# Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 05-Jan-2020 | Report No: PIDC208359

## BASIC INFORMATION

### A. Basic Program Data

| Country | Project ID | Parent Project ID (if any) | Program Name |
|---|---|---|---|
| India | P172226 | | Raising and Accelerating MSME Productivity |
| Region | Estimated Appraisal Date | Estimated Board Date | Does this operation have an IPF component? |
| SOUTH ASIA | 16-Jul-2020 | 18-Dec-2020 | No |
| Financing Instrument | Borrower(s) | Implementing Agency | Practice Area (Lead) |
| Program-for-Results Financing | Republic of India | Ministry of Micro, Small and Medium Enterprises | Finance, Competitiveness and Innovation |

**Proposed Program Development Objective(s)**

Strengthening institutions and markets to enhance MSME productivity.

## COST & FINANCING

### SUMMARY (USD Millions)

| | |
|---|---|
| **Government program Cost** | 1,000.00 |
| **Total Operation Cost** | 1,000.00 |
| Total Program Cost | 1,000.00 |
| **Total Financing** | 500.00 |
| **Financing Gap** | 500.00 |

### FINANCING (USD Millions)

| | |
|---|---|
| **Total World Bank Group Financing** | 500.00 |
| World Bank Lending | 500.00 |

## B. Introduction and Context

### Country Context

**India is a lower middle-income country with a population of over 1.3 billion people.** While the country has made substantial progress in improving overall economic outcomes, productivity levels are still relatively low. Economic growth has failed to generate enough jobs for India's expanding working age population. While still high by global standards, India's growth rate has decelerated in the past two years. After peaking at 8.2 percent in FY16/17, economic growth has been lower in FY17/18 (7.2 percent) and FY18/19 (6.8 percent) with further decrease to 6.4 percent currently estimated for FY19/20. While there are various factors at cause here, two crucial engines of growth have underperformed[1]. First, private investment has been low compared to pre-crisis levels, driven by factors that constrain credit supply and investment opportunities. Second, exports have slowed and India's share in world trade has stagnated. At 6.1 percent, the current unemployment rate is substantially higher than the 2-3 percent rate experienced over the last four decades.[2] Underlying this weak performance is the issue of productivity.

**Central to the agenda of productivity growth and job creation, particularly of good quality jobs, is the Micro Small and Medium Enterprises (MSME) sector.** Micro enterprises and SMEs employ a large fraction of non-farm employment in India. Around 77 percent of the non-farm employment is in firms with less than ten workers while firms with over 100 workers employ around 10 percent of the non-farm workers. 3 They play a pivotal role in broader sector competitiveness, with the potential to provide specialization to the value chain in the form of inputs and support activities. However, many of these enterprises are unproductive and lacking in dynamism with low value addition per worker, which does not improve over time. This is exacerbated by policies that hamper the growth of its most efficient producers and overprotect its least efficient ones. The outcome has been low MSME productivity rates that constrain the sector's competitiveness and suppress growth and job-creation potential.4 Enhancing productivity and increasing the domestic and export market shares of Indian MSMEs is key to job creation and remains an urgent national economic priority for the Government of India (GoI). This has been articulated in the "Strategy for New India @ 75" Commissioned by the Prime Minister's Office (PMO) and prepared by Niti Aayog.

### Sectoral (or multi-sectoral) and Institutional Context of the Program

**Not only are most Indian firms small, they also do not grow with age.** The most common firm size in India is of one worker. Around 94.6 percent of firms have less than 5 workers. In fact, 99 percent of the firms have less than 10 workers and the share of larger establishments is negligible (Sixth Economic Census). India's stunted firm dynamics has been highlighted as a key area of concern in the India Systematic Country Diagnostic (SCD).[5] Global experience, particularly from emerging and advanced economies, suggests that in the absence of distortions, firms grow with age. This happens because the less productive firms shrink and exit the market while the surviving firms grow more productive and increase in size (as measured by employment) over time. However, in India, the average number of employees for a 40-year-old Indian plant is almost the same as for its five-year-old counterpart. These skewed patterns of size and growth impose huge productivity costs.[6] This is worrying because long-term growth and job creation are driven by productivity growth.

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[1] World Bank. 2017. "Jobless Growth." South Asia Economic Focus (April), Washington, DC
[2] GoI, Periodic Labor Force Survey (2017-18); Kapoor 2019. "Understanding India's Jobs Challenge." The India Forum
[3] GoI. Sixth Economic Census (2012-13)
[4] GoI 2019. "Economic Survey of India"
[5] World Bank. 2018. "India - Systematic Country Diagnostic: Realizing the Promise of Prosperity." Washington, D.C.
[6] Contrast this with the United States, where firm employment grows eightfold over 40 years, or Mexico, where it doubles. While a 35-year-old plant is 9.3 times more productive than a five-year-old plant in the United States, it is only 1.5 times higher in India. See Hsieh and Klenow. 2014. "The Life-Cyle of Plants in India and Mexico". The Quarterly Journal of Economics

The evidence suggests that this productivity gap is, in large part, due to allocative inefficiencies arising from weaknesses in both the investment climate and in the utilization of inputs at the firm level. [7]

**Recognizing the constraints to productivity growth of MSMEs, the Reserve Bank of India (RBI) constituted the Expert Committee on MSMEs to undertake a comprehensive review of the sector and recommend long-term solutions.** The report identified a substantive set of sector policy, institutional, legal and regulatory constraints requiring attention. This includes the need to remove licensing and size restrictions, implement targeted labor regulations and financial sector reforms (including updated bankruptcy laws) and improved procedures for enforcing contracts and the removal of barriers to foreign market entry. The report also highlighted specific challenges faced at the firm level in areas such as formalization and digitization, access to knowledge and marketing services, timely and adequate finance and the availability of skilled man-power.

