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EXAMINING FINANCING CHALLENGES OF SMALL AND MEDIUM SCALE ENTERPRISES IN LILONGWE: A CASE STUDY OF AREA 23 MARKET

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ABSTRACT

Small and Medium Scale Enterprises (SMEs) play an important role in supporting economic growth, creating employment opportunities and improving the lives of people in communities. However, a lot of small businesses face difficulties in accessing finance, which affects their ability to grow and expand their businesses. This study examines the financing challenges faced by Small and Medium Scale Enterprises in Lilongwe, focusing on Area 23 Market.

The study aims to identify the main challenges that prevent SMEs from accessing financial support and to understand how these challenges affect business operations. The study focuses on issues such as high interest rates, lack of collateral, limited financial records, and strict requirements from financial institutions.

The research used questionnaires to collect information from SME owners at Area 23 Market. The findings are expected to show the major financial barriers affecting small businesses and provide suggestions on how access to finance can be improved.

The study recommends that financial institutions should provide suitable financial services for SMEs, while business owners should improve their financial management skills and record keeping. Improving access to finance can help SMEs grow, create more jobs, and contribute to economic development in Malawi.

KEYWORDS: Small and Medium scale enterprises (SMEs), Financing Challenges, Access to Finance, Financial inclusion and Business growth.

INTRODUCTION

Small and Medium scale Enterprises (SMEs) are very important for the growth and development of Malawi's economy. These small businesses create jobs, reduce poverty and contributes to Gross domestic product. They are often the backbone of local communities, providing goods and services that people depend on every day. Many of these businesses encounter a lot of challenges when they want to access loans from commercial banks and other finance institution. High collateral demands, high interest rates, insufficient financial records, and financial institutions perception of them as high risk borrowers are some of the biggest problems many small business owner face. They always work hard and know how to run their businesses. They know how to make more profits and grow business, but they often have not had any chance to access loans from lending institution due to inaccessible requirements (Beloke, 2024).

Lack of finance access from banks and others microfinance institutions can make it hard for them to grow their business (Chonsawat, 2020). For example, if a small business owner fail to show collateral and even financial records, a bank might think the business is risky even if it's actually doing well. Formal financial institutions in Malawi generally mandate collateral that a lot small scale entrepreneurs are unable to access. This means many of these small business owner don't have opportunities to grow, improve, and to grow during economic crisis.

A study by Batizani (2024) also portrays that limited access to finance is a major challenge for start-ups and SMEs in Malawi due to high collateral demands, high interest rates, insufficient financial records, and financial institutions perception of them as high risk borrowers. As a result, businesses continue to operate on a limited scale, remain vulnerable, and struggle to compete successfully in the market.

Improving finance access among small business owners is vital. With the access to finance and support from government, small businesses in Malawi can become even stronger drivers of economic progress and help build a more stable and prosperous future for the majority of the youth and women (Barney J. B., 2021).

OBJECTIVE

1. To assess the key factors that hinder SME access to formal financing in Area 23.

LITERATURE REVIEW

Empirical Reviews

Empirical studies across Malawi and other African countries consistently show that SMEs rely heavily on internal and informal sources of finance (owner savings, family and friends, rotating savings and credit associations) rather than formal bank lending. Cross-country reviews and recent regional analyses find that internal finance is the dominant source because formal institutions perceive SMEs as costly to serve and risky; consequently, many small firms self-finance growth or turn to informal lenders (Mwalwanda, 2023). Local Malawi studies confirm this pattern. Surveys of Malawian SMEs and city-level studies (Blantyre, Lilongwe) report that most firms use personal savings and trade credit; only a minority use commercial bank loans, while microfinance institutions and SACCOs serve some segments but often with strict conditions. These Malawi studies highlight liquidity shortfalls and a dependence on short-term, low-value borrowing to meet working capital needs.

According to the above researches conducted by (Moffat, 2024) and another by (Mwalwanda, 2023), it is obvious that the small and medium scale enterprises have a major difficulty in accessing fund/credit from the formal financial institutions in the country.

