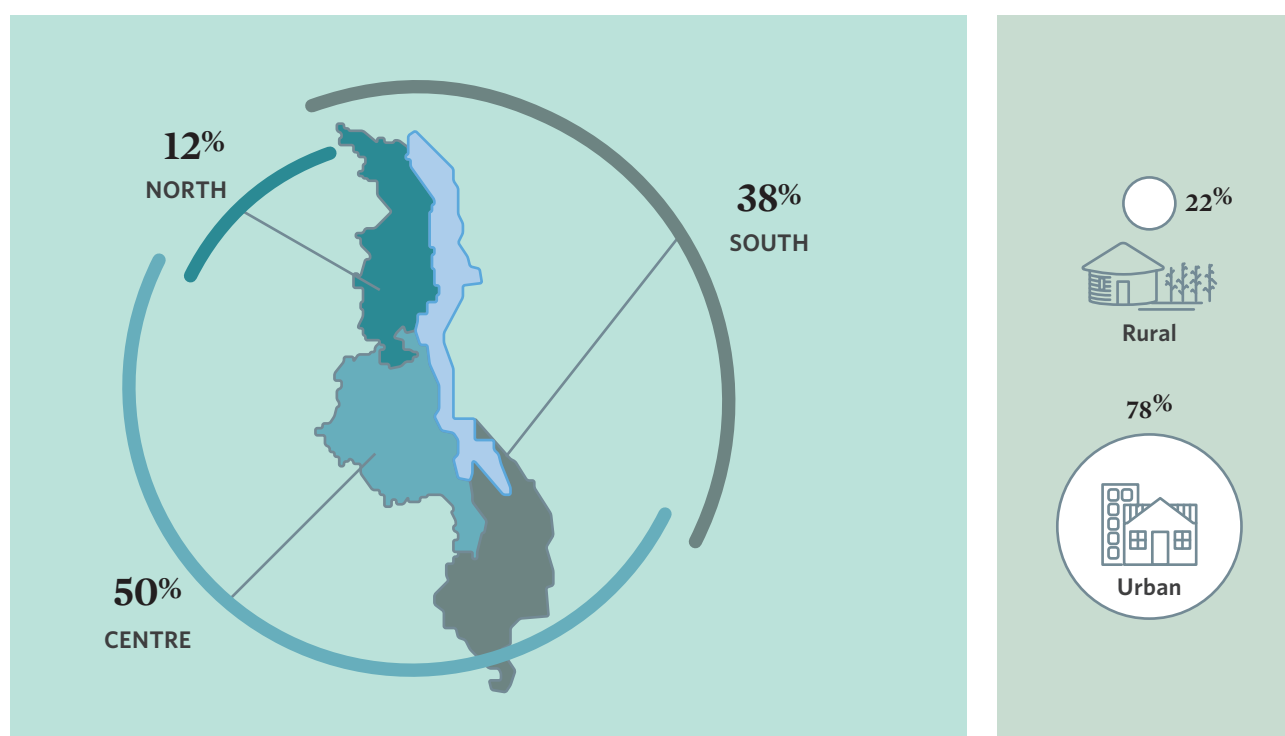
Source: Finscope MSME Malawi 2019 Survey



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



enterprises. The high MSMEs concentration in the city is due to high proportion of adult population living in the city (urbanisation) and more economic activities taking place in the urban areas. Urban areas also have higher disposable incomes per household.

3.5 Motivation for starting a business

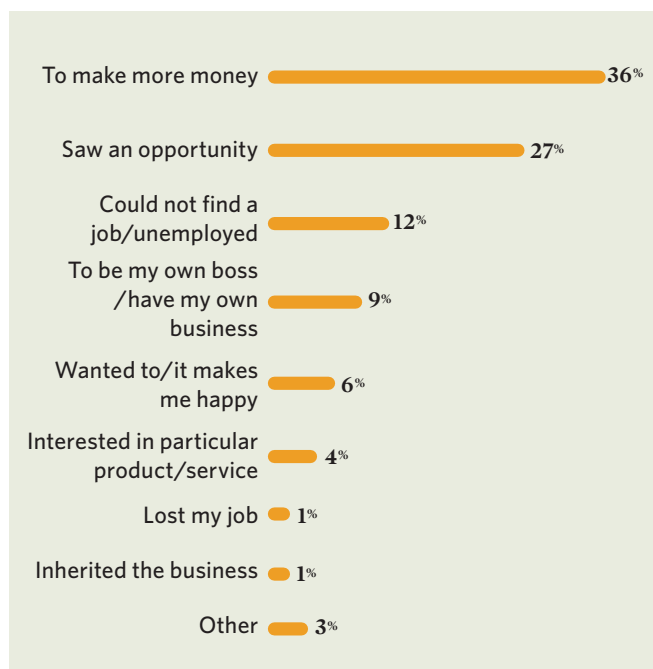
Research has shown that entrepreneurial inclination has an important role in small business survival growth. Studies have reported that small businesses that are established by those with entrepreneurial mind-set are better than those that are established by people who just wanted to make their living by running a small business. The study therefore analysed

motivation of small business owners in starting their business. Reasons for starting a business are classified into three categories: Entrepreneurial, Desperate and others.

Entrepreneurial category are individuals who started a business because they saw an opportunity, interested in a product or desired to use their skills. Desperate category comprised those that started a business due to either loss of job or unable to find employment. These are different from the first group because they were compelled into running a small business because of exclusion from the job market. Others category includes business owners that either inherited their business from family or started their business either to make more money or 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 percent of the MSME owners started business because they were motivated to start the business by a need entrepreneurship reasons and provide for families, 27 percent saw an opportunity in MSMEs, 12 percent started business out of desperation for failing to find employment. The finding that 63 percent of the MSME owners have entrepreneurial is good for the growth of the MSMEs.

3.6 Business Turnover

Development of the MSME sector is needed because the sector can boost national output besides its useful contribution to job creation. Turnover is an indicator that only takes into account volume of sales and does not take into account expenses. Income and turnover are subjective and prone to under- / over- statement but can provide indicative performance of the business and overall sector. The income of the business owner, assumed to be derived mainly from the business, reflects fluidity of the enterprise.

The analysis of business turnover Table 3 indicates that about 11.5 Trillion Malawi kwacha or 15.8 billion USD are the volume of business within the MSME sector. The comparison of turnover across sectors shows that a large turnover is obtained from the wholesale and retail sectors contributing 74 percent of total turnover, followed by manufacturing, agriculture and community and household activities with less than 10 percent each. The least contribution comes from the construction and 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 enterprises.

The share proportion of the wholesale and retail and retail sector is argued 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 proportion of all GDP is reflective of the consumption power of the economy. It is therefore not surprising that the bulk of the turnover is from the wholesale and retail sector. Looking at the average and median turnover tells us the contribution of a single enterprise per sector. The tourism sector has the highest turnover of all sectors trailed by manufacturing, construction and community and household. It shows that focus on these sectors to grow will have a far-reaching effect per enterprise.

The turnover to business size distribution indicates that as a business grows from micro to medium size, so does its turnover. This is evident in that the total turnover for medium enterprises is the largest contributor. The medium enterprises contribute 39 percent of total turnover and also have the highest average turnover. It is worth noting that however the micro enterprises are a major force contributing to 32 percent of total turnover in the MSME sector. The average annual turnover of micro enterprises is \$5,957 while that of medium enterprises is \$163,770. Due to outliers it may be best to use the median turnover which compare between sectors and size.













3.7 MSME sector contribution to GDP

It is highly argued that the sector contributes significantly to the Malawian GDP. According to the 2019 Annual Economic report by the MFEPS, the estimated GDP for 2019 is about USD 8,2 billion at current prices of June 2019. To capture as best possible the contribution of the MSME sector, the survey summed up the total turnover generated by the sector estimated at USD15,8 billion in Table 3 less the total expenses of the sector i.e.USD 8,9 billion giving a profit of USD6,8 billion. This can be interpreted loosely as the value addition or contribution of the MSME sector.

It will be important to note that of the USD 6,8 billion, about USD3,6 billion (53 percent) is likely already captured in the total estimate of USD 8,2 billion as 11% of MSMEs are formal (only 125 thousand businesses) and can be assumed that their contribution is already counted in the total GDP estimate. Hence, the unseen or grey sector (informal) contributes USD 3,2 billion (47 percent of MSME sector) although this is generated by 89 percent of the MSMEs (1 million enterprises). This estimate warrants the need to understand informal enterprises in order to capture their contribution to national output. Therefore, the potential of the informal MSME economy is about 40 percent of current GDP output. Understanding drivers and barriers to formalisation particularly of the informal MSMEs is identified as a important consideration for policymakers. Due to their high number and fragmented nature, informal enterprises are likely micro (78 percent), rural (82 percent), and in their start-up and growth phases (61 percent). Targeted interventions are required for the effort of formalising these enterprises taking into account high mortality associated with these enterprises.

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	
Agroprocessing	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

It is well researched on how technology is a critical enabler in business particularly in gaining efficiencies in 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 on modern day businesses, and in particular MSMEs, relates to their adaptability in harnessing technology in their day to day operations. The potential for Malwian MSMEs to participate in the global industrialisation depends on a myriad of issues from The report looks at the current ownership of technological equipment by MSMEs.

As stated earlier, only 12 percent of MSMEs are employers. Of these, 27% need specialised skills of their employees with inky 11% of them requiring information and technology (IT) or computing skills. One in four businesses requiring specialised skills require equipment maintenance with nearly

50 percent (48 percent) requiring marketing and sales skills from their staff. The usage of technology and IT skills is still in infancy according to the survey findings. With regard to training on computers or IT related skills, none of the MSMEs had received training or assistance on this.

The study further explored the extent to which MSMEs used technology in their business operations. About two in three MSMEs used (and owned) business technological equipment such as a mobile phone, fax machine or website or used a computerised record keeping system (65 percent). The single driver for this high usage was the mobile phone with 99 percent of these MSMEs using technology having/using a mobile phone. Other technology enabled equipment such as printer (1 percent), computer (3 percent), email address (2 percent), cash register/till (2%) and marketing through television, websites, etc. at 2 percent registering low usage. Surprisingly, only 2% of MSMEs using technology equipment accessed the internet for business despite nearly all 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.



them owning a mobile phone. When looking at the usage by business size, the medium enterprises recorded about triple usage on average compared to micro and small enterprises with 6 percent having internet usage, email addresses or a website and 9 percent using computerised record keeping.

Looking at usage of technology for marketing in the enterprise by sector brought some interesting findings. While low proportion of enterprises in wholesale/retail, manufacturing and community and household sectors used some form of technology to market their businesses (2 percent, 2 percent, 4 percent respectively), other sectors showed high usage of technology tools and not the expected sectors such as wholesale/retail. Construction (38 percent), business services (16 percent) and tourism (12 percent) showed increased usage of marketing technology. Natural resource and mining, agriculture/farming and agroprocessing all recorded under one percent which is non-intuitive.

Overall usage of technology by sector is mainly driven by mobile phone usage with high levels of penetration across construction, tourism and business services nearing 100 percent (refer to Table 4). 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. Tourism was mainly driven by usage of computers while business services and construction mostly use printers, switchboards, or computers, and internet to aid business. A survey limitation to measure actual usage of technology in production or services can be explored further in other research. Considering machinery usage in various enterprises, the extent technology is used will need to be a further consideration on future studies on the MSME sector.

Generally the use of technology in the broader sector is very low, linked to a generally high population of entrepreneurs having secondary education and less and nearly none having had training on technology or computers.

The scope of using digital financial services to aid financial transactions is explored in the access to finance section five.

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	
Agroprocessing	90	1	

There is a need to explore the readiness and impact of MSMEs to embrace technology in their day-to-day business operations and digitising value chains within and across sectors. It must also be noted that the enabling environment for technology to play a role in business needs to be created by facilitating more exposure of MSMEs to technological advancements related to their business such as alternative energy, modern equipment, infrastructure investments in IT and communications at a national level such as 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 business sector, source of start-up capital, awareness and use of the support infrastructure and employment across business sectors. The relative importance of level of education on the size of a business is highlighted by comparing business size across different levels of education.

Comparison of MSME ownership in Malawi against other countries within the region presented in table 4 shows that MSME ownership in Malawi is lower than in Zimbabwe, South Africa, and Mozambique but higher than in Eswatini and Lesotho. With 11 percent of MSME registered, Malawi MSMEs are relatively less formal than that of Eswatini, Lesotho, Zimbabwe, Mozambique and South Africa at 25 percent, 18 percent, 15 percent, 14 percent and 17 percent respectively. The employment potential of Malawi MSMEs is only better

than Mozambique in the SADC region where FinScope MSME surveys have been conducted.

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

The employment of the MSME sector in 2019 is further looked 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 the sector becomes more important when MSMEs operate in sectors of the economy considered strategically important. However, capital constraints and accessibility of markets may lead to concentration of small businesses in sectors of the economy that are not strategically important. Another factor is skills and education of individuals to enter into certain sub-sectors often leading to exporting of cheaper raw goods to importing expensive finished goods.

