THE POLICY ENVIRONMENT FOR
PROMOTING SMALL AND MEDIUM-SIZED ENTERPRISES IN GHANA AND MALAWI

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By

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II. Abstract

The dynamic role of small and medium scale enterprises (SMEs) in developing countries have been highly emphasised. These enterprises have been identified as the means through which the rapid industrialisation and other developmental goals of these countries can be realised. This paper explores the achievements of the Small and Medium Scale Enterprise (SME) sector in Ghana and Malawi and the role government, internal and external support institutions have played in promoting the sector. The findings will assist policy makers, development agencies and business organisations to ascertain the appropriate strategy to improve the SME sector.
THE POLICY ENVIRONMENT FOR PROMOTING SMALL AND MEDIUM-SIZED ENTERPRISES IN GHANA & MALAWI

1.0 INTRODUCTION

The dynamic role of small and medium enterprises (SMEs) in developing countries as engines through which the growth objectives of developing countries can be achieved has long been recognised. It is estimated that SMEs employ 22% of the adult population in developing countries (Daniels, 1994; Daniels & Ngwira, 1992; Daniels & Fisseha, 1992; Fisseha, 1992; Fisseha & McPherson, 1991; Gallagher & Robson, 1995). The sector employs about 15.5% and 14.09% of the labour force in Ghana and Malawi respectively (Parker et al, 1994), has experienced higher employment growth than micro and large scale enterprises (5% in Ghana and 11% in Malawi). In Ghana, the sector’s output as a percentage of GDP accounted for 6% of GDP\(^1\) in 1998.

This paper seeks to identify the achievements of the SME sector, to consider the constraints to the development of the sector, and to highlight the role governments, internal and external support institutions have played in promoting the sector in Ghana and Malawi. Section one reviews the macroeconomic background of the two countries. This will be followed by definitions and basic concepts, the role and characteristics of SMEs and constraints to SME development in the two countries. Section three discusses the various policies put in place by government and other support institutions to promote the SME sector. The paper concludes with a summary and recommends directions for further research.

Macro-Economic Background

Ghana and Malawi have common macroeconomic traits; in 1991 they both had a per capita income of less than $400. Appendix I gives some of the macroeconomic indicators of both countries. Although Ghana’s per capita income declined between 1965 and 1991, the country has a relatively well educated population, a capable bureaucracy and abundant natural resources. While Malawi showed a positive growth in per capita income, its per capita income is less than $200, it also has a thin industrial base, a limited educated class and has a population density well above the Sub-Saharan average of 21 persons per square kilometre (Parker et al, 1994).

In the late 1970s and early 1980s, both countries experienced severe economic crises arising from internal and external factors. Externally, the oil price hikes and declining world prices for major exports depleted foreign reserves, thereby reducing the import capacity of many industries. Both countries faced a deterioration in their terms of trade due to weak market conditions for key export commodities besides the increases in their import prices. Another significant external factor peculiar to Ghana was the expulsion of a million Ghanaians from Nigeria in 1983. In the case of Malawi, the civil war in Mozambique (from 1979 to 1981) also disrupted the traditional trade route of land-locked Malawi.

These developments had repercussions on the countries balance of payments; in Malawi, the cost, insurance and freight (CIF)/free on board (FOB) margin rose from an average of 15 percent in the early 1970s to 40 percent during the early 1980s, following the re-routing of the country’s external trade through the ports of Durban in South Africa and Dar-es-Salaam in Tanzania. Both countries also suffered the adverse effects of the global debt crisis of the early 1980s. Since both countries had contracted some commercial debt in the 1970s, particularly for infrastructural investments, they experienced a massive increase in their debt obligations (Aryeetey et al, 1992; Parker et al, 1995). Internally, problems such as large inefficient public sectors, policy biases that favoured industry over agriculture, overvalued exchange rates and inflation were dominant.

In the 1980s, the deteriorating economic conditions led to the implementation of Structural Adjustment Programmes (SAP) with similar but distinct emphases, tailored to address specific economic issues.

Ghana embarked on its reforms in 1983 and they included elements of stabilisation and liberalisation. Prominent among them was the liberalisation of the exchange rate and greater access to foreign exchange. This was achieved through a series of devaluations and the setting up of auction markets aimed at fostering market-based exchange rate setting and the licensing of foreign exchange bureaux to trade in the currency (Dordunoo, 1988). In short, the country operated the Dutch Auction system. Other important measures contained in the programme included:

(i) rationalisation of the tax structure and the broadening of its base;
(ii) cut in subsidies to public enterprises and a shift in emphasis towards education and infrastructure;
(iii) abolishing of price controls;
(iv) decontrolling of interest rates;
(v) reduction in tariff and abolishing of import licensing;
(vi) revision of the investment code;

The SAP embarked upon by Malawi consisted of two elements: between 1981 and 1985 the country sought to restore macroeconomic stability and encourage economic growth. The authorities initially responded by maintaining aggregate demand and income through deficit financing supported by external commercial borrowing (Parker et al, 1995). This resulted in a rapid increase in the fiscal deficit and a widening of the current account deficit. To deal with these emerging balance of payments and fiscal deficits, the authorities adopted several policies that resulted in a more inward oriented economy and a deterioration in competitiveness. The policies included an introduction of quantitative restrictions on imports, and an increase in the level and spread of tariff rates, partly intended to raise revenue and close the fiscal gap.

The second component of the SAP consisted of the following:
(i) measures to establish fiscal discipline such as tax reforms, reduction in government expenditure and improved budget planning;
(ii) agricultural sector reforms mainly in producer prices, increasing the role of small private farmers and greater incentives for large scale production.
(iii) trade liberalisation.
The implementation of the SAP and the degree of commitment to reform varied between the two countries. Ghana’s reform is said to be the most extensive and its implementation has been thorough. Malawi on the other hand, undertook at least partial measures in almost all sectors. Below is a summary of the policies and achievements.

