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THE IMPACT OF INFLATION ON THE GROWTH OF SMES IN AREA 23 TOWNSHIP, LILONGWE, MALAWI

[*1]Justin Mark Mendere, [2]Madalitso Mukiwa

[1]Department of Business Administration, [2](Supervisor and Head of Department)

[1,2]DMI St. John the Baptist University, Malawi.

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***Corresponding Author: Justin Mark Mendere**

Department of Business Administration, DMI St. John the Baptist University, Malawi.

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ABSTRACT

This research analysed how rapid inflation affects the growth trajectory and operational survival of small and medium-sized enterprises (SMEs) located in Area 23 Township, Lilongwe, Malawi. Grounded in a pragmatic paradigm, the investigation adopted a convergent parallel mixed-methods approach to gather and evaluate both statistical and narrative data simultaneously. The empirical sample consisted of 55 participants, including 45 enterprise owners selected via stratified random sampling who completed quantitative surveys, and 10 key stakeholders (representatives from local business groups and financial institutions) who participated in semi-structured interviews. Quantitative responses were analysed using descriptive statistics and Ordinary Least Squares (OLS) linear regression in SPSS (Version 26), whereas thematic analysis was applied to qualitative transcripts.

The statistical outcomes demonstrated a strong, statistically significant negative impact of inflation transmission channels on business performance, with the regression model explaining 61.0% of the overall variation in enterprise results (R^2 = 0.610, F=21.368, P<0.001). Sudden increases in operational costs emerged as the most damaging predictor (β = -0.455, P<0.001), followed by declining consumer purchasing power (β=-0.341, P=0.003) and institutional credit barriers (β = -0.198, P = 0.039). Qualitative testimony reinforced these statistical findings, revealing that surging wholesale prices, high logistics fees, reduced customer buying power, and elevated loan interest rates are the central forces driving small business decline. The study concludes that ongoing price instability remains a major structural bottleneck to informal urban development and recommends that policymakers

introduce targeted low-interest credit facilities and inflation-adjusted financial safeguards for local entrepreneurs.

KEYWORDS: Small and Medium Enterprises (SMEs), Inflation, Profitability, Consumer Demand, Credit Access, Area 23 Township, Lilongwe, Malawi.

INTRODUCTION

Background of the Study

Small and Medium Enterprises (SMEs) serve as vital engines of economic growth, employment generation, and community resilience across developing nations (World Bank, 2023). However, persistent macroeconomic disruptions—specifically high and volatile inflation—severely threaten their ongoing viability by raising production expenses, shrinking profit margins, and depressing consumer demand (Furceri et al., 2018).

While global inflation stood around 5.9% in 2023, sub-Saharan African nations experienced much higher rates, ranging between 10% and 25% (AfDB, 2023; IMF, 2024). Malawi faced particularly severe price surges, recording an average inflation rate near 28.5% in 2023 due to ongoing currency devaluation, supply chain disruptions, and food price volatility (RBM, 2024). Although SMEs generate 40–50% of Malawi's GDP and provide over 70% of national employment (NSO, 2023), micro-enterprises remain exceptionally vulnerable to these macroeconomic headwinds.

Problem Statement

In peri-urban environments such as Area 23 Township in Lilongwe (population ~51,691; NSO, 2018), local business owners face extreme operational instability. Trapped between rising wholesale expenses and lower customer buying power, traders are forced to either absorb cost spikes or pass them on to low-income customers at the risk of losing market share. Prior economic research in Malawi has focused primarily on national-level monetary policies and macro-indicators. Consequently, a critical empirical gap exists regarding how these macroeconomic shocks directly transmit to and impact the survival of micro-scale traders operating within informal peri-urban markets.

Objectives

Primary Objective

To evaluate the effect of inflationary volatility on the operational growth and overall performance of SMEs in Area 23 Township, Lilongwe, Malawi.

Specific Objectives

1. To measure the impact of inflation-induced operational cost increases on firm profit margins and overall performance.
2. To examine the relationship between general price hikes, customer demand contraction, and sales volume.
3. To determine how inflationary pressures and monetary policy tightening affect micro-enterprise access to commercial credit and financial services.

Literature Review & Theoretical Framework

Theoretical Transmission Channels

Cost-Push Effect: Escalating raw material and logistics costs directly squeeze corporate profit margins when businesses are unable to pass cost increases fully to price-sensitive consumers (Mankiw, 2021).

Demand Contraction: Elevated general price levels reduce real household disposable income, shifting spending away from non-essential products and lowering overall sales volumes for small businesses (Keynes, 1936).

Credit Exclusion: Central bank interest rate hikes designed to curb inflation force commercial banks to raise lending rates and collateral requirements, effectively pricing micro-enterprises out of formal credit markets (Fisher, 1911; Fowowe, 2017).

Empirical Background

Research across sub-Saharan Africa highlights that inflation acts as an unannounced tax on informal traders who lack market pricing power (Adeniran et al., 2021). Furthermore, rising policy rates force commercial lenders to charge high-risk premiums, driving small businesses toward under-funded informal savings mechanisms like Village Savings and Loan Associations (VSLAs) (Fowowe, 2017). In Malawi, national statistics indicate that over 70% of urban micro-businesses downsize inventory within three months of significant currency devaluation (NSO, 2023).