As shown in Table 5, MSMEs operate predominantly in the wholesale and retail or agricultural sector. The wholesale and retail sector contribute about two thirds of the business activities of MSMEs, 69 percent followed by 17 percent in the agricultural sector. The fact that about 6 percent of MSMEs operate in the manufacturing sector (when combined with agroprocessing) means the sectors contribution to the industrialisation effort of the government

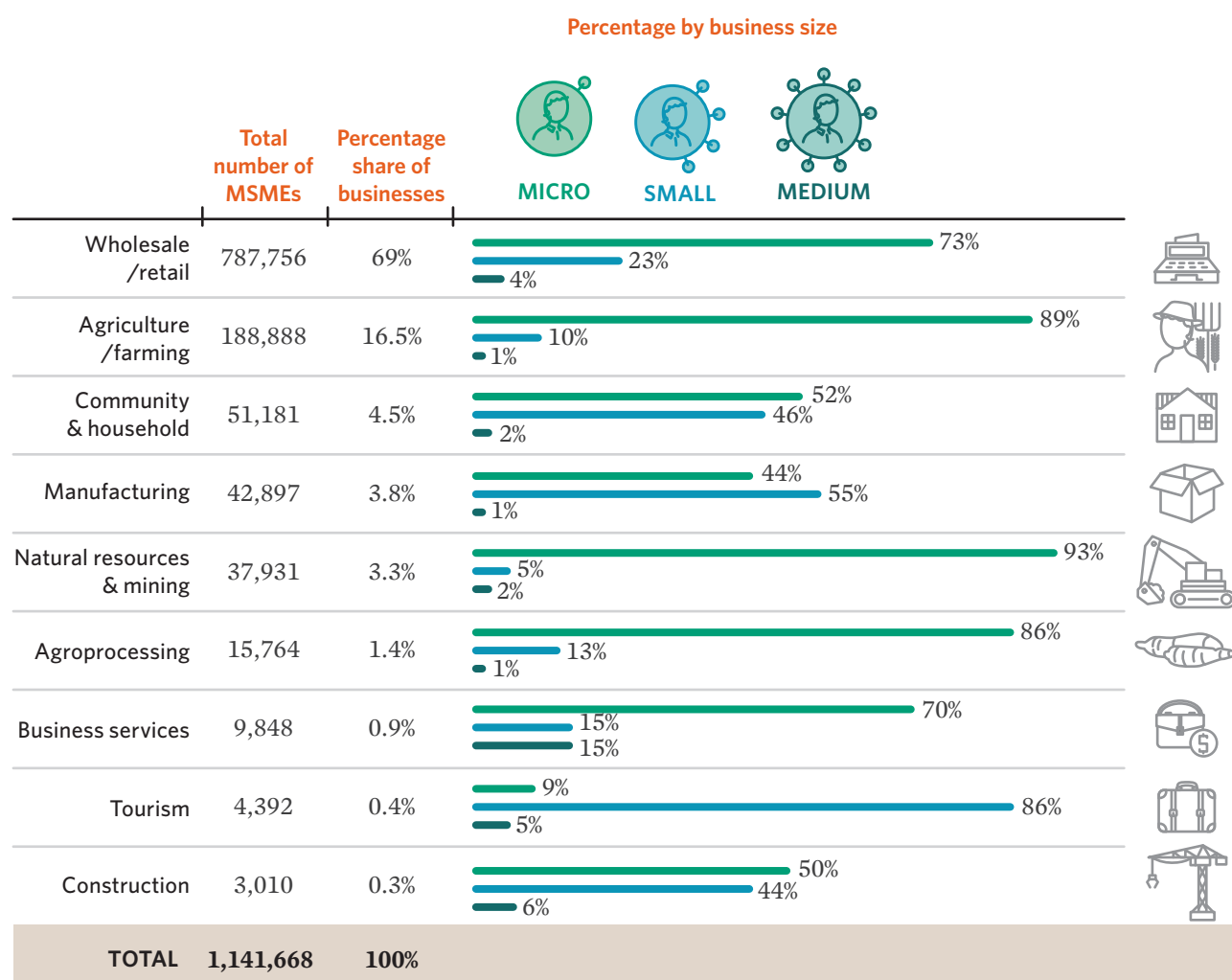
is marginal for the sector implying that manufacturing as a whole is comprises large scale enterprises.

Small enterprises have the largest proportion of businesses in the tourism (86 percent) and manufacturing sectors (55 percent) which also have the higher average turnovers per business. Tourism shows to be a high growth sector and has the propensity for high rural job creation. Beyond these, construction also records a high proportion of small and medium sized businesses with 50 percent falling across these bands. This calls for a concerted effort by the government to help MSME owners identify opportunities in the small and medium manufacturing sectors and also to provide incentive packages to attract more entrepreneurs to the sector.

High proportions of micro enterprises are in the agriculture/farming and natural resources/mining sectors which score lower revenues than specialised sectors such as manufacturing. It reflects that these sectors are predominantly primary sectors with natural resources and mining showing very rudimentary levels of enterprise.

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. Small enterprises are mostly formalised activities engaging between 5 to 20 people or with capital investment of K20,000,000.00 and turnover of up to K50 million. Medium enterprises employ between 21 to 100 people or use capital investment of K250 million and a turnover of up to K500 million.

In this report, the study classified businesses using a combination of number of employees and turnover into different size categories as prescribed in the Malawi MSME Policy 2019 that prescribes usage of a set of criteria that includes number of employees and annual turnover while asset value were not used due to bias on valuation. Three categories were created where the first category consists of micro enterprises that employ between 0 to 5 workers and or a turnover of less than MK5,000,000, while the second category small enterprises consists of businesses that employ between 5- 20 employees and or a turnover of up to K50 million. The third category are medium enterprises that employ between 21 to 100 people and or a turnover of up to K500 million.

As shown in Figure 7, more than two thirds of the MSMEs are micro enterprises, 23 percent are small enterprises and only 3 percent are medium enterprises. Overall, micro and small enterprises account for 97 percent of the MSME sector. From

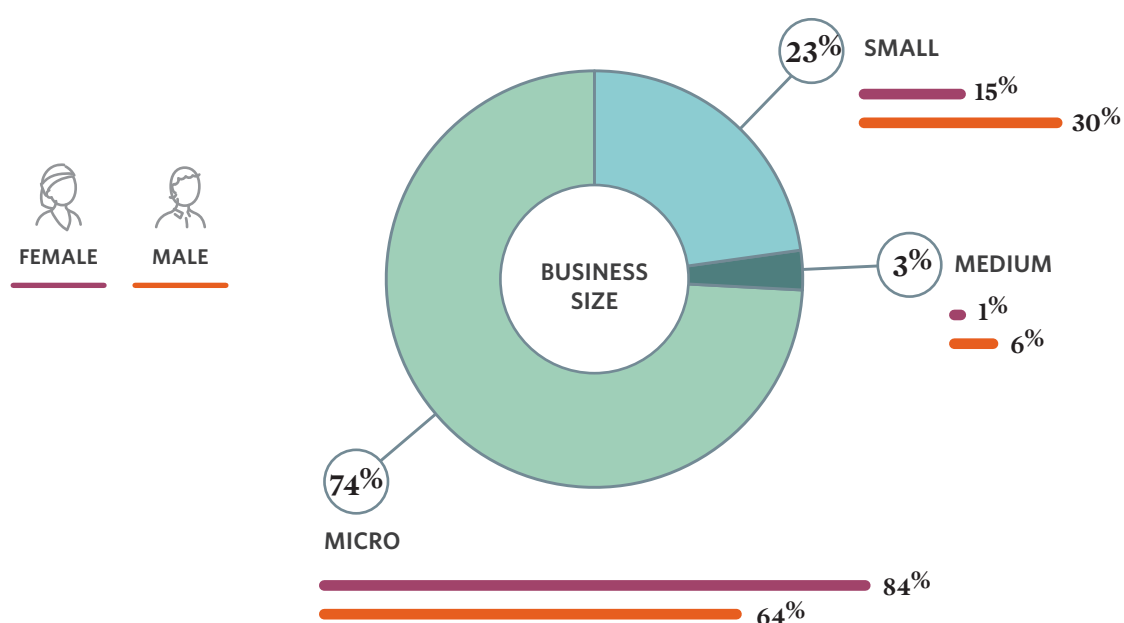
the analysis of the findings it is indicated that as business size grows the participation of women in businesses declines. For instance, female business owners make the majority of micro enterprises owners 84 percent compared to 64 percent for male business owners, only 15 percent of females own small enterprises compared to 30 percent for males and only 1 percent females own the medium sized enterprises compared to 6 percent males. The same applies to business lifecycle where a higher proportion of females are in the start-up phase (61 percent), lowering in the growth and established phases at 49 and 41 percent respectively. Less female owned enterprises are recorded at the mature phase with 35 percent. The fact that most MSMEs are either micro or small implies limited employment potential of the MSME sector in the country.

Analysis of business size by owner's level of education provides expected insights. As shown in Figure 8, ownership of a micro enterprise decreases as one moves up in the education ladder from those who do not have formal education to those with tertiary education. The size of the MSME increases with the level of education. A bigger proportion of micro enterprises have not been able to climb up the education ladder beyond primary education, limiting opportunities and access to formal wage and employment opportunities for them.

Interestingly, almost half of both small and medium enterprises are more likely to be owned by those with secondary education. Those with work related training and special technical education also have a good share across all business sizes. The most prominent educational attainment for most 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. The issue of survivalist businesses is borne from adults that source small capital to set up a business as a form of survival. This somehow blurs the notion of start-up capital as it is mostly time as a resource they have and small capital usually sourced from within a household. Most studies have opted to sieve these enterprises out of the scope due to their survivalist nature as opposed to entrepreneurship.

Figure 9 indicates that over 80 percent of MSME owners start a new business using money from their own saving, salaries, selling of assets and family and friends. Only 10 percent of

them 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 high degree of reliance on own saving and money from family and friends or otherwise from informal lenders poses a significant challenge to the MSME sector. This is because it takes time for individuals to accumulate saving big enough to finance a start-up. It can also be a cause of proliferation of micro-enterprises that are started with a small amount of seed money and remain unchanged for a considerable period. This may be explained by the observance of a majority of MSME owners citing that source of funds are a major challenge in start-up, growth and operations. At the same time, it is observed that they claim they do not need to borrow money as a 'barrier' to credit. This conflicting observation requires further understanding on 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

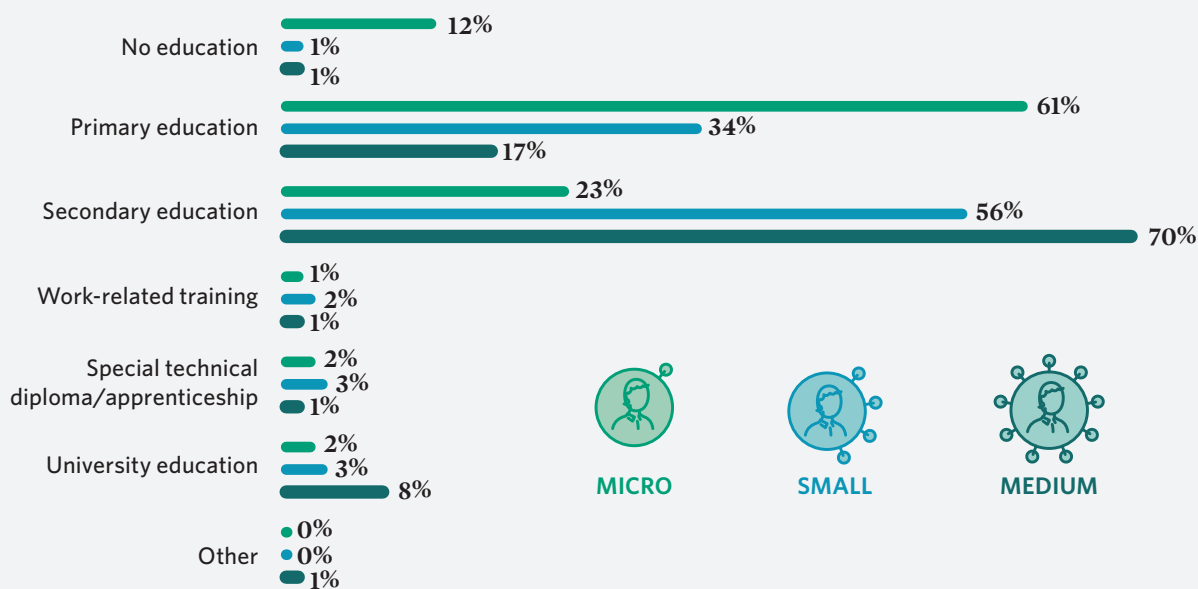
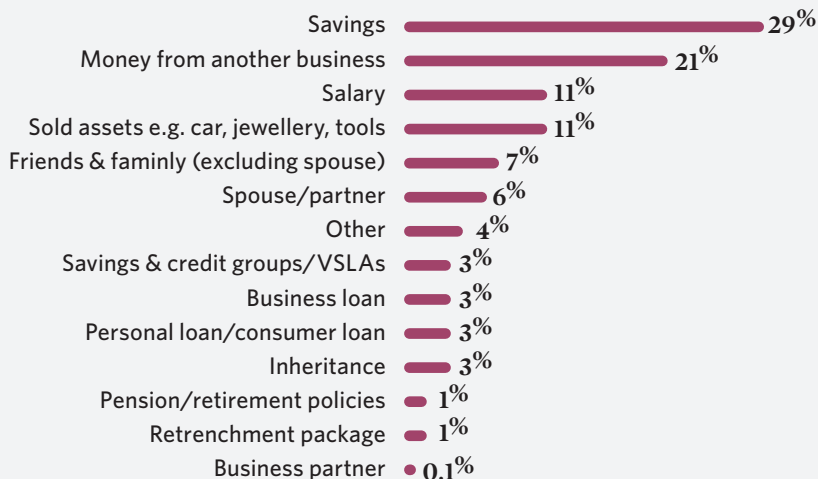


FIGURE 9: Source of start-up capital (%)

Source: FinScope MSME Malawi 2019 Survey



4.4 Employment creation by MSMEs








Employment creation is one of the main thrust of economic growth. The analysis shows that MSMEs in Malawi contribute a significant share of employment within the Malawi total labour force (24 percent). Findings as indicated in table 6 below shows that a total of 1,8 million persons are employed in the MSMEs. A total number of about 1,1 million are self-employed with 12 percent of them employing other people amounting to about 680 thousand. According to type of employment, 367 thousand (22 percent) of these are full-time employees yet about 98 thousand (6 percent) were employed as part-time employees and 218 thousand (13 percent) were employed as part-time employees.

According to the Malawi Labour Force Survey Report (2014), Malawi's unemployment (both formal and informal) indicates that 20.4 percent are unemployed. Urban unemployment at 28.4 percent is higher than rural unemployment which is at 19.2 percent. Unemployment is higher amongst females than males, 14.3 percent for males compared to 25.7 percent for females respectively. Youth Unemployment rate was 26.8 percent, youth unemployment was higher in the urban areas (47 percent) than in the rural areas (24 percent) in 2014, (MLFS, 2014).

Table 6 shows that the total number of MSMEs in Malawi employ a ratio 0.4 employees excluding the owners. Urban, male owned, and small and medium enterprises have a ratio of 1 employee per business or more (only medium enterprises). To focus interventions on employment, it can be alluded that medium businesses are the low hanging fruits to increase employment.

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)	
		No. of MSMEs	No. of Workers	No. of Workers	No. of Workers	No. of Workers	Average 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

In general, analysis of characteristics of MSME shows that most small business employees work either in the wholesale/retail which employs about 710 thousand persons (42 percent) as individual proprietors. On average, the tourism and business services sectors provide more employment while the wholesale and surprisingly manufacturing and agroprocessing provide the lowest employability on average. Therefore, the service sector is providing the most job opportunities in Malawi. It is noteworthy that a very small percentage of MSMEs operate in the manufacturing and agroprocessing sectors with most being underdeveloped to absorb a significant labour force. Promotion of the services sector shows significant growth prospects for the MSME sector. With 95 percent of MSMEs employing at most 3 workers, the job creating capacity of the 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 differ across sectors due to differences in labour intensity of businesses in each sector. As shown in Figure

10, MSMEs in the small-scale mining and natural resources, manufacturing, wholesale and retail and agroprocessing are dominated by owner employees or independent entrepreneurs where the owner is the only employee of the business. Micro enterprises that employ less than 5 employees are dominating in the construction, agriculture/farming, and community and household sectors account for 55, 42 and 28 percent respectively. Over three quarters of the tourism sector and 17 percent of the MSMEs in the business services sectors employ between 5 and 20 workers. Medium enterprises that employ over 20 are presented in the business services sector. This implies that growth in the service sector (business service and tourism) as well as agriculture/farming, construction and community and household sectors would create more jobs than in the other sectors.

