

Effects of Microcredit on the Financial Performance of Small Scale Cooking Oil Processors in Central Malawi

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Abstract

The study was conducted to determine the effect of microcredit on financial performance of small scale cooking oil processors in central Malawi. Adopting a mixed research approach, the DuPont identity was used to compare the financial strengths and weaknesses between businesses that acquired a microcredit and those that did not. First, the study found that small scale cooking oil processing is a profitable business, regardless of their status in microcredit acquisition. However, microcredit had mixed effects on the financial performance of businesses. Microcredit improved the level of business capital for the businesses translating into better production efficiency, competitiveness and acquisition of a market share thus positively contributing to financial performance. On the other hand, microcredit increased the debt equity ratio hence increasing the businesses' risk of default. The study recommends the businesses to further improve production efficiency and net asset turnovers. In addition, small and medium scale businesses ought to prudently contract microcredit in order to enhance their financial performance whilst checking for their risk of financial distress.

Keywords: dupont identity, financial performance, microcredit

1. Introduction

In recent years, the Malawi economy has experienced a proliferation of Microfinance Institutions (MFIs) offering a wide range of microfinance products including but not limited to provision of microcredit. To this effect, microfinance and development related literature for the country has recorded livelihood uplifting effects associated with these microcredit schemes. Yet, this literature does not come out clearly to indicate the effects that these microcredit schemes have on the financial performance of Micro, Small and Medium Enterprises (MSMEs). It is this gap in literature that enthused this study. While several studies on the impact of microfinance have used the livelihood approach, this study used the MSMEs' profitability approach.

Generally, the Malawi economy continues to face several salient challenges including high poverty levels, reportedly at 50.7 percent (NSO, 2012b). High levels of unemployment in the formal employment sector and overdependence on rain-fed agriculture remain other conspicuous challenges stifling the economy (MoEPD, 2012). These factors, combined, have driven a large proportion of the economically active population into informal employment. This has largely been in form of self-employment in MSMEs. According to NSO (2012b), about 92 percent (Note 1) of the Malawian population is involved in the MSME sector in form of self-employment, family or individual businesses. This has resulted a surge in the number of micro-entrepreneurs contributing widely to different agricultural value chains. The Malawian economy has 987 480 MSMEs employing 1, 050 320 people and generating an income of around 326 billion Malawi Kwacha (MK) (Note 2), (Finmark Trust, 2012). These statistics suggest that the MSME sector plays a crucial role in the Malawian economy. Besides supporting the economy through creating employment opportunities, the sector also plays a key role in improving people's livelihoods (Sub-Saharan Consulting Group, 2012).

Given their widespread presence and contribution to the economy, MSMEs are regarded as one of the drivers of sustainable economic development in Malawi. MSMEs present a potential base for economic growth and

poverty reduction. Therefore, the development of the sector and the systems that impinge upon it emerge as a key factor in poverty reduction efforts in the country.

However, realization of this potential, is profoundly dependent on the development of the MSMEs themselves, which is dependent on several factors. Key among these factors is their financial performance. Theoretically, holding other factors constant, improving MSMEs' financial performance is anticipated to guarantee improved returns from the businesses and hence translating into improved livelihoods for business owners. On the other hand, improving financial performance of MSMEs relies on other factors as well among them access to microcredit. Growing a business requires more funds for, among other things, working capital, facilities, equipment and operating expenses. Internally generated funds are usually insufficient to support these needs. Hence, availability and accessibility of microcredit is key to business growth and improved financial performance (Churchill & Mullins, 2001).

2. Material Studied

2.1 Microfinance and Microcredit Delivery in Malawi

The microfinance industry in Malawi is still relatively small but actively involved in providing for the financial needs of the poor in both rural and peri-urban areas (Chirwa & Mvula, 2014). The industry is characterized by various types of institutions including: savings and credit cooperatives, government-run programs, non-profit making non-governmental organizations (NGOs), private moneylenders, banks, and cooperatives. In addition, other institutions operate local microcredit programs supporting both farm and non-farm business activities. This entails that microfinance supply in Malawi is a mixture of agricultural and non-agricultural credit.

