



Champion SME Diagnostic Report

Malawi Nacala Rail and Port Value Addition
and Inclusive PSD Project, Fund for Africa
Private Sector Assistance (FAPA)

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the People of Japan



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Acronyms

ESCOM	Electricity Supply Corporation of Malawi
FAPA	Fund for African Private Sector Assistance
FGD	Focus Group Discussion
SIVAP	Smallholder Irrigation and Value Addition Project
ICT	Information & Communication Technology
MOITT	Ministry of Industry, Tourism and Trade
PPP	Public Private Partnerships
SME	Small and Medium Enterprises

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Enclude, BV

1. INTRODUCTION

1.1 Background

The Nacala Corridor Rail and Port Value Addition and Inclusive Private Sector Development Project aims to support inclusive and sustainable economic growth along the Malawi Nacala Corridor through the improvement on the efficiency and competitiveness of local businesses situated in the Nacala Corridor in order to enable them to better exploit the newly available transport infrastructure, and to achieve accelerated economic and social development in Malawi. The project's targeted beneficiaries are agro-processing SMEs, farmers' support organizations, smallholder farmers, extension service workers, financial institutions, and the Government of Malawi.

The project is designed to be achieved through three components namely: capacity building of key stakeholders, access to markets and access to finance. The capacity building component will build the capacities of 15 growth-oriented agribusiness entrepreneurs, 25 farmer groups and about 1000 smallholder farmers in the Nacala corridor to increase their ability to effectively make use of the available transport infrastructure. The access to markets component will focus on creating and facilitating access to markets for SMEs, farmer groups and also smallholder farmers. The access to finance component will focus on facilitating access to finance for SMEs and farmer groups primarily. It will also include capacity building for loan officers of selected financial institutions. By implementing the three components, the project envisages accomplishing the following results:

- Increased agriculture production
- Increased small holder farmer productivity
- Increased value addition by agro-processors
- Increased incomes for small holder farmers
- Increased profitability for SMEs in agro-processing
- Contribution to a PPP dialogue to improve the enabling environment for industrialization

Prior to the diagnostic study, a call for proposals was conducted, and 31 potential champion SMEs and 60 farmer groups were shortlisted for further assessment so that the required number of 15 champion SMEs and 25 farmer groups can be selected by the project Selection Committee. The smallholder farmers to participate in the project will be members of the selected farmer groups.

1.2 Objective of the Champion SME Diagnostic Study

The broad objective of the champion SME diagnostic study was to identify capacity building and training needs of the selected SMEs. This was expected to inform the design of appropriate training curricula and other interventions aimed at building the capacities of the value chain actors in the project to become effective exporters of value added products, effective providers of raw materials to SMEs for value addition and effective producers of crops to be used as raw materials in the targeted value chains. The diagnostic study was therefore expected to establish the prevailing status of each Champion SME in terms of their capacity building gaps, access to markets and access to finance challenges and needs.

This report presents the results of the diagnostic study of selected SMEs conducted in all the FAPA Nacala Corridor project districts.

2. METHODOLOGY

2.1 Sampling

All shortlisted potential champion SMEs in the Nacala Corridor region were selected for consultation during the diagnostic study.

2.2 Data collection

Face-to-face Interviews were the main method of data collection which were employed during consultations with potential champion SMEs. These were conducted using an interview guide which was prepared for this purpose. Appendix 1 below is a sample of the Interview guide that was used during consultations with potential champion SMEs.

2.2.1 Face to face interviews

The shortlisted potential champion SMEs were visited in their respective business premises and interviewed face-to-face using the 'interview guide'. The interview guide provided flow and direction of the discussions between the interviewer and the interviewee. Visiting the business premises also provided an opportunity for due diligence on the businesses. A total of 22 SMEs were visited and interviewed (See list in Appendix 2). Nine of the shortlisted SMEs were out of reach during the days of the study and were therefore not interviewed (See list in Appendix 3).