From the analysis of findings above there is need for Government to find long lasting measures of reducing unemployment one of which should be through incentives to micro and small enterprises which employ a greater number of employees. Box 2 indicates some of the programmes in place that are promoting Business and employment creation 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	5,756	2
Tourism	4,392	31,818	417		32,235	7
Agroprocessing	15,764	6,483	62		6,544	0.4



Business support projects in Malawi

There are some business opportunities and initiatives that are being implemented to address some of the challenges.

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

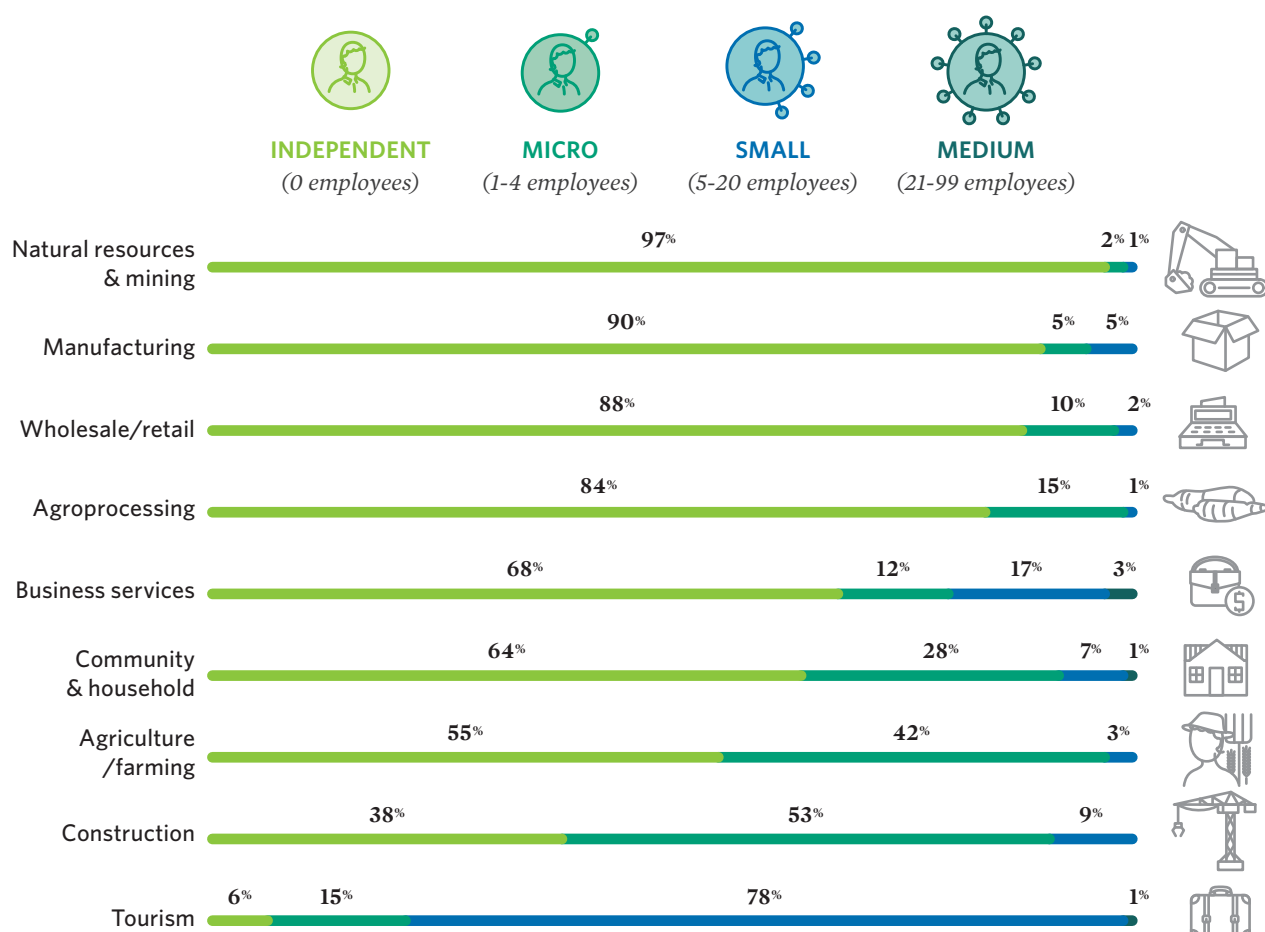
DFID Malawi has been delivering a Private Sector Development programme with activities that support individual firms with high growth potential, to grow key sectors and improve the environment for business more generally. DFID projects that have targeted MSME development to date include the Malawi Innovation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

The AfDB is implementing the 'Jobs for Youth Project' in Malawi which seeks to economically empower young women and men for improved employability in decent work 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 percent informal enterprises and 11 percent formal enterprises in the MSME sector

4.6 Formalisation (business registration/licensing) amongst MSMEs

The majority of firms in Malawi register in what is termed registering as a “Business Name”⁶. The three key steps 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 in much of the rest of Africa and businesses can choose which aspects of formality, if any, to obtain.

The findings from the 2019 Finscope Survey in Figure 11 indicates that there are more sole traders (86 percent) or Private Company (8 percent) and only 3 percent are in partnerships. Overall the findings imply that there are 89 percent informal enterprises and 11 percent formal enterprises in the MSME sector. This is an improvement from 3 percent 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 seeking to enforce the registration of informal enterprises; drafted a new Business Licensing Bill; and was transitioning to an online-based electronic system of business registration reducing the time to register firms. The goal was to reduce the turnaround time from 14 days to less than five.⁷

The findings further indicate that formality differs across the three segments, as shown in Figure 12, there are only 7 percent registered enterprises with the registrar of Companies and 10 percent licensed enterprises. According a large number of registered businesses are in the medium sector 20 percent and 35 percent licensed. Business licensing and registration is high 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 business include the small size of their businesses which account for 47 percent, the lack of information on registration 19 percent, and the costs associated with registration. The cost of registration is MWK 2,000 (equivalent to \$4 in 2019).

With regards to the perceived benefits of registration, the findings obtained give perceptions of MSMEs on the benefits of formalisation. About 21 percent of MSMEs reported that registering is good for the business to comply with the law, Access finance and government assistance (12 percent), 10 percent reported that they don't see any benefits and 4 percent reported registration helps avoid fines (4 percent) this is mostly common with city authorities that do inspections for 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. The 2018 Global Competitiveness Index (GCI) report, defined as the set of institutions, policies and factors that determine the level of productivity, ranks Malawi's infrastructure on position 129 out of 140 economies in 2018, an improvement from 135 out of 138 economies in 2016, which is lower than other SADC countries⁸.

Likewise, the number of reforms have led Malawi to register 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 Doing Business Report (DBR). The MGDS III target for the DBI is to be at a position less than 100. The initiatives undertaken include: reforms to corporate tax; investments in innovation, science, telecommunications and transport infrastructure; streamlining of business regulatory processes; and improvements to competition laws. However, the necessary business environment for the MSME sector to deliver on its potential is not yet created, and private sector growth is hampered by a number of factors discussed in the section below.

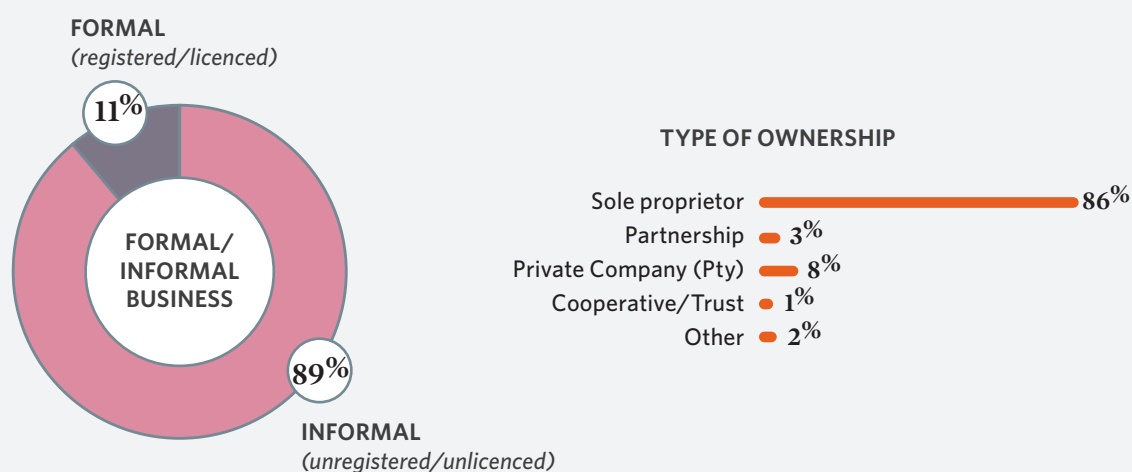
6. Approximately 135,000 firms are registered as “Business Names” vs 11,000 as limited liability firms, 2018.

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

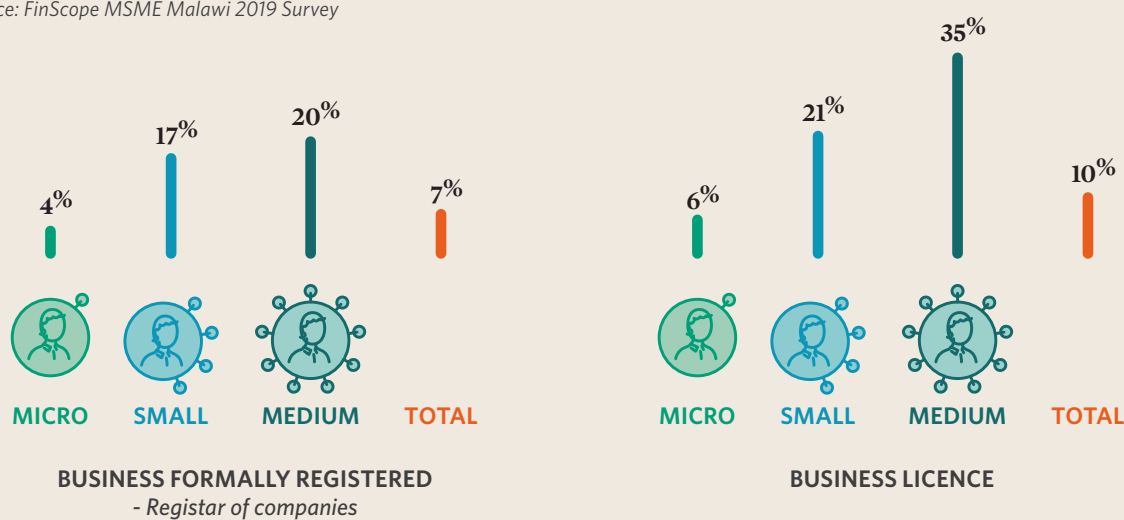
8. Mozambique ranks 124, South Africa ranks 64, Zambia ranks 125 and Zimbabwe ranks 123

FIGURE 11: Formal and informal businesses and type of ownership

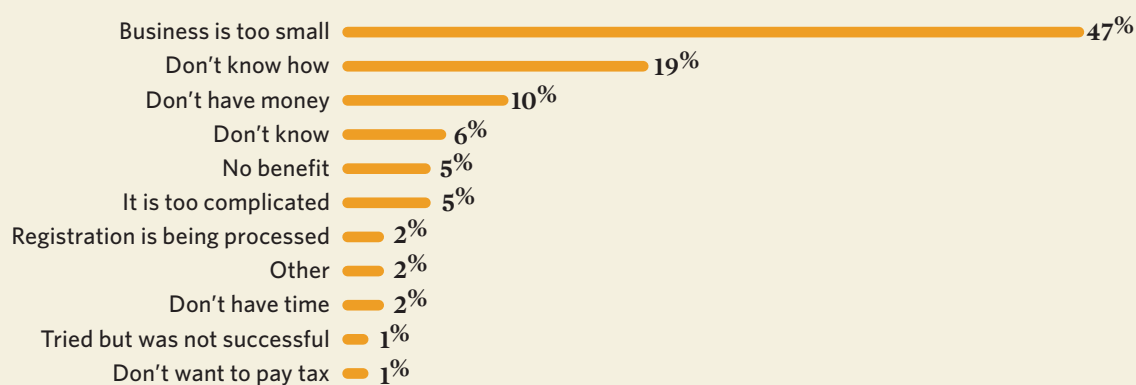
Source: FinScope MSME Malawi 2019 Survey

**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 age of most Malawi's MSMEs businesses is 7.5 years. Figure 14 indicates that about a third of Malawi's MSMEs are aged less than 3 years old. 27 percent in the growth stage 16 percent are established and 23 percent are in the mature stage. Likewise, there is perception of growth with most start-ups claiming they are growing (45 percent) and some in stagnation (29 percent). Growth-established MSMEs claimed a worsening outlook at average of 30 percent with more micros being under 5 years (64 percent). Two in five small enterprises are established or mature compared to 32 percent of medium enterprises that are established and 46 percent being mature. More female entrepreneurs belong in the in start-ups (61 percent).

The analysis implies that MSME firms are growing not only through expansion of existing firms but also through birth of new firms seen by the larger proportion of start-ups. The trend also shows a higher death rate of MSMEs as almost two thirds of the MSMEs are below five years old and only 39 percent survive from 6 years and above.

MSMEs may fail due to lack of key skills needed to successfully run a business. This is over and above those businesses that become obsolete in their value offering or simply bad investments. Support to the sector provided to MSMEs is therefore believed to alleviate this problem and help firms in the sector to survive and grow.