The proliferation of microfinance institutions in the country has expanded access of microfinance services. However, despite the increase in the number of microfinance institutions, the proportion of adults utilizing products and services from these microfinance institutions remain low (Chirwa & Mvula, 2014). Lack of financial services remains a primary constraint in the expansion of MSMEs in Malawi. This is collaborated by United Nations (2010) who reported that expansion in outreach of microfinance services has not been commensurate with the growth that MFIs have achieved in outstanding loan portfolio and assets. For instance, gross loans and advances, for Malawian MFIs in 2014, accounted for only 52.2 percent of total assets because microfinance institutions were still cutting back on lending due to loan repayment collection problems. Nevertheless, in the year 2014, microfinance institutions served 854,172 clients (Reserve Bank of Malawi, 2015).

Generally, credit delivery in the country has been characterized by high default rates regardless of type of clientele (Chirwa, 2002). Simtowe and Phiri (2006) also reported that high default rates, among the low-income credit clientele, is one of the main constraints hindering the development of a sustainable microfinance industry in Malawi. In a bid to address this problem, the microfinance industry in Malawi adopted the tenets of the Grameen Bank and hence follow the group-based lending approach. Microfinance institutions use peer character reference and peer monitoring to secure the loans extended to group members, through the concept of joint liability for loans contracted by group members. The joint liability is used as a substitute for physical collateral. This approach works through exploiting social sanction opportunities among borrowers, and the fear of denial of future credit to the group. Access to credit is made difficult for the resource poor in formal financial institutions because of the high collateral requirement, such as marketable assets, which many poor people do not possess (Simtowe & Phiri, 2006).

2.2 The Role of Microcredit on Micro and Small Agribusinesses in LDCs

Nearly all the economies of LDCs depend on agriculture, as their single essential and strategic industry (Pennisi, 2012). Through its different micro and small agribusinesses, the industry makes a significant contribution to the: rate of economic growth, level of employment, demand for other goods, economic stability and food security and, overall, poverty reduction. Alike other MSMEs, the development of micro and small agribusinesses is dependent on availability of microcredit. Improved availability and accessibility of microcredit is anticipated to play a crucial role in the development of these enterprises in developing countries. Theoretically, microfinance is anticipated to aid micro and small agribusinesses in a number of ways.

Microcredit is anticipated to open up new sources of funds thus changing the investment behavior of the MSMEs in a number of ways. Kessy (2009) noted that improved access to microcredit enables micro-business owners to invest in capital intensive technologies and develop their enterprises. Microcredit alleviates financing constraints for micro and small agribusinesses making them more efficient and able to acquire the appropriate inputs for investment.

By extension, microcredit reduces the opportunity cost associated with capital-intensive assets relative to family labor. With improved access to credit, micro agribusinesses are enabled to acquire and engage more capital intensive technologies in their production rather than relying on family labor. Thus, access to financial services encourages employment of labor-saving technologies consequently raising labor productivity (Kromann, Skaksen, & Sørensen, 2011). In addition, employment of such technologies could potentially play a crucial role in adding value to agricultural production that would enable micro agribusiness firms in LDCs to compete with large firms in developed countries.

Finally, microfinance credit reduces pressure on micro and small scale agribusinesses to support household consumption (Simtowe & Phiri, 2006). Microcredit sourced from microfinance institutions can be used directly to finance immediate consumption needs of the households in lean periods of food scarcity. The households may stabilize their consumption in bad states of nature by adjusting their disposable income or liquidity through borrowing. This frees up pressure on the micro and small agribusinesses to provide support in such lean periods, and hence indirectly enhancing growth of the businesses *ceteris paribus*.