Table 1

<table>
<thead>
<tr>
<th>Policy Areas</th>
<th>Ghana</th>
<th>Malawi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade &amp; Exchange Rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import Licensing</td>
<td>Abolished</td>
<td>Nearly Abolished</td>
</tr>
<tr>
<td>Elimination of Quotas</td>
<td>Fully</td>
<td>Fully</td>
</tr>
<tr>
<td>Tariff Reform</td>
<td>Extensive</td>
<td>Partial</td>
</tr>
<tr>
<td>Exchange Rate Depreciation</td>
<td>Extensive</td>
<td>Extensive¹</td>
</tr>
<tr>
<td>Regulatory</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Regulatory Reform²</td>
<td>Partial</td>
<td>Partial</td>
</tr>
<tr>
<td>Industrial Price decontrol</td>
<td>Nearly fully</td>
<td>Partial</td>
</tr>
<tr>
<td>Financial</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rate liberalisation</td>
<td>Fully</td>
<td>Nearly Fully</td>
</tr>
<tr>
<td>General Financial Reforms</td>
<td>Extensive</td>
<td>Partial</td>
</tr>
<tr>
<td>Public</td>
<td></td>
<td></td>
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<tr>
<td>Public enterprise reform</td>
<td>Partial</td>
<td>Extensive</td>
</tr>
<tr>
<td>Tax structure reform</td>
<td>Extensive</td>
<td>Extensive</td>
</tr>
</tbody>
</table>


1. Malawi’s extensive exchange rate depreciation was tampered with due to scarcities and government controls on foreign reserves in the 1990s.
2. This refers to the adoption of investment codes, labour codes, commercial codes etc.

2.0 THE CHARACTERISTICS OF SMEs IN GHANA & MALAWI

2.1.1 Definitions & Concepts
There is no single, uniformly acceptable, definition of a small firm (Storey, 1994). Firms differ in their levels of capitalisation, sales and employment. Hence, definitions which employ measures of size (number of employees, turnover, profitability, net worth, etc.) when applied to one sector could lead to all firms being classified as small, while the same size definition when applied to a different sector could lead to a different result.

The first attempt to overcome this definition problem was by the Bolton Committee(1971) when they formulated an “economic” and a “statistical” definition.
Under the economic definition, a firm is regarded as small if it meets the following three criteria:

(i) it has a relatively small share of their market place;
(ii) it is managed by owners or part owners in a personalised way, and not through the medium of a formalised management structure;
(iii) it is independent, in the sense of not forming part of a large enterprise.

The Committee also devised a “statistical” definition to be used in three main areas:
(a) quantifying the size of the small firm sector and its contribution to GDP, employment, exports etc.;
(b) comparing the extent to which the small firm sector’s economic contribution has changed over time;
(c) applying the statistical definition in a cross country comparison of the small firms’ economic contribution.

Thus, the Bolton Committee employed different definitions of the small firm to different sectors. Table 2 below indicates the various sectoral definitions:

**Table 2: The Bolton Committee Definitions of a small firm**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>200 employees or less</td>
</tr>
<tr>
<td>Construction</td>
<td>25 employees or less</td>
</tr>
<tr>
<td>Mining &amp; Quarrying</td>
<td>“ ”</td>
</tr>
<tr>
<td>Retailing</td>
<td>“ ”</td>
</tr>
<tr>
<td>Miscellaneous Services</td>
<td>Turnover of 50,000 pounds or less</td>
</tr>
<tr>
<td>Motor Trades</td>
<td>“ ”</td>
</tr>
<tr>
<td>Wholesale Trades</td>
<td>Turnover of 100,000 pounds or less</td>
</tr>
<tr>
<td>Road Transport</td>
<td>“ ”</td>
</tr>
<tr>
<td>Catering</td>
<td>Five Vehicles or less</td>
</tr>
<tr>
<td></td>
<td>All excluding multiples and Brewery – managed houses</td>
</tr>
</tbody>
</table>

Source: The Bolton Committee(1971)

**Criticism of the Bolton Committee’s “Economic” Definition**

A number of weaknesses can be identified with the Bolton Committee’s “economic” and ‘statistical’ definitions. First, the economic definition which states that a small business is managed by its owners or part owners in a personalised way, and not through the medium of a formalised management structure, is incompatible with its statistical definition of small manufacturing firms which could have up to 200 employees. As firm size increases, owners no longer make principal decisions but devolve responsibility to a team of managers. For example, it is unlikely for a firm with a hundred employees to be managed in a personalised way, suggesting that the ‘economic’ and ‘statistical’ definitions are incompatible.

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Another shortcoming of the Bolton Committee’s economic definition is that it considers small firms to be operating in a perfectly competitive market. However, the idea of perfect competition may not apply here; many small firms occupy ‘niches’ and provide a highly specialised service or product in a geographically isolated area and do not perceive any clear competition (Wynarczyk et al, 1993; Storey, 1994).

Alternatively, Wynarczyk et al (1993), identified the characteristics of the small firm other than size. They argued that there are three ways of differentiating between small and large firms. The small firm has to deal with:
(a) uncertainty associated with being a price taker;
(b) limited customer and product base;
(c) uncertainty associated with greater diversity of objectives as compared with large firms.

As Storey (1994) stated, there are three key distinguishing features between large and small firms. Firstly, the greater external uncertainty of the environment in which the small firm operates and the greater internal consistency of its motivations and actions. Secondly, they have a different role in innovation; small firms are able to produce something marginally different, in terms of product or service; this differs from the standardised product or service provided by large firms. A third area of distinction between small and large firms is the greater likelihood of evolution and change in the smaller firm; small firms which become large undergo a number of stage changes.