Another research by (Banda, 2021) was conducted to find out the financing gap that exist in the between the SME sector the large corporations in Malawi. In their research, it was concluded that there exist a financing gap in the country as most small enterprises are denied access to finance by the formal financial institutions in the country.

There are many other researches such as (Kalengamaliro, 2023), which concluded with the similar findings as the above ones and that is why it is of great importance for this study to be conducted to find out why those financing gaps exist and the forces that cause them to exist.

Theoretical Framework

1.Financial Inclusion Theory

Financial inclusion refers to the systematic endeavor of guaranteeing that individuals and enterprises, particularly those situated in marginalized or inadequately served communities, possess access to essential and economically viable financial products and services that align with their specific requirements. This encompasses a diverse array of services, including banking, payments, savings, credit, and insurance (Simatele, 2021). The World Bank (2022) reports that approximately 1.7 billion adults worldwide remain unbanked, underscoring the critical necessity for the implementation of policies that foster financial accessibility. For entrepreneurs in developing economies, financial inclusion is not merely advantageous; it frequently constitutes a vital component for both survival and expansion. The availability of financial services empowers entrepreneurs to obtain the requisite capital for initiating or augmenting their enterprises, thereby facilitating investments in technology, inventory, and marketing (Ozili, 2020). In Malawi, where opportunities for formal employment are sparse, entrepreneurship emerges as an essential pathway for economic engagement. Empirical evidence suggests that when entrepreneurs gain access to credit and other financial products, their probability of business survival is markedly enhanced (Kling, 2022). A survey conducted by the Reserve Bank of Malawi (2021) revealed that over 70% of participants recognized access to finance as the foremost obstacle to entrepreneurship. This indicates a widespread acknowledgment among prospective business owners that, in the absence of financial resources, their innovative ideas remain actualized, thereby constraining their economic contributions. Consequently, the enhancement of financial inclusion is of paramount importance for the development of the entrepreneurial ecosystem and the stimulation of economic growth in Malawi. In conclusion, the theory of financial inclusion accentuates the critical significance of accessible financial services for entrepreneurs in Malawi (Beloke, 2024). By improving access to credit and financial products, policymakers can catalyze entrepreneurial endeavors and bolster economic growth. This theoretical framework highlights the necessity for targeted interventions that address both systemic impediments and the distinctive challenges confronted by entrepreneurs in Malawi.

2.Resource-Based Theory

The resource-based theory (RBT) asserts that a firm's distinctive resources and capabilities are fundamental to the attainment of competitive advantage and superior performance within the marketplace. Formulated by Barney (1991), this theoretical framework posits that firms can achieve enduring competitive advantages by capitalizing on resources that are valuable, rare, inimitable, and non-substitutable (Barney J. B., 2021). Within the framework of entrepreneurship, this theory underscores the manner in which individual entrepreneurs can harness their distinct capabilities and assets to effectively navigate the challenges associated with accessing finance and scaling their enterprises. In Malawi, where access to traditional financial resources is frequently constrained, resource-based theory serves as a valuable paradigm for comprehending how entrepreneurs can surmount the obstacles to financing. Entrepreneurs possess a diverse array of resources, encompassing local knowledge, networks, and innovative concepts. For instance, an in-depth comprehension of local market dynamics can empower entrepreneurs to develop products or services that fulfill specific community demands, thereby enhancing their appeal to prospective investors (Stoelhorst, 2023). By concentrating on individual resources and capabilities, this theory accentuates the potential for entrepreneurs to transcend financial impediments through strategic optimization of their assets. When integrated with financial inclusion theory, the resource-based perspective provides a comprehensive understanding of the entrepreneurial environment, emphasizing the necessity for policies and initiatives that bolster both financial access and the cultivation of unique entrepreneurial resources (Varadarajan, 2023). This cohesive framework will inform the analysis of both qualitative and quantitative findings in investigating the challenges and opportunities associated with entrepreneurial finance in Malawi.