METHODOLOGY

Research Design & Sampling Strategy

The study utilized a convergent parallel mixed-methods design under a pragmatic research framework. Quantitative survey data and qualitative key informant interview data were collected concurrently, analysed separately, and merged during interpretation to achieve empirical triangulation.

Applying Yamane's (1967) formula to an estimated target population frame of N = 80 registered and semi-formal SMEs at a 0.05 margin of error yielded an initial target sample of 67, which was adjusted to 60 for practical feasibility:

$$n = \frac{N}{1+N(e)^2} = \frac{80}{1+80(0.05)^2} = \approx 67$$

To ensure representative coverage across sub-sectors, a stratified random sampling technique was employed for the survey component (n=45), while purposive sampling was used to select key stakeholder informants (n = 10). After data cleaning, 55 usable responses were retained (91.67% execution rate).

Participant Category	Target Sample (n)	Final Sample (n)	Sampling Method	Data Collection Method
SME Owners & Operators	50	45	Stratified Random	Quantitative Survey
Business Association Leaders	5	5	Purposive	Key Informant Interview
Financial Service Representatives	5	5	Purposive	Key Informant Interview
Total	60	55	Mixed	Integrated Mixed-Methods

Empirical Analysis & Statistical Results

Sample Characteristics

Of the 55 participants, 56.36% were male, and 43.64% were female. Over half (50.91%) held a high school qualification (MSCE), and 27.27% had completed tertiary education. Business sector distribution included Grocery/Retail (45.45%), Catering/Food Services (23.64%), Artisanal/Repair Shops (18.18%), and Local Transport (12.73%). Notably, 47.27% of enterprises had operated for only 1 to 3 years, while only 10.91% had survived beyond 5 years, demonstrating high vulnerability.

Key Survey Metrics

Severity Perception: 69.09% rated local inflation over the past year as "Extremely Severe".

Cost Pressures: 90.91% confirmed wholesale supplier prices had doubled or tripled, and 78.18% reported shrinking profit margins.

Sales Impact: 60.00% observed sharp reductions in sales volume due to weakened consumer buying power.

Credit Constraints: 52.73% identified high interest rates as their primary barrier to borrowing, while 32.73% cited strict collateral requirements.

Econometric Regression Model

An OLS linear regression model evaluated the predictive impact of three inflationary transmission vectors on SME operational performance (n = 45):

SME Performance = $\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$

Where:

X_1 = Cost Shocks (Wholesale & Logistics)

X_2 = Demand Contraction (Consumer Buying Power)

X_3 = Credit Constraints (Interest Rates & Collateral)

e = Error term

Diagnostic tests confirmed acceptable Variance Inflation Factors (VIF) = 1.21 - 1.45, well below the threshold of 5.0, and no autocorrelation (Durbin-Watson = 1.89).

Model Summary & Regression Coefficients

Model Diagnostics: R= 0.781, R^2 =0.610, Adjusted R^2 =0.581, F=21.368 (P<0.001).

Model Predictors	Unstandardized β	Std. Error	Standardized β	t-statistic	Sig. (p)	VIF
(Constant)	4.210	0.415	—	10.145	<0.001	—
Cost Shocks (X_1)	-0.412	0.098	-0.455	-4.204	<0.001	1.32
Demand Contraction (X_2)	-0.328	0.104	-0.341	-3.154	0.003	1.45
Credit Constraints(X_3)	-0.185	0.087	-0.198	-2.126	0.039	1.21

DISCUSSION & ACTIONABLE RECOMMENDATIONS

Core Findings

High Explanatory Power: Inflationary channels account for 61.0% of the variance in SME operational performance (R^2= 0.610, P < 0.001).

Cost Shocks as Primary Driver: Wholesale price spikes and elevated transport fees represent the single largest negative predictor of firm performance (β= -0.455, P < 0.001).

Erosion of Household Purchasing Power: Weakened consumer demand suppresses overall sales volumes (β= -0.341, P = 0.003).

Credit Market Exclusion: High monetary policy rates inflate commercial bank lending costs, pricing micro-businesses out of formal credit β= -0.198, P = 0.039).

Strategic Recommendations & Operational Implementation

Concessional Micro-Lending Facilities: Government agencies and commercial banks should establish dedicated low-interest credit lines tailored to urban traders, incorporating flexible group-guarantee mechanisms to lower collateral thresholds.

Macroeconomic Exchange Rate Stabilization: National policy authorities must prioritize foreign exchange stability to minimize import-driven wholesale cost spikes.

Operational Capacity Building via SMEDI: Institutions such as the Small and Medium Enterprises Development Institute (SMEDI) should roll out targeted field workshops in peri-urban hubs on dynamic pricing models, cash-flow management, and inventory preservation during high-inflation periods.

Integration with Informal Savings Networks (VSLAs): Microfinance institutions should formalize linkages with local Village Savings and Loan Associations (VSLAs) to provide liquidity injections and working capital buffers during inflationary peaks.

CONCLUSION

This empirical study demonstrates that persistent macroeconomic inflation severely impairs the operational viability, profitability, and growth of SMEs in Area 23 Township, Lilongwe. Operating through input cost shocks, demand contraction, and credit exclusion, inflation serves as a major structural bottleneck in urban informal economies. Over 61% of business performance variation stems directly from these inflationary channels, with wholesale cost spikes representing the most damaging vector. Protecting township micro-enterprises requires an integrated strategy combining macroeconomic price stabilization, concessional micro-financing, and targeted business management training.

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