

Title

**ASSESSING THE ROLE OF MICRO FINANCE INSTITUTIONS' PRODUCTS ON THE
GROWTH OF SMALL MEDIUM ENTERPRISES IN MALAWI-A CASE STUDY OF
AREA 25 SMES**

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ABSTRACT

This study assessed the role of micro finance institutions' products on the growth of small medium enterprises in Malawi a case study of area 25 SMEs. A case study design was used to obtain data on the thoughts of SMEs in the area

A qualitative research approach was used to gain understanding of underlying reasons and opinions of the respondents. This method was applied because of its convenience and reliability in collecting data in the study.

Descriptive statistics were used to interpret demographic characteristics and the research objectives, mainly through frequencies and percentages. Frequency tables, graphs, and charts will be generated using Microsoft Excel 2007 to present the collected data in a concise and easily understandable form. Frequencies and percentages were further applied during tabulation to display statistics used for analyzing and interpreting the findings.

Quantitative data was analyzed mathematically through the arrangement of responses in tables, using descriptive statistical methods such as frequency distribution and tabulation. For the qualitative component, a thematic analysis approach was adopted. This method involves examining narrative responses, identifying recurring ideas, grouping related concepts into themes, and deriving major points that reflect respondents' views. The thematic approach was provided deeper insight into the underlying patterns and perspectives expressed in the qualitative data.

The study found that the utilization of microfinance services and repayment of loans by SMEs in Area 25, Lilongwe, is influenced by a mix of internal business elements, external economic forces, and institutional procedures. It is demonstrated

in the findings that long procedures involved in seeking loans, the use of collateral, high interest rates, lack of financial literacy, and seasonality are major elements that impact the ability of SMEs to utilize loans. Furthermore, poor financial management practices, as measured by the absence of financial records, poor budgets, the blurring of business and household finances, and the lack of cash flow analysis, also impact the successful repayment of loans and business performance.

Keywords: SMEs, Micro-Finance, Case study, Malawi

INTRODUCTION

This chapter actually presents an introduction on assessing the role of micro finance institutions' products on the growth of small medium enterprises in Malawi. According to *Koech, (2011)* Small and Medium-sized Enterprises (SMEs) are generally regarded as the driving force of economic growth, job creation and poverty reduction in developing countries. Microfinance is not a new concept. It dates back to the 19th century when money lenders were informally performing the role of now formal financial institutions. In recent years with the evolution of microfinance and small and medium-sized enterprises, there have been some changes. Microfinance institutions provide savings and credit services for small and medium-sized enterprises. However it should be noted that microfinance is not a panacea but it is the main tool that fosters development in developing countries (*Yigzaw, 2015*). They have been the means through which accelerated growth and rapid industrialization have been achieved. *Cooper, (2012)* did a research on the impact of micro finance services on the growth of small businesses where it was found out that there is a strong positive relationship between micro finance services and the growth of small businesses.

Background of the study

Microfinance institutions (MFIs) are crucial to the Malawi economy by providing customized financial services to small and medium-sized enterprises (SMEs). They play an essential role in promoting financial inclusion and stimulating economic growth by effectively addressing the financial needs of marginalized communities (*Mwanza & Phiri, 2020*). SMEs significantly impact the Malawi economy by providing jobs, generating income, and helping to alleviate poverty. However, these businesses frequently face challenges in accessing formal financial services such as credit and savings. Microfinance institutions (MFIs) aim to tackle this issue by offering customized financial products like microloans and savings accounts that address the unique requirements of SMEs. This assistance cultivates entrepreneurship and encourages economic development (*Kalunda, 2014*)

Existing research often overlooked the role of microfinance institutions products on the growth of SMEs in Malawi and instead focused on large enterprises which usually have support from traditional banking in raising their capital.

Problem Statement:

Micro finance institutions ease access of financial lending services. Recently we have seen an increase in the number of microfinance institutions that offer microloan services to the public. Area 25, Nsungwi Market in Lilongwe is one of the locations with a high number of SMEs who rely on microfinance to boost their businesses. The institutions offer a spectrum of products and services to the masses in urban, semi urban and rural areas but there is not much growth.

