

Title

**ASSESSING THE REGULATORY FACTORS INFLUENCING SMALL MEDIUM
ENTERPRISES ACCESS TO LOANS. A CASE STUDY OF COMMERCIAL BANKS OF
MALAWI BENEFICIARIES IN LILONGWE.**

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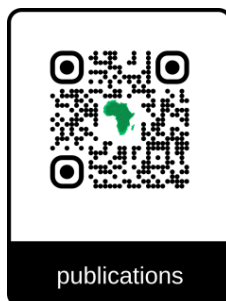
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Issued February 2026 Certificate

AR2026FLR1FW



ABSTRACT

This study examined the regulatory factors influencing Small and Medium Enterprises' access to loans from commercial banks in Malawi, with a specific focus On Small Medium Enterprises that have obtained credit from Commercial Banks of Malawi in Lilongwe. Despite the critical role Small Medium Enterprises play in national development, many continue to face financing challenges, particularly due to regulatory requirements imposed by financial institutions. This study sought to assess how collateral requirements, interest rates, borrowing procedures, and unsettled credit history influence Small Medium Enterprise access to loans.

The study adopted a quantitative research approach supported by a positive philosophy, allowing objective measurement of relationships between variables. A structured questionnaire with closed-ended questions was administered to a sample of 120 Small Medium Enterprises, drawn from the population of businesses that accessed loans at Commercial Banks of Malawi in Lilongwe. Out of these, 100 Small Medium Enterprises fully completed the questionnaire, representing an 83.3% response rate, which is considered adequate for reliable statistical analysis. Data were analyzed using the Statistical Package for Social Sciences (SPSS), employing descriptive statistics and binary logistic regression, suitable for studies with a binary dependent variable such as loan access success (Yes/No).

The logistic regression findings revealed that collateral requirements, interest rates, unsettled credit history and borrowing procedures had a statistically significant and positive influence on Small Medium

Enterprise access to loans. This implies that favorable collateral conditions, manageable interest charges, settled credit history and simplified procedures increase the likelihood of Small Medium Enterprises securing credit. Overall, the model achieved a strong predictive ability, indicating that regulatory factors meaningfully shape Small Medium Enterprises' loan accessibility.

Keyword: Small Medium Enterprises, access to loans, interest rates, collateral requirements, credit history and borrowing procedure

INTRODUCTION

Small and Medium Enterprises play a vital role in promoting economic development, poverty reduction, and employment creation across the globe. According to *the World Bank (2023)* Small and Mediums Enterprises account for about 90% of businesses worldwide and over 50% of employment. In developing economies, formal Small Medium Enterprises contribute up to 40% of GDP, making them drivers of economic transformation. Globally, even in developed nations like the United Kingdom, loan approval rates for Small Medium Enterprises have declined from 67% in 2018 to around 50% in recent years pushing many Small Medium Enterprises to rely on alternative lenders. In Africa, the challenge is even more pressing, with nearly 50% of Small Medium Enterprises lacking sufficient access to loans. The financing gap for formal Small Medium Enterprises in developing countries is estimated at \$5.2 trillion annually, severely limiting their potential to scale up operations, innovate, and contribute more robustly to national economies. In Malawi, Small Medium

Enterprises face similar financial challenges despite several initiatives by the government. Programs such as the National Economic Empowerment Fund (NEEF) and the Malawi Financial Inclusion Strategy aim to expand access to loans and financial services. For example, in 2021, NEEF disbursed K5.56 billion to youth and women groups. Nevertheless, many Small Medium Enterprises remain financially excluded due to regulatory barriers such as interest rates, collateral requirements, borrowing procedures, and unsettled credit history.

This study therefore aims to assess the extent to which these regulatory factors like interest rates, unsettled credit history, borrowing procedures, and collateral requirements influence access to loans among Small Medium Enterprises in Lilongwe, Malawi. The study will particularly focus on the Commercial Bank of Malawi, one of the leading commercial banks in the country, to understand its lending policies and challenges.

Background of the Study

This study focuses on historical background, theoretical background, conceptual background and contextual framework.

Historical Background

Small Medium Enterprises are essential to global economic development. They constitute approximately 90% of businesses worldwide and contribute over 50% of employment. In emerging economies, formal Small Medium Enterprises contribute up to 40% of GDP. Their role in job creation and innovation underscores their importance in both developed and developing nations

(World Bank, 2023).

