Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 11-May-2020 | Report No: PIDA27272
**BASIC INFORMATION**

**A. Basic Project Data**

<table>
<thead>
<tr>
<th>Country</th>
<th>Project ID</th>
<th>Project Name</th>
<th>Parent Project ID (if any)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malawi</td>
<td>P168577</td>
<td>Financial Inclusion and Entrepreneurship Scaling Project</td>
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<tr>
<th>Region</th>
<th>Estimated Appraisal Date</th>
<th>Estimated Board Date</th>
<th>Practice Area (Lead)</th>
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<td>AFRICA</td>
<td>14-May-2020</td>
<td>09-Jul-2020</td>
<td>Finance, Competitiveness and Innovation</td>
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<table>
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<tr>
<th>Financing Instrument</th>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
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<tr>
<td>Investment Project Financing</td>
<td>The Republic of Malawi</td>
<td>Ministry of Industry, Trade and Tourism, Reserve Bank of Malawi</td>
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</table>

**Proposed Development Objective(s)**

The Project Development Objective (PDO) is to increase access to financial services, promote entrepreneurship and capabilities of MSMEs in Malawi and addressing Covid-19 implications on the private sector.

**Components**

- Liquidity Enhancement for MSMEs
- Scaling Entrepreneurship and Building Firm Capabilities
- Enhancing the Enabling Environment for Supporting the Financial Inclusion and growth of Entrepreneurs
- Project Implementation Support

**PROJECT FINANCING DATA (US$, Millions)**

**SUMMARY**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (US$ millions)</th>
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<tr>
<td>Total Project Cost</td>
<td>86.00</td>
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<td>Total Financing</td>
<td>86.00</td>
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<tr>
<td>of which IBRD/IDA</td>
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<tr>
<td>Financing Gap</td>
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**DETAILS**

World Bank Group Financing
B. Introduction and Context

Country Context

1. Malawi is a small low-income landlocked country in south-eastern Africa, with most of its people living below the poverty line and a youth bulge in need of employment. Malawi’s population stands at 17.6 million with a Gross Domestic Product (GDP) per capita of US$389.4 (2018 estimates), making it one of the poorest countries in the world. Malawi has a large youthful innovative and enterprising population which sets the scene for a spurt in private sector growth if adequately supported. Only 14 percent of the Malawian labor force holds wage employment (39 percent in urban areas), so that most of its labor force is highly vulnerable to shocks and hold limited safety nets. While the agriculture sector has traditionally been the mainstay of the economy (contributing 80 percent of total export earnings and 85 percent of total employment), the services sector contribution to GDP has been accelerating rapidly.

2. The country’s stable macroeconomic indicators in recent years are set to be disrupted by the Covid-19 global pandemic. The good economic performance in 2019 was expected to continue in 2020, however, due to Covid-19’s potential impact, real GDP growth estimate for 2020 has been revised downwards from the 5.5 percent estimated in February 2020 to a current estimate of 1.9 percent. This implies that the coronavirus is expected to erase the equivalent of 3.6 percent of 2020 output that would have been attained without it. The real GDP growth projection for 2021 has also been revised downwards to 4.5 percent from 5.8 percent as reported in February 2020. The FY2019/20 fiscal deficit is expected to be around 6.5 percent of GDP, almost double the approved budget. Revenues are expected to perform below targets as business activities slow down, while expenditures will come to be under pressure due to Covid-19 response, expected higher wage payments, and election costs.

3. The Covid-19 outbreak poses considerable downside risks for the economy and, in an adverse scenario, could lead to a recession this year. A reduction in global demand and supply chain bottlenecks could further slow and reduce demand for Malawi’s exports, slow imports and raise their cost, and reduce public and private investment. The Government is projecting a decline in domestic revenue by 0.9 percent of GDP due to the expected general economic slowdown, coupled with increased spending of about 0.4 percent of GDP for Covid-19 preparedness. If the virus spreads extensively in Malawi and aversion behavior increases and/or market and trading restrictions are imposed, it could severely reduce trade and business activity, particularly in urban areas and for the informal sector.