RESEARCH OBJECTIVES

Primary Objective

- To assess the role of microfinance institutions' products on the growth of SMEs in Malawi, with a case study of SMEs in Area 25, Lilongwe.

Secondary objectives

- To identify the challenges SMEs face when accessing microfinance services in Area 25.
- To evaluate the contribution of microfinance loans to the growth and sustainability of SMEs in the area 25.
- To examine the factors contributing to loan default among SMEs.
- To determine the internal and external factors influencing SME growth in Area 25

RESEARCH QUESTIONS

- What challenges do SMEs in Area 25 face when accessing microfinance services?
- In what ways have microfinance products contributed to the growth of SMEs in the area?
- What are the main causes of loan default among SMEs in Area 25?
- What internal and external factors hinder the growth of SMEs in the area?

SIGNIFICANCE OF THE STUDY

This study is significant because it explores the role of microfinance institutions (MFIs) in enhancing the growth of small and medium enterprises (SMEs) in Malawi, focusing on Area 25 in Lilongwe. The findings will provide policymakers and regulators with evidence that can guide the development of inclusive financial policies aimed at improving SME access to credit and business support. Microfinance institutions will also benefit through a deeper understanding of the financial management challenges and repayment issues their clients face, enabling them to refine their products, strengthen training programs, and improve sustainability. For SMEs, the study will offer practical knowledge on effective utilization of microfinance services to strengthen their operations and competitiveness.

THEORETICAL FRAMEWORK

The Grameen Solidarity Group Theory

This model is based on group peer pressure whereby loans are made to individuals in groups of four to seven (*Armendariz & Morduch, 2005*). Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members.

Credit Rationing Theory

The Credit Rationing Theory was introduced by *Joseph Stiglitz and Andrew Weiss* in 1981 to explain how credit markets operate under imperfect information. The theory highlights the problems of adverse selection, where high-risk borrowers are more likely to seek loans, and moral hazard, where borrowers may misuse funds after obtaining credit. Rather than simply raising interest rates, lenders often restrict access to credit in order to minimize risk.

This theory aligns with the first secondary objective, which examines the challenges

SMEs encounter in accessing microfinance loans. Many SMEs in Malawi, particularly in Area 25, face collateral requirements, limited financial records, and risk perceptions that discourage lenders from approving credit. Credit Rationing Theory explains why SMEs continue to experience difficulties in securing finance even though many microfinance institutions are present, highlighting the influence of information asymmetry and lender risk assessment.

Resource-Based View (RBV) Theory

The Resource-Based View (RBV) was first proposed by *Edith Penrose in 1959* and later refined by *Jay Barney in 1991*. The theory argues that business growth and competitive advantage are built on the possession and effective use of resources that are valuable, rare, difficult to imitate, and non-substitutable. These resources can take many forms, including financial capital, entrepreneurial skills, technology, and organizational knowledge. RBV emphasizes that firms with better access to and use of such resources are more likely to grow and sustain long-term success.

This theory connects with the second secondary objective, which seeks to assess the role of microfinance loans in SME growth. Loans from microfinance institutions provide entrepreneurs with vital resources such as working capital, equipment, and training opportunities. In Area 25, these financial inputs enhance the ability of SMEs to expand operations, improve productivity, and build sustainable enterprises. The RBV framework clarifies how microfinance products strengthen the resource base of SMEs, leading to improved growth outcomes.

Moral Hazard Theory

The Moral Hazard Theory was developed in the field of economics through the work of *Kenneth Arrow in 1963* and was later extended to financial markets. The theory

suggests that individuals or firms may take excessive risks or neglect responsibilities when shielded from the consequences of their actions. Within lending, moral hazard emerges when borrowers misuse loan funds, delay repayment, or divert resources toward unintended purposes. Weak monitoring and limited accountability mechanisms in microfinance often increase this risk.

This theory is relevant to the third secondary objective, which examines factors that contribute to loan default among SMEs. Entrepreneurs in Malawi often struggle with poor financial literacy, unstable income streams, and insufficient planning, which makes loan misuse and default more likely.