The benefit acquired from the support infrastructure in the country depends to a large extent on awareness about existence of such a facility and usage. Therefore, the report explored the extent of awareness of MSME owners of availability of the support infrastructure and its usage. Almost 97 percent of the MSME owners are aware of the availability of Business support services. Disappointingly, however less than a fifth of those that are aware actually used services (18 percent). This implies that whilst business support infrastructure exists, there is lack of information on its usage hence the low take up rate of the business support services. Encouragingly, almost all (95 percent and above) of the MSME owners that used the support facility found it useful. In terms of Business institutions most MSMEs are not aware of the appropriate business institutions, (Figure 13). About 14 percent are aware of MoFEPD, 13 percent are aware of Ministry of Industry and Trade & TEVET 6 percent are

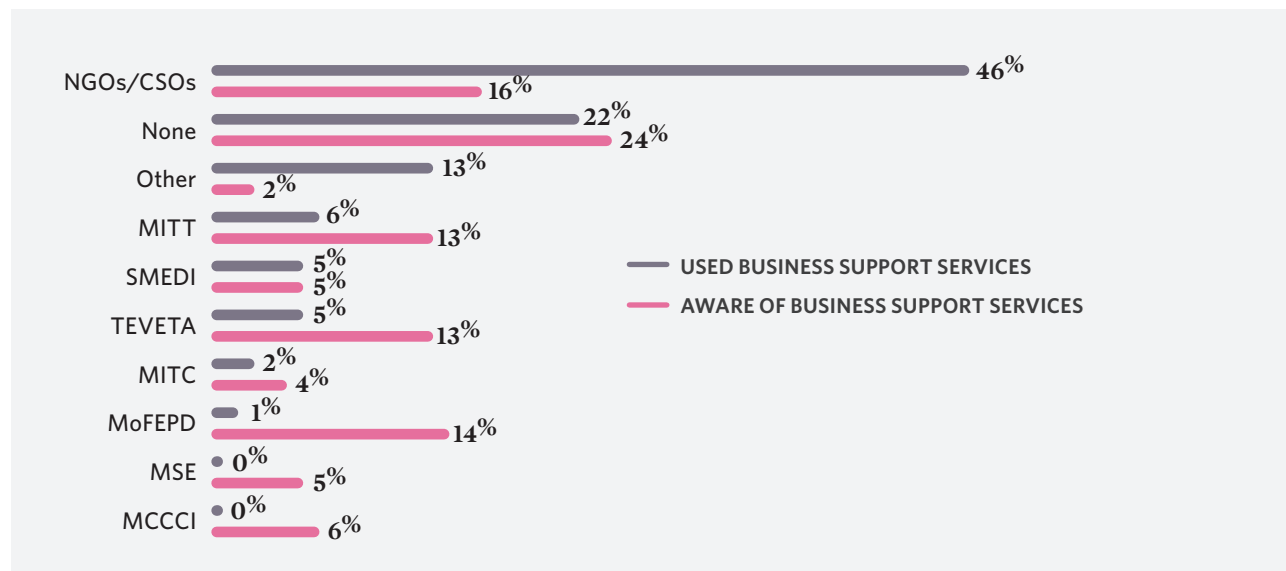
FIGURE 14: Business cycle of MSMEs

Source: FinScope MSME Malawi 2019 Survey



FIGURE 15: Awareness and usage of business support Institutions

Source: FinScope MSME Malawi 2019 Survey



aware of other organisations like Chamber of Commerce and 5 percent aware of SMEDI. Likewise, 49 percent used NGOs/CSO, 14 percent used other organisations and 6 percent used services from Ministry of Trade and SMEDI.

Comparison of awareness and use as well as usefulness of the support service across sectors differs. It shows that while awareness is high among MSMEs owners in the service sector, usage is high among MSMEs in the agricultural sector. Usage of support infrastructure is low among MSMEs in the wholesale and service sector. The analysis suggests that increasing awareness about the support infrastructure and encouraging MSME owners to use the services is likely to benefit the MSME sector in the country. This may have a spill over with formalisation.

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

Source: FinScope MSME Malawi 2019 Survey

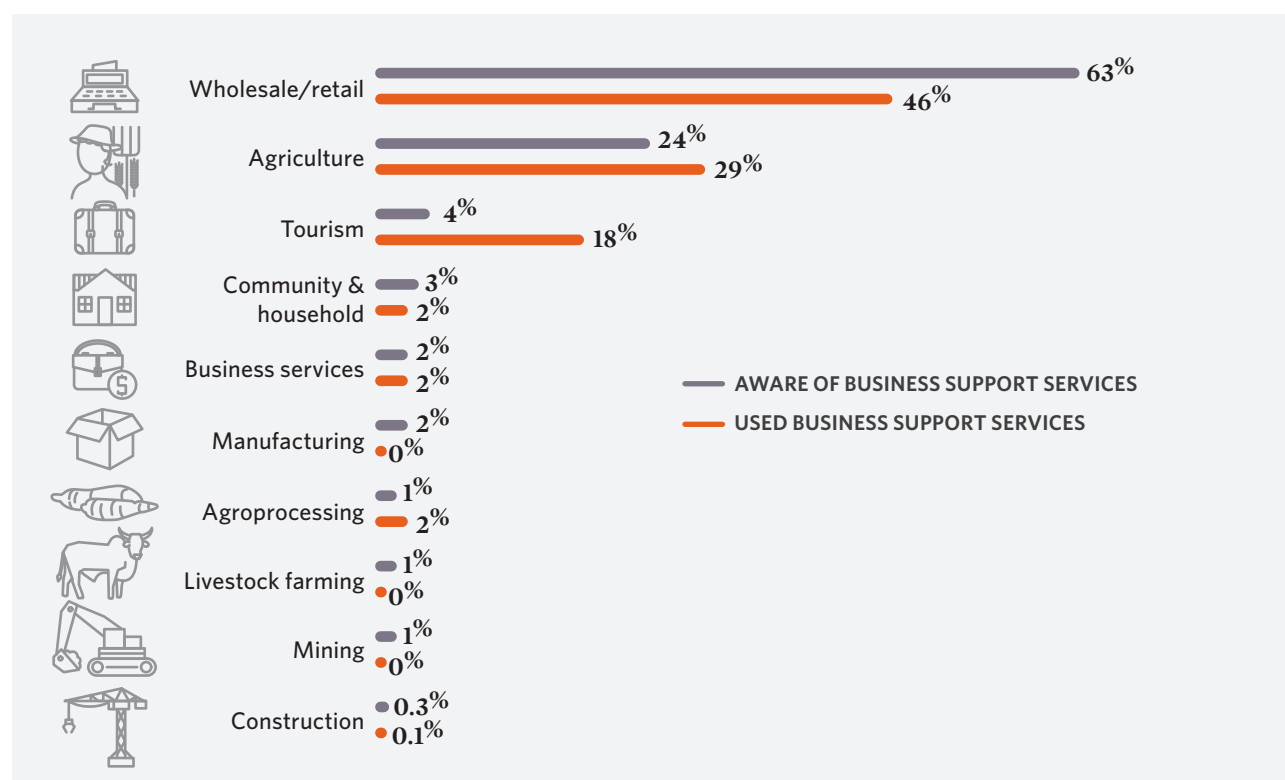
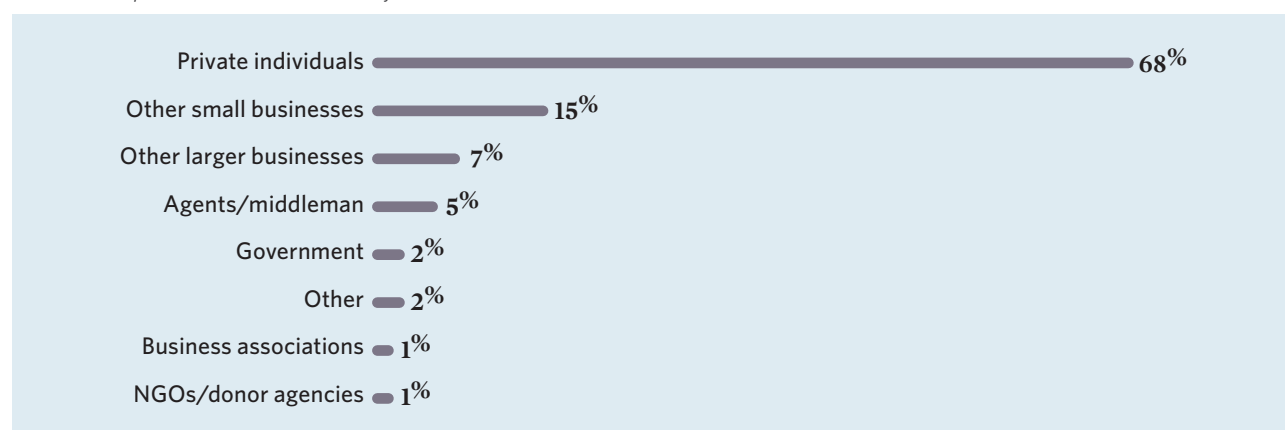


FIGURE 17: Access to markets (%)

Source: FinScope MSME Malawi 2019 Survey



4.9 Access to markets and business linkages

Almost two thirds of MSMEs sell their products directly to individual consumers (68 percent) about 22 percent of MSM show some forward linkages by selling and linking to other enterprises. The MSMEs selling to the Government is very low. The findings note that only 3 percent of the MSME were able to tender for government procurements out of these 79 percent of the tenders were successful. The low forward business linkages suggest the need for deliberate efforts of ensuring participation of MSMEs in government procurement of goods and services. Only 2 percent of MSMEs export commodities to foreign markets while 6 percent import some of their inputs from foreign countries, this already shows the trade imbalance between imports and exports against the Malawi MSME sector. The major destination of exports include Tanzania and Zambia and the main origin of imports included China, RSA and Zambia.

4.10 Agriculture and farming sector

About 189,000 farmers (16 percent of MSME sector) were in the primary agriculture sector. The major sources of income in the agriculture sector includes tobacco 35 percent followed by edible nuts. This is line with the high value cash crop system in Malawi as growing of maize/corn is usually for household food consumption and not for business. The findings also found that the main source of capital for the agriculture business was from Selling crop or livestock 24 percent, 14 percent borrowed from Agric-supplier and 13 percent used their Savings. The average land holding size is 5 hectares and the main market for agriculture production includes collection centres (41 percent), retailers (31 percent), directly to customers (27 percent). This shows some backward linkages as most of these productions are sold unprocessed.

4.11 Agroprocessing segment

The MSME survey also examined sector specific issues withing manufacturing around the agro-processing as an emerging high growth segment. The findings show that the agro-processing sector has about 40,614 owners (4 percent of MSMEs) of which 4 percent are in the micro enterprises, 2 percent in the small enterprises and 1 percent in the medium enterprise category. The sector employs about 6,500 people and is relying on use of local inputs 95 percent and the largest market is the domestic market 99 percent. Figure 19 indicates that fruit & vegetables processing forming that largest sub sector within agro-processing 33 percent, other products 27 percent and nuts and animal oils 25 percent, grain milling contributes 9 percent of the sector.

An analysis of bottlenecks within the agroprocessing sector shows that some of the main barriers in agro-processing include marketing (8 percent), procurement of material inputs (6 percent), other logistical problems that include: Lack of storage facilities (44 percent), lack of transportation (28 percent), bad road conditions (20 percent) and high cost of fuel (7 percent). Insights from focus group discussions shed more light on the bottlenecks faced.

FIGURE 18: Agriculture and farming

Source: FinScope MSME Malawi 2019 Survey (%)

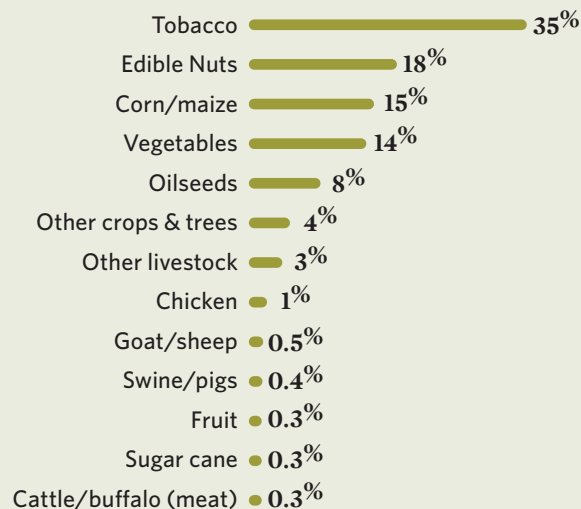


FIGURE 19: Agroprocessing distribution (%)

Source: FinScope MSME Malawi 2019 Survey

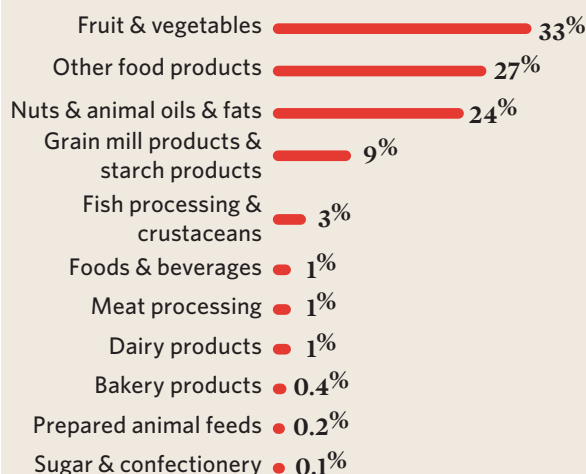


FIGURE 20: Manufacturing distribution (%)

Source: FinScope MSME Malawi 2019 Survey

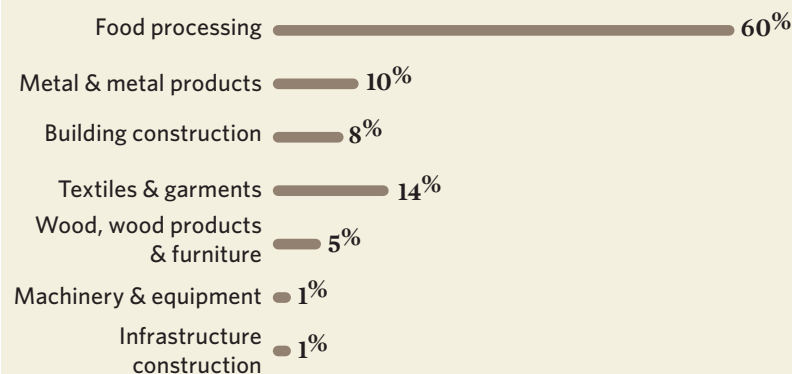




















TABLE 9: MSMEs access to amenities by location, size and sector

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
	Agroprocessing	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 percent operate in the manufacturing sector. The MSME survey conducted a specific manufacturing module to delve into the gist of the subsector. The findings in Figure 20 indicates that the Malawi's MSME sector is mostly operating in food processing 60 percent this includes items such as fruit and beverages, edible oils and so forth. About 14 percent is contributed by the textiles and garments industry. This has been one of Malawi's traditional industry but declined due to falling cotton prices, the sector now involves mostly tailoring and manufacture of wearing apparel and garments and printing of fabrics.