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1 The country has a total land area estimated at 118,484 square kilometers, 20 percent of which is occupied by a lake.
Transport; tourism; accommodation and food services; wholesale and retail trading; and manufacturing sectors are the most hard-hit sectors of the economy due to the Covid-19 crisis. The Government has declared a state of disaster and proposed measures seeking support from donors and development finance institutions and organizations. In March 2020, the President declared the outbreak a national disaster, and announced basic social distancing and protection measures to stop the spread of the virus. In April, the President announced additional measures mostly aimed at cushioning the financial sector and the private sector, including: a moratorium on interest and principal repayment of loans by MSMEs, the restructuring of all existing loans, and setting up an emergency liquidity assistance framework to support banks when liquidity weakens. These measures have an implication on an already constrained financial position.

Sectoral and Institutional Context

4. **Malawi’s private sector is mostly informal with a few largescale companies capturing most economic opportunities.** Broad-basing growth to a larger set of firms has been a challenge. Micro small and medium enterprises (MSMEs)\(^3\) have low capacity and are primarily concentrated in the services sector. Sourcing capital is the leading challenge faced by the MSMEs sector across business life cycles from start-up to mature enterprises. Low levels of business and financial management skills affect the operations of the MSMEs and impacts their ability to access finance. Low awareness and knowledge constrain formalization and compliance. Most women and youth-led entrepreneurs are not aware of the process or the importance of formalizing, which is expected given that they mainly operate as a micro and small business.

5. **Micro small and medium enterprises (MSMEs) in Malawi face numerous challenges that constrain their ability to contribute to economic growth and yet they will need to play a significant role in helping the economy recover from the potential Covid-19 induced recession.** Access to finance is a key constraint for MSMEs. Only 10 percent of medium enterprises, 5 percent of small enterprises and 3 percent of micro enterprises have credit from a commercial bank. Part of this relates to the lack of capacity in financial institutions, which do not do much by way of credit intermediation and financial inclusion. By some estimates, 90 percent of all loans are channeled to a handful of large corporates. Some of the demand side issues are also factors constraining access to finance. High government borrowing and high profits generated through non-lending activities crowd out bank lending to the private sector which will be further constrained by the impact of Covid-19. With the impending decrease in trade and exports due to the Covid-19 crisis, expected increase in non-performing loans (NPLs), and majority of large corporations who may call in their Lines of Credit, combined with the recent forbearance measures announced by the Government, banks’ liquidity and sustainability and hence their capacity to do any lending to MSMEs will be severely impacted.

6. **Size and broader weaknesses in financial sector capacity pose additional challenges to financial intermediation.** According to the 2018 Financial Sector Assessment Program (FSAP) the Malawi banking system suffers from a lack of critical mass, low productivity and high costs, and limited outreach and product variety to facilitate adequate financing for MSMEs. Since, most commercial banks prefer to lend to larger corporations and to government, MFIs and smaller banks which have limited deposits in the first place are further constrained by their inability to access affordable wholesale funding. Not surprisingly, the cost of credit for MSMEs remains highly unaffordable while longer-term bank financing is very limited. Collateral requirements are significantly high, at times reaching close to 300 percent of the loan amount\(^4\), further deterring borrowing by MSMEs.

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\(^3\) Based on the national MSME policy document, a micro enterprise is defined as one that has 1 to 4 employees, a turnover of up to and an asset value of up to US$1,370. A small enterprise has 5 to 20 employees, a turnover of between US$6,849 and US$68,849 and maximum assets value of US$27,397. A medium enterprise has 21 to 99 employees, turnover of between US$68,849 and US$136,986 and maximum asset value of US$342,466

\(^4\) 2014 Enterprise Survey
7. Capabilities among firms are not developed along such dimensions as attitude/mindset to skills, financial literacy, management practices, business language, market assessment, and behavioral characteristics of successful entrepreneurs that include clear goal setting, long-term involvement, and drive and energy. The majority of MSMEs (89 percent) are informal, 36 percent do not keep records, and 45 percent lack innovation and diversification (FinScope survey 2019). Even the few credible MSME business owners are often unable to present relevant evidence of their financial history to meet the requirements of banks. MSMEs have poor perception of banks, with those not banked perceiving the banks as not being interested in extending products and services to them. This is particularly a strong deterrent to women-led and youth-led businesses and first-time borrowers. Most women and youth-led entrepreneurship are said to be unaware of the process or the importance of formalizing. With limited capacities and low levels of productivity, both public and private business development services (BDS) providers are challenged to provide effective support to MSMEs and without support to properly adjust operations and delivery of services during Covid-19 most private sector BDS’s may shut down. A government sponsored BDS provider, the Small and Medium Enterprise Development Institute (SMEDI), and most of the private BDS providers require support especially during the Covid-19 crisis and post Covid-19 economic recovery.