**Criticism of the Bolton Committee’s “Statistical” Definition:**
(i) no single definition or criteria was used for “smallness”, (number of employees, turnover, ownership and assets were used instead)
(ii) three different upper limits of turnover were specified for the different sectors and two different upper limits were identified for number of employees. This makes the definition complex to allow for cross country comparison.
(iii) comparing monetary units over time requires construction of index numbers to take account of price changes. Moreover, currency fluctuations make international comparison more difficult.
(iv) the definition considered the small firm sector to be homogeneous, however, firms may grow from small to medium and in some cases to large.

It was against this background that the European Commission (EC) coined the term ‘Small and Medium Enterprises (SME)’. The SME sector is made up of three components:
(i) firms with 0 to 9 employees - micro enterprises
(ii) 10 to 99 employees - small enterprises
(iii) 100 to 499 employees - medium enterprises.
Thus, the SME sector is comprised of enterprises (except agric, hunting, forestry and fishing) which employ less than 500 workers. In effect, the EC definitions are based solely on employment rather than a multiplicity of criteria. Secondly, the use of 100 employees as the small firm’s upper limit is more appropriate given the increase in productivity over the last two decades (Storey, 1994:13). Finally, the EC definition did not assume the SME group is homogenous, that is, the definition makes a distinction between micro, small, and medium-sized enterprises.

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\(^3\) this does not mean large firms do not innovate; small firms are able to adopt quicker to customer demands than do large firms.
However, the EC definition is too all-embracing for a number of countries. Researchers would have to use definitions for small firms which are more appropriate to their particular ‘target’ group (an operational definition). It must be emphasized that debates on definitions turn out to be sterile unless size is a factor which influences performance. For instance, the relationship between size and performance matters when assessing the impact of a credit programme on a targeted group. (also refer to Storey, 1994).

**Alternative Definitions:**

World Bank since 1976 - Firms with fixed assets (excluding land) less than US$ 250,000 in value are Small Scale Enterprises.

Grindle et al (1989:9-10) - Small scale enterprises are firms with less than or equal to 25 permanent members and with fixed assets (excluding land) worth up to US$ 50,000.

USAID in the 1990s - Firms with less than 50 employees and at least half the output is sold (also refer to Mead, 1994).

UNIDO’s Definition for Developing Countries:

- **Large** - firms with 100+ workers
- **Medium** - firms with 20 - 99 workers
- **Small** - “ “ 5 - 19 workers
- **Micro** - “ “ < 5 workers

UNIDO’s Definition for Industrialised Countries:

- **Large** - firms with 500+ workers
- **Medium** - firms with 100 - 499 workers
- **Small** - “ “ ≤ 99 workers

From the various definitions above, it can be said that there is no unique definition for a small and medium scale enterprise thus, an operational definition is required. This is one of the main issues this project intends to address.

**Country Definitions**

Small Scale enterprises have been variously defined, but the most commonly used criterion is the number of employees of the enterprise. In applying this definition, confusion often arises in respect of the arbitrariness and cut off points used by the various official sources. As contained in its Industrial Statistics, The Ghana Statistical Service (GSS) considers firms with less than 10 employees as Small Scale Enterprises and their counterparts with more than 10 employees as Medium and Large-Sized Enterprises. Ironically, The GSS in its national accounts considered companies with up to 9 employees as Small and Medium Enterprises.

An alternate criteria used in defining small and medium enterprises is the value of fixed assets in the organisation. However, the National Board of Small Scale Industries (NBSSI) in Ghana applies both the ‘fixed asset and number of employees’ criteria. It

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defines a Small Scale Enterprise as one with not more than 9 workers, has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million Cedis (US$9,506, using 1994 exchange rate). The Ghana Enterprise Development Commission (GEDC) on the other hand uses a 10 million Cedis upper limit definition for plant and machinery. A point of caution is that the process of valuing fixed assets in itself poses a problem. Secondly, the continuous depreciation in the exchange rate often makes such definitions out-dated.

Steel and Webster (1990), Osei et al (1993) in defining Small Scale Enterprises in Ghana used an employment cut off point of 30 employees to indicate Small Scale Enterprises. The latter however dis-aggregated small scale enterprises into 3 categories: (i) micro -employing less than 6 people; (ii) very small, those employing 6-9 people; (iii) small -between 10 and 29 employees.

In the case of Malawi, the official definition of enterprise sizes dates back to 1992. The definition is based on three criteria, viz.: the level of capital investment, number of employees and turnover. An enterprise is defined as small scale if it satisfies any two of the following three criteria, that is, it has a capital investment of US$2,000 - US$55,000, employing 5 - 20 people and with a turnover of up to US$110,000 (using 1992 official exchange rate). For manufacturing enterprises, capital investment is taken to mean the cost of plant and machinery, including working capital and the cost of land and buildings. It may be observed that since this official definition was given in 1992, the economic situation in the country has changed drastically, with the value of the kwacha falling from an official rate of MK3.60 to US$1 in 1992 to MK15.30 to US$1 in 1996 and to MK43.15 as of January 1999. The implication is that the existing official definition is out of date and needs to be revised.

**Why Small and Medium Scale Enterprises?**

The choice of small and medium scale enterprises within the industrial sector is based on the following propositions:

(a) **Large Scale Industry**

(i) has not been an engine of growth and a good provider of employment;
(ii) already receive enormous support through general trade, finance, tax policy and direct subsidies;

(b) **Small and Medium Scale Enterprises**

(i) Mobilise funds which otherwise would have been idle;
(ii) Have been recognised as a seed-bed for indigenous entrepreneurship;
(iii) Are labour intensive, employing more labour per unit of capital than large enterprises;
(iv) Promote indigenous technological know-how;
(vi) are able to compete (but behind protective barriers);
(vii) Use mainly local resources, thus have less foreign exchange requirements;
(ix) Cater for the needs of the poor and;
(x) Adapt easily to customer requirements (flexible specialisation).
2.1.1 The Role & Characteristics of SMEs

Role
Small-scale rural and urban enterprises have been one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low income countries. These enterprises have been recognised as the engines through which the growth objectives of developing countries can be achieved. They are potential sources of employment and income in many developing countries. It is estimated that SMEs employ 22% of the adult population in developing countries (Daniels, 1994; Daniels & Ngwira, 1992; Daniels & Fisseha, 1992; Fisseha, 1992; Fisseha & McPherson, 1991; Gallagher & Robson, 1995).