Nevertheless, it is imperative to note that the positive link between access to microfinance services, especially microcredit, and new investments is dependent on the profitability of the projects that are financed by the credit. In addition, the positive relationship depends on the ability of those investments to generate direct and indirect employment and sales levels that would justify such investments.

Malawi's development drive is currently being guided by its medium term overarching development strategy, the Malawi Growth and Development Strategy II (MGDS II). The emphasis of this strategy is pursuing of an export led growth with multi-sectoral major investments in strategic sectors key among them, the agriculture sector (Government of Malawi, 2011). Under this strategy, the country's economic growth is driven by agro-processing leading to value added products that can compete and earn a valuable share of the international market. Thus, micro and small agribusinesses involved in agro-processing are key to the economic growth of the country. Given this status quo, this study focused on cooking oil processing small scale agribusinesses.

3. Area Descriptions, Methods and Techniques

The study adopted a mixed research approach, where both qualitative and quantitative data was collected for three case studies. In identifying the three case studies, this study adopted the multi-stage sampling technique used by Finmark Trust (2012) that included a listing phase. At the time of data collection, there were 4 businesses that were involved in groundnut cooking oil production in central Malawi, at small scale. From this population, the study purposively selected 3 businesses that constituted the sample for the study. This selection represented 75 percent of the eligible population and according to Krejcie and Morgan (1970), this sample was regarded to be large and representative enough based on the population of the sampling frame that was available for the study. The 3 small scale businesses that were sampled included; Kamwendo and Mthiramsembe small scale cooking oil producers from Mchinji district and Khama Lipindula small scale cooking oil producers from Kasungu district. These businesses were selected on the basis of their locality relative to the comparative advantage that these districts have in groundnut production.

Sampling also took into consideration the state of financial leverage in the businesses in the period under study. Kamwendo and Mthiramsembe had acquired a microcredit while Khama Lipindula had not acquired any microcredit in the period under study.

Estimating financial performance entailed conducting an in depth evaluation of the businesses understudy. The evaluation went beyond determining the profitability of the businesses to accommodate analyses that aimed at determining efficiency in business operations. The DuPont identity was used to carry out this detailed evaluation. According to Hadley (2012), the DuPont identity provides a means to fairly quickly and easily assess where the business strengths and weaknesses potentially lie. Eventually, this analysis assisted the study to isolate the effects of microcredit on the financial performance of the sampled businesses. Throughout this analysis, the study compared the findings for the two businesses that acquired microcredit to the one that did not.

