THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP

Report No: PAD3415

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 62.7 MILLION
(US$86 MILLION EQUIVALENT)

TO THE

THE REPUBLIC OF MALAWI

FOR A

FINANCIAL INCLUSION AND ENTREPRENEURSHIP SCALING PROJECT

August 3, 2020

Finance, Competitiveness and Innovation Global Practice
Africa Eastern and Southern Region

CURRENCY EQUIVALENTS

Exchange Rate Effective May 31, 2020

| | |
|---|---|
| Currency Unit = | Malawi Kwacha (MWK) |
| US$1 = | MK 736.1 |
| US$1 = | SDR 0.72885235 |

FISCAL YEAR
July 1 – June 30

| | |
|---|---|
| Regional Vice President: | Hafez M. H. Ghanem |
| Country Director: | Mara K. Warwick |
| Regional Director: | Asad Alam |
| Practice Manager: | Niraj Verma |
| Task Team Leaders: | Efrem Zephnath Chilima, Randa Akeel |

## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| ADF | African Development Fund |
| AGCOM | Agriculture Commercialization |
| AfDB | African Development Bank |
| AS | Advisory Service(s) |
| ATS | Automated Trading System |
| BDS | Business Development Service(s) |
| CAT-DDO | Catastrophe Deferred Drawdown Option |
| CEO | Chief Executive Officer |
| CPF | Country Partnership Framework |
| CSD | Central Securities Depository |
| CUCI | COVID-19 Urban Cash Initiative |
| DFI | Development Finance Institution |
| DFS | Digital Financial Services |
| E&S | Environmental and Social |
| ELA | Emergency Liquidity Assistance |
| ESMS | Environmental and Social Management System |
| ESS | Environmental and Social Standards |
| EU | European Union |
| FA | Financing Agreement |
| FInES | Financial Inclusion and Entrepreneurship Scaling Project |
| FM | Financial Management |
| FSAP | Financial Sector Assessment Program |
| FSDS | Financial Sector Development Strategy |
| FSTAP | Financial Sector Technical Assistance Project |
| GAVI | Global Alliance for Vaccines and Immunization |
| GBV | Gender-based violence |
| GCF | Green Climate Fund |
| GDP | Gross Domestic Product |
| GHI | Global Hunger Index |
| GRM | Grievance Redress Mechanism |
| GRS | Grievance Redress Service |
| HCI | Human Capital Index |
| HDI | Human Development Index |
| ICT | Information and Communication Technology |
| IEG | Independent Evaluation Group |
| IFC | International Finance Corporation |
| IFR | Interim Financial Report |
| IPF | Investment Project Financing |
| IPDC | Internal Procurement and Disposal Committee |
| JET | Jobs and Economic Transformation |
| LoC | Line of Credit |
| M&E | Monitoring and Evaluation |
| MAIIC | Malawi Agriculture and Industrial Investment Corporation |

| | |
|---|---|
| MCCCI | Malawi Confederation of Chambers of Commerce and Industry |
| MFD | Maximizing Finance for Development |
| MFI | Microfinance Institution |
| MGDS | Malawi Growth and Development Strategy |
| MICF | Malawi Innovation Challenge Fund |
| MoFEPD | Ministry of Finance, Economic Planning and Development |
| MoIT | Ministry of Industry and Trade |
| NBM | National Bank of Malawi |
| MSMEs | Micro, Small, and Medium Enterprises |
| NPL | Nonperforming Loan |
| NSFI | National Strategy for Financial Inclusion |
| PC | Project Coordinator |
| PCG | Partial Credit Guarantee |
| PDO | Project Development Objective |
| PDU | Procurement and Disposal Unit |
| PFI | Participating Financial Intermediary |
| PIM | Project Implementation Manual |
| PIU | Project Implementation Unit |
| PM | Project Manager |
| PPSD | Project Procurement Strategy for Development |
| PSC | Project Steering Committee |
| RBM | Reserve Bank of Malawi |
| SACCO | Savings and Credit Cooperative |
| SADC | Southern Africa Development Community |
| SEP | Stakeholder Engagement Plan |
| SMEs | Small and Medium Enterprises |
| SMEDI | Small and Medium Enterprises Development Institute |
| STEP | Systematic Tracking of Exchanges in Procurement |
| TA | Technical Assistance |
| TOT | Training of Trainers |
| TWG | Technical Working Group |
| VC | Venture Capital |