Institutional Theory and Human Capital Theory

Institutional Theory, developed by *Meyer and Rowan in 1977* and expanded by *DiMaggio and Powell in 1983*, emphasizes the role of external environments such as laws, policies, cultural norms, and governance structures in shaping organizational behavior..

These theories are connected to the fourth secondary objective, which identifies the factors influencing SME growth. Institutional Theory explains how regulatory frameworks, economic instability, and limited government support constrain SMEs in Malawi, while Human Capital Theory emphasizes the impact of inadequate skills, limited training, and weak financial management among entrepreneurs. Taken together, the two perspectives highlight how external constraints and internal capacities interact to determine the growth trajectory of SMEs in Area 25.

RESEARCH METHODOLOGY

Research Design and Methodology

Given the purpose of the study which is to examine the impact of increase in number of micro finance institutions' products a case study strategy seemed most appropriate. A case study involves a concentrated and in-depth study and exploratory interaction between the case and the context under study (*Marshall & Rossman, 2014*). Therefore, a case study design was the best method of obtaining data on the thoughts of SMEs. A single case was selected because it provided me with an opportunity to observe and analyse a phenomenon that few have considered before.

Research Setting

The study was conducted at area 25 Nsungwi market in Lilongwe. The area was selected because there is a large number of small businesses which benefit from MFIs like shops, butgeries, restaurants, market entrepreneurs selling cereals, groceries and so on therefore data collection will be easy and accurate

Target Population

The target population is a specific subgroup possessing essential qualities or experiences (*Neuman 2014, Creswell. & Creswell 2017*). The study targeted those with businesses that rely on microfinance and have limited access to loans from traditional banks.

Sampling Technique

The study employed Probability sampling techniques. The study used Stratified sampling technique for relevant SMEs because these are the people that had the potential to provide the necessary

information needed for the study. Those with very small shops were excluded because they cannot provide relevant data.

Sample Size

The Sample size was derived from a population of 82 SMEs that are found at Nsungwi market in area 25 .I targeted 82 SMEs because of resource constraints and I felt it is a good number since it is a qualitative research.The Slovin's formula($n=N/(1+Ne^2)$) was utilized in order to attain a sample of 45 from the population 82 SMES in area 25.

Research Instrument

A questionnaire with close ended and open questions was used to collect qualitative data from SMEs in the market. These comprises of three sections, the first section (A) with closed ended questions that will capture the descriptive socio-demographical information of the respondents. Sections B and C respondents were required to show their extent of agreement with various statements drafted basing on the objectives of the study. This particular tool was considered because it gives respondents an opportunity to express themselves without being influenced by others.

RESEARCH FINDINGS

To Identify the Challenges SMEs Face when Accessing Microfinance Services in Area 25

The findings indicate that the loan accessibility process stands out as the most significant barrier, as many SMEs struggle with lengthy procedures, stringent requirements, and limited understanding

The results point out that fifteen respondents, or thirty-three percent, highlighted complex steps for solo borrowers. At the same time, twelve

respondents, or twenty seven percent, emphasized strict collateral as a key block. In contrast, ten respondents, or twenty two percent, noted that group lending reduces risks and quickens approvals. Eight respondents, or eighteen percent, supported group guarantees.

The bar graph on Collateral and Documentation covers four concerns tied to loan needs. The top score of sixteen covers the hassle from not having property or assets. Needing full financial records rates twelve, so it counts as a real issue too. Heavy document asks, which raise chances of denial, hit ten for medium trouble. The bottom at seven links to how easier collateral rules open up access. That implies loosening them helps more people borrow.

These results are consistent with *Robinson (2001)*, who argued that affordable interest rates improve borrower participation and repayment performance, and *Qayyum et al. (2006)*, who observed that reasonable loan pricing enhances SME sustainability, supporting the Resource- Based View Theory which emphasizes access to affordable financial resources as a driver of firm

To Evaluate the Contribution of Microfinance Loans to the Growth and Sustainability of SMEs in the Area 25.