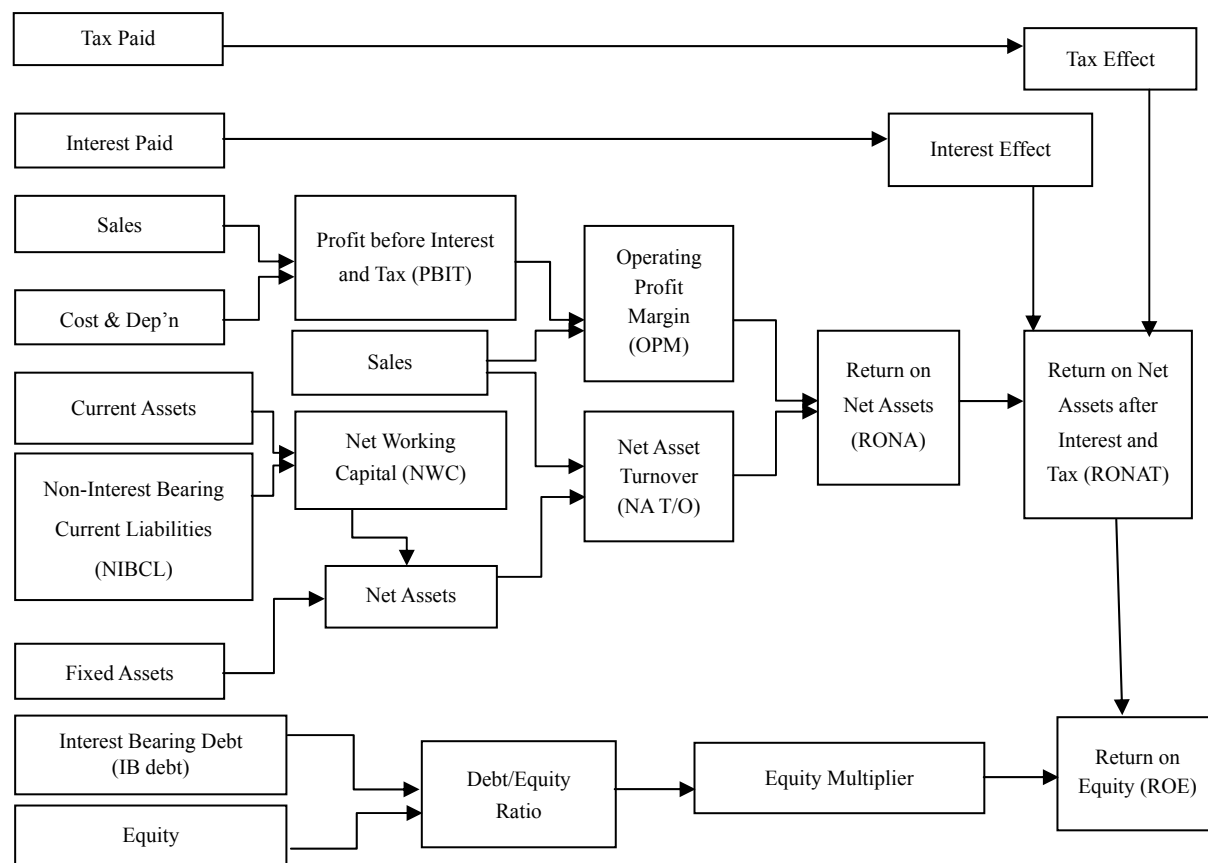


Figure 1. The DuPont Identity framework

Source: Isidore, Norsiah, and Razack (2010).

Figure 1 above shows the DuPont Identity framework outlining the stages and components of a DuPont analysis. Applying the DuPont identity encompasses financial ratio analysis. In order to draw meaningful interpretations and conclusions from financial ratio analysis two approaches can be used. First comparing the trends, over time, of the commensurate ratios that have been used in the analysis. Second, or compare the appropriate ratios generated from the analysis to other universally acceptable benchmarks that are applicable for that particular industry (Melicher, 2006). These conclusions can also be drawn by comparing the ratios to similar ratios of other businesses within the same industry. Due to poor record keeping associated with all the sampled businesses, the study could not generate the relevant ratios for the preceding years, in order to compare the trends. To determine the level of financial performance, therefore, the study compared the ratios with other universally acceptable ratio benchmarks and among the sampled businesses.

The study adopted and used the universally accepted Farm Financial Standards Council (FFSC) benchmarks. The FFSC benchmarks were chosen considering that the businesses under study were agricultural related businesses and that these benchmarks are universally acceptable. Table 1 below illustrates the FFSC benchmarks for selected ratios that were key in the application of the DuPont identity. The benchmarks classify the business' level of financial performance as strong, stable and weak implying good, average and poor performance respectively.

Table 1. The farm financial standards council ratio benchmarks

Type of Ratio	Strong	Stable	Weak
Debt-Equity Ratio	< 42%	42% to 230%	> 230%
Operating Profit Margin Ratio	> 25%	10% to 25%	< 10%
RONA	> 5%	1% to 5%	< 1%
Asset turnover Ratio	Depends heavily on type of operation and whether it is owned or leased		
ROE	Look at trends and compare to other farm and non-farm investments		

Source: The Farm Financial Standards Council (1997).

4. Results and Discussion

After conducting the DuPont analysis, the study isolated the relevant ratios from the analysis for each of the sampled businesses. These ratios constituted the major findings and they are duly presented in Table 2 below.