### Relationship to CAS/CPF

**The proposed operation is fully aligned with the India Country Partnership Framework (FY 18-FY 22), which identifies 'Enhancing Competitiveness and Enabling Jobs Creation' as one of the three focus areas.** Through this focus area, the CPF highlights the need to "partner with central and state agencies responsible for the development of firm capabilities to improve the institutional setup promoting start-ups, technology, innovation, quality standards, and managerial skills development". Through integrating gender in the design and targeting of interventions, the proposed operation will aim to reach women entrepreneurs and increase the availability of jobs for women, a key results area of the CPF.

### Rationale for Bank Engagement and Choice of Financing Instrument

**The Ministry of Micro, Small and Medium Enterprises (MoMSME) is seeking to increase the scale of its support to MSMEs as well as the quality of its interventions.** The reform agenda it is planning to implement in furtherance of these objectives establishes the Ministry as a strategic partner to introduce international best practices in the design and implementation of MSME programs. The MoMSME can provide the demonstration effects and spillovers that can generate the momentum for wider change in the institutional and market performance of ministries, departments and agencies (MDAs) operating in the MSME space. The primary project engagement would be through support to the MoMSME which, in turn, will contribute to the efforts of the Government of India to enhance the productivity and exports of Indian manufacturing and services and the creation of jobs in large numbers. This would encompass interventions that strengthen: (i) institutions and governance of targeted MSME programs, and (ii) market access, firm capabilities and access to finance.

**There is a considerable body of global knowledge and lessons learned within the World Bank and IFC through its support interventions** on the design and implementation of policies and instruments for MSME development, that can contribute to this initiative. The demand from the client is for a results-based instrument. While the IPF would provide an opportunity to support specific interventions for MSMEs, it would not be the best option where the goal is to strengthen country capacity of a key institution and position it as a sector innovator and change agent towards a more comprehensive "systems" approach, with a substantial state-level empowerment agenda. The interventions proposed through the PforR operation aim also to augment country system solutions in following ways: (i) elevate the overall capacity and institutional mechanisms within the MoMSME to deliver on its mandate; and (ii) demonstrate results in the

[7] In aggregate terms, only 33 percent of the current gap in output per worker between India and the United States is accounted for by the gap in their human and physical capital levels; the rest is due to the difference in their "total factor productivity" (TFP) levels. See C.I. Jones, Chapter 1 - The Facts of Economic Growth, Editor(s): John B. Taylor, Harald Uhlig, Handbook of Macroeconomics, Elsevier, Volume 2, 2016, Pages 3-69

key areas of market access, firm capabilities and access to finance, while innovating more effective utilization of the MoMSME systems and procedures.

## C. Program Development Objective(s) (PDO) and PDO Level Results Indicators

### Program Development Objective(s)

Strengthening institutions and markets to enhance MSME productivity.

### PDO Level Results Indicators

Key Performance Indicators to capture Productivity growth in targeted beneficiary firms, Improved institutional capability in targeted central / state MDAs and Market Services Development will be finalized during preparation.

## D. Program Description

### PforR Program Boundary

The Government of India announced a package of twelve initiatives to facilitate MSME growth in November 2018 and the MoMSME has brought its support and outreach program for MSMEs under the banner of "Udyam Jyoti". The objective of "Udyam Jyoti: From Livelihood to Market" is to streamline support to the MSME ecosystem by facilitating synergies and convergence across departments and schemes currently implemented by Central and State Governments around 7 thematic areas, each one associated with one or more existing schemes:

- Human Capital Development
- Knowledge Dissemination
- Access to Finance including Insurance
- Access to Technology
- Common Facility Infrastructure
- Facilitating Access to Markets
- Policy and Governance

**The proposed PforR operation will support a part of the overall government program** – with particular attention to the Government's thematic areas of "Policy and Governance", "Access" (markets, technology and common infrastructure and finance) and "Knowledge Dissemination". **This support will be designed across the following two Results Areas (RAs) over a five-year period through a partnership with the MoMSME, deployment of market-based solutions and a focus on firm productivity improvements.**

I. Strengthening Institutions and Governance of the MSME Program
II. Support to Market Access, Firm Capabilities and Access to Finance

## E. Initial Environmental and Social Screening

*[Potential environmental and social effects; knowledge and general understanding of the Program system to manage environmental and social risks and impacts; and timeframe for launching the E&S systems assessment including consultation on and disclosure of the draft systems assessment]*

**Environmental and Social Risks are identified as "substantial".** This is based on a rating of "moderate" for social risks and "substantial" for environmental risk. No negative impacts related to land acquisition, involuntary resettlement or livelihoods related displacements are expected under the present scope of the operation. The Program has a wider scope and may involve many states whose environmental management systems and capacities to manage environmental risks and impacts from MSMEs vary. The environmental management system and capacity of the main Implementing Agency may also need enhancement to screen and manage environmental risks from participating MSMEs. At this stage where the boundaries of the Program and the typologies of activities to be supported by the Program have yet to be well-defined and the environmental and social systems assessment (ESSA) has yet to be carried out, the environmental risk of the Program is tentatively assigned Substantial. This will be revisited and revised as soon as the Program boundaries and types of activities are defined, and the ESSA is carried out.

## CONTACT POINT

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### Borrower/Client/Recipient

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|---|---|---|---|
| Borrower : | Republic of India | | |
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### Implementing Agencies

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|---|---|---|---|
| Implementing Agency : | Ministry of Micro, Small and Medium Enterprises | | |
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