However, some authors have contended that the job creating impact of small scale enterprises is a statistical flaw; it does not take into account offsetting factors that makes the net impact more modest (Biggs, Grindle & Snodgrass, 1988). It is argued that increases in employment Small and Medium Enterprises is not always associated with increases in productivity. Nevertheless, the important role performed by these enterprises cannot be overlooked. Small firms have advantages over their large-scale competitors. They are able to adapt more easily to market conditions given their broadly skilled technologies. However, narrowing the analysis down to developing countries raises the following puzzle: Do small scale enterprises have a dynamic economic role?

Due to their flexible nature, SMEs are able to withstand adverse economic conditions. They are more labour intensive than larger firms and therefore, have lower capital costs associated with job creation (Anheier & Seibel, 1987; Liedholm & Mead, 1987; Schmitz, 1995). SSEs perform useful roles in ensuring income stability, growth and employment. Since SMEs are labour intensive, they are more likely to succeed in smaller urban centres and rural areas, where they can contribute to the more even distribution of economic activity in a region and can help to slow the flow of migration to large cities. Because of their regional dispersion and their labour intensity, the argument goes, small scale production units can promote a more equitable distribution of income than large firms. They also improve the efficiency of domestic markets and make productive use of scarce resources, thus, facilitating long term economic growth.

Characteristics of SMEs In Ghana & Malawi
A distinguishing feature of SMEs from larger firms is that the latter have direct access to international and local capital markets whereas the former are excluded because of the higher intermediation costs of smaller projects. In addition, SMEs face the same fixed cost as Large Scale Enterprises(LSEs) in complying with regulations but have limited capacity to market products abroad.

SMEs in Ghana and Malawi can be categorised into urban and rural enterprises. The former can be sub-divided into `organised’ and `unorganised’ enterprises. The organised ones tend to have paid employees with a registered office whereas the unorganised category is mainly made up of artisans who work in open spaces, temporary wooden structures, or at home and employ little or in some cases no salaried workers. They rely mostly on family members or apprentices. Rural enterprises are largely made up of family groups, individual artisans, women engaged in food production from local crops. The major activities within this sector include:- soap and
detergents, fabrics, clothing and tailoring, textile and leather, village blacksmiths, tinsmithing, ceramics, timber and mining, bricks and cement, beverages, food processing, bakeries, wood furniture, electronic assembly, agro processing, chemical based products and mechanics (Liedholm & Mead, 1987; Osei et al, 1993, World Bank, 1992; Gray, Cooley & Lutabingwa, 1997).

It is interesting to note that small scale enterprises make better use of scarce resources than large scale enterprises. Research in Ghana and many other countries have shown that capital productivity\(^5\) is often higher in SMEs than is the case with LSEs (Steel, 1977; Child 1971). The reason for this is not difficult to see, SMEs are labour intensive with very small amount of capital invested. Thus, they tend to witness high capital productivity which is an economically sound investment. Thus, it has been argued that promoting the SCE sector in developing countries will create more employment opportunities, lead to a more equitable distribution of income and will ensure increased productivity with better technology (Steel & Webster, 1991).

2.1.3 Constraints To SME Development

Despite the wide-ranging economic reforms instituted in the region, SMEs face a variety of constraints owing to the difficulty of absorbing large fixed costs, the absence of economies of scale and scope in key factors of production, and the higher unit costs of providing services to smaller firms (Schmitz, 1982; Liedholm & Mead, 1987; Liedholm, 1990; Steel & Webster, 1990). Below is a set of constraints identified with the sector.

**Input Constraints:** SMEs face a variety of constraints in factor markets (also see Levy, 1993). However, factor availability and cost were the most common constraints. The specific problems differed by country, but many of them were related, varying according to whether the business perceived that their access, availability or cost was the most important problem and whether they were based primarily on imported or domestic inputs (World Bank, 1993; Parker et al, 1995). SMEs in Ghana and Malawi emphasised the high cost of obtaining local raw materials; this may stem from their poor cashflows (Parker et al, 1995). Aryeetey et al (1994) found that 5% of their sample cited the input constraint as a problem. However, Daniels & Ngwira (1993) reported that about a third of Malawian SMEs reported input problems. This can also be contrasted with only 8.2%, 7.5% and 6.3% of proprietors in Botswana, Swaziland and Lesotho. It was also found that input constraints vary with firm size.

• **Finance** Access to finance remained a dominant constraint to small scale enterprises in Ghana and Malawi. Credit constraints pertaining to working capital and raw materials were cited by respondents (between 24% and 52% in Parker et al, 1995). Aryeetey et al (1994) reported that 38% of the SMEs surveyed mention credit as a constraint, in the case of Malawi, it accounted for 17.5% of the total sample (Daniels & Ngwira, 1993:30-31). This stems from the fact that SMEs have limited access to capital markets, both locally and internationally, in part because of the perception of higher risk, informational barriers, and the higher costs of intermediation for smaller firms. As a result, SMEs often cannot obtain long-term finance in the form of debt and equity.

\(^5\) value added per unit of capital invested.
• **Labour Market** This seems a less important constraint to SMEs considering the widespread unemployment or underemployment in these countries. SMEs generally use simple technology which does not require highly skilled workers. However, where skilled workers are required, an insufficient supply of skilled workers can limit specialisation opportunities, raise costs, and reduce flexibility in managing operations. Aryeetey et al (1994) found that 7% of their respondents indicated that they had problems finding skilled labour, and 2% had similar problems with unskilled labour. However, only 0.9% of Malawian firms were reported to have had labour problems.

