

Institutional Practices of Microfinance Institutions and Their Contribution to MSME Development in North Macedonia. A Qualitative Approach

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ABSTRACT: In North Macedonia, micro, small and medium enterprises (MSMEs) represent a fundamental pillar of the local economy. Nevertheless, they continue to face various challenges, in particular the challenges of access to formal finance. According to the accessed empirical literature, this happens mainly due to information asymmetry, limited collateral, informality and unequal financial capacity, which excludes these enterprises from the possibility of accessing formal finance. In this context, microfinance institutions appear as intermediaries by providing financial services to underserved enterprises, through alternative institutional practices. This study explores how microfinance institutions (MFIs) in North Macedonia operationalize access to finance for MSMEs through alternative institutional practices. Using a qualitative research approach, the paper draws on two in-depth institutional interviews with MFIs (Horizonti and FULM), complemented by an analytical review of the relevant academic literature. The findings show that MFIs promote financial inclusion, especially among women and rural entrepreneurs, through alternative screening mechanisms, relationship-based lending, flexible guarantees and ongoing non-financial support. However, the developmental contribution of MFIs remains constrained by regulatory fragmentation and limited access to long-term refinancing. By shifting analytical attention from outcomes to institutional practices, this paper contributes qualitative evidence on how microfinance operates in practice in North Macedonia as a part within a Western Balkan transition economy.

KEYWORDS - access to finance, financial inclusion, institutional practices, microfinance, MSMEs, North Macedonia

I. Introduction

The importance of small and medium-sized enterprises is manifold. They play a crucial role in job creation, entrepreneurship development and income generation in North Macedonia [1]. Despite their economic importance, these enterprises face numerous financial constraints that pose significant obstacles to their growth and competitiveness [2] [3] [4]. In North Macedonia, micro and small enterprises continue to face exclusion from formal bank credit, as commercial banks apply restrictive lending criteria, particularly collateral requirements and formal financial documentation, before approving loans [5].

As a result of this exclusion, alternative forms of financial service provision to these groups of enterprises emerged. Microfinance institutions offered alternative financing models that addressed funding gaps by providing smaller loans, employing non-traditional screening mechanisms, and maintaining close, direct engagement with

clients [6][7]. The topic of financial inclusion, financial literacy and sustainability has been discussed and elaborated in many papers, there is little evidence of the functioning at the institutional level of MFIs in practice and the practice of providing alternative methods that expand access to finance for underserved enterprises.

Therefore, this study contributes to the literature by providing qualitative evidence at the institutional level on the practices of microfinance institutions, focusing on the alternative mechanisms with which small and medium-sized enterprises are served, in a transition economy such as North Macedonia. This study addresses the following research questions:

1. How do microfinance institutions design and implement institutional practices to extend access to finance for MSMEs underserved by the banking sector?
2. Which institutional practices distinguish MFIs from banks and other non-bank lenders?
3. How do MFIs perceive their contribution to MSME growth, resilience, and financial inclusion?

II. Literature Review and Analytical Framework

2.1 Microfinance: Definition and Regulatory Context in North Macedonia

In North Macedonia, there is a lack of regulatory framework for microfinance services. The lack of a law that would regulate the work of microfinance institutions constitutes a challenge in itself for this form of financial services. Therefore, these services are usually provided by institutions established as foundations or savings houses. This regulatory fragmentation that stems from the lack of a law on microfinance has been evidenced in other works [6][7] but is also confirmed through interviews conducted with representatives of the institutions for the purposes of this research.

Taking into analysis the two institutions that formed the basis of this research, we see the following observations. Horizonti acts as a foundation and consequently, the law prohibits it from collecting deposits. Its lending activity is enabled through funds borrowed from domestic and international sources, which in fact, may cause problems and challenges in the long term. On the other hand, FULM, operates in North Macedonia as a savings house, therefore, in that aspect, the law allows it to provide deposit services in addition to loans. This also means that the institution has additional obligations for capital adequacy and supervisory requirements.

The lack of legal aspects causes institutional asymmetries that directly affect the operating models, funding structures and outreach capacities. Consequently, microfinance in North Macedonia cannot be defined under a simple legal prism, therefore, a more useful approach would be to define it as a set of institutional practices that aim to provide financial services to underserved enterprises.

2.2 Access to finance and MSME constraints

MSMEs face obstacles in obtaining formal loans. According to the used literature, we find that some of the most frequent obstacles are in the form of information asymmetry, insufficient collateral, and firm informality [2] [8]. In this context, we find the credit rationing theory, created by the authors Stiglitz and Weiss [9], as very relevant to the described situation. According to this theory, enterprises may be rejected for continuous applications for loans even in conditions when they are capable and have the opportunity to pay those loans with high interest rates. This happens when borrower risk is difficult to assess and banks may limit their offer so as to reduce the risk of adverse selection and moral hazard.

In North Macedonia, we have a similar situation, as many micro and small enterprises may be excluded from bank loans due to the lack of formal financial statements in the appropriate forms, as well as the lack of adequate collateral [5]. Therefore, these enterprises, not having many sustainable alternatives, often decide to obtain finance from informal sources, which in fact, may undermine their investment capacities in the long term [10].