The augmented theoretical framework for entrepreneurial finance in Malawi amalgamates two essential theories Financial Inclusion Theory and Resource-Based Theory while contextualizing the local entrepreneurial milieu. Financial Inclusion Theory underscores the significance of ensuring access to financial services for all individuals, particularly those belonging to marginalized demographics. In the Malawian context, this theory accentuates the necessity for mechanisms that facilitate entrepreneurs' acquisition of loans and financial products that are conventionally out of reach due to elevated banking costs and rigorous lending standards (Barney J. B., 2021).

RESEARCH METHODOLOGY

Research Design

The study uses a mixed methods approach, combining both Qualitative and Quantitative methods of data collection. A qualitative study entails collection of data using interviews in order for the researcher to understand a particular phenomenon. The study deployed the qualitative method to collect data through the use of face-to-face interviews. An advantage of qualitative study is the fact that it offers deeper insight on study subjects (Oranga, 2023). It also involves the use of a smaller sample, which reduces the cost of the study while providing a greater understanding of the study question. A major concern, however, is that it may produce unreliable data due to its subjective nature. While Quantitative methods examines data through the application of statistical techniques. The quantitative research approach yields dependable information, as it employs a substantial sample size, thereby augmenting the credibility of the resultant findings.

Research Setting

The study conducted at area 23 market, located in Lilongwe City, Malawi. The market hosts various types of businesses, including grocery retailing, clothing sales, small-scale manufacturing, and service-oriented enterprises.

The choice of area 23 market as the research setting is justified by its high concentration of small businesses and its significant contribution to local economic activities. The market provides an appropriate environment for examining financing challenges faced by small businesses, as many businesses operate under informal or semi-formal conditions and rely heavily on both formal and informal sources of finance (Beloke, 2024). Conducting the study in this setting will allow the researcher to gather first-hand information from business owners and operators who directly experience difficulties related to access to finance**.**

Target Population

The population used in this research derived from the small businesses in the area 23 market. It includes small businesses from various industries such as agri-business, manufacturing, both retail and wholesale. The market is estimated to have approximately 100 SMEs, including both registered and unregistered businesses engaged in retail, wholesale, manufacturing, and service-related activities. These enterprises form the target population from which the study sample will be drawn.

Sampling technique

The sampling technique used in this study is non-probability sampling. This is the method where the probability of a particular sample being selected in unknown. Non probability sampling involves a researcher's subjective selection of sample units, as described by (Stratton, 2023). The sampling process utilized existing data on small and medium enterprises (SMEs) from the Small and Medium Enterprise Development Institute (SMEDI).

Sample Size

To be able to get a wider picture and a broader knowledge of the research, the sample size for this study will consist of 80 small and medium scale enterprise (SME) owners/operators from Area 23 Market in Lilongwe. . The SME sample vary among small and medium enterprises to ensure reasonable generalization. A total of 80 respondents will be selected based on their availability and willingness to participate in the study.

Research Instrument

The study uses structured questionnaires as the main research instrument for data collection. This instrument are considered appropriate because they allow the researcher to collect both quantitative and qualitative data relevant to the study objectives. The structured questionnaire will be administered to owners and operators of small and medium scale enterprises in Area 23 Market. The questionnaire will consist of both closed-ended and open-ended questions. Closed-ended questions will be used to collect quantitative data on sources of finance, access to credit, types of financing challenges faced, and the effects of these challenges on business growth (Bilali, 2022). Open-ended questions will allow respondents to freely express their views and experiences regarding financing challenges.

Data analysis

This study uses both quantitative and qualitative analysis to examine the financing challenges faced by SMEs in Area 23 Market, Lilongwe. Quantitative data collected through questionnaires analyzed using SPSS, to identify the main sources of financing and common challenges faced by SMEs. Qualitative data analyzed by thematic methods to explore the key factors hindering SMEs from accessing formal financial support (Sahr, 2022). This combined approach allows for a comprehensive understanding of the challenges affecting SMEs' access to finance in Area 23.

Ethical Consideration

Ethical issues will be carefully considered throughout the conduct of this study to ensure the protection and rights of all participants. The following ethical principles guided the research process.

DATA ANALYSIS AND INTERPRETATION

Response Rate

A total of 80 questionnaires were distributed to SME owners and operators at Area 23 Market. All 80 were returned complete and valid, yielding a response rate of 100%.