2.2.2 Data analysis

The data gathered during the interviews was analyzed through a process of identifying the themes from the checklists and synthesizing them. Summaries of each theme were then developed and written down.

2.3 Challenges

The main challenge that was faced during the diagnostic study was that some SMEs were not available and therefore could not be interviewed. However, selected champion SMEs who were not interviewed during the diagnostic study phase were later visited to obtain their specific needs which appear in Appendix 4 below.

3. FINDINGS

The diagnostic study has revealed that SMEs have many needs are described below:

3.1 Capacity building needs:

3.1.1 Production equipment

Some SMEs, especially those in the cooperatives category which were participants in the SIVAP project, have good and modern equipment for value addition of crops such as rice, groundnuts, and pigeon peas. The equipment can produce sufficient quantities for them to supply the export market. However, at the time of study, the equipment was not in use because their factories were not supplied with electricity by ESCOM. Most of the other SMEs own very small equipment with limited production capacity. As a result, they are unable to produce enough to satisfy local demand let alone the export market. For example, most oil expellers owned by SMEs are small and inefficient requiring higher quantities of raw materials to produce 1 liter of cooking oil. Another area of need for the production equipment owned by SMEs is calibration and standardization. Such

services are not readily available or are very expensive to procure. As a result, the SMEs operate without calibration which compromises accuracy and consistency.

3.1.2 Availability of raw materials

SMEs indicated that raw materials such as groundnuts, sunflower and soya beans are generally only available in greater quantities during the crop harvesting period of May to July. Although they are also available during the other periods of the year, the purchase prices are higher because they are in short supply. The exception is sunflower which is not available in sufficient quantities throughout the year because it is not grown by many farmers. For example, Dwale Supplies which is an SME based in Lilongwe buys its sunflower from Kasungu, a distance of 120 or more kilometers. This increases their cost of production.

3.1.3 Procurement of raw materials

The study has found that prices of agricultural crops are not stable because of market liberalization. There are no regulatory frameworks for market prices. The buyers who mainly are middlemen set prices for the produce. Prices therefore fluctuate a lot thereby making it difficult for SMEs to plan their raw material procurement. Transport costs also tend to be high because the raw materials are procured deep in the rural areas since there are no established markets. Furthermore, the roads to these areas become impassable during the rainy season and soon after because of poor maintenance.

3.1.4 Quality of raw materials

The diagnostic study has revealed that the quality of raw materials is problematic. SMEs mostly buy raw materials from farmers by setting up buying points in rural markets. The farmers often sell raw materials that are not completely dry. At times they engage in dishonest practices by deliberately adding water to the produce to increase its weight so as to fetch more money from the buyers. Since the SMEs do not have moisture content measuring equipment, they just buy the raw materials believing that they are dry enough. The wet raw materials result in the development of aflatoxin which also leads to losses. Farmers also have a tendency to sell ungraded produce and at times they deliberately mix the produce with other matter such as stones in an attempt to increase its weight. Sometimes, the farmers mix different varieties of raw materials when selling to the market. Such poor handling of raw materials also leads to losses for the SMEs.

3.1.5 Lack of warehouses

Some SMEs do not have adequate space for the storage of raw materials. Since most raw materials are only available in sufficient quantities during the harvest period, SMEs miss opportunities to stock up because of lack of warehouses which limits the quantities that they can buy. This puts them at a disadvantage because when they require the raw materials outside the harvest period, they are required to pay a premium due to scarcity.

3.1.6 Electricity supply

Malawi is currently generating less power than the amount that is required by consumers and industry. This leads to load-shedding on a daily basis, and this limits the operations of SMEs which rely on electricity to run their machines and are therefore highly dependent on it. The only reliable alternative source of power is to use a diesel or petrol genset, but the cost of running a genset is unsustainable for an SME.