The results make clear that microfinance groups fill a key spot in giving small and medium enterprises the money to grow work, lift sales, and raise profits. Getting microfinance also keeps businesses going by aiding cash flow ups and downs and handling economic hits. Plus, these loans aid lasting strength when paired with advice and skill building from the groups. In all, the proof shows the microfinance acts as more than just money help. It sparks business building and toughness for small and medium enterprises.

These findings support *Cooper (2012)*, who

established a strong positive relationship between microfinance access and business expansion, and *Chiu (2015)*, who found that financial resource availability improves SME productivity and market reach, in line with the Resource-Based View Theory (*Barney, 1991*).

The outcomes suggest microfinance efforts build strong money habits in borrowers, with steady payback as the big win. The solid twelve for savings shows loans not just handle debt but push forward planning. Moderate hits on spending cuts and long term strength imply loans aid responsibility and toughness overall. This backs the view that microfinance shapes good money practices well. It lifts small and medium enterprises money handling and helps steady growth.

These findings align with *Robinson (2001)*, who argued that structured repayment schedules promote financial discipline, and *Qayyum et al. (2006)*, who observed that microfinance savings products enhance long-term financial stability, supporting Human Capital Theory (*Becker, 1964*).

The results say microinsurance exists but falls short on shielding small and medium enterprises from risks, especially money shocks. High worry on payback in losses points to microfinance adding risk when things go bad. Weak coverage cuts the shield further, calling for fuller and easier products. Medium hope in better tools means folks think upgrades could aid toughness a lot. This pushes for new ways in risk handling. Input urges groups to make insurance or buffers that cover real losses. That way, loan loads do not worsen weak spots.

These findings are consistent with *Churchill (2006)*, who noted that microinsurance products often provide limited protection against real business risks, and *Dercon et al. (2014)*, who found that inadequate risk

mitigation increases SME vulnerability, refuting the assumption of Risk Pooling Theory that insurance fully shields borrowers from losses

The results say training and help count big in small and medium enterprises growth and staying power. Strong focus on money training shows small and medium enterprises value skills like cash. That means know how matters as much as funds for steadiness. Medium backing for records, savings, and efficiency points to gains in habits and runs from non money aid. In all, the data says microfinance groups amp impact by mixing skill programs with loans. Small and medium enterprises lean on these for long term health. Training builds money smarts, sets saving and spend rules, and cuts waste in ops. Responses show knowledge access pairs with finance for real small business wins.

These findings are consistent with *Ledgerwood (2013)*, who emphasized that combining financial services with business training improves SME performance and loan utilization, and *Becker (1964)*, whose Human Capital Theory explains that skills development enhances productivity, financial discipline, and long-term business sustainability.

Overall, the graph says linked training equips small and medium enterprises for money handling, smart picks, and best loan use. Results show skills with funds drive steady growth and better finance in small and medium enterprises.

These results align with *Cooper (2012)*, who found that financial literacy and record-keeping skills improve SME profitability, and *OECD (2017)*, which emphasized that managerial and planning skills enhance effective use of capital, supporting Human Capital Theory.

Examines Factors Contributing to Loan Default Among SMEs.

The results uncover that not paying back loans comes from mixes of inside and outside troubles, like weak money planning, spotty business runs, and short skills in leading or admin. Sales swings by season and surprise personal or economy hits mess up small and medium enterprises payback timing. Also, stiff loan rules and weak group help can make repaying harder. In sum, the outcomes say defaults in small and medium enterprises tie to business weak spots and outside pushes. This stresses better money learning, bendy loan setups, and solid help systems.

These results align with *Mungure (2015)* and *Bichanga and Aseyo (2013)*, who identified unstable income and personal shocks as major contributors to loan default, supporting Moral Hazard Theory which explains default behavior under income instability and weak monitoring.

The results say smart, clear, fair priced loans boost payback results well. When terms feel good, trust and payback drive rise. This shows design and price matter big for cutting defaults.