• **Equipment & Technology:** SMEs have difficulties in gaining access to appropriate technologies and information on available techniques. This limits innovation and SME competitiveness. Besides, other constraints on capital, and labour, as well as uncertainty surrounding new technologies, restrict incentives to innovation. 18% of the sampled firms in Aryeetey et al (1994) mentioned old equipment as one of the four most significant constraints to expansion (18.2% in Parker et al, 1995), this is in contrast to the 3.4% reported in Malawi (Daniels & Ngwira, 1993; Makoza & Makoko, 1998).

• **Domestic Demand** 24.9% of Malawian proprietors indicated they had marketing constraints, while 5% of respondents was the figure quoted in the Ghanaian case (Aryeetey et al, 1994; Daniels & Ngwira, 1993). The business environment varied markedly among SMEs in Ghana and Malawi, reflecting different demand constraints after adjustment. There were varying levels of uncertainty caused by macroeconomic instability and different levels of government commitment to private sector development. Recent economic policies have led to a decline in the role of the state in productive activity, but a renewed private investment has created new opportunities for SMEs. Nonetheless, limited access to public contracts and subcontracts, arising from cumbersome bidding procedures and/or lack of information, inhibit SME participation in these markets. Also, inefficient distribution channels often dominated by larger firms pose important limitations to market access for SMEs. As noted in the case of Ghana, demand constraints limited the growth of SMEs (Parker et al, 1995).

• **International Markets** Previously insulated from international competition, many SMEs are now faced with greater external competition and the need to expand market share. However, this problem was mostly identified in medium-sized enterprises in Ghana (12.5% in Aryeetey et al, 1994: 13), less than 1% of the total sample complained there were too many imported substitutes coming into the country. Daniels & Ngwira (1993) also reported a similar figure for Malawi (0.9%). However, Riedel et al (1988), reported that Tailors in Techiman (Ghana) who used to make several pairs of trousers in a month went without any orders with the coming into effect of trade liberalisation. Limited international marketing experience, poor quality control and product standardisation and little access to international partners, impede expansion into international markets. It is reported that only 1.7% of firms export their output (Aryeetey et al, 1994).

**Regulatory Constraints**

Although wide ranging structural reforms have improved, prospects for enterprise development remain to be addressed at the firm-level.

• **Legal** High start-up costs for firms, including licensing and registration requirements, can impose excessive and unnecessary burdens on SSEs. The high cost
of settling legal claims and excessive delays in court proceedings adversely affect SME operations. In Malawi, prohibitive laws like The Business Licensing Act, The Electricity Act, The Control of Goods Act, and The Export Incentives Act, have severely constrained SME development (Makoza & Makoko, 1998). 5.3% of proprietors in Malawi mentioned this as a constraint (Daniels & Ngwira, 1993). In the case of Ghana, the cumbersome procedure for registering and commencing business were key issues oftencited. However, Aryeetey et al (1994) found that this accounted for less than 1% of their sample. Meanwhile, the absence of antitrust legislation favours larger firms, while the lack of protection for property rights limits SME access to foreign technologies.

Managerial Constraints

• Lack of Entrepreneurial & Business Management Skills
Lack of managerial know-how places significant constraints on SME development. Even though SMEs tend to attract motivated managers, they can hardly compete with larger firms. The scarcity of management talent, prevalent in most countries in the region, has a magnified impact on SMEs. The lack of support services or their relatively higher unit cost can hamper SME efforts to improve their management because consulting firms often are not equipped with appropriate cost effective management solutions for SMEs. Furthermore, absence of information and/or time to take advantage of existing services results in weak demand for them.

Despite the numerous institutions providing training and advisory services, there is still a skills gap among the SME sector as a whole. According to Daniels & Ngwira (1993), about 88% of Malawian SMEs desired training in various skills but as of 1992, less than 6% have actually received it. In Ghana, a lot has actually been achieved in this regard, though there is still room for improvement (refer to page 2 of this paper).

Institutional Constraints

The lack of cohesiveness and the wide range of SME interests limits their capacity to defend their collective interests and their effective participation in civil society.

Associations and collective action
Associations providing a voice for the interests of SMEs in the policy-making process have had a limited role compared to those of larger firms. Many of the entrepreneurs associations have yet to complete the transition of their goals from protectionism to competitiveness (World Bank, 1993). Additionally, the potential economies of collaborative arrangements in production and sales among SMEs have not been adequately explored. It is reported that about 98% of all SMEs in Malawi sell their products to the final consumer with the exception of chemicals, plastics, and wholesale trade which sell to other commercial or manufacturing enterprises (Makoza & Makoko, 1998). There are very few forward linkages. However, backward linkages were common with 71% of enterprises procuring unprocessed, semi-processed or finished products.

The dependence of the SME sector in Ghana on large-scale enterprises as purchasers of output, either for sale, as final goods or to be used as intermediate inputs, is very limited. Only 13% of firms produce any item for or component for larger firms. Interdependence among SMEs is very minimal. As reported in Osei et al (1993), only
17.6% of firms with growing output and 8.4% of those whose output stagnated have other SSEs as customers.

3.0 POLICIES FOR PROMOTING SMEs IN GHANA & MALAWI

Small scale enterprise promotion in Ghana was not impressive in the 1960s. Dr. Nkrumah (President of the First Republic) in his modernisation efforts emphasised state participation but did not encourage the domestic indigenous sector. The local entrepreneurship was seen as a potential political threat. To worsen the situation, the deterioration in the Balance of Payments in the 1980s and the overvaluation of the exchange rate led to reduced capacity utilisation in the import dependent large-scale sector. Rising inflation and falling real wages also forced many formal sector employees into secondary self-employment in an attempt to earn a decent income. As the economy declined, large-scale manufacturing employment stagnated. According to Steel and Webster (1991), small scale and self employment grew by 2.9% per annum (ten times as many jobs as large scale employment) but their activities accounted for only a third of the value added.