2.3 Microfinance as an Institutional Response

Microfinance institutions began their activities by providing a missing intermediary for entrepreneurs who had problems with formal credit. They provide financial services to groups in need, mainly based on alternative work mechanisms, including relationship-based lending, progressive credit cycles, flexible guarantees and close monitoring [11].

The positive effects for MSMEs are arguable and distinct. The contributions of microfinance are mainly observed in the support they provide towards improving liquidity and working capital for enterprises, although these effects differ depending on the program applied by the respective institutions [12][13]. In North Macedonia, the social contribution of microfinance is present. Mainly, the orientation of these programs towards support for underserved groups, including women and rural entrepreneurs, is present and actual [6][7].

Therefore, this study aims to fill a gap in the research on the effects of microfinance, from an institutional level, including internal institutional practices.

2.4 Analytical Framework

This study consists of an analytical framework that aims to elaborate on institutional practices related to access to finance, exploring their approach to clients in a developing economy such as North Macedonia. This analytical framework is composed of 3 main elements:

1. **Access to finance mechanisms**, which examines the mechanisms with which these institutions work, such as alternative screening methods, flexible guarantees, simplified procedures;
2. **Institutional differentiation**, which examines the differences of these institutions with commercial banks and providers of so-called fast loans providers;
3. **Perceived development contribution**, which examines the effects of microfinance on entrepreneurship development, MSME sustainability and the improvement of financial inclusion in existing conditions.

III. Methodology

This study employs a qualitative research design based on institutional analysis of the interviewed institutions. Primary data are obtained through in-depth interviews conducted with senior representatives of two microfinance institutions operating in North Macedonia: Horizonti and FULM.

These institutions were selected with a purposive sampling strategy that aimed to find differences among institutional models in the field of microfinance in the country. The two institutions have legal working differences with different institutional practices. While the number is limited, this research prioritizes in-depth analytical analysis, which goes in line with qualitative institutional research.

Interview themes consisted of institutional mission, target groups, lending practices, non-financial support as well as perceived impacts and effects on entrepreneurship. The data were analyzed based on thematic analysis in accordance with the analytical framework and the findings were interpreted in conjunction with existing academic literature.

IV. Findings and Discussion

4.1 Extending Access to Finance (RQ1)

The data from the conducted interviews show that both institutions contribute to expanding access to finance through their relationship-based practices with clients and field-oriented lending practices. Thus, Horizonti, through continuous and direct contact with the client is close to his entrepreneurial activities, therefore, they are able to make direct verifications of repayment capacities in addition to the necessary documentation that is part

of the review. FULM, on the other part, applies more simplified procedures and evaluates cash flows by not relying only on the financial statements.

These alternative screening mechanisms significantly reduce the documentation barriers, as well as directly enable more favorable financing for micro and family businesses that have been excluded from the formal bank lending.

4.2 Institutional Differentiation (RQ2)

Regarding the differentiation and differences that microfinance institutions have with commercial banks and fast-credit providers, the findings are as follows. Unlike commercial banks, MFIs offer smaller loan sizes, faster and simpler procedures, flexible guarantees, and closer client and business engagement. On the other hand, they are distinguished from fast-credit providers because MFIs support productive lending oriented to business activities, examine repayment capacities more carefully, and aim to avoid borrower over-indebtedness. These goals and activities of MFIs, demonstrate their role in society and the economic and social orientation with which they work.

4.3 Perceived Contribution to MSME Development (RQ3)

Both MFIs provide data on the positive effects that they had on MSMEs, mainly in the areas of improved liquidity, business development, and their long-term sustainability. Horizonti supports incremental development through the cyclical loans it provides by supporting the continuous development of clients' businesses, while FULM provides data that their activity has developed increased turnover, employment, and gradual formalization of their clients. Regarding their joint role, both institutions have development programs for women-managed businesses and rural enterprises. They also support non-financial programs that help clients develop more sustainable decision-making, therefore, this is seen as a complementary risk-mitigation tool.

4.4 Constraints and Future Directions

Among the key constraints identified are informality, restricted access to refinancing, and a fragmented regulatory framework. The lack of a law on microfinance undermines institutional sustainability and limits the opportunities for these institutions to further develop. Looking ahead, MFIs point to green finance, energy efficiency, and sustainable agriculture as key areas of focus.

V. Conclusion

This study demonstrates that MFIs in North Macedonia contribute to MSME development primarily through institutional practices that address structural barriers to finance. Relationship-based lending, alternative screening mechanisms, flexible guarantees, and non-financial support enable MFIs to extend access to finance, promote inclusion, and support enterprise stability.

The findings suggest that microfinance functions more effectively as a stabilisation and inclusion mechanism than as a rapid growth engine, particularly in environments characterised by informality and regulatory uncertainty. From a policy perspective, the results highlight the need for a coherent regulatory framework that recognises microfinance as a distinct segment of the financial system. Clear legal definitions, proportional supervision, and access to refinancing mechanisms could strengthen MFIs' sustainability while preserving their social mission.

Future research should triangulate institutional perspectives with borrower-level data and quantitative indicators to further assess microfinance impact.

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