Table 4.1 Response Rate.

Description	Frequency	Percentage
Questionnaires distributed	80	100.0%
Questionnaires returned	80	100.0%
Invalid/incomplete	0	0.0%
Valid response rate	80	100.0%

The 100% response rate obtained in this study is exemplary and significantly exceeds the thresholds recommended in the methodological literature. Nulty (2008) suggests that response rates of 50% are generally considered adequate for most research purposes, 60% are considered good, and 70% or above are considered excellent. The achieved response rate of 100% can be attributed to the use of face-to-face questionnaire administration, which allowed the researcher to personally distribute and collect questionnaires on-site, clarify any ambiguities, and encourage participation. This approach is consistent with the methodology described by Oranga (2023), who noted that direct researcher–respondent interaction in mixed methods studies tends to yield higher response rates and more complete data. The absence of missing values in the dataset further confirmed the high quality of the data collected, as all 80 respondents provided complete responses to all 24 survey items, eliminating the need for missing data imputation and ensuring that all subsequent analyses were based on the full sample.

Demographic Information

This section presents the demographic profile of the 80 respondents across six variables: gender, age group, education level, marital status, business type, and years in operation.

Table 4.2 Gender Distribution of Respondents.

Gender	Frequency	Percentage
Male	40	50.0%
Female	40	50.0%
Total	80	100.0%

The sample comprised an equal number of male and female respondents, with each gender accounting for 40 respondents (50.0%). This balanced gender distribution is notable, as it reflects the growing participation of women in entrepreneurial activities at Area 23 Market. In the context of SME financing research, gender is an important variable, as studies have consistently shown that women-owned businesses often face greater difficulties in accessing formal credit compared to their male counterparts, due to factors such as limited collateral ownership, lower financial literacy, and gender-biased lending practices (Beck & Demirgüç-Kunt, 2006; Beloke, 2024). The equal representation of both genders in this study ensures that the findings capture the financing experiences of both male and female SME operators, thereby enhancing the comprehensiveness and gender sensitivity of the analysis.

Table 4.3 Age Group Distribution of Respondents.

Age Group	Frequency	Percentage
18–25 years	16	20.0%
26–35 years	31	38.8%
36–45 years	14	17.5%
46 years and above	19	23.8%
Total	80	100.0%

The largest proportion of respondents fell within the 26–35 years age bracket (38.8%, n = 31), followed by those aged 46 years and above (23.8%, n = 19), those aged 18–25 years (20.0%, n = 16), and those aged 36–45 years (17.5%, n = 14). The dominance of the 26–35 age group is consistent with global patterns of entrepreneurial activity, which tend to peak among young adults who are in the early to middle stages of their careers and are motivated by the pursuit of economic self-sufficiency. This finding aligns with the observations of Mambula (2002), who noted that the majority of SME operators in African markets are young to middle-aged individuals. The presence of a substantial proportion of respondents aged 46 and above (23.8%) also indicates that a significant number of older, more experienced business operators are active at the market, potentially bringing greater business maturity and accumulated knowledge to their enterprises.

Table 4.4 Education Level of Respondents.

Education Level	Frequency	Percentage
Primary education	21	26.2%
Secondary education	39	48.8%
Tertiary education	20	25.0%
Total	80	100.0%

Nearly half of the respondents (48.8%, n = 39) had attained secondary education as their highest level of formal education, followed by respondents with primary education (26.2%, n = 21) and those with tertiary education (25.0%, n = 20). The educational profile of the sample is significant for the study of SME financing, as the level of education can influence an entrepreneur's awareness of available financing options, ability to navigate loan application procedures, and capacity to maintain proper financial records. Beck, Demirgüç-Kunt, and Maksimovic (2008) observed that lower levels of education among SME owners are often associated with reduced access to formal financial services, as educated entrepreneurs are better equipped to understand loan terms, prepare business plans, and interact effectively with financial institutions. The finding that 48.8% of respondents have only secondary education suggests a potential knowledge gap that may constrain effective engagement with formal financial systems, a theme that is further explored in subsequent sections.