What is evident from the Malawi government’s development policies for the period 1964-1980 is the lack of a coherent and comprehensive policy framework for SSE development. The post-colonial development policy in Malawi, at least up to 1980 exhibited a “large scale sector” bias, rather than the urban bias. The unsustainability of the “large scale sector” policy stance was clearly demonstrated by the dismal performance of both public/quasi-public enterprises in the late 1970s. It is the poor performance of the economy in the late 1970s which brought about a policy re-orientation, in favour of SMEs, in the early 1980s; this constituted two main forms: the provision of industrial estates in the main cities of Blantyre and Lilongwe and the secondary town of Liwonde, and the formation of a number of specialised institutions supporting SMEs.

It was in the light of the above that the government started promoting small scale enterprises. They were viewed as the mechanism through which a transition from state-led economy to a private oriented developmental strategy could be achieved. Thus the SME sector’s role was re-defined to include the following:
(i) assisting the state in reducing its involvement in direct production
(ii) absorbing labour from the state sector, given the relatively labour intensive nature of small scale enterprises, and;
(iii) developing indigenous entrepreneurial and managerial skills needed for sustained industrialisation.

3.1.1 Government & Institutional Support to SMEs

To enable the sector perform its role effectively, the following technical, institutional and financial supports were put in place by government.

GHANA
(i) Government

Government, in an attempt to strengthen the response of the private sector to economic reforms undertook a number of measures in 1992. Prominent among them is the setting up of the Private Sector Advisory Group and the abolition of the Manufacturing Industries Act, 1971 (Act 356) which repealed a number of price
control laws, and The Investment Code of 1985 (PNDC Law 116) which seeks to promote joint ventures between foreign and local investors. In addition to the above, a Legislative Instrument on Immigrant Quota which grants automatic immigrant quota for investors has been enacted. Besides, certain Technology Transfer Regulations have been introduced.

Government also provided equipment leasing, an alternative and flexible source of long term financing of plant and equipment for enterprises that cannot afford their own. A Mutual Credit Guarantee Scheme was also set up for entrepreneurs who have inadequate or no collateral and have limited access to bank credit. To complement these efforts, a Rural Finance Project aimed at providing long term credit to small scale farmers and artisans was set up.

In 1997, government proposed the establishment of an Export Development and Investment Fund (EDIF), operational under the Exim Guarantee Company Scheme of the Bank of Ghana. This was in aid of industrial and export services within the first quarter of 1998. To further improve the industrial sector, according to the 1998 Budget Statement, specific attention will be given to the following industries for support in accessing the EDIF for rehabilitation and retooling: Textiles/Garments; Wood and Wood Processing; Food and Food Processing and Packaging.

It was also highlighted that government would support industries with export potential to overcome any supply-based difficulty by accessing EDIF and rationalise the tariff regime in a bid to improve their export competitiveness. In addition, a special monitoring mechanism has been developed at the Ministry of Trade and Industries.

In a bid to improve trade and investment, particularly in the industrial sector, trade and investment facilitating measures were put in place. Visas for all categories of investors and tourists were issued on arrival at the ports of entry while the Customs Excise and Preventive Service at the ports was made proactive, operating 7-days a week.

The government continued supporting programmes aimed at skills training, registration and placement of job-seekers, training and re-training of redeployees. This resulted in a 5% rise in enrolment in the various training institutes such as The National Vocational and Training Institute (NVTI), Opportunity Industrialisation Centres (OIC) etc. As at the end of 1997, 65,830 out of 72,000 redeployees who were re-trained under master craftsmen have been provided with tools and have become self-employed.

(ii) Institutions
The idea of SME promotion has been in existence since 1970 though very little was done at the time. Key institutions were set up to assist SMEs and prominent among them is The Office of Business Promotion, the present Ghana Enterprise Development Commission (GEDC). It aims at assisting Ghanaian businessmen to enter into fields where foreigners mainly operated but which became available to Ghanaians after the 'Alliance Compliance Order' in 1970. GEDC also had packages for strengthening small scale industry in general, both technically and financially.

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6 This is a move by the government of the day to reduce the dominance of foreign nationals in the country.
The Economic Recovery Programme instituted in 1983 has broadened the institutional support for SMEs. The National Board for Small Scale Industries (NBSSI) has been established within the Ministry of Industry, Science and Technology to address the needs of small businesses. The NBSSI established an Entrepreneurial Development Programme, intended to train and assist persons with entrepreneurial abilities into self employment. In 1987, the industrial sector also witnessed the coming into operation of the Ghana Appropriate Technology Industrial Service (GRATIS). It was to supervise the operations of Intermediate Technology Transfer Units (ITTUs) in the country. GRATIS aims at upgrading small scale industrial concerns by transferring appropriate technology to small scale and informal industries at the grass root level.

ITTUs in the regions are intended to develop the engineering abilities of small scale manufacturing and service industries engaged in vehicle repairs and other related trades. They are also to address the needs of non-engineering industries. So far, 6 ITTUs have been set up in Cape Coast, Ho, Kumasi, Sunyani, Tamale and Tema.

(iii) Financial Assistance
Access to credit has been one of the main bottlenecks to SME development. Most SMEs lack the necessary collateral to obtain bank loans. To address this issue, the Central Bank of Ghana has established a credit guarantee scheme to underwrite loans made by Commercial Banks to small scale enterprises. Unfortunately, the scheme did not work out as expected. It was against this background that the Bank of Ghana obtained a US$ 28 million credit from the International Development Association (IDA) of the World Bank for the establishment of a Fund for Small and Medium Enterprises Development (FUSMED).