3.1.7 Business plans

About 70% of the SMEs interviewed had business plans. The business plans were seen and in some instances shared with the researchers. Those that had business plans pointed out that they were using them for monitoring the performance of their businesses, and in some cases they used them to access credit. The remaining 30% did not have business plans because they did not know how to develop them and how to use them.

3.2 Access to Markets Challenges

3.2.1 Access to Markets

Sustainable access to markets is required to guarantee SMEs an increase in income and to expand their businesses. This study, has established that there are a number of factors that impede SMEs access to markets as summarized below:

- SMEs believe that information on big markets (e.g. chain stores, export markets) is kept by government officials and is not shared with them.
- There is no hub for market information and there is no formal channel of getting marketing information.
- MITC only provides a limited set of information.
- At the local level, there is no formal database of information on markets in the country. The Confederation of Chambers of Commerce and Industry does not have a useful site for information either.

- There are no useful ICT and media platforms for sharing market export information
- There are no social media adverts for export markets. No technology exposure and lack of marketing websites

3.2.2 Export procedures and documentation

The export process from farm gate to the Malawi border requires that the exporting entity be established as a legal entity, based on the World Bank's Doing Business (2013). The process to export crop produce, according to the Malawi standards requires that the exporter should get the following six official documents: 1) Buying License, 2) Export License, 3) Currency Declaration (CD1) Form, 4) SADC Certificate of Origin, 5) A phytosanitary Certificate, and 6) Customs and Excise Declaration Form (Form 12). The diagnostic study has established that some SMEs are not aware of this process and the required documents for export. The following is a list of documents that some of the SMEs confirmed to be aware of: Seed certification, phytosanitary certificate, import certification, orange certificate, export permit, MRA bill of entry, SADC certificate, foodstuff certification, commercial invoice and bill of lading. This confirms that there are gaps in their understanding of the export requirements and documentation.

3.2.3 Access to export markets

- Production levels are generally low to meet the demands of exports markets.
- Taxation is very high and the cost of regional and international transportation of processed goods is also very high.
- Usually exportation is done by individual SMEs and not SME groups. Average export volumes tend to be (very) small. As such it becomes difficult to meet the quantities requirements of most importers.
- Malawi embassies do not provide landing zones in the Malawi embassies for example in Zambia, Mozambique, and Zimbabwe where exporters can store their goods.
- There are no contracts for export markets that are made available to different value chains by government.
- The cost of production in Malawi is generally high and as a result it is difficult to get prices that would break in the export market.
- The processing of export documents in Malawi takes a long time and this leads to lost contracts.

- Sometimes, the government imposes an export ban for certain crops for fear of creating a deficit in the country. Such a ban leads the exporter to lose the export markets which had already been secured and it also causes the SMEs to be in bad debts because of a lack of a market to sell the produce. SMEs sometimes get credit from commercial banks to buy and supply the required goods and this causes them financial hardship.
- There are inefficiencies in policy implementation within and across related sectors. For example, issuing of export licenses is done by the Ministry of Agriculture and the Ministry of Industry, Trade and Tourism (MoITT). The Ministry of Agriculture first scrutinizes every application for an export license on a case-by-case basis and refers them to the MoITT which issues the license. This brings delays before the export is finally concluded. Buyers tend to lose patience and often cancel their orders resulting in loss of potential export markets.
- Export policies are restrictive in that there is so much paper work to be completed before an export permit is granted.
- Honest buyers are difficult to get in the export market. For one to get a good market one has to travel to the buyer's country.

3.2.4 Packaging

The study noted that improper packaging is an issue for some of the SMEs. Most SME food processors face difficulties in securing appropriate and reasonably priced packaging materials because such materials are hard to find locally. The packaging materials that are readily available in the market are of poor quality. For example, some of the plastic bottles being used for packaging cooking oil become brittle within weeks of using them. This means that transporting the cooking oil for a long distance would not be possible.