Table 2. DuPont ratios for cooking oil producers

Type of Ratio	Kamwendo	Mthiransembe	Khama Lipindula
ROE	100.81	45.83	82.83
OPM	67.65	53.70	46.03
NAU	1.31	0.45	1.80
RONA	88.72	24.02	82.83
IE	0.90	0.97	1.00
TE	1.00	1.00	1.00
RONAT	79.87	23.42	82.83
D/E R	0.26	0.96	0.00
EM	1.26	1.96	1.00

Source: Author's survey (2013).

The results in Table 2 above show that Kamwendo had the highest level of ROE at 100.81 percent followed by Khama Lipindula at 82.83 percent and Mthiransembe at 45.83 percent. The positive levels of ROE for all businesses suggested that all the three businesses were profitable. This demonstrates good financial performance for all the three businesses and suggests that the businesses are financially strong. The results agree with Fuhrmann (2014) who reported that a ROE level above 10 percent for most businesses is deemed strong and manages to cover the cost of capital for the business. Bearing in mind that two of the three businesses had acquired a microcredit, the results indicate that microcredit did not have a direct effect on the profitability of small scale businesses. This may have resulted owing to the timing that the two businesses had acquired the credit and their associated investments. Worth noting, the microcredit that was acquired by the two businesses was invested in machinery for cooking oil production in the year preceding this study hence the time may have been short to warrant any tangible profitability effect on the businesses.

The findings imply that Kamwendo generated MK100.81 in return for every MK100.00 worth of equity invested in the business. On the other hand, Khama Lipindula and Mthiransembe yielded MK82.83 and MK45.83 respectively for a similar level of investment of equity. By generating positive and relatively high levels of ROE, all the businesses showed good levels of financial performance. However, this revelation was not enough for the purposes of this study. As Lan (2012a) pointed out, the ROE, alone, falls short of indicating the factors that are helping or hurting a business' performance. Therefore, the study analyzed the results further to determine the sections of the businesses that contributed to these levels of ROE.

Beginning with the Operating Profit Margin (OPM), the findings show that the OPM levels for Kamwendo, Mthiransembe and Khama Lipindula stood at; 67.65 percent, 53.70 percent and 46.03 percent respectively. The businesses were able to manage their operating expenses relatively well, to generate profitable sales. Again, the

findings suggest that Kamwendo was good at managing its operating expenses as it spent only MK32.35 in operating expenses in order to generate MK100.00 worth of sales. Thus, the business yielded an operating profit of MK67.65 from every MK100.00 worth of sales. Similarly, Mthiransembe and Khama Lipindula made MK53.70 and MK46.03 operating profit on every MK100.00 worth of sales that each of the two businesses made. The results indicate that, Mthiransembe and Khama Lipindula incurred more operational costs as opposed to Kamwendo. The findings indicate that Khama Lipindula earned less than half of their sales as operating profit. This may be attributed to its low levels of capital investments resulting from the inactivity in microcredit acquisition. This agrees with Lan (2012a) who reported that firms that are more capital intensive sustain higher profit margins.

In terms of the FFSC benchmarks, however, the OPM levels for all the three businesses suggest that they were all strong at managing their operational costs as they generated their sales. With their OPM levels surpassing the 25 percent benchmark, all the three businesses would be classified as strong businesses (The Farm Financial Standards Council, 1997).

Net asset utilization ratio shows how best a business is using its assets to generate sales. The findings in Table 2 above show that Kamwendo, Mthiransembe and Khama Lipindula had net asset turnovers of 1.31, 0.45 and 1.80 respectively. This implies that every MK1.00 worth of net asset for Kamwendo generated MK1.31 worth of sales. Similarly, every Malawi kwacha invested in net assets generated MK0.45 sales for Mthiransembe and MK1.80 sales for Khama Lipindula. For Kamwendo and Khama Lipindula, the results showed good performance in asset utilization whilst the performance of Mthiransembe in asset utilization was poor. Generating an amount of sales that was less than the amount invested in net assets suggested that Mthiransembe was not using its assets to their full potential resulting in low production and consequently poor asset utilization ratio. This agrees with Lan (2012b) who reported that a low asset turnover may imply that a business is inefficient in its use of its assets. Poor asset utilization by Mthiransembe could be attributed to their acquisition of additional capital goods as a result of acquiring a microcredit.