Challenges in manufacturing include; lack of good markets (26 percent), electricity (18 percent) access to finance (availability and cost) (17 percent), not getting loans/ lack of funds (14 percent) crime, theft and disorder (8 percent), corruption (8 percent) and transportation (4 percent). These findings were echoed from the desk reviews that state that industrial production index has stagnated as evidenced from the closing down of several manufacturing firms in the last decade citing lack of profitability on account of 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 drag on competitiveness as business ended up paying several licenses fees and levies to several institutions that can be streamlined. e.g. business registration, council business license, council food licenses, beverages licenses, MBS levies, TEVET levy, etc.

4.13 Access to amenities

Water and electricity supply challenges pose a threat to the country's growth of industrialisation drive, 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

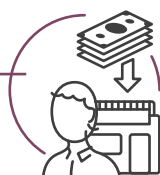
Malawi's MSME sector faces a lot of challenges that hinder its growth and development in the areas of access to finance, access to markets, infrastructure, policy and regulatory environment, bureaucracy, capacity in doing business and meeting quality standards, among others. Access to finance is the biggest challenge faced by business owners when starting up a business. The rest of other barriers faced are listed in the box below. The main barriers to financial service use include transaction costs including relatively high banking costs, low financial literacy, and cost of travel to financial sector providers, lack of identification, ill-suited financial products, limited income, unavailability/insufficient loan collateral.

TABLE 10: Challenges at start up

Source: FinScope MSME Malawi 2019 Survey

Finance

- 45% Sourcing money
- 11% Cash flow
- 9% Being owed money/debtors
- 3% Financial records
- 1% Opening a bank account
- 0.3% Banks didn't want to help



Sales & marketing

- 31% Not enough customers
- 18% Selling price lower than expected
- 17% Who to sell to - i.e. who the customers will be
- 15% Too many competitors
- 8% Problems with stock/goods sold
- 7% Raising awareness of products/services
- 4% What product/service to sell



Resources

- 13% Transport, e.g. moving stock
- 6% Finding business premises/space
- 4% Crime/theft by staff
- 4% Equipment
- 3% Other
- 2% No appropriate storage facilities
- 1% Connecting electricity
- 0.2% Connecting water services



Skills & staff

- 11% Own lack of skills/experience
- 1% Finding the right staff
- 1% Problems with staff
- 0.2% Writing a business plan



Legal Issues

- 1% Laws and regulations
- 1% Tax compliance
- 1% Registering the business
- 0.1% License and construction permit

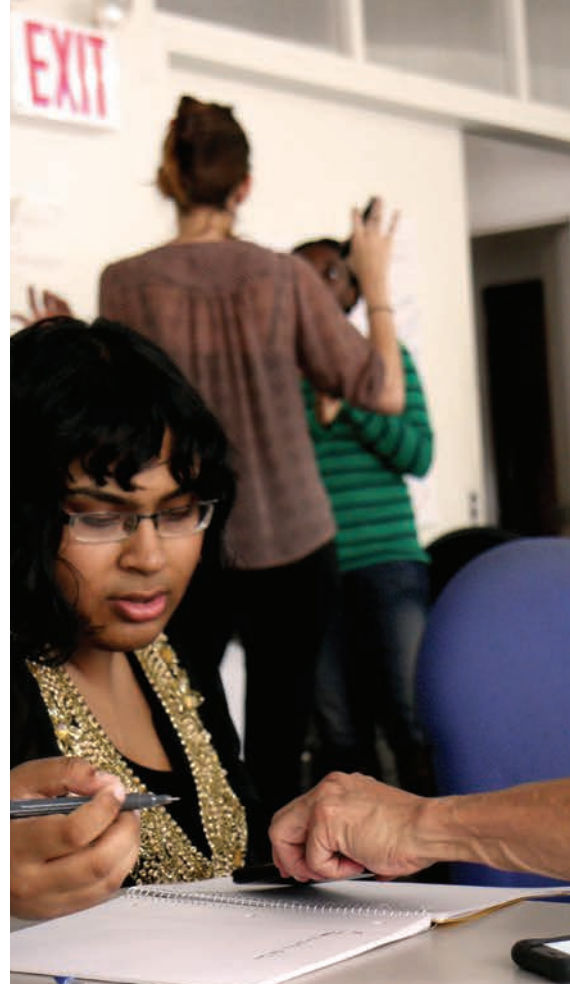


Other

- 1% Crime/theft by staff



Access to finance is the biggest challenge faced by business owners when starting up a business



SECTION 5

FINANCIAL SERVICES PRODUCT UPTAKE AND USAGE

Access to finance is one of the most common factors that contribute or constraint MSME growth in various levels of their life cycles. Finance is a crucial component 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 products that they have/use.

FIGURE 21: Financial inclusion framework

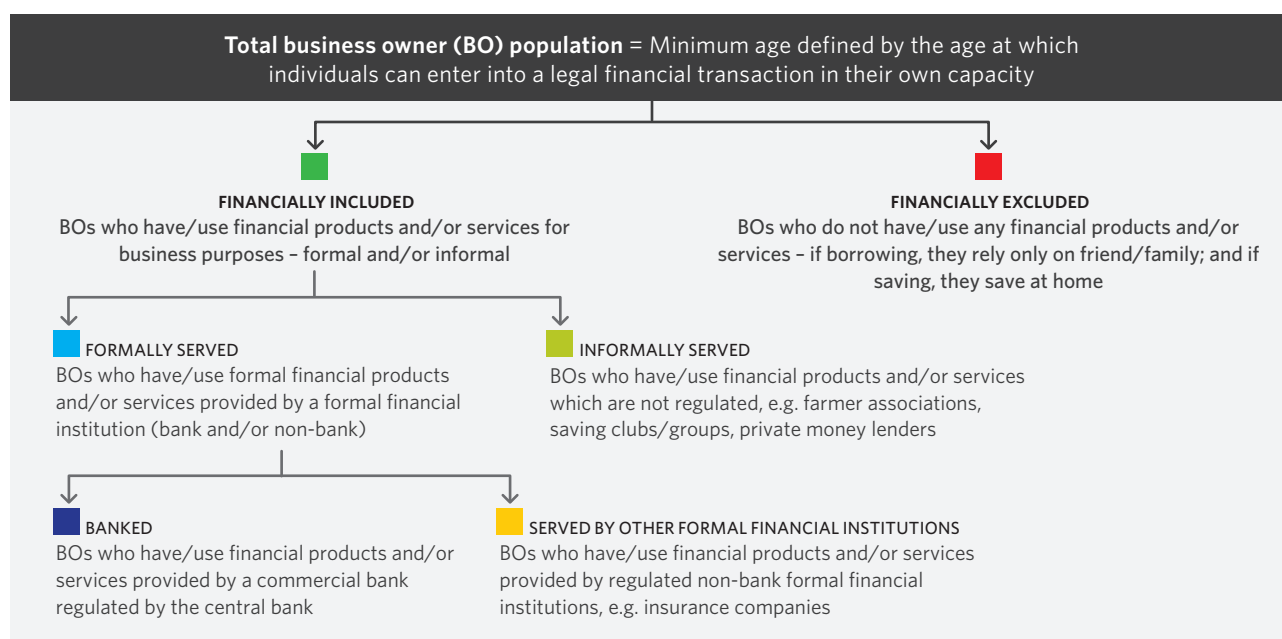
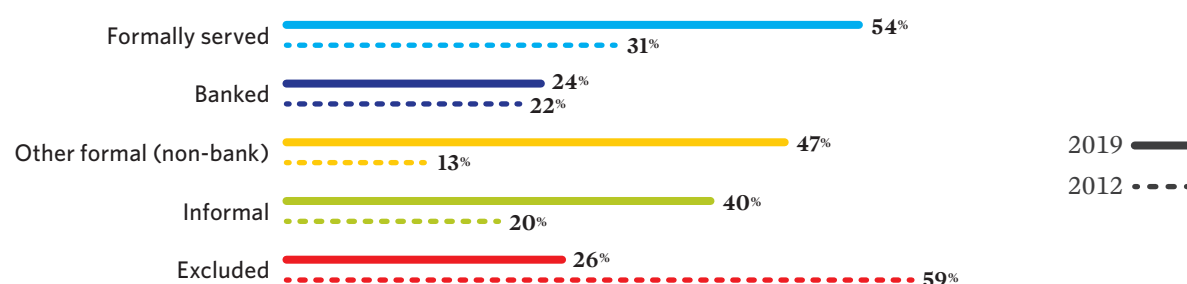


FIGURE 22: Overview of financial product use (with overlaps)

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 different mechanisms that are accessed by the business owner to be identified and can be used in combination. This allows a deeper understanding of what access to finance really entails in the day-to-day needs of the business, ranging from payments to risk mitigation mechanisms. Figure 22 shows the overview of financial product use across the categories comparing between 2012 and 2019.

Looking at Figure 22, there has been a notable increase in the proportion of business owners with access to formal financial services/products from 2012 to 2019 showing a 23-percentage point increase. This is largely driven by mobile money account ownership and SACCOs. Bank access has also increased marginally in terms of proportion of banked business owners but a significant increase is noted in terms of absolute numbers, leaping 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 different financial service providers ranging from informal to formal. Hence, there may be overlaps when looking at any MSME owners' ownership and usage of financial services/products. A further look at the overlaps shown in Figure 23 reveals MSME owners' usage of financial services from multiple sources such as banks, other formal institutions and informal operators. This might be driven by difference in the suitability of financial services offered by each sector, the business cycle phase of the business, location, and other intrinsic factors such as demographics. Issues around collateral, KYC requirements and arduous procedures may be and impediment to take-up of formal products and services.

There have been significant shifts in the financial product uptake between 2012 and 2019 which can be explained in the individual products such as payments where mobile money plays a role in the growth of other formal (non-bank) up take, growth within credit from informal mechanisms such as VSLAs. The report will explore these in detail in the following sections as well as explain the drop in the proportion of excluded business owners.

FIGURE 23: Overlaps and Financial Access Strand (%)

Source: FinScope MSME Malawi 2019 Survey

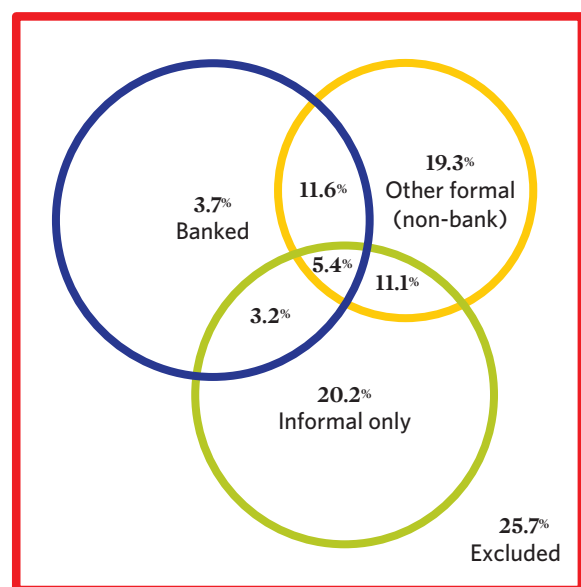
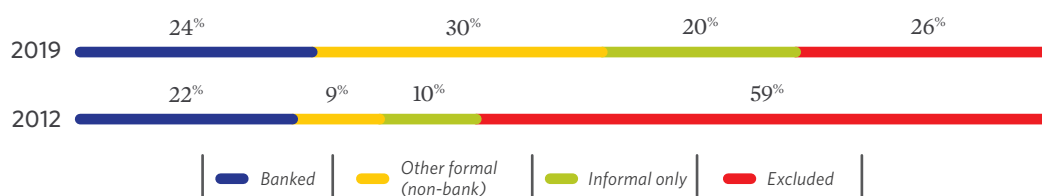


FIGURE 24: Access Strand 2019 (%)

Source: FinScope MSME Malawi 2019 Survey



5.2 Financial access and usage

Conventionally, the driving institution of formal services and products were banks. The landscape significantly changed with introduction of mobile money in 2012 and microfinance institutions much earlier in the early 2000's. 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 percent in 2012 to 54 percent 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 bank and other formal (non-bank) is evident as earlier shown in Figure 23.

There are definite drivers to the increase in formal product access mainly attributed to mobile money. This is mainly because in 2012, there was no mobile money offering in Malawi. There has been a rapid uptake since its introduction to the market after 2012. Another driving agent of formal financial access are banks. The penetration of business owners with ownership of bank products increased from 22 percent in 2012 to 24 percent in 2019. This was largely driven by transactional products as savings with bank dropped in proportion but overall there is an increase in the actual number of business owners accessing savings products.

The level of financial access also differs by sector as the demands of financial services differ with complexity of the business (due to intrinsic factors such as development of the sector as well as the business life cycle phase the business is in). As shown in Figure 24, more developed sectors such as business services, tourism and construction sectors have higher banked businesses. Less sophisticated 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/products. This can be attributed to higher uptake of mobile money and SACCOs. High informalisation and low turnovers discussed in section 3 that may not motivate the business owner to use formal products due to cost and convenience. The most common barrier cited being the lack of a need for bank products.

Formal product access and usage also depends on the business ecosystem. If clients and input suppliers largely operate on a cash system, the use of formal products like Point of Sale (POS) may actually be costly to the business

owner. Understanding the ecosystem of the business will help create products that improve the way business owners collect and make payments and improve their cash flow management and security.

The business life cycle stages present different financial needs to the business. From start-up the capital mix can look totally different to that of an established or mature business. Looking at the access to finance at each business stage allows for ideal financial tools to be deployed in the market as not all phases have the same needs. Due to the large variations between sectors, life cycles are difficult to ascribe to businesses. Hence, for simplicity, as in earlier sections, this report uses the business age as a life cycle indicator to look at financial usage at each phase.

Figure 26 shows that access of formal products also increases with progression in the life cycle of a business. It is interesting that other formal (non-bank) uptake is steadily increasing at each life cycle point reaching a high of 42 percent (58 percent overall) in mature businesses and low at 42 percent (35 percent overall) in start-ups. The use of informal mechanisms is also similar across all stages in the business life with the largest proportion coming from the growth and established phases at 31 percent each (44 percent overall for growth - also having business owners only dependent on informal mechanisms for their financial needs at 23 percent).