8. Information asymmetry due to lack of appropriate technological infrastructure and awareness contributes further to the perception of high risk of MSMEs and consequently their high cost of borrowing. Malawi’s credit infrastructure supported by a revised Credit Reference Bureau Act in 2016, is not yet fully utilized by banks and their clients. While there has been progress in this area, more will be required for the bureaus to improve the quality of reports and to generate good credit scores that can help some MSMEs get lower borrowing rates. In addition, the inadequate usage of the national identification system in the financial system poses a challenge. While the collateral registry is functioning well, its usage by banks and creditors is low due to lack of awareness and training. As a result, the limited financing that goes to MSMEs is at a high-risk premium and a limited term (no more than 12 months) meaning that business expansion and investment loans are not meaningfully available – thereby constraining growth and job creation opportunities.

9. Alternative forms of financing suited to support innovative high-growth-potential firms is lacking but there is room for growth. Despite being a small proportion of MSMEs, literature shows that innovative startups and MSMEs with high-growth potential create the highest number of jobs among all MSMEs and hence are an important area of focus for governments. Malawi has a nascent market of investors in venture capital. However, a large gap in equity financing exists starting at the seed stage, acceleration, to venture capital (VC) stage, with only a few business applications receiving some form of support.

10. In the medium to longer-term, the project will support job creation and sustainable inclusive growth by contributing to the twin pillars of ‘connecting to and creating markets’ and ‘building capabilities’ under the IDA19 Jobs and Economic Transformation (JET) agenda. The project will focus on the cross-cutting issues related to finance, business regulation, and innovation, and on building capabilities of entrepreneurs and MSMEs. By facilitating MSME access to finance and markets and boosting firm productivity, and by using a ‘push’ strategy that incorporates increasing the supply of financing combined with capacity building to startups and MSMEs will provide a demonstration effect of successful MSME borrowers that would encourage financial institutions and investors to increase funding to this group over the medium to long term. This will encourage more youth and entrepreneurs to start businesses and over time create a snowball effect of increased entrepreneurship and job creation. Specific focus will be to support women business capabilities to enhance their potential to access financing.

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5 For instance, a World Bank report “Jobs for Growth” (2015, MNA) showed that it is younger firms and more productive firms that create more jobs in MENA.
C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

The Project Development Objective (PDO) is to increase access to financial services, and entrepreneurship and skills support for micro small and medium enterprises.

Key Results

11. **PDO Level Indicators Progress towards achieving the PDO will be measured through the following key results indicators:**

- Volume of MSMEs loans provided by the PFIs through the line of credit
  - Ratio of loans from PFIs to women-owned\(^6\) MSMEs (%) (Percentage)

- Volume of funds financed by MAIIC for innovative start-ups and early-stage SMEs
  - Ratio of which are women-owned enterprises (%) (Percentage)

- Volume loans to MSMEs financed from the Covid-19 emergency liquidity facility

- Number of new firms established through the project support to incubators, and accelerators
  - Ratio of which are women-owned (%) (Percentage)

- Number of MSMEs reporting improvement in capabilities
  - Ratio of which are women-owned MSMEs (%) (Percentage)

12. **In the long-term, the project is expected to contribute indirectly to the creation of a large number of jobs, due to spillover effects on the supply and value chain.** However, this is beyond the direct monitoring scope of the project. While this will have some economic impact, it will not be included as a core indicator. However, the project will track the number of jobs created directly by the project, disaggregated by gender and by age. The project will explore best practice frameworks working with experts in the Jobs Unit to determine how to measure the number of indirectly created jobs under such an operation and will monitor the results to the extent possible.

D. Project Description

13. **Activities for this project will be structured under four mutually reinforcing components:** 1) Liquidity Enhancement for MSMEs; 2) Scaling Entrepreneurship and Building Firm Capabilities; 3) Enhancing the Enabling Environment for Supporting the Financial Inclusion and growth of Entrepreneurs; and 4) Project Implementation Support. Digital innovation, skills and entrepreneurship especially for women and youth will be an underlying and cross-cutting element across the four components. The project will also provide funding to support the RBM’s Covid-19 response alongside the Emergency Liquidity Assistance Facility (ELAF).