Financial performance of the three businesses in asset utilization was reflected in their levels of RONA. The RONA levels for Kamwendo and Khama Lipindula were higher than their respective preceding levels of OPM. The RONA for Mthiransembe, on the other hand, was lower than its preceding OPM due to their poor asset utilization. Efficiency in net asset utilization by Kamwendo resulted in an increase in its level of OPM from 67.75 percent to a RONA of 88.72 percent. This means that the business was really using its assets efficiently such that 88.72 percent of the total profit before interest and tax realized by the business was contributed by the net assets owned by the business.

The RONA for Khama Lipindula was also responsive to the efficiency in asset utilization. Due to efficient use of its net assets, the OPM for Khama Lipindula improved from an OPM of 46.03 to a RONA of 82.83 percent. This implied that 82.83 percent of the profit before interest and tax that was realized by the business was contributed by net assets. Clearly, this shows that the bulk of the profit before interest and tax that was realized by Khama Lipindula, was contributed by the net assets owned by the business. These findings confirmed the fact that net asset utilization was a point of strength for Khama Lipindula cooperative.

On the other hand, the inefficiencies in asset utilization by Mthiransembe became more evident in the level of RONA that was realized by the business. This concurs with Ross, Westerfield and Jordan (2010), who reported that weaknesses in asset use efficiency shows up in a diminished RONA, and hence translates into a lower ROE. The results show that poor asset utilization by the business heavily undermined the efforts that the business made in containing its operating costs. Earlier, the results indicated that Mthiransembe did well to manage its operating costs as it yielded MK53.70 profit before interest and tax. Nevertheless, inefficiencies in asset utilization compromised that strength by reducing the contribution that net assets made in generating a return on net assets. With a RONA of 24.02 percent, it meant that the net assets owned by Mthiransembe contributed MK24.02 for every MK100.00 worth of profit before interest and tax that was generated by the business. This suggested underutilization of assets on the part of Mthiransembe hence a weak point to the business. The inefficiencies in net asset utilization by Mthiransembe were attributed to the increased levels of capital base that the business had. The business reported to have used part of the credit that they acquired to purchase pressing machines and sieves. This increased the levels of capital base for the business. Thus, as Lan (2012b) reported, the management of the business made a strategic decision to venture into more capital intensive led production, which resulted in low asset utilization levels. However, the business had not yet improved its productivity despite the improvement in asset base. The business had not yet fully commissioned the pressing machine due to poor technical knowledge of operating the machine. However, this revelation shows that credit alleviated the financing constraints of the businesses.

Further to that, the findings for the two businesses that had acquired microcredit suggest relatively huge discrepancies between their levels of RONA and ROE compared to the business that did not. Kamwendo had a ROE of 100.81 percent and a RONA of 88.72 percent while Mthiransembe had a ROE of 45.83 percent and a RONA of 24.02 percent. On the other hand, Khama Lipindula had a ROE of 82.83 percent and a RONA of 82.83 percent. The discrepancies in the two businesses could be attributed to the fact that they had acquired microcredits. According to Lan (2012b), businesses that incorporate some debt tend to have large discrepancies between the ROE and RONA. In this case, therefore, as Lan (2012b) pointed out, the two businesses would be prudent enough if only they can closely examine their liquidity and solvency ratios.

The levels of RONA for all the three businesses were well over the 5 percent FFSC benchmark. This meant that all the three businesses could be classified as strong businesses based on the RONA based on the FFSC benchmarks. It follows that the businesses were able to generate a positive return on their net assets and that was deemed as good financial performance. Thus, despite the negative effect resulting from inefficiencies in net asset utilization, Mthiransembe was still classified as a strong business owing to their RONA that was above 5 percent.