Under the Programme of Action to Mitigate the Social Cost of Adjustment (PAMSCAD), a revolving fund of US$ 2 million was set aside to assist SMEs.

MALAWI

(i) Government
There was no consolidated policy on industrial development in Malawi until The Draft Integrated Trade and Industrial Policy of 1996. Even though government recognises the need for the SME sector, there have never been policies and strategies specifically designed for the development of the SCE sector. The sector had to operate within a policy framework created for the large scale enterprise sector.

Recently, government has taken steps to make the policy environment more conducive for the sector. A competition policy has been adopted for the sector and a Bill to that effect is in the final process of drafting (Makoza & Makoko, 1998). The Competition Policy was put in place to prohibit anti-competitive trade practices, regulate and monitor monopolies, protect consumer welfare, strengthen the efficiency of production and distribution of goods and services. Besides, an investment policy is in place; it is aimed at promoting both local and foreign investment. In addition, a number of Acts which hindered SME development have been repealed (the Industrial Development Act was repealed in 1991) to allow easier entry into the manufacturing sector.
Under the current Industrial Licensing Act (1991), SMEs no longer require an Industrial License to start a manufacturing enterprise. It is only required if the manufacturer intends to produce firearms, ammunition, chemical and biological weapons, explosives, radioactive or hazardous wastes.

In addition to the above, the Department of Customs and Excise gives tax rebates on certain imported inputs. A Duty Drawback Scheme is also in operation, it is meant for goods manufactured or processed in Malawi from any raw materials specified in the Customs and Excise Regulations. An example of raw material which qualifies for a drawback is raw materials used in manufacturing agricultural machinery and tools.

Last but not the least, the Control of Goods Act which gave the Ministry of Commerce and Industry the right to control the prices of goods in Malawi went through a series of Amendments between 1983 and 1994. Presently, there is no policing of prices except for petroleum products and motor vehicle spares, which is also under review.

(ii) Institutions
The government of Malawi recognises the important role the sector plays in the national economy and has established a number of institutions to support the activities of the sector. The institutions are categorised as parastatal, state owned enterprises and private sector organisations. A comprehensive list of these institutions alongside their roles provided in appendix II. The support institutions provide entrepreneurship training, business advisory services, market information, credit finance and appropriate technologies. However, there are two distinct features that may be noted from these support institutions. Firstly, a significant number of institutions offer similar services to the same beneficiaries, particularly to those in the micro and small enterprises category. Second is the wide diversity of institutions. This arises from policies and interests of different donors who assist these institutions outside a single, well co-ordinated government framework to which each donor conforms. Such diversity is commonly justified by the outcry that the demand for services greatly exceeds the delivery capacity of any one institution and that competition among institutions promotes efficiency to the benefit of the clients the organisation serve.

(iii) Financial Assistance
A number of Government, Parastatals and Private Sector Organisations provide financial support to SMEs. Institutions such as The Development of Malawian Enterprises Trust (DEMAT), The National Association of Small and Medium Scale Enterprises (NASME), Women’s World Banking (WWB), and The National Association of Business Women (NABW) have received financial support from the Reserve Bank of Malawi to establish credit programmes for SMEs, that is, The Small and Medium Enterprise Fund (SMEF). It is sad to note that SMEF was unsuccessful (Makoza & Makoko, 1998).

Other Institutions such as the Malawian Rural Finance Company, World Vision (Malawi), PLAN International and Malawi Union of Savings and Credit Co-operatives (MUSCCO) have credit programmes for rural SMEs. As at December 1996, MUSCCO had mobilised domestic savings to the tune of MK 49 million and granted credit worth MK 41 million.

The Small Enterprise Development Organisation of Malawi (SEDOM) also provided credit to the SME sector financing mainly rural enterprises. To date, SEDOM has guaranteed loans worth K 40 million.
4.0 SUMMARY AND RECOMMENDATIONS

The paper sought to analyse the small scale enterprise sector in Ghana and Malawi. The analysis first reviewed the macroeconomic background of the two countries concerned. Both countries have common macroeconomic traits; in the late 1970s and early 1980s, these countries experienced severe economic crisis emanating from internal and external factors. Externally, the oil price hikes and decline in world prices of key exports were prominent factors. On the other hand, large inefficient public sectors, policy biases that favoured industries over agriculture, overvalued exchange rates and inflation were the major internal factors. In the early 1980s, the deteriorating economic conditions forced the countries to embark on economic reforms with the technical and financial support from the World Bank and IMF. Both countries implemented the Structural Adjustment Programmes with similar but distinct emphasis aimed at addressing specific economic issues.

In reviewing the definitions of small scale enterprises, the study concluded that, there is no single, universal, uniformly acceptable definition of small scale enterprises. Several measures have been used to define the small scale enterprise sector. The most commonly used is the number of employees of the enterprise. However, in applying this definition, confusion often arises in respect of the arbitrariness and cut off points used by various official sources.

Small scale enterprises in these two countries fall into categories, that is, urban and rural enterprises. The former can be sub-divided into “organised” and “unorganised” enterprises. The organised groups have registered offices and have paid workers, whilst the unorganised ones are mainly made up of artisans. Rural enterprises are largely made up of family groups and individual artisans. The activities in the small scale enterprise sector range from pottery and ceramics to manufacturing of spare parts and electronic assembly.

SMEs face a variety of constraints. Factor availability and cost are the most common constraints. The specific problems differ by country, but many are related. Access to finance remains a dominant constraint to small scale enterprises in Ghana and Malawi. Other constraints faced by the sector include: lack of access to appropriate technology; the existence of laws, regulations and rules that impede the development of the sector; weak institutional capacity and lack of management skills and training.