**Component 1: Liquidity Enhancement for MSMEs (US$61.0 million)**

\(^6\) Women-owned enterprises/MSMEs in this case means the main founder owner is/are women and/or women have a majority (51% and above) in the enterprise
14. This Component aims at increasing the supply of wholesale financing to the project’s participating financial intermediaries (PFIs) and scaling lending and/or investments to MSMEs.

15. Funding will cover two main interventions organized under the following sub-components:

(i) **Credit line and technical assistance to participating financial intermediaries (US$51.0 million):** This aims at increasing the level of wholesale financing to PFIs to facilitate increased lending to traditional MSMEs in key development sectors. The credit line will be extended through the RBM to commercial banks, microfinance institutions, and SACCOs (referred to as the project’s participating financial intermediaries, or PFIs), that meet eligibility criteria for on-lending to MSMEs. Technical assistance will be provided to the RBM to complement and reinforce project implementation of the credit line; and to the PFIs to strengthen capacity to serve MSMEs to manage emerging risks such as the corona virus, and to adopt fintech approaches in order to sustain improvements beyond the period of the life of the project. This activity will create a demonstration effect for lending to the MSME sector, which currently has very low levels of access to finance. Up to US$20.0 million from this allocation will be set aside to support the RBM’s Covid-19 response alongside the Emergency Liquidity Assistance Facility (ELAF) but targeting MSMEs.

(ii) **De-risking MSME financing (US$ 10.0 million):** This subcomponent will provide support to MAIIC in form of Technical Assistance (TA) to play a key role as catalyst and mobiliser of resources and a key bridge in building partnerships between the public and private sector. Beyond this, the subcomponent will support the following: a) Equity and quasi equity financing for innovative start-ups and SMEs; and b) Strengthening ecosystem for innovative, early-stage SMEs to pilot promising new ideas.

Component 2: Scaling Entrepreneurship and Building Firm Capabilities (US$11.5 million)

17. This Component will facilitate the building of firms’ capabilities, with measures to enhance the quality of business support provided by Business Development Services (BDS) providers, using a training of trainers (TOT) approach. This Component will be delivered by competitively selected service providers (local and/or international). It is intended to enhance firms’ internal capabilities and to increase their eligibility for financing under Component 1 of the project. The support will focus on developing the capabilities of micro and small enterprises and those owned and managed by women, with this segment groups standing to benefit the most from this training.

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7 There is a potential to consider providing funding from this component to a Partial Credit Guarantee (PCG) being developed by another ongoing World Bank project, if this is determined to be feasible and in line with the PDO. Funds would be used to underwrite guarantees to PFIs for loans extended to MSMEs. This will be considered at the mid-term review of this project.
18. Funding will cover two interventions: (i) Building Firm Capability for SMEs; and (ii) Developing the Domestic Capacity of BDS providers.

(i) Building Firm Capability for SMEs: to provide training to entrepreneurs and firms, using a three-stage approach. This training will encompass the development of psychological and technical skills, followed by measures to connect trainees with market opportunities. Enhancing firms’ capabilities will be achieved using a graduated approach, with firms that show significant improvements in terms of their level of awareness and capabilities qualifying as “transformative” enterprises rather than “subsistence” enterprises and moving to the subsequent stages of the program.

(ii) Developing the Domestic Capacity of BDS providers - to sustain the provision of adequate quality BDS services beyond the life of the project. This will be complemented with TA to be provided to the SMEDI to build capacity, to support training of trainers (TOT) as well as developing training materials. The project will incorporate a certification initiative for BDS providers so that potential clients will have some signal of the quality of these providers. Training for the startups will be done separately by the incubators and accelerators that will be selected competitively, while firm capabilities training will be conducted through the BDS providers.

Component 3: Enhancing the Enabling Environment for Supporting the Financial Inclusion and growth of Entrepreneurs (US$9.0 million).

This Component builds on activities supported under the Financial Sector Technical Assistance Project (FSTAP). This Component builds on activities supported under the Financial Sector Technical Assistance Project (FSTAP). Through this component, the project will finance the implementation of the activities that will make it possible for MSMEs to access finances from financial institutions, to improve their capabilities and to grow. Specifically, this component will finance continuation of improvements of the financial infrastructure and their support systems, in order to link MSMEs in remote places to the formal financial system and be able to access financing for their enterprises and to improve usage of digital financial services. It will also support financial literacy programs as a way of improving capability of the MSMEs to formalize their enterprises, be eligible to access finance and be able to grow.