In developed nations, Small Medium Enterprises often face challenges in accessing loans. For instance, in the United Kingdom, approval rates for Small Medium Enterprises' loan application have declined from 67% as it was in 2018 to 50% in recent years. This has caused many small businesses to seek financing from alternative, often riskier, private lenders. Such trends highlight the persistence barriers Small Medium Enterprises encounter in securing necessary funding, even in advanced economies (World Bank, 2023). In Africa, the situation is more pronounced. Approximately 50% of Small Medium Enterprises on the continent require more capital than they currently access (World Bank, 2023). The financing gap for formal Small Medium Enterprises in developing countries is estimated at \$5.2 trillion annually, with East Asia and Pacific accounting for the largest share (World Bank, 2023).

The Government of Malawi has implemented various initiatives to support Small Medium Enterprises, notably through NEEF formerly the Malawi Enterprise Development Fund which aims to economically empower individuals in both rural and urban areas by providing affordable and sustainable microfinance services. In May 2021, NEEF paid out MK5.56 billion in cash to various women and youth groups (World Bank, 2023). Despite these efforts by Malawi Government, access to loans among Small Medium Enterprises remains limited, indicating that additional measures may be necessary to bridge the financing gap. The Malawi government also introduced the Malawi Financial Inclusion Strategy launched by Reserve Bank of Malawi to

promote financial access to Small Medium Enterprises. Despite all these efforts by Malawi Government, most of the Small Medium Enterprises do not have the access to loans. As of 2023, Commercial Banks had disbursed approximately K3.5 billion to Small Medium Enterprises with over K1 billion allocated to women entrepreneurs and close to K500 million to youth entrepreneurs (*World Bank, 2023*).

On collateral requirements, in *South Africa*, *Attrams and Tshehla (2022)* argued that there is mismatch between the collateral demanded by banks and what Small Medium Enterprises can offer. They further concluded that collateral is not the only or most significant factor, banks should accept flexible alternatives like insurance or character-based lending strategy when Small Medium Enterprises are accessing loans. According to *Walabuka (2021)* In Meru County, Kenya, over 42% of Small Medium Enterprises got access to loans without providing any collateral. However, in *Japan*, *Thein, Niigata and Inaba (2024)* concluded that collateral requirements are a significant barrier to credit access for Small Medium Enterprises in less competitive banking markets, after finding out that high bank market concentration increases collateral demands, making it harder for Small Medium Enterprises to access loans. On interest rates, *Belo and Saldanha (2021)* in *Timor - Leste*, found out that interest rates did not have an influence on access to loans by Small Medium Enterprises, suggesting that Small Medium Enterprises may not consider interest rates a critical factor when seeking loans. However, in *South Africa*, *Msomi (2023)* found out that interest rates have a significant negative effect on credit access for Small Medium Enterprises. *Otieno (2021)* in Kenya argues that high lending rates discourage borrowing, limiting

Small Medium Enterprises' performance and access to loans.

In the context of mixed findings, credit history serves as a vital component in the financial situation of Small Medium Enterprises acting as a reflection of a company's creditworthiness and financial behavior over time (*Funds for N.G.O 2024*). According to *Dr Ahmed Popoola*, in an interview in Daily Trust, he emphasized that Small Medium Enterprises with good credit histories are more likely to secure bank loans due to the role of credit bureaus. The academic study of *Gyimah, Akande, and Muzondutsi (2022)* concluded that credit reference information mediates access to finance and supports Small Medium Enterprises by strengthening lender confidence. However, *Msomi and Maharaj (2022)* found that unsettled credit history had limited effect on bank loan approval, leading Small Medium Enterprises to rely on overdraft facilities. On borrowing procedures, *Msangi and Kasambara (2025)* in Tanzania, found out that borrowing procedures do not affect Small Medium Enterprises access to loan but other factors do. In Kenya, *Walabuka (2021)* suggested that borrowing procedures may not be as prohibitive on Small Medium Enterprises access to loan as perceived. However, in *Botswana*, *Mutoko (2021)* argues that complex borrowing procedures, including rigorous screening and evaluation stages, hinder Small Medium Enterprises access to loans. Zegara and Wilson in United Kingdom argue that cumbersome loan application processes discourage Small Medium Enterprises to access loans.

Small Medium Enterprises contribute over 90% of businesses and more than 50% of employment globally (*World Bank, 2023*). In Malawi, they play a vital role in poverty

reduction, job creation, and income generation. Therefore, improving access to finance for Small Medium Enterprises can significantly boost Malawi's economic development. Despite numerous Government initiatives like NEEF and the Malawi Financial Inclusion Strategy, access to formal credit remains a major challenge.