TABLE OF CONTENTS

DATASHEET

## BASIC INFORMATION

| Country(ies) | Project Name | |
|---|---|---|
| Malawi | Financial Inclusion and Entrepreneurship Scaling Project | |
| **Project ID** | **Financing Instrument** | **Environmental and Social Risk Classification** |
| P168577 | Investment Project Financing | Moderate |

### Financing & Implementation Modalities

| | |
|---|---|
| [ ] Multiphase Programmatic Approach (MPA) | [ ] Contingent Emergency Response Component (CERC) |
| [ ] Series of Projects (SOP) | [ ] Fragile State(s) |
| [ ] Performance-Based Conditions (PBCs) | [ ] Small State(s) |
| [✓] Financial Intermediaries (FI) | [ ] Fragile within a non-fragile Country |
| [ ] Project-Based Guarantee | [ ] Conflict |
| [ ] Deferred Drawdown | [✓] Responding to Natural or Man-made Disaster |
| [ ] Alternate Procurement Arrangements (APA) | [ ] Hands-on Enhanced Implementation Support (HEIS) |

| Expected Approval Date | Expected Closing Date |
|---|---|
| 25-Aug-2020 | 30-Sep-2025 |

| Bank/IFC Collaboration |
|---|
| No |

### Proposed Development Objective(s)

The Project Development Objective (PDO) is to increase access to financial services, promote entrepreneurship and capabilities of MSMEs in Malawi including addressing Coronavirus Disease 2019 (COVID-19) implications.

### Components

| Component Name | Cost (US$, millions) |
|---|---|

| | |
|---|---|
| Liquidity Enhancement for MSMEs | 65.00 |
| Scaling Entrepreneurship and Building Firm Capabilities | 7.50 |
| Enhancing the Enabling Environment for Supporting the Financial Inclusion and Growth of Entrepreneurs | 9.00 |
| Project Implementation Support | 4.50 |

### Organizations

| | |
|---|---|
| Borrower: | The Republic of Malawi |
| Implementing Agency: | Ministry of Industry and Trade<br>Reserve Bank of Malawi |

## PROJECT FINANCING DATA (US$, Millions)

### SUMMARY

| | |
|---|---|
| **Total Project Cost** | 86.00 |
| **Total Financing** | 86.00 |
| **of which IBRD/IDA** | 86.00 |
| **Financing Gap** | 0.00 |

### DETAILS

**World Bank Group Financing**

| | |
|---|---|
| International Development Association (IDA) | 86.00 |
| IDA Credit | 86.00 |

### IDA Resources (in US$, Millions)

| | Credit Amount | Grant Amount | Guarantee Amount | Total Amount |
|---|---|---|---|---|
| **Malawi** | 86.00 | 0.00 | 0.00 | 86.00 |
| National PBA | 86.00 | 0.00 | 0.00 | 86.00 |
| **Total** | **86.00** | **0.00** | **0.00** | **86.00** |

### Expected Disbursements (in US$, Millions)

| WB Fiscal Year | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|---|---|
| Annual | 0.00 | 28.67 | 8.00 | 12.00 | 13.87 | 12.00 | 11.46 |
| Cumulative | 0.00 | 28.67 | 36.67 | 48.67 | 62.54 | 74.54 | 86.00 |

## INSTITUTIONAL DATA

**Practice Area (Lead)**

Finance, Competitiveness and Innovation

**Contributing Practice Areas**

Macroeconomics, Trade and Investment, Poverty and Equity

**Climate Change and Disaster Screening**

This operation has been screened for short and long-term climate change and disaster risks

## SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

| Risk Category | Rating |
|---|---|
| 1. Political and Governance | Moderate |
| 2. Macroeconomic | Substantial |
| 3. Sector Strategies and Policies | Low |
| 4. Technical Design of Project or Program | Moderate |
| 5. Institutional Capacity for Implementation and Sustainability | Moderate |
| 6. Fiduciary | Moderate |
| 7. Environment and Social | Moderate |
| 8. Stakeholders | Moderate |
| 9. Other | Substantial |
| 10. Overall | Moderate |

## COMPLIANCE

### Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [√] No

Does the project require any waivers of Bank policies?