Component 4: Project Implementation Support (US$4.5 million).

19. Funds under this Component will be utilized to meet the costs of the Project Implementation Unit (PIU) in its capacity as the implementing entity, including costs related to fiduciary and safeguards aspects and monitoring and evaluation (M&E). An M&E system will be developed to monitor and track the progress of the project. The M&E activities will include updating the baseline data, based on information derived from on-going surveys. This Component will also fund a PPA/Retroactive Financing arrangement that may be required to finance studies and activities and help to develop and implement the Covid-19 responses.

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<th>Legal Operational Policies</th>
<th>Triggered?</th>
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<tr>
<td>Projects on International Waterways OP 7.50</td>
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<tr>
<td>Projects in Disputed Areas OP 7.60</td>
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Summary of Assessment of Environmental and Social Risks and Impacts

A screening of similar MSMEs under FSTAP was undertaken and it was determined that environment and social risk is low and that there is no likelihood of adverse impacts.

E. Implementation

Institutional and Implementation Arrangements

20. The borrower is the Republic of Malawi, represented by the Ministry of Finance, Economic Planning and Development (MoFEPD). The Reserve Bank of Malawi (RBM) will be responsible for the overall implementation of the project.

21. A Project Implementation Unit (PIU) has been established at the RBM to manage the project. The PIU will oversee day-to-day project implementation, monitor progress, and coordinate and account for the utilization of project funds. The PIU will report directly to the Governor of the RBM. Under the guidance of the PSC, the PIU may hire other specialists or support staff as required for the purposes of project implementation.

Component 1: Liquidity Enhancement for MSMEs (US$61.0 million)

22. Sub-component 1.1 (Liquidity Enhancement for MSMEs): The RBM will implement the Line of Credit (LOC) and the training of Participating Financial Intermediaries (PFIs). The RBM will contract qualified service providers and/or consultancies to implement the TA for the LOC.

23. For Sub-component 1.2 (Developing the long-term equity finance market for MSMEs), the RBM will enter into a subsidiary agreement with the MAIIC, which will (i) facilitate equity and quasi-equity financing to innovative start-ups and SMEs; and (ii) provide support to help build capacity of the start-up investment and support ecosystem to enhance the development of start-ups.

Component 2: Scaling Entrepreneurship and Building Firm Capabilities (US$11.5 million)

24. Under Component 2, the MoIT will act as the implementing agency and will manage contract and technical implementation. The MoIT will employ competitively selected local and/or international service providers, with a proven track record, to implement the firm support program in accordance with the criteria developed and contained in the project operations manual.

Component 3: Enhancing the Enabling Environment for Supporting the Financial Inclusion and growth of Entrepreneurs (US$9.0 million)

25. The RBM will implement all activities under this Component through the deployment of qualified service providers/consultancies. The RBM will be responsible for implementing the TA on financial inclusion, and TA activities to support the development and improvements of systems that the project will support.

Component 4: Project Implementation Support (US$4.5 million)

26. The RBM will be responsible for all activities under this Component. To fulfil these roles, the RBM will deploy a qualified project manager (PM) at the PIU, as well as the required technical and fiduciary experts in accordance to criteria established in the project implementation manual.
Project Oversight:

27. The Project Steering Committee (PSC) has been established to provide the Borrower and implementing entities overall strategic guidance in line with national development objectives and monitor project impact. The PSC will be chaired by the Secretary to the Treasury and co-chaired by the Governor for the RBM or the Secretary for Ministry for Industry and Trade.

28. A Project Technical Working Group (TWG) has been established under the PSC to monitor project impact and ensure dialogue with stakeholders is done. The TWG will report to the PSC. The project will also utilize existing policy dialogue forums to improve dialogue and coordination, such as the Joint Sector Reviews (under TIP-SWAp), the TWGs and the PPD Forum.

29. In order to facilitate project implementation, a detailed Project Operational Manual (POM) will be developed. This manual will describe implementation arrangements, including the eligibility criteria for PFIs; fiduciary and E&S risk management arrangements; project audit requirements, the terms of reference (TOR) for the project audit; disbursement arrangements; the IFR formats; monitoring and evaluation framework. It will provide guidance for each responsible agency on the procedural aspects of the Project. It will also include the organizational chart for the project implementation.

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