FIGURE 25: Financial Access Strand by sector (%)

Source: FinScope MSME Malawi 2019 Survey

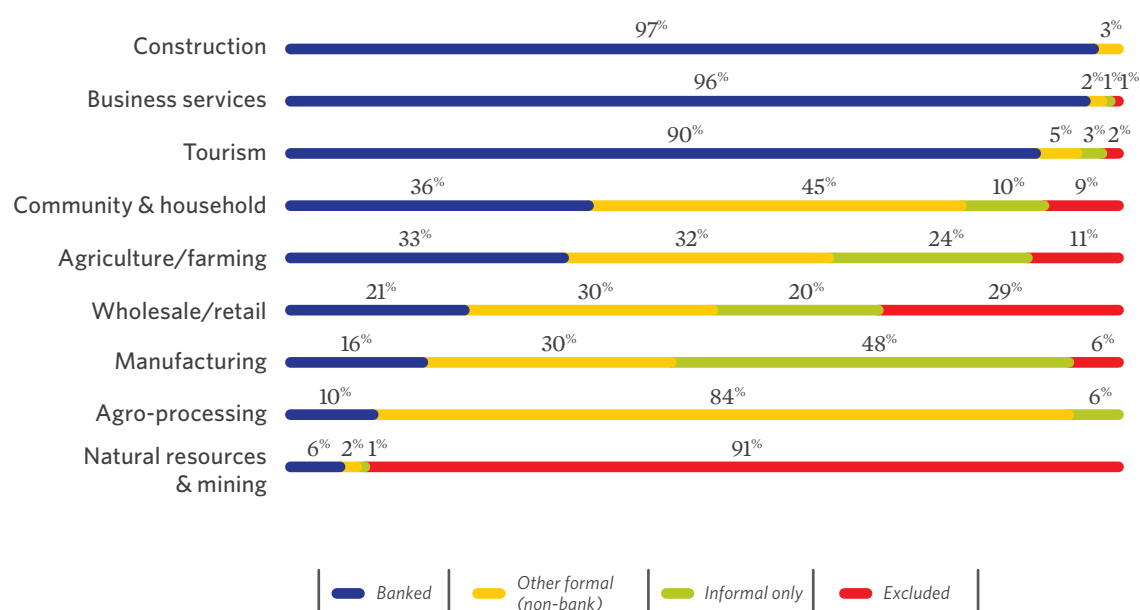
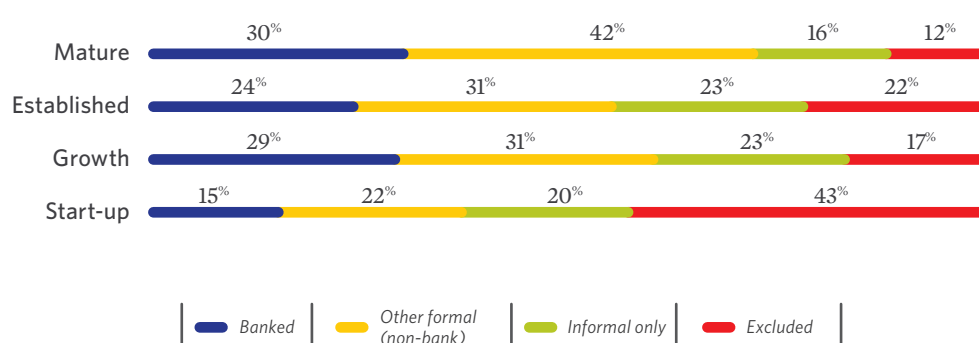


FIGURE 26: Financial Access Strand by business life cycle (%)

Source: FinScope MSME Malawi 2019 Survey

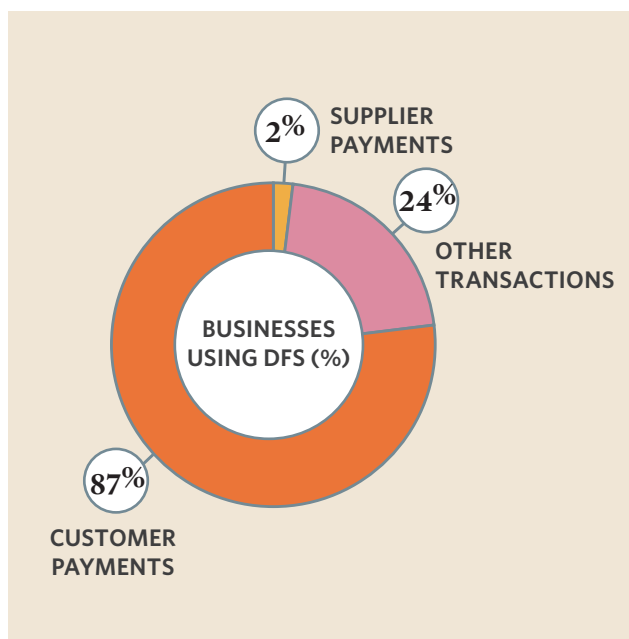


5.3 Digital financial services

Digital financial service (DFS) tools have seen a rapid increase in adoption particularly in developing economies where there is a growing ownership of mobile phones and cheaper and more accessible mobile based financial services. This expands the finance offering to reach more businesses across distant geographies in real time. With the introduction of mobile money and its high uptake, this broadens the financial landscape on the digital ecosystem.

FIGURE 27: DFS universe

Source: FinScope MSME Malawi 2019 Survey



The MSMEs in Malawi have 40 percent adoption (uptake) of mobile money. It is unpredicted to have only 9 percent using DFS which may be attributed to largely cash-in and cash-out transactions and not transacting on digital platforms such as transferring payments to suppliers (only 1 percent) and receiving of payments from customers (87 percent), see Figure 26. Business owners who typically use DFS are banked (67 percent) and also have mobile money accounts (67 percent) showing a cross use between banks and mobile money. In this instance, the contribution of DFS lies in the interoperability between banks and mobile money wallets. The launching of mobile money cards can also increase the digital footprint of mobile money on the digital ecosystem. Further, interoperability between bank accounts and mobile wallets can increase the DFS usage (bi-directional transfers) as well as across mobile wallets, along with an increase in awareness of platforms to those that have access to formal services/products from bank and mobile money.

Usage of technology or digital payments (for both customer and supplier) is higher at two in three users of DFS being the youth. This is despite the seniors having far greater ownership of bank, mobile money and MFI accounts.

5.4 Access to credit

One of the most important services in developing the MSME sector in Malawi captured in the FinScope MSME 2012 survey as well as in the NSFI 2016-2020 is credit for growth. As was cited in the 2012, 34 percent of MSMEs found access to finance to be the biggest growth impediment while in 2019, 36 percent of MSMEs stated the same. Looking at the Credit Strand in Figure 27, it shows there is no improvement in access to formal finance (both at 11 percent in 2012 and 2019) although absolute numbers increased from 86,500 in 2012 to 114,000 in 2019.

The most significant barrier to entry for MSMEs in any market is the capital required to start the enterprise. As the business moves from the start-up to growth various capital instruments come into play with credit still being an important fund-raising avenue. Access to formal credit particularly for tourism, construction and business services is high. The same three sectors do not borrow from other formal (non-bank) institutions. With the exception of the business services sector (65 percent) tourism and construction sectors also borrow minimally from the informal sector (<5 percent overall with 2 percent only borrowing from informal). The rest of the sectors have lowering bank credit access especially the manufacturing and agro-processing sectors that are deemed to be pro-industrial to the overall MSME sector. There is a high dependency on the informal sector mechanisms such as VSLAs, ROSCAs and money lenders. While there is a decrease in those without access to credit, the financial landscape seems to face challenges in providing credit to critical sectors of the economy.

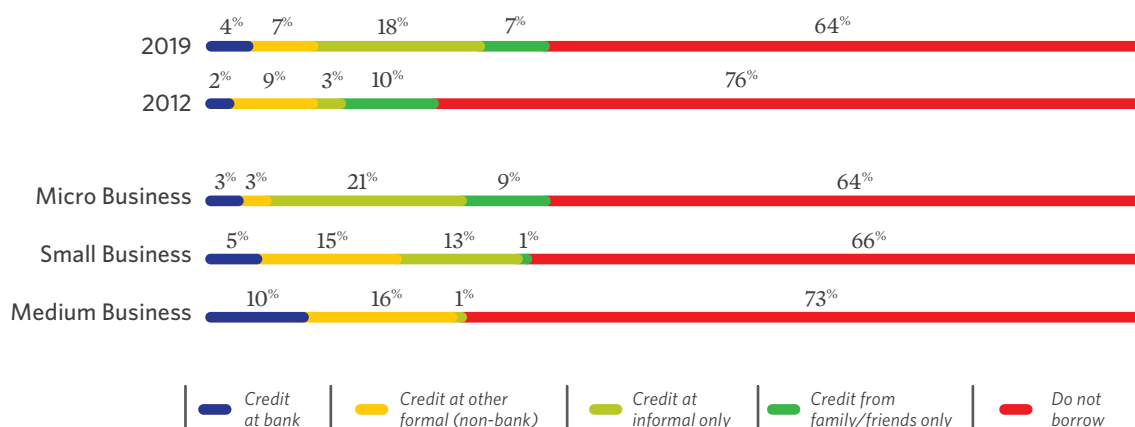
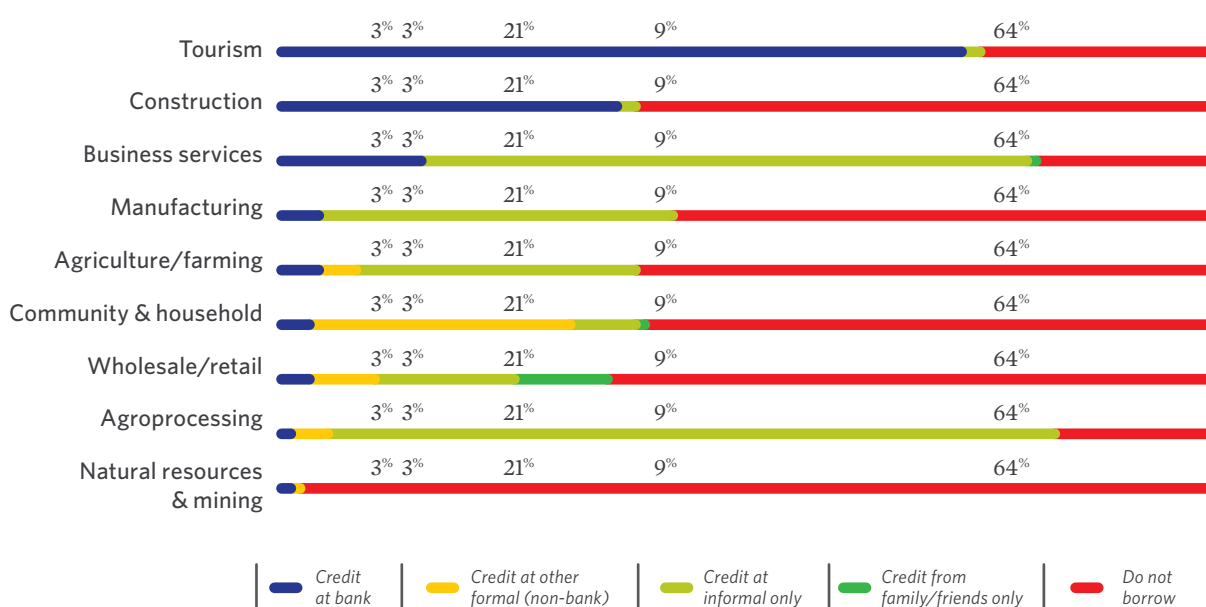
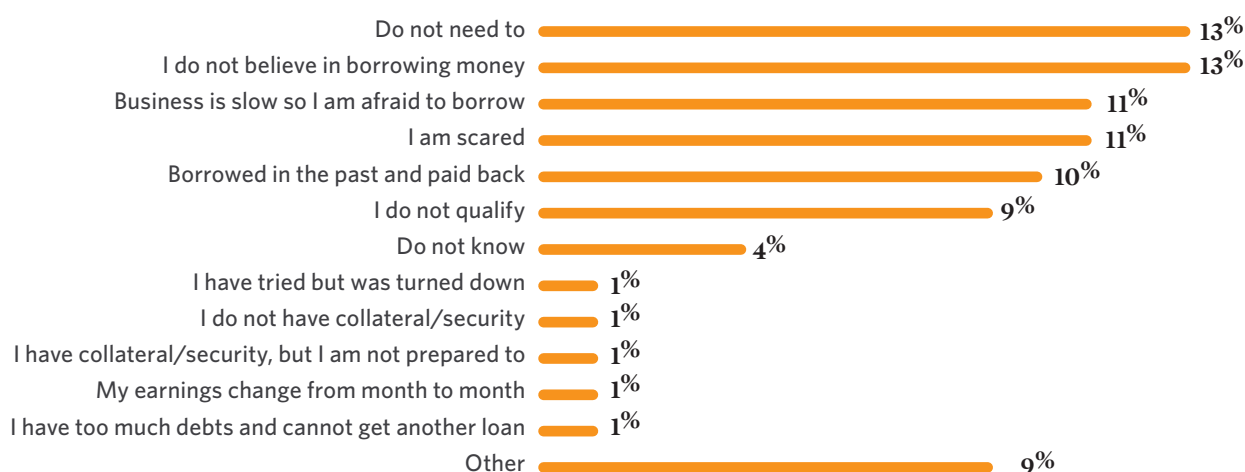
It is expected that the larger the enterprise the more formal and overall credit access the business has, which is shown in Figure 27. More micro-enterprises depend on informal credit mechanisms as well as family and friends who become a critical support for business cashflow and working capital.

A total of 736,000 business owners (64 percent) are not currently borrowing for their business. Looking at Figure 29, the top three barriers have not changed from 2012. This is a peculiar observation as over 60 percent of business owners cite an access to finance issue which is not limited to access to credit. Drawing from the focus group discussion to enunciate on this observation, it was found that MSMEs may have access (contributing to the overall 60 percent) but the finance was cumbersome to use, credit was insufficient and expensive and those who did not have access were simply afraid to acquire credit.

Profiling those without access showed that these are likely to be business owners in a start-up (34 percent), male-led (51 percent) aged 35 years and above (52 percent) and in rural areas (78 percent).

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 for returned earnings from MSMEs to be re-invested in formal enterprises thereby increasing funds available for investment or credit. However, looking at the Savings Strand, a drop in savings at bank is noted between 2012 and 2019 from 16 percent to 2 percent respectively. This is largely attributed to the allocation of savings accounts previously under savings in 2012 but now as non-saving transactional products in 2019. The rationale for this has been applied in 2014 to the FinScope Consumer survey following a change in the savings book or account to transactional cheque account in the banking system. This was because the savings book or account was used as a chequing account despite its original intent to be a savings tool. The drive for this was its low entry deposit requirement. Products addressing the savings need are called fixed term deposit or notice accounts as well as long term saving accounts.

The drop in overall savings by business owners from 78 percent to 46 percent may also be attributed to refinement of the questionnaire as well as measurement framework between the first generation of FinScope MSME surveys (such as the 2012 studies in Malawi, Zimbabwe and Mozambique) and third

generation surveys conducted in 2019. The main questionnaire phrasing change was asking in terms of the business i.e. is the business owner saving specifically for business purposes. It may be difficult to separate personal or household savings to that of the business. Together with tougher economic environment, dependency on retained earnings as a source of capital injection and having less to put away as savings may explain the drop in overall proportion of enterprises saving in 2019.