Conceptual framework

This study is guided by credit rationing theory which explains why lenders may choose not to increase interest rates or loosen lending requirements even when there is excess demand for credit.

RESEARCH OBJECTIVE

General objective of the study

To assess the influence of regulatory factors that affect the Small Medium Enterprises access to loans.

Specific objectives of the study

- To assess the influence of collateral requirements on Small Medium Enterprises to access loans.
- To determine the influence of borrowing procedures on Small Medium Enterprises' access to loans.
- To determine the influence of interest rates on Small Medium Enterprises access to loans.
- To examine the influence of unsettled credit history on Small Medium Enterprises' access to loans

LITERATURE REVIEW

Theoretical review

The Credit Rationing Theory was introduced by *Joseph Stiglitz and Andrew Weiss in 1981*. It explains why lenders may choose not to increase interest rates or loosen lending requirements even when there is excess demand for credit. This theory is grounded in the concept of asymmetric information, where the borrower knows more about their ability to repay a loan than the lender does (*Arroyo, 2007; EIF, 2015*).

Banks, fearing adverse selection and moral hazard, often ration credit rather than increasing interest rates. Instead of adjusting prices, banks apply non-price mechanisms such as strict collateral requirements, complex loan application procedures, reliance on unsettled credit history, and controlled interest rates (*Jin and Zhang, 2019; Yang Zhang and Lu, 2018*).

RESEARCH METHODOLOGY

Research design

This study adopted a quantitative research method. According to *Saunders (2021)*, the quantitative method is effective in studies where the researcher seeks to test theories or examine relationship between variables using measurable data. The quantitative approach will provide objective results that can be statistically tested, ensuring that the conclusions drawn will be reliable and ensure generalization

Target population

The study population comprised of 500

Small Medium Enterprises from different sectors whether manufacturing, service providers or agriculture operating in Lilongwe that have accessed loans from Commercial Banks of Malawi in Lilongwe. The focus on Small Medium Enterprises is guided by their importance as International monetary Fund (2021) highlight, Small Medium Enterprises contribute significantly to employment and income generation, yet they often face challenges in securing adequate financing.

Sample size and sampling technique

A total of 120 Small Medium Enterprises participated in the study. The study adopted a simple random sampling method to select Small Medium Enterprise participants. Under this approach, each Small Medium Enterprise that has accessed loans at different Commercial banks had equal chance of being selected for participation in the study.

Data collection methods

Data will be collected using structured questionnaires. These questionnaires will be given directly to Small Medium Enterprise owners and managers either by visiting their business locations physically or through electronic mail depending on the respondent's preference.

Data analysis and interpretation rate

Response rate

This research study included the gender of the respondents to provide an insight into patterns among gender categories.

Source: Data Analysis (2025)

100 out of 120 questionnaires were returned and deemed valid, yielding a response rate of 83.3%. This high response rate strengthens the credibility of the results and reduces non-response bias.

Key findings

On collateral requirements on Small Medium Enterprises' access to loans, the study revealed that affordable collateral policies enhance the likelihood of Small Medium Enterprises accessing loans. This finding suggests that when banks recognize movable assets such as machinery, stock, or vehicles as acceptable collateral, more entrepreneurs are encouraged to seek loans.

In addition, interest rates on Small Medium Enterprises' access to loans, the study found that high lending rates deter Small Medium Enterprises from borrowing due to increased repayment costs and uncertainty about business returns. The observed trend could be linked to tightening monetary policies in Malawi, which have raised commercial interest rates to curb inflation, thereby limiting affordability for small enterprises.

Furthermore, the study found that borrowing procedures have an influence on Small Medium Enterprises' access to loans in a sense that simplified, transparent, and efficient loan application processes increase the likelihood of Small Medium Enterprises accessing loan. The outcome may be attributed to the adoption of digital systems and reduced paperwork in loan applications, which have made banking processes faster and more user-friendly.

Likewise, the study revealed that credit history has an influence on Small Medium Enterprises' access to loans. Poor or unsettled credit histories reduce the likelihood of obtaining loans. This suggests that Small Medium Enterprises with default records or delayed repayments are often perceived as high-risk borrowers by Commercial Banks of Malawi. The results can be attributed to the increased reliance on credit reference bureaus and digital risk assessing Small Medium Enterprises' systems that flag borrowers with unfavorable repayment histories.