Table 4.5 Marital Status of Respondents.

Marital Status	Frequency	Percentage
Single	15	18.8%
Married	35	43.8%
Divorced	16	20.0%
Widowed	14	17.5%
Total	80	100.0%

The majority of respondents were married (43.8%, n = 35), followed by those who were divorced (20.0%, n = 16), single (18.8%, n = 15), and widowed (17.5%, n = 14). The predominance of married respondents is relevant to SME financing, as marital status may influence the availability of financial support from a spouse and the household's overall financial resource base. Married entrepreneurs may have access to pooled household resources that can serve as supplementary capital, while also bearing family financial responsibilities that increase the pressure to maintain business profitability.

Table 4.6 Type of Business Operated.

Business Type	Frequency	Percentage
Retail	29	36.2%
Wholesale	27	33.8%
Manufacturing	13	16.2%
Other	11	13.8%
Total	80	100.0%

Retail businesses constituted the largest category (36.2%, n = 29), closely followed by wholesale businesses (33.8%, n = 27). Manufacturing enterprises accounted for 16.2% (n = 13), while other types of businesses represented 13.8% (n = 11). The dominance of retail and wholesale businesses (collectively 70.0%) reflects the commercial character of Area 23 Market, which primarily serves as a trading hub for goods and commodities (Beloke, 2024). Manufacturing enterprises, while fewer in number, represent an important segment, as they typically require larger capital investments and longer production cycles, making them particularly vulnerable to financing constraints.

Table 4.7 Years in Operation.

Years in Operation	Frequency	Percentage
Less than 10 years	26	32.5%
10–16 years	30	37.5%
Above 16 years	24	30.0%
Total	80	100.0%

The largest group of respondents had been in operation for 10–16 years (37.5%, n = 30), followed by those operating for less than 10 years (32.5%, n = 26) and those with more than 16 years of operation (30.0%, n = 24). The distribution suggests a relatively mature SME population, with 67.5% of businesses having been in operation for 10 years or more. This longevity indicates that many of the enterprises at Area 23 Market have survived beyond the critical early years during which SME failure rates are typically highest. However, the continued operation of these businesses does not necessarily imply adequate access to finance; rather, it may reflect resilience in the face of persistent financing challenges, as many

SMEs survive on informal financing mechanisms that limit their growth potential (Chimuka, 2014). The demographic profile of the respondents is visually summarised in Figure 4.1 below.