For those not saving (54 percent the main reasons for not saving mentioned were that all money is put back in the business (21 percent) and the business was not making enough to save (18 percent).

5.6 Insurance and risk mitigation

MSMEs face a myriad of risk that contributes to their overall risk profile as clients of financial services and products. The most common risks facing MSMEs is theft of business stock (34 percent), rain damage (24 percent) and fire, flood or natural disaster (23 percent). With the bulk of MSMEs being sole proprietors and informal, risk easily transfers to the household further haemorrhaging the livelihoods of MSME owners. The bulk of risks facing the sector are insurable,

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

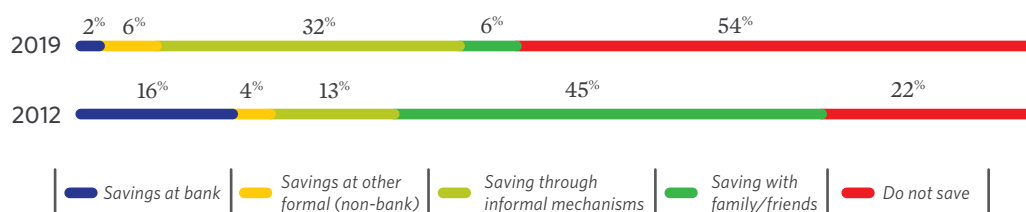


FIGURE 32: Insurance strand (%) | Source: FinScope MSME Malawi 2019 Survey

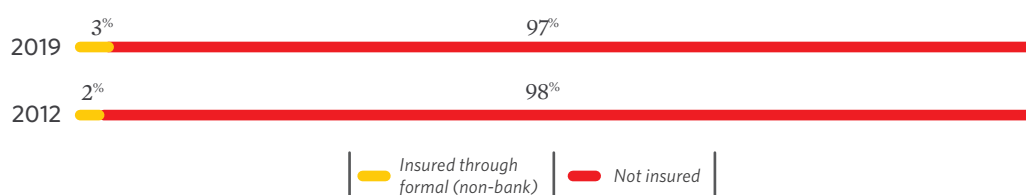


FIGURE 33: Barriers to insurance | Source: FinScope MSME Malawi 2019 Survey



however the uptake of insurance remains low. Most of the those with insurance, are covered at a personal level and the business risk is still largely uninsured. There is negligible change in the proportion of MSMEs covered between 2012 (2 percent) and 2019 (3 percent).

As most MSMEs are uninsured yet they faced risk, most did nothing while those that did something to cope with the risk used their savings or borrowed.

Given the need for insurance and barriers above, the NFIS poses wholesale disaster insurance as a viable product target primarily at farmers through their loan providers such as MFIs. Identifying the most common risks, sizing the market to which an insurable risk lies allows for the product to be more affordable. The bundling of products can assist in getting a larger pool of agri-business owners (and even subsistence farmers) insured. It is equally important that targeted insurance products are coupled with financial education to allow more business owners to understand the concept of insurance and so empowering them to take up the correct policies.

SECTION 6

FOCUSING EFFORT: HIGH IMPACT MSMEs FOR GROWTH AND EMPLOYMENT

The NFIS identifies affordable credit to those MSMEs and farmers with the ability and motivation to grow as a priority. While the sector provides a significant contribution to livelihoods and the broader Malawian economy, not all MSMEs will have a notable and sustainable impact on employment let alone economic growth. Governments often cast a wider net by attempting to promote development of the MSME sector by providing support to businesses of all sizes. However, such an approach often fails to deliver the expected outcome due to lack of resources to reach out to all businesses in the MSME sector. Moreover, it is not efficient to spend limited resources to assist every business enterprise

without adequately understanding the enterprise's growth prospects and potential contribution to employment and national output.

It is therefore imperative that a focused approach is followed where limited resources are used in promoting the growth and development of enterprises. These should show the potential to register rapid growth and hence contribute to economic development of the country.

Due to limited resources in developing the sector, a segmentation of the MSME sector to identify those MSMEs that have the highest potential to grow and provide employment (impact) are described in the table below.

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 in across Malawi and the following sections profile the high impact SMEs.

What are high impact MSMEs?

The study classified businesses into high impact category using a battery of criterion that includes business size, owner's perception of business performance, employer status and personal monthly income.

The study used small and medium enterprises (SMEs) dropping

micro enterprises which have high proportion of survivalist businesses. Further, the SMEs had to be currently an employer to qualify in this segment. This has been used in conjunction with a qualitative measure that signifies the owner's perception of business performance. Owner's perception of business performance was captured using the survey question, "Thinking about the last 12 months, would you best describe your business as growing or the same or worst or

just starting out?" In addition, as a measure of business performance the study used the owner's personal monthly income and applied the median of MK500,000 and above. This was to give an indication of business performance indicated by the income they provide to the business owner. Therefore, the criteria for high impact SMEs included growing and stable business with personal monthly income of MK500,000 and above and have employees.

6.1 Who are high impact SME owners?

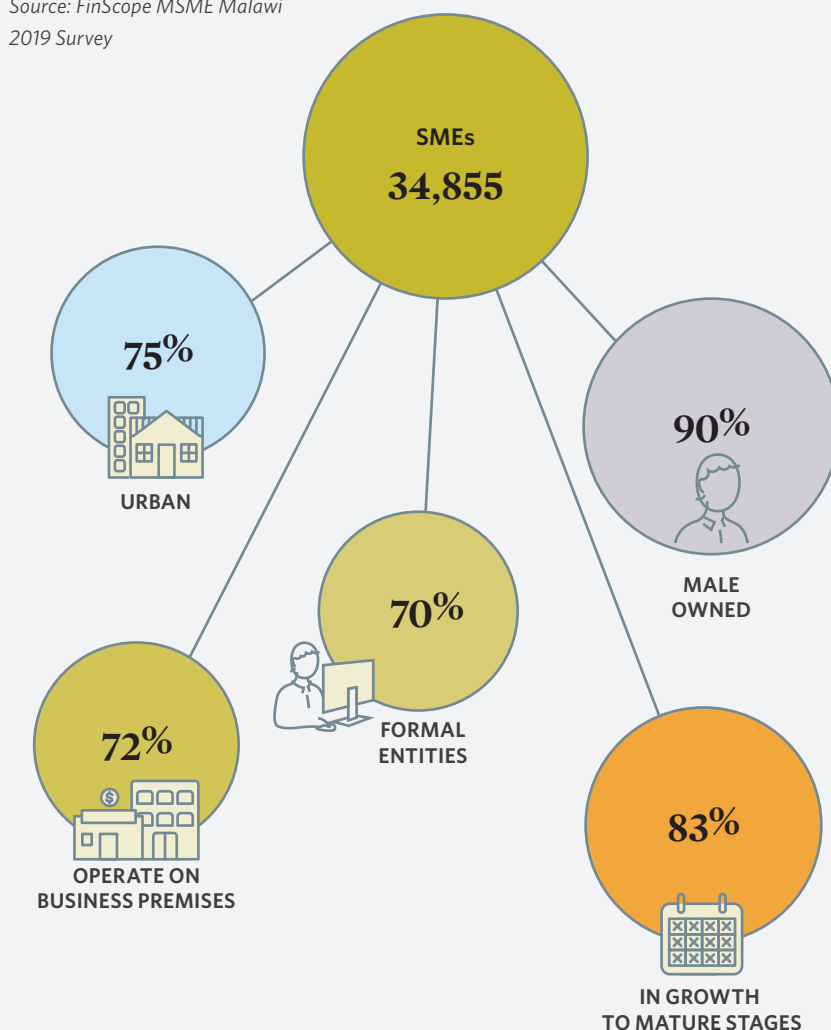
To be able to target specific SME owners in the high impact group requires them to be identifiable and quantifiable. There are two main outcomes desired from this segment hence, there was a split of the overall high impact segment into two target groups mainly by sector. The first is the aggressive growth target group which has the agriculture/ farming, manufacturing, construction and business services sectors. This target group is identified to be key in industrializing the SME economy and purported to grow substantially in its contribution to economic growth. The second is the employment generation target group which comprises wholesale/retail, community and household, tourism, agro-processing and natural resources and mining. While there is scope for agroprocessors in the sector to develop meaningfully, the current status quo of the micro-sector is still in its infancy with most agro-processors in the SME sector being millers and secondary food processors. The bulk of the agro-processing sector is dominated by large enterprises.

The educational attainments of most SMEs in the high impact group slightly improve compared to the MSME population with 52 percent having secondary education, 11 percent having university degree and 14 percent having special technical diploma. Related to education is knowing the importance of keeping financial records. Just about two in three (69 percent) keep financial records and mostly through manual systems (86 percent) with 21 percent using computerized systems. Nine in ten high impact SME owners are male with most being based in urban areas (75 percent) and operating on business premises such as workshops, stores or markets.

The level of development among the group shows as most SMEs are in the growth phase or higher as indicated by the higher proportion of formal SMEs (70 percent) and number of years in business. While the latter indicator may not hold in some sectors to show the

FIGURE 34: Overview of high impact SMEs

Source: FinScope MSME Malawi 2019 Survey



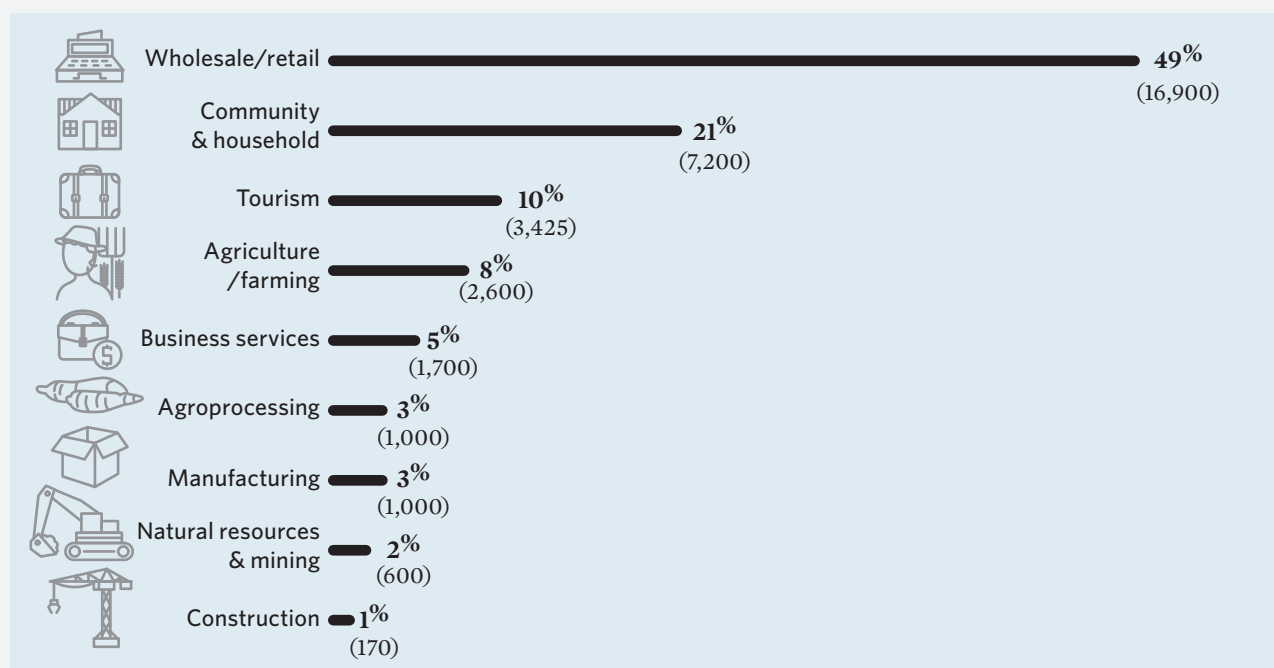
development of the enterprise, it gives a sense of where the business is in a typical life cycle. The sectoral split of the high impact SMEs is shown in Figure 34. As can be expected the higher proportion of SMEs fall in the wholesale/retail sector (49 percent - 17,000 SMEs) and community and household (21 percent - 7,200 SMEs). A further breakdown of the overall high impact SMEs is shown to delve into the growth obstacles, uptake and usage of financial services and products, usage and awareness of business support services.

Access to infrastructure by the high growth SMEs indicated to be high for electricity at 79 percent while access to piped water was at 53 percent. However, consulting with a few of

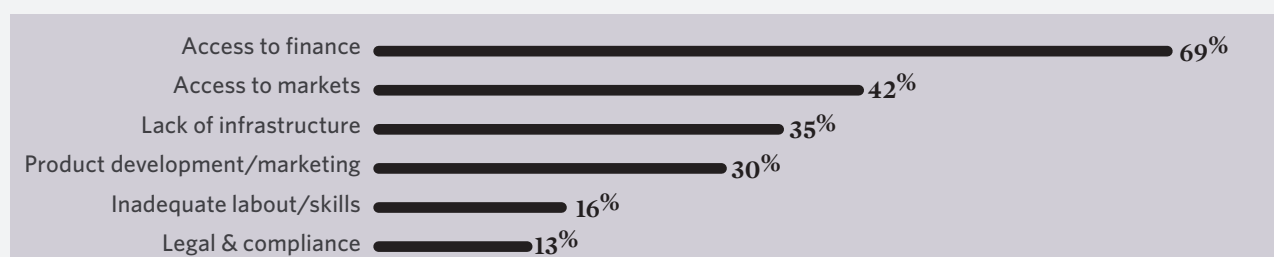
these enterprises revealed numerous challenges with connecting to the electricity grid, power cuts and high cost of electricity connections. It was added that enterprises have challenges with poor road infrastructure especially roads which affects their business through increased transportation costs. They suffered delays or failure to collect and deliver products in certain areas especially during rainy season. This contributes to the second most common obstacle i.e. access to markets. Moreover, ESCOM tariff rates were considered high by this segment. The infrastructural environment makes it difficult for SMEs to operate or compete. Coupled with low skills or inadequate labour, contribute to poor product development and poor-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 coined as the most popular obstacle in the region including recently conducted FinScope Eswatini 2017 survey. Malawi is no exception with both 2012 and 2019 surveys finding access to finance as the major barrier particularly for the high impact group. Further unpacking this, the study found that sourcing funds (37 percent), cashflow (25 percent) and high debt books (10 percent) were the main issues. This indicates that access to finance is a broad concept that shows the inadequacy of the current service provision to this segment of SMEs. It is also a largely misconstrued term that bundles finance-related issues that are not necessarily 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.