RECOMMENDATIONS OF THE STUDY

Recommendations to Reserve Bank of Malawi (RBM) and policy makers

Derived from the significant influence of interest rates On Small Medium Enterprises' access to loans, the Reserve Bank of Malawi and policymakers should revise relevant sections of the *Financial Inclusion Strategy (2022–2027)* and the *Credit Reference Bureau Regulations (2018)*. These revisions should ensure that lending frameworks and interest rate guidelines better accommodate Small Medium Enterprise financing needs. A more supportive regulatory environment would help reduce borrowing costs and improve credit accessibility for small businesses.

Since collateral requirements significantly influence Small Medium Enterprises' access to loans, the Reserve Bank of Malawi should expand the *Movable Property Security Interest Act (2013)*. This expansion would encourage financial institutions to recognize non-traditional collateral such as vehicles,

stock, and business equipment. Allowing Small Medium Enterprises to use movable assets as security would ease one of the main barriers to obtaining credit.

Emerging from the positive influence of borrowing procedures on Small Medium Enterprises' access to loans, the *National Small Medium Enterprise Policy (2019)* should be updated to ensure that financial institutions simplify and digitalize their loan application processes. Streamlined and transparent digital systems would reduce delays, improve efficiency, and make it easier for Small Medium Enterprises to access financial support.

Recommendations to Small Medium Enterprises

Linked to the findings that collateral requirements significantly influence Small Medium Enterprises' access to loans, entrepreneurs should consider partnering with microfinance institutions or cooperative societies to make use of movable assets or group guarantees as alternative forms of collateral. For example, Small Medium Enterprises can join Savings and Credit Cooperative Organizations (SACCOs) or use warehouse receipts to demonstrate financial reliability and creditworthiness.

Related to the significant influence of borrowing procedures on Small Medium Enterprises' access to loans, business owners should ensure that all company records, including financial statements, tax registration, and business licenses, are consistently updated to meet formal loan application requirements.

Training in basic financial documentation would further help reduce delays and

improve compliance with bank procedures. Indeed, interest rates significantly influence Small Medium Enterprises' access to loans. So, entrepreneurs should compare loan options among financial institutions and seek products that offer lower interest terms, particularly those developed under the *Reserve Bank of Malawi's Financial Inclusion Strategy (2022–2027)*. Negotiating for favorable terms can reduce the cost of borrowing and enhance business sustainability

Recommendations to the Commercial Banks of Malawi

Since interest rates were found to significantly influence Small Medium Enterprises' access to loans, the Commercial Bank of Malawi should review its interest rate policies. The bank should consider introducing preferential or tiered interest rates specifically tailored for Small Medium Enterprises. Lowering interest rates can encourage more borrowing and stimulate business growth, particularly among Small Medium Enterprises that depend on loans for working capital. Increased access to affordable credit would enable Small Medium Enterprises to expand operations, create employment opportunities, and contribute to national economic growth through tax revenue and enhanced government spending.

Since collateral requirements significantly influence Small Medium Enterprises' access to loans, the bank should adopt more flexible collateral policies. Accepting alternative forms of security such as movable assets, stock, insurance guarantees, or group guarantees, would accommodate Small Medium Enterprises that lack traditional property-based collateral. The

current reliance on fixed assets as loan security remains one of the major barriers to credit access for many small businesses. More inclusive collateral options would therefore enhance financial accessibility for a wider range of Small Medium Enterprises.

Drawing from the positive influence of borrowing procedures on Small Medium Enterprises' access to loans, the Commercial Bank of Malawi should continue simplifying and modernizing its loan processes. This includes expanding digital platforms for loan applications, minimizing unnecessary paperwork, and establishing faster loan approval mechanisms. Streamlined and transparent procedures would not only enhance efficiency but also improve customer experience, ultimately increasing Small Medium Enterprises' access to credit.

CONCLUSIONS OF THE STUDY

This study successfully addressed the research problem by empirically examining the regulatory factors influencing Small and Medium Enterprises' access to loans in Malawi, with evidence drawn from the Commercial Bank of Malawi. The research filled contextual gaps by focusing on the Malawian banking sector, where most Small Medium Enterprises face limited access to credit despite being the backbone of the economy.

The study successfully met its objectives by empirically examining how collateral requirements, interest rates, borrowing procedures and credit history influences Small Medium Enterprises access to loans at Commercial Bank of Malawi. Collateral requirements showed a strong positive relationship, suggesting that Small Medium Enterprises with adequate and verifiable

assets were more likely to secure loans.

Furthermore, the study has delivered its promised significance by contributing to the ongoing debate on unsettled credit history, interest rates, collateral requirements and borrowing procedures. The study has also tested the Credit Rationing Theory from a Malawian context. Most importantly the study has provided insights for policy makers such as the Reserve Bank of Malawi and Financial institutions.

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