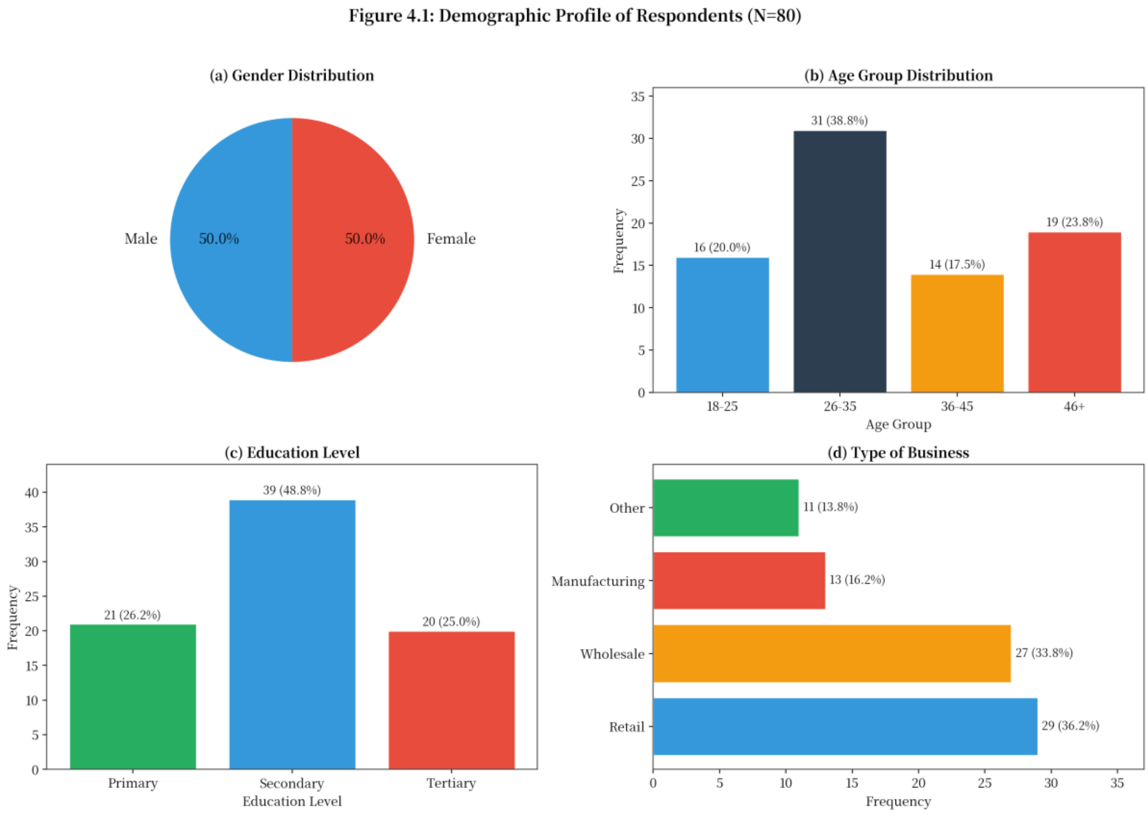

Figure 4.1 Demographic Profile of Respondents. (N = 80)

FINDINGS

Objective: Key Factors Hindering SME Access to Formal Financing

Table 4.11 Challenges Faced in Accessing Finance — Likert Scale Distribution. (N = 80)

Challenge	Strongly Agree	Agree	Disagree	Strongly Disagree	Combined Agree
High interest rates	18 (22.5%)	22 (27.5%)	25 (31.2%)	15 (18.8%)	40 (50.0%)
Lack of collateral	20 (25.0%)	22 (27.5%)	20 (25.0%)	18 (22.5%)	42 (52.5%)
Short repayment period	22 (27.5%)	20 (25.0%)	22 (27.5%)	16 (20.0%)	42 (52.5%)

All three challenges received agreement from approximately half of respondents. Lack of collateral and short repayment period each achieved 52.5% combined agreement, while high interest rates achieved 50.0%. To provide a more precise measure of respondents' perceptions, the Likert-scale items were recoded numerically, and descriptive statistics were computed, as presented in Table 4.12.

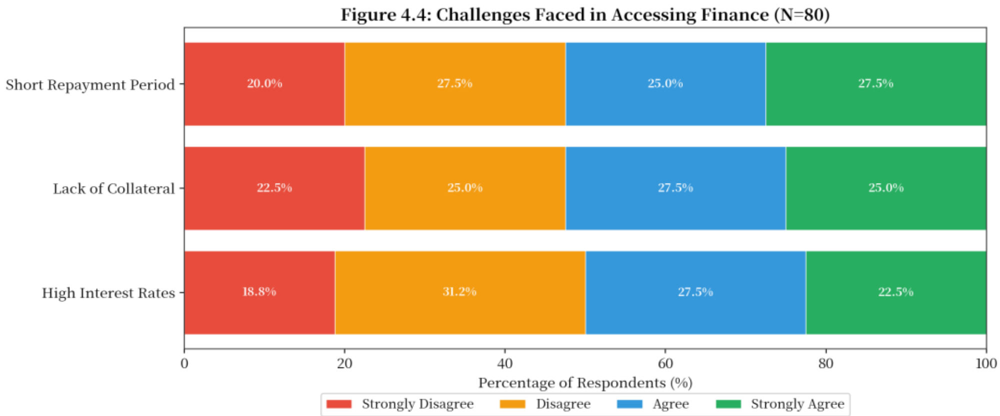

Figure 4.4 ***Challenges Faced in Accessing Finance. (N = 80)***

Table 4.12 Descriptive Statistics for Financing Challenges. (Recoded 1–4)