In an attempt to enable the sector perform its role effectively, a number of technical and financial support institutions were put in place by the governments of Ghana and Malawi. These ranged from government institutions, parastatals, private institutions and non-governmental organisations.

The importance of the small scale enterprise sector in the economic development and growth of low income countries has been widely recognised and need not be over-emphasised. This sector has the potential for the future growth of both employment and incomes as well as in alleviating urban and rural poverty. In order for the sector to flourish, the playing field has to be levelled in terms of policies and strategies that are required to assist the sector attain its full potential. To begin with, one of the constraints cited that the sector faces is the existence of laws, regulations and rules that impede the development of the sector. Therefore, in order to address this problem,
there is need to amend the laws and regulations and that governments should play the role of a facilitator rather than that of a regulator and provide a conducive framework within which the sector operates.

DIRECTIONS FOR FURTHER RESEARCH

(i) How can we further promote the small-scale industrial sector in Ghana and Malawi?
(ii) What are the internal and external sources of finance these SMEs? do the sources of finance vary with firm size?
(iii) Does ownership affect firm performance?
(iv) Have these sources changed since Structural Adjustment? In other words, how has financial sector liberalisation improved finance to the sector?
(v) How have these changes affected employment, income, growth and consequently poverty alleviation.
(vi) Collective Efficiency: (a) to what extent has clustering been observed in Ghana and Malawi? (b) are there any backward and forward linkages and if there are, how can they be further promoted? (c) what roles do clustering and the formation of inter-firm networks play? (d) how has collective efficiency been enhanced by public and private sector institutions?

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Collective Efficiency is defined as the competitive advantage firms derive from local external economies and joint action. This is usually possible when there is sectoral and geographical concentration of firms.
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## APPENDIX I

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APPENDIX II: SUPPORT INSTITUTIONS.

A. GOVERNMENT MINISTRIES.

Ministry of Commerce and Industry.
Line ministry responsible for the Micro, Small and Medium Enterprises (MSME) sector in Malawi. Its main functions include co-ordination and policy formulation and implementation. The ministry is sub divided into two departments namely commerce and industry departments. The commerce department is responsible for the development of the commercial sub sector, creation of an enabling environment, provision of marketing and export support for trade in strategic goods. The industry department on the other hand is responsible for facilitating the development of industries, assisting in the identification of industrial opportunities, improving availability of long term capital, promotion of MSMEs in manufacturing, clarifying and harmonising roles and resources of the various public, parastatal and private organisations involved in MSMEs development.

Ministry of Labour.
Regulating terms and conditions of private sector employment, monitoring developments in wage labour and minimising open unemployment.

District Administration:
Issuing of trade licenses in rural areas.

Ministry of Women, Children Affairs, Community Development and Social Welfare:
Appropriate Technology Training Unit: Promotion of income generating activities and appropriate technologies
Community Development Unit: Promotion of income generating activities

Ministry of Finance.
Providing fiscal incentives and stable macroeconomic environment, and assisting with funding for MSMEs development.

B. PARASTATAL ORGANISATIONS.

Malawi Export Promotion Council (MEPC): Promotion of Malawian exports through market research, analysis, education overseas visits, trade fares etc.

Malawi Union of Savings and Credit Co-operatives Organisation (MUSCCO): Muscco is a national association of savings and credit co-operatives. Its mandate is to promote savings and credit co-operatives. It provides technical assistance to savings ands credit co-operatives.

Development of Malawian Entrepreneurs Trust (DEMAT): It was established in 1979 originally as a business extension service for rural traders, but recently had its mandate extended to include provision of business and technical advisory services, credit, marketing and entrepreneurship development and skills training to MSMEs.
Malawi Industrial and Technology Development Centre (MIRTDC): Established in 1991 for the purpose of conducting industrial technology research as well as product development, and development and transfer of appropriate technologies.

Malawi Entrepreneurship Development Institute (MEDI): It was established to enhance self-employment creation for the large labour force in semi-urban or rural areas where the need for off-farm income generation is greatest. The institute provides entrepreneurship and business training.

Malawi Investment Promotion Agency (MIPA): Investment service facilitation agency.

Malawi Bureau of Standards (MBS): Monitoring the maintenance of acceptable quality standards in goods offered for sale.

Small Enterprise Development Organisation of Malawi (SEDOM): Provision of loans and business advisory services to MSMEs.

C. PRIVATE SECTOR ORGANISATIONS.

Indefund Limited: Provision of loan and equity finance and advisory services to small and medium enterprises

Malawi Chamber of Commerce and Industry (MCCI): Promotion of medium and large-scale business interests. Now promoting the same for small enterprises through affiliation of associations of small-scale enterprises to it.

D. NON GOVERNMENTAL ORGANISATIONS.

Africare: Savings and credit schemes in rural areas.

National Association of Small and Medium Enterprises of Malawi (NASME). Assistance to MSMEs in business formulation and promotion and linking with credit facilities as well as promoting the interests of MSMEs.

Zipatso Association of Malawi: Promotion of fruit growing as a business.

Save the Children Federation (US): Promotion of income generating activities and appropriate technologies.

Mission for Evangelical Training and Development (METDEV): Business and technical skills training

Women World Banking (WWB): Provision of credit to women entrepreneurs.

National Association of Business Women (NABW): Income generating activities, promotion of business women and provision of credit.
**Malawi Association of Spices and Herbs**: Promotion of commercial production of spices and herbs for local and export markets.


Note:

Apart from government and parastatal institutions, many of the private sector support institutions were established only within the past 8 to 10 years. All of the private sector institutions face the common problem that they have weak institutional capacity, which limits their contribution to the development of MSMEs in Malawi. Without the proactive involvement of the government and donors to significantly accelerate the pace of their institutional capacity development, policy initiatives for MSMEs development will largely be introduced on an adhoc basis and be of the supplier driven type.