These findings are consistent with *Robinson (2001)* and *Qayyum et al. (2006)*, who emphasized that flexible repayment terms and affordable interest rates improve loan performance, supporting Loan Contract Theory which highlights the importance of well-designed loan agreements.

RESEARCH FINDINGS

The purpose of this study was to assess the role of microfinance institutions' products on the growth and sustainability of SMEs in Area 25, Lilongwe. The study was guided by these objectives: To identify the challenges SMEs face when accessing microfinance services, To evaluate the contribution of microfinance loans to SME growth and sustainability, To examine the factors contributing to loan default among SMEs, and To determine the internal and

external factors influencing SME growth in Area 25.

To Identify the Challenges SMEs Face When Accessing Microfinance Services in Area 25

The findings show that SMEs face several obstacles when accessing microfinance. Majority of respondents, with 33%, strongly agreed that complex loan application procedures are difficult to follow. Strict collateral requirements were highlighted by 27% of respondents. Heavy documentation and financial verification were challenging for 35% of respondents, while 31% noted that document submission is demanding. Institutional delays in loan disbursement were reported by 29% of respondents. Additionally, 22% of respondents indicated that loan affordability, despite lower interest rates than informal lenders, remains a concern.

To Evaluate the Contribution of Microfinance Loans to SME Growth and Sustainability

Majority of respondents, with 34%, strongly agreed that loans enabled them to increase stock levels, while 27% reported that loans helped them reach more customers. Financial discipline was improved, with 30% stating that repayment responsibilities encouraged better financial management and 24% noting that microfinance promoted regular savings habits. Non-financial support through training was acknowledged by 29% of respondents as helpful in improving record-keeping, cash-flow management, and other business skills. However, 32% of respondents indicated that microinsurance coverage is insufficient to fully protect SMEs during business shocks.

To Examine the Factors Contributing to Loan Default Among SMEs

Findings show that irregular business performance is the leading cause of default,

reported by 33% of respondents. Personal emergencies affected repayment for 27%, while 22% cited economic shocks like inflation and market fluctuations. Favorable repayment terms were noted by 29% to improve repayment, and 18% emphasized that affordable interest rates reduce financial pressure. Seasonal variations impacted repayment ability, with 31% indicating that low sales periods make repayment difficult, while 24% reported that peak seasons ease repayment. Internal business issues such as poor customer management affected repayment for 30% of respondents. Respondents also highlighted the need for more institutional support during difficult times (33%).

To Determine the Internal and External Factors Influencing SME Growth in Area 25

The most critical internal challenge is poor financial planning during seasonal sales, reported by 38% of respondents. Limited administrative skills and weak management practices were noted by 25% and 20% of respondents, respectively. External factors include restrictive policies such as mandatory business registration (33%), high taxes (27%), and complex registration processes (22%). Low innovation and limited entrepreneurial knowledge were highlighted by 35% and 28% of respondents, respectively. Access to microfinance loans was identified by 42% of respondents as contributing positively to increased stock levels, profitability, and long-term sustainability.

CONCLUSION

The study found that the utilization of microfinance services and repayment of loans by SMEs in Area 25, Lilongwe, is influenced by a mix of internal business

elements, external economic forces, and institutional procedures. It is demonstrated in the findings that long procedures involved in seeking loans, the use of collateral, high interest rates, lack of financial literacy, and seasonality are major elements that impact the ability of SMEs to utilize loans. Furthermore, 8poor financial management practices, as measured by the absence of financial records, poor budgets, the blurring of business and household finances, and the lack of cash flow analysis, also impact the successful repayment of loans and business performance.

This research further examined that microfinance institutions are also affected by these factors in terms of decreased efficiency of loan delivery, high cost of monitoring and recovery, restricted lending capacity, as well as reputation risks.

Given these findings, SMEs and financial institutions can benefit through better financial literacy practices, improved financial management practices, prudent usage of microfinance instruments, and better support structures within microfinance institutions. It can be noted that there is a significant positive relationship between prudent loan use, loan repayment difficulties, and the performance of both SMEs and microfinance institutions. In addition, there is a significant positive relationship between prudent loan use and loan repayment difficulties.

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