The high growth SMEs were then split into two groups as stated earlier – aggressive vs. employment segments. The report delves into these segments below.

6.2 Aggressive versus employment growth SMEs

The MSME Policy (2009) correctly described the MSME sector as under-developed and uncompetitive. In order for any prosperous transformation to be witnessed, a few sectors are to be targeted and supported to convey development to the sector and compete regionally and globally. Hence, the report attempted to identify those sectors that are likely to aggressively grow and transform this narrative. This segment is positioned to be industrial-driven with the propensity to participate more in exports and value addition. Table 9 shows the overview of this breakdown.

It is equally important to focus on employment creation and increase incomes for the livelihoods of Malawians. Further, with increased manufacturing, smooth and structured value chains as well as access to markets become crucial for the sector. Hence, the other segment which has higher employment prospect becomes a critical complement to the aggressive growth segment.

One of the issues raised during the qualitative research was that debtors took long to make good on their debt. One quarter of aggressive growth SMEs always give credit compared to 6 percent of employment generation. Best practices should be applied and delivered through business support and other formal financial services such as cashflow management and funding to ensure that the both segments are not at risk of overexposure and are applying best practice.

Access to markets remain an important factor to any sector or business size. About 5 percent of the high impact group export showing low export capacity. Value addition sectors need to produce quality products meeting global standards in order to compete. However, local markets comprise the bulk of the client base for both aggressive and employment segments. A closer look at the value chains they participate paint an interesting picture.

TABLE 11: High impact group segments overview

Source: FinScope MSME Malawi 2019 Survey

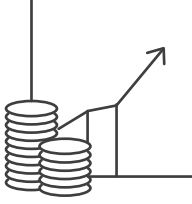







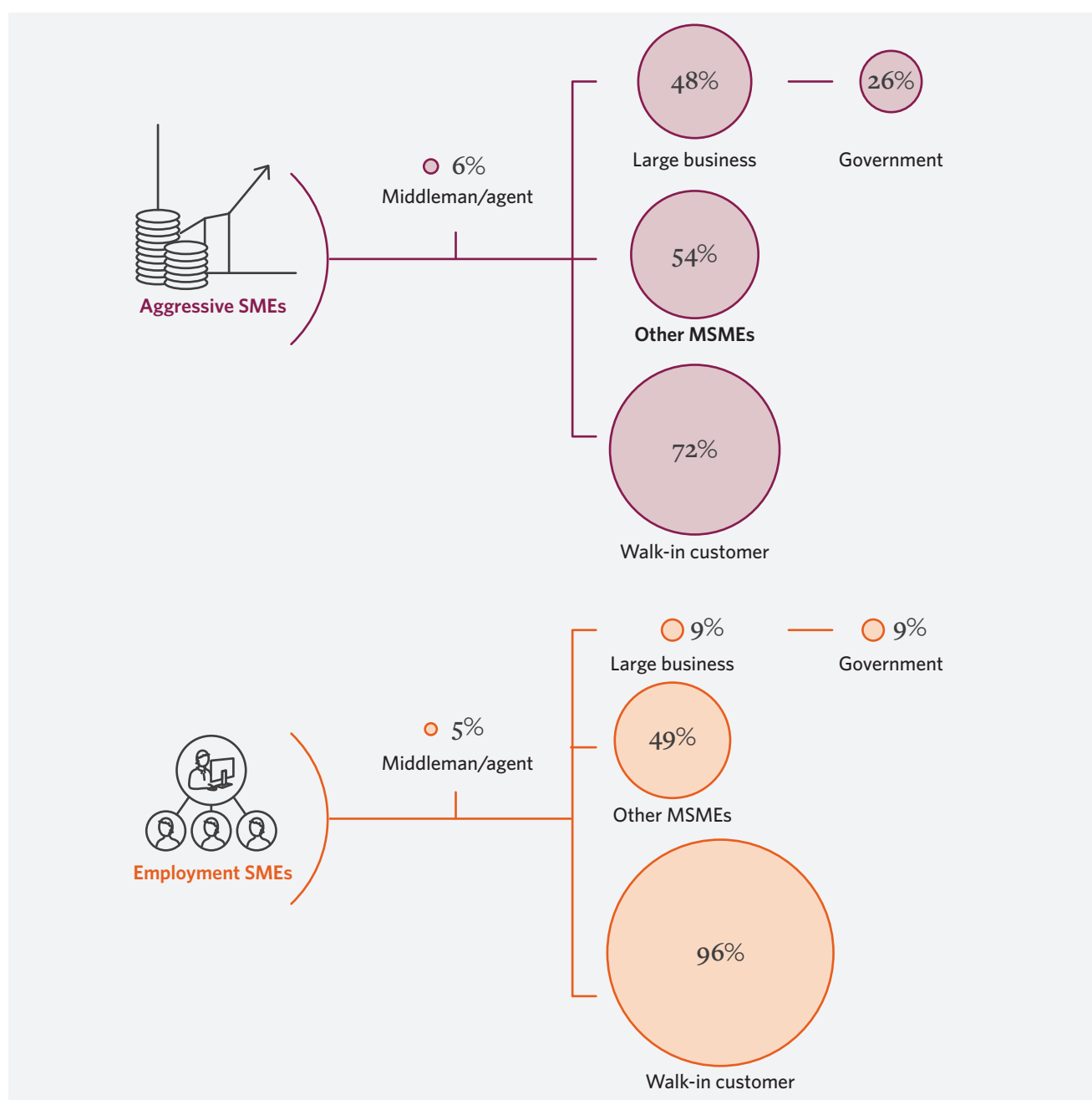
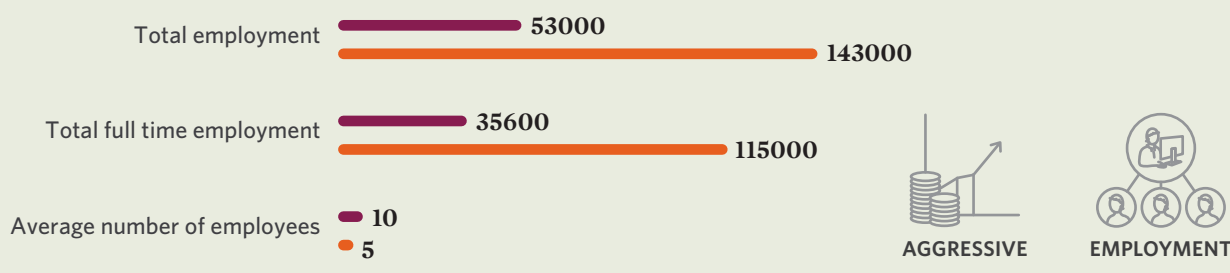
		 Aggressive growth		 Employment creation	
		Agriculture Manufacturing Business services Construction		Wholesale/retail Community & household Agro-processing Tourism	
	Urban	58%		78%	
	Female	10%		10%	
	Electricity access	73%		80%	
	Piped water access	61%		52%	
	Median annual turnover (USD)	\$26,300		\$24,650	
	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 and Employment segments | Source: FinScope MSME Malawi 2019 Survey

The figure above (37) shows the different value chains the two segments are a part of. Nearly half of aggressive SMEs (48 percent) have large businesses and government (26 percent) as customers. This shows the vertical linkages that aggressive SMEs are a part of. Employment SMEs have a lower proportion linking to large businesses or government perhaps due to the nature of the sectors being predominantly wholesale/retail and community and household services. However, for both segments it shows

that there is a strong horizontal linkage with other MSMEs with one in two (on average) trading with other similar enterprises with agriculture/farming being the highest of all sectors (80 percent). Walk-in customers still make the bulk of the client base with the employment SMEs having nine in ten as their customer base. Few high growth SMEs use middlemen or agents (<5 percent) while overall medium enterprises (19 percent) use them driven by medium wholesale/retail medium enterprises.

Access to formal financial services is high for the two segments with nine in ten enterprises having formal access. Formal credit (35 percent vs 24 percent) is also higher within the aggressive segment largely driven by bank credit in both segments. Interestingly, two in five aggressive SMEs use informal mechanisms mainly savings and credit groups such as VSLAs and ROSCAs most common in the business services and agriculture sector. While access to finance may be high, the depth of financial services

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%
All MSMEs	\$6 855 076 646.00	

seems to be inadequate to cater for the business needs. This is reflected from the qualitative study with the high impact focus group, “Informal finance through VSLs is a better option because the requirement to access loan 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 in relation to creating employment and their contribution to GDP. Using the study as a baseline to sizing the target areas as well as their overall performance, Figure 37 shows the employment contribution of the segments. The most pertinent findings is that while the employment segment is best positioned to absorb more employees

than the aggressive segment (i.e. 143 000 full-time employees in employee segment versus 53 000 in aggressive segment) the aggressive sector employs more employees (on average). This suggests that improving the number of enterprises in this segment will have a bigger impact on employment (on average). There are various factors that enterprises face with regards to employment as it is an indirect demand factor.

Looking at the contribution to GDP of the segments also shows interesting but expected findings, the employment sector has the highest contribution to GDP due to its size. This makes the employment segment account to a quarter of all MSMEs in Malawi. However, the contribution per enterprise shows that aggressive SMEs have a higher contribution on average \$84 000 compared to \$59 000 for 2019. Looking at the ratio of formalisation between the two segments suggests that about two in three enterprises for both segments

contribute formally to the economy. This may already be captured in formal accounts. However, about a third of businesses in both segments have the aptitude to contribute formally i.e. about \$650 million. Incentives or benefits of transitioning to formal enterprises for these SMEs in both segments should be made more transparent together with assistance on accurate reporting on turnover and compliance. The study found that most high impact enterprises can adequately account for turnover and account for business expenses such as family labour.

To ensure these segments deliver on growth and employment, interventions need to ensure they stem from the intricate knowledge of the SME environment they operate in. These issues 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 as well as taxation and access to markets.



most high impact enterprises can adequately account for turnover and account for business expenses such as family labour.



SECTION 7

CONCLUSIONS AND IMPLICATIONS FOR STAKEHOLDERS

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

- **The largest proportion of MSME business owners operate in the wholesale and retail**, i.e. they sell something, particularly agricultural products, operate agricultural activities and render business services, e.g. professional services (accountant, lawyer, consultants) and skilled services (hair salon, plumber, and mechanics). The most common place of MSME business operations are either from their residential premises (24 percent) or at 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 expansion of existing firms but also through birth of new firms seen by the larger proportion of start-ups. The trend also shows a higher death rate of MSMEs beyond this phase as almost two thirds of the MSMEs are below five years old. And only 39 percent survive from 6 years and above. This phase of a business requires special attention with regards to expansion and support.
- **The majority of MSMEs trade informally being neither registered nor licensed.** However, this is on a positive trajectory compared to 3 percent that were formal in 2012. Only 7 percent of MSMEs are registered by the Registrar of Companies and 11 percent are licenced- those surveyed cited their business being too small as the main reason for not registering. Other studies recommends that cost of registration is not the only barrier but MSMEs need to be told the benefits of registration, which include being able to open a business account, obtaining a loan and other business support services.
- **Nearly (80 percent) of MSME owners started a new business used own savings to start-up their businesses.** While the MSME owners primarily rely on their own savings including salaries, selling of assets and family and friends, 10 percent of MSMEs manage to access both formal and informal credit from other channels, including Village savings and credit groups (VSLs) also known as Bank Nkhonde and other financial institutions. This provides room for government to strengthen financial inclusion initiatives.
- **Almost half (42 percent) of the MSMEs owners are the youth.** Young entrepreneurs aged below 35 years constitute 42 percent of MSME business owners in Malawi, which shows the potential of the MSME sector in job creation and alleviating youth unemployment problem. It also contributes to the government's effort of promoting economic empowerment of young people in Malawi. The young entrepreneurs may have limited business experience and this provides opportunity for the government to expand business support services to these group of MSME 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 (no employee) and also proportionately fewer women own high impact MSMEs. This calls for provision of training programs tailored to women MSME owners to enable them to grow their businesses.
- **High impact SMEs are key for sustainable growth.** Focusing on interventions that support the businesses that account for about a third of all MSME GDP contribution and have the potential to industrialise the MSME economy is a worthwhile cause. The segmentation has revealed that aggressive SMEs such as construction and agriculture have a higher propensity to contribute to tax and employment. Formalisation still remains a core issue which must be designed to draw informal high impact SMEs into the formal economy as opposed to a push strategy that results in the growing informal sector. Often, tax issues are not why the most prominent SMEs are not formalised. The study concluded that high impact SMEs do not see the benefit of formalising.
- **Malawi's MSME sector faces a lot of challenges** that hinder its 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.

Implications for stakeholders

Based on conclusions drawn from analysis the study forwards the following policy recommendations for policy makers, NGOs and financial service providers.

- Recommendations include policy revision with an industrialisation focus and further understanding of the business environment. On formalisation it is recommended that an awareness strategy should be developed that links the importance of formalisation with other benefits such as financial institutions access. 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 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 business registration with an information session at commercial banks with evident benefits to the firm are provided. Firms open business bank accounts and increase their use of a range of formal financial services. Therefore, governments seeking to increase economic growth, should aim at reducing the costs of registration and coupling it with interventions that increase direct contact with formal financial institutions provide one compelling option.
- The MSME sector is constrained by a manifold of factors that are not part of the regulatory business environment- these include supply side and infrastructural constraints that limit the potential of growth in the economy such as energy and water supplies. Constraints range from indirect factors such as better transport infrastructure (roads, railway and air transport) and logistics, incentives to SMEs, and knowledge networks, to more direct factors supportive financing and banking facilities and more investments in mechanized farming and agro-processing. Increasing the potential rate of growth will require a combination of deep structural reforms and a number of medium-term investments that would reduce the cost of doing business.
- Value chain analyses is important to understand in the case of agriculture business. The main rationale for this initiative would be to provide in-depth understanding on sector-

specific bottlenecks that hinder development of an industry that is considered to be strategic. Unpacking some of the linkages becomes key. For example, urban-market-oriented or export-oriented value chains can be better understood and linked with the development of infrastructure such as quality roads and ports. This comprehension can allow an improved participation of the MSME if these value chains are identified.

Recommendations for financial service providers (FSPs)

The main barriers to financial service inclusion include high transaction costs including relatively high banking costs, low financial literacy, and cost of travel to financial sector providers, lack of identification, ill-suited financial products, limited income, unavailability /insufficient loan collateral. Financial service providers often view the MSME sector not commercially viable because of too much risk they bring to their portfolio. In addition, MSMEs demand small amounts of loan that makes financial service providers incur a processing cost that exceed the amount of revenue they can generate from it. This is aggravated by lack of competition in the banking market leading to a tendency among banks to rely more on 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
- Collaborate with other financial service providers to ease MSME financing needs

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