The results in Table 2 above indicate that Kamwendo and Mthiransembe paid interest only, while Khama Lipindula paid neither interests nor taxes in the period under study. The payments for the interests on the credit obtained by the two businesses eroded the respective RONA for their businesses. The results suggest that none payment of tax by the three businesses did not have a deductibility effect on their RONA. Even though Kamwendo did not pay any taxes, payment of interest alone had an adverse effect on the business. This payment brought about a 0.90 reduction effect which reduced the RONA from 88.72 percent to a RONAT of 79.87 percent. Thus, the interest that was paid effectively reduced the return that the business realized from its net assets. Instead of contributing MK88.72 to every MK100.00 worth of profit after interest and tax, the net assets for Kamwendo contributed a lower value of MK79.87 due to the interest effect. On another note, the findings indicate that interest payments burdened the business with interest payments thus obliging it to cope up with such payments. In the event that Kamwendo were to fail to pay these interest payments, the businesses would be forced into bankruptcy. This agrees with Lan (2012a) who reported that businesses which are burdened with interest payments risk failing to service their debts and may be forced into bankruptcy.

Similarly, Mthiransembe did not pay any taxes in the period under study. However, the business paid interests that resulted in an interest effect of 0.97. This interest effect rendered a weak point to the business as it reduced the contribution that net assets made to the profit after interest and tax realized by the business. Due to interest payment, net assets for Mthiransembe ended up contributing only MK23.42 to every MK100.00 worth of profit after interest and tax. Otherwise, the net assets would have contributed MK24.02 to each MK100.00 worth of profit after interest and tax, had there been no interest and tax payments.

Nevertheless, the RONAT reductions suffered by the businesses as a direct effect of interest payments were not severe relative to the amount of interest they were paying. The study established that the businesses acquired the microcredit at reasonably low cost translating into low interest payments. Thus, much as these interest payments reduced RONA levels, they were not alarm causing reductions owing to the low cost of the microcredit that they acquired.

Khama Lipindula paid neither interests nor taxes. This maintained the level of contribution that net assets made to the profit before and after interest and tax. Therefore, net assets contributed about MK82.83 to every MK100.00 worth of profit after interest and tax that Khama Lipindula realized. By not acquiring a credit, Khama Lipindula had a point of strength since it did not have any negative effect on the level of RONAT.

Further, the capital structures of each of the three businesses revealed that Kamwendo and Mthiransembe had long term debts while Khama Lipindula did not have a long term debt. In terms of debt-equity ratio, therefore, Kamwendo had a ratio of 0.26 while Mthiransembe had a ratio of 0.96. Khama Lipindula had a 0.00 debt-equity ratio since it did not have any long term credit.

The debt-equity ratios for Kamwendo and Mthiransembe meant that the capital structures of the two businesses were made up of 26 percent and 96 percent debt respectively. At 26 percent, the debt-equity ratio for Kamwendo was under the 42 percent benchmark set by the FFSC. As such, Kamwendo could be classified as a strong business based on FFSC benchmarks. These findings suggested lower levels of borrowing on the part of Kamwendo relative to Mthiransembe thereby making the business more attractive to future money lenders. Thus, the low ratio provided Kamwendo with wider flexibility for future borrowing as it would easily take advantage of upcoming borrowing opportunities as and when they arise. The results on capital structure for Kamwendo signify that the business had a point of strength in terms of leveraging. In addition to that, the low ratio resulted into a lower rate of equity multiplier which, in turn, provided room for business operations to make significant

contributions to the ROE as opposed to debt.