3.3 Access to Finance Challenges

3.3.1 Inadequate finances for raw material procurement

Over 80% of SMEs do not have adequate finance for the procurement of raw materials. Since most raw materials are only available in sufficient quantities during the harvest period, SMEs miss opportunities to stock up because of lack of finance which limits the quantities that they can buy. This puts them at a disadvantage because when they

require the raw materials outside the harvest period, they are required to pay a premium due to scarcity.

3.3.2 Access to financial information

SMEs feel that financial institutions have information pertaining to suitable credit and other financial services and products but there is no channel through which such information can be passed on to the SMEs. There are no platforms, information hubs and financial information sharing forums that are deliberately organized to share information with the SMEs. In addition, there are no walk-in financial information centers run by financial institutions or other actors in the country.

3.3.3 Lack of adequate marketable collateral

The diagnostic study has established that SMEs have challenges to access credit because of lack of appropriate and adequate collateral. Banks require collateral to secure their loans in case of default. The study established that collateral deficiencies are an important constraint for SMEs to obtain loans. Collateral is not a risk free asset because it can be damaged or moved before the creditor seizes it. As such, titled land and savings are the most common accepted collateral. The absence of assets that can be pledged and the transaction costs for establishing and enforcing security interests of available forms of collateral are the two most important collateral obstacles that banks face when considering credit finance for SMEs. The study has therefore established that the requirement for collateral is a significant hindrance to access finance by SMEs.

3.3.4 High interest rates on Loans

Interest rates charged on loans by banks and MFIs are very high ranging from 23% to 90%. High interest rates on credit significantly increases the cost of finance and contributes to barriers to access financial capital by SMEs. The study noted that there are high interest spreads, mainly contributed by high operating costs incurred by financial institutions. The base lending rate was 24.8 percent against the average savings rate of 5.00 percent in June 2018. High loan interest rates is a significant barrier to access loans and is also one of the main challenges faced in repaying loans by SMEs.

3.3.5 Delays in processing loans and missing appropriate time for loans

When SMEs have tried to access credit, they have experienced long loan processing periods by banks and financial institutions before they get the credit. This is due to long

procedures employed by the financial service providers. This severely impacts their business operations and their relationship with suppliers. For example, Tingadalire Organic Food Products applied for a loan from Export Development Fund, but it took so long that by the time the loan was approved and accessed by the SME, paprika farmers had sold their produce to vendors.

3.4 Specific Diagnostic Findings

3.4.1 Summary of Specific Needs of SMEs

The following summary gives a list of all the specific needs of champion SMEs showing the frequency of each need and the project component where the need falls.

NO	NEED	FREQUENCY	PROJECT COMPONENT
1	Working capital for raw material procurement	13	Access to Finance
2	Support to develop export market	13	Access to Markets
3	Support to develop a bigger local market	10	Access to Markets
4	Equipment for value addition	9	Access to Finance
5	Create linkages with reliable suppliers	6	Access to Markets
6	Factory construction and renovations	4	Access to Finance
7	Support to restructure production	2	Capacity building
8	Trade finance for export	1	Access to Finance

A detailed list of Champion SME needs is provided in Appendix 4 below.

4. CONCLUSION

The study has established that SMEs face enormous access challenges both to markets and to finance and they need help to overcome these challenges. With regard to access to markets, there are challenges with regard to access to both local and

export markets. The absence of market information is a major constraint in the local market. A number of factors including lengthy procedures and documentation contribute to challenges in accessing export markets. Collateral and high interest rates are among the prohibiting factors to access to finance.

The SMEs also have knowledge and capacity gaps in production, marketing, finance and management. These are hindering the growth and profitability of their businesses.

Despite these challenges, many opportunities still exist which can enhance the growth of the champion SMEs. Consequently, action can be taken to improve their access to both finance and markets. SMEs could become reliable markets for farmer groups as they in turn become reliable suppliers of appropriate raw materials to the SMEs. What is required to achieve this is to establish linkages between the two groups.