Challenge	Mean	Standard Deviation
High interest rates	2.54	1.04
Lack of collateral	2.55	1.10
Short repayment period	2.60	1.10

All mean scores exceeded the scale midpoint of 2.5, indicating a general tendency towards agreement. Short repayment period recorded the highest mean (M = 2.60, SD = 1.10), suggesting it is perceived as the most significant challenge. This reflects a practical tension between loan terms and the revenue-generating cycles of small market-based businesses, where mismatched tenures create repayment pressure (Gitman & Zutter, 2012). Lack of collateral (M = 2.55) aligns with Beck et al.'s (2008) finding that collateral demands in developing countries often exceed 100% of loan amounts, effectively excluding many SMEs. The finding that high interest rates received the lowest mean (M = 2.54) among the three challenges is somewhat surprising given that 63.7% of respondents separately indicated that interest rates are unaffordable, suggesting that while the cost of borrowing is a concern, structural barriers such as collateral and repayment terms may be perceived as even more constraining.

Table 4.13 ***Affordability of Interest Rates. (N = 80)***

Response	Frequency	Percentage
Yes	29	36.2%
No	51	63.7%
Total	80	100.0%

A substantial majority of respondents (63.7%, n = 51) indicated that interest rates are not affordable, while only 36.2% (n = 29) considered them affordable. This finding provides strong confirmatory evidence that the cost of borrowing is a significant concern. This is consistent with studies across Sub-Saharan Africa identifying high interest rates as a defining feature of SME lending markets, exacerbated by high inflation environments and monetary policy stances that maintain elevated lending rates (Beloke, 2024). The disproportionate impact on small businesses with limited profit margins makes interest rate affordability a critical policy concern.

Table 4.14 ***Cross-Tabulation — Loan Application by Education Level. (N = 80)***

Education Level	Applied (Yes)	Not Applied (No)	Total
Primary	14	7	21
Secondary	29	10	39
Tertiary	10	10	20
Total	53	27	80

Note. $\chi^2 = 3.511$, $df = 2$, $p = 0.173$.

The Chi-square test revealed no statistically significant association between education level and loan application behaviour ($\chi^2 = 3.511$, df = 2, p = 0.173). Although there appears to be a descriptive pattern — respondents with secondary education applied at a higher rate (74.4%) than those with primary (66.7%) or tertiary (50.0%) education — this association did not reach statistical significance at the 0.05 level. Additional Chi-square tests confirmed that gender ($\chi^2 = 0.224$, df = 1, p = 0.636) and business type ($\chi^2 = 0.517$, df = 3, p = 0.915) were also not significantly associated with loan application. The absence of significant associations suggests that financing barriers at Area 23 Market are systemic rather than demographically driven, affecting SME owners across different segments of the population relatively uniformly. This finding has important implications for policy interventions, as it suggests that broad-based, system-level reforms rather than targeted interventions for specific demographic groups are needed to improve SME access to finance.

RECOMMENDATIONS

Based on the findings of the study, the following recommendations are proposed: Financial institutions should simplify loan application procedures to make borrowing more accessible to SMEs and also Lending institutions should review interest rate structures and develop affordable credit products specifically targeted at SMEs. The Government of Malawi should establish or strengthen SME financing schemes that provide affordable credit to small businesses.2. Government should introduce credit guarantee programmes to reduce the risks faced by lending institutions when financing SMEs. SME owners should improve record-keeping practices to enhance their credibility when applying for loans.

CONCLUSION

Based on the findings of the study, it can be concluded that SMEs operating in Area 23 Market face significant financing challenges that constrain their growth and development. Although both formal and informal sources of finance are available, many entrepreneurs continue to experience difficulties in accessing affordable and suitable credit facilities.

The study concludes that lack of collateral, high interest rates, and short loan repayment periods are the major obstacles preventing SMEs from obtaining adequate financing. These barriers limit the ability of businesses to invest, expand operations, increase productivity, and improve profitability. Consequently, many SMEs remain small in scale despite having the potential to grow and contribute more significantly to employment creation and economic development.

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