The debt-equity ratio for Mthiransembe fell between 42 percent and 230 percent FFSC benchmarks. Hence, the business was categorized as stable, based on that ratio. The capital structure for Mthiransembe, however, brought about interesting revelations about the relationship that existed between the capital structure and the ROE. Due to the high amount of debt that was at work in the business, Mthiransembe had an equity multiplier of 1.96. At this level, the equity multiplier almost doubled the RONAT for the business. This meant that about half of the ROE for the business was contributed by the debt. This concurred with Ross, Westerfield, and Jordan (2010), who reported that the ROE of a business could be leveraged up by increasing the amount of debt in the business. It further agrees with the capital structure theory which suggests that use of relatively high debt levels increases the cost of financial distress for businesses. This was not a healthy financial situation as it made the business to be deemed as a more risky venture for investment especially to future money lenders. As a result, leveraging for Mthiransembe was still regarded as weak point even though the business was classified as stable based on the FFSC benchmarks.

On the other hand, Khama Lipindula had a debt-equity ratio of 0.00. This meant that the business did not have any long term debt, as expected. That is, the business was wholly financed using owner's equity. At 0.00, the debt-equity ratio for Khama Lipindula fell in the strong business category as classified by the FFSC benchmarks. Accordingly, the low debt-equity ratio resulted in an equity multiplier of 1.00 which had no meaningful effect on the levels of RONAT and ROE of the business. The capital structure for Khama Lipindula ensured that the ROE for the business was wholly contributed by the business operations as opposed to debt. In essence, the business was more attractive to potential money lenders as it was at a very low risk of default. Hence, Khama Lipindula was regarded as a strong business in terms of leveraging. From these findings, the study found that credit affected default prediction and consequently affected the attractiveness of a business to future money lenders.

5. Conclusions and Recommendations

5.1 Conclusions

The findings suggest that all the sampled businesses exhibited good financial performance, evidenced by the recorded positive ROE. This implies that the businesses were profitable albeit at different degrees.

The findings show that microcredit enhanced the financial performance of the MSMEs, owing to the fact that it increased the capital base for the businesses thus meeting one of the key success factors of the businesses in that regard. Through increased capital base, the results further confirm the positive effects of microcredit towards enhancing production efficiency of the businesses. In addition, the results indicate that microcredit positively contributed to the financial performance of these businesses by enhancing the competitiveness of these business hence promoting market share acquisition by the businesses.

However, it was also noted that acquisition of the credit itself came with a cost which diminished the RONA. Nevertheless, this effect was negligible owing to the low cost of capital that the project supported microcredit is associated with. In addition, acquisition of microcredit increased the debt-equity ratio for the businesses thus compromising the creditworthiness of the relevant business in the long run. This implied that excessive use of microcredit would increase the risk of financial distress on the businesses.

5.2 Recommendations

- 1) Kamwendo was found to be operating well. However, they could improve their financial performance further by increasing their net assets turnover. Kamwendo could achieve this by reducing their net assets through a reduction of their net working capital. This could be achieved if the business avoided tying up their cash in the business for instance through bloated inventories and cash at bank.
- 2) Mthiransembe would also improve their financial performance if they improve their net assets turnover. This could be achieved through either increased sales and/or reducing the value of net assets. In order to increase sales, Mthiransembe needs to improve their production levels and find alternative markets for their products. On the other hand, the business could reduce the value of their net assets by reducing the value of their working capital. This can be done by freeing up some of their cash that is held up in their current assets.
- 3) Khama Lipindula was operating profitably even without acquiring a microcredit. For the business to improve their business performance further, however, they need to improve their efficiency levels in production. The businesses need to reduce their cost of production which would result in higher operation profit margins hence improve their ROE.

4) As far as it is realistic to do so, small and medium scale businesses need to contract microcredit in order to improve their financial performance. However, the businesses need to be adequately prudent to avoid excessive borrowing that may subject them to unprecedented financial distress.

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Notes

Note 1. NSO (2012b) reported that 78.6 percent of the Malawian population is involved in subsistence farming, 8.5 percent in family and individual businesses and 4.9 percent are self-employed.

Note 2. Around US\$432 million at the exchange rate of MK755 per US\$1 as of 10 February, 2016.

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