[ ] Yes [√] No

### Environmental and Social Standards Relevance Given its Context at the Time of Appraisal

| E & S Standards | Relevance |
|---|---|
| Assessment and Management of Environmental and Social Risks and Impacts | Relevant |
| Stakeholder Engagement and Information Disclosure | Relevant |
| Labor and Working Conditions | Relevant |
| Resource Efficiency and Pollution Prevention and Management | Not Currently Relevant |
| Community Health and Safety | Not Currently Relevant |
| Land Acquisition, Restrictions on Land Use and Involuntary Resettlement | Not Currently Relevant |
| Biodiversity Conservation and Sustainable Management of Living Natural Resources | Not Currently Relevant |
| Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities | Not Currently Relevant |
| Cultural Heritage | Not Currently Relevant |
| Financial Intermediaries | Relevant |

**NOTE**: For further information regarding the World Bank's due diligence assessment of the Project's potential environmental and social risks and impacts, please refer to the Project's Appraisal Environmental and Social Review Summary (ESRS).

### Legal Covenants

Sections and Description

Financing Agreement. Schedule 2, Section I.A.4.(a)

The Recipient shall cause RBM to maintain at all times during the implementation of the Project, the Project Implementation Unit with mandate, composition and resources satisfactory to the Association to be responsible for, inter alia, (i) the day to day implementation of Part 1, 3 and 4 of Project; (ii) coordinating the implementation of the Project with MoIT and supporting MoIT with fiduciary, environmental and social, procurement, monitoring and evaluation under Part 2 of the Project; and (iii) serve as the secretariat for both the PSC and the TWG. Without limitation to the previous paragraph the PIU shall inter alia include an environmental specialist, a social specialist, a finance management specialist, a monitoring and evaluation specialist, a procurement specialist and a financial sector specialist.

Sections and Description
Financing Agreement. Schedule 2, Section I.D.1.

For the purpose of carrying out Part 1.2 of the Project, the Recipient shall cause RBM to, not later than three (3) month after the Effective Date, enter into an agreement with MAIIC ("MAIIC Agreement") under terms and conditions acceptable to the Association.

Sections and Description
Financing Agreement. Schedule 2, Section I.F.1.

Not later than May 31 in each calendar year (or one month after the Effective Date for the first year of Project implementation), the Recipient shall prepare or cause to be prepared for the purpose of forwarding to the Association: (i) a draft annual work plan and budget for the Project (including Training and Operating Costs) for the subsequent calendar year of Project implementation, of such scope and detail as the Association shall have reasonably requested; and (ii) any instruments required by the ESCP for the implementation of the activities included in the draft annual work plan and budget.

Sections and Description
Financing Agreement. Schedule 2, Section I.G.1.

The Recipient shall, and shall cause RBM to, ensure that the Project is carried out in accordance with the Environmental and Social Standards, in a manner acceptable to the Association.

### Conditions

| Type | Description |
|---|---|
| Effectiveness | Financing Agreement, Article IV, 4.01 (a):<br><br>The Subsidiary Agreement has been executed on behalf of the Recipient and the Project Implementing Entity in accordance with the provisions of Section I.B of Schedule 2 to this |

| | |
|---|---|
| | Agreement. |
| Type<br>Effectiveness | Description<br>Financing Agreement, Article IV, 4.01 (b):<br><br>The Project Implementation Manual has been adopted in accordance with the provisions in Section I.E of Schedule 2 to this Agreement. |
| Type<br>Disbursement | Description<br>Financing Agreement. Schedule 2, Section I.B.1<br><br>Notwithstanding the provisions of Part A of the Financing Agreement, no withdrawal shall be made:<br><br>(a) for any Sub-Financing to a PFI under Category (3), unless and until the PIE has executed a Subsidiary Financing Agreement in accordance with the provisions of Section I.C.4 of Schedule 2 to this Agreement; (b) under Categories (4), (5), (6) and (7) unless and until the MAIIC Agreement has been executed between the PIE and MAIIC in accordance with the provisions of Section I.D.1 of Schedule 2 to this Agreement; (c) under Categories (5) and (6) unless and until the Investment Committee has been established according to Section I.D.1(i) of Schedule 2 to this Agreement; (d) under Category (6) in an amount exceeding the total committed amount for Indirect Equity Investments under one or more IV Agreements executed according to Section I.D.6 of Schedule 2 to this Agreement and reasonable management fees; and (e) under Category (7) in an amount exceeding the total amount guaranteed under the Partial Credit Guarantee Fund. |

# I. STRATEGIC CONTEXT

## A. Country Context

1. **Malawi is a low-income landlocked country[1] in Southeastern 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$411.2 in 2019[2], making it one of the poorest countries in the world. Close to 70 percent of the country's people in 2017 lived below the international poverty line of US$1.90 per day.[3] Malawi ranks 172 out of 189 countries in the Human Development Index (HDI 2018). The country's poor standing in the Human Capital Index (HCI) at number 125 out of 157 countries recorded in 2018 implies that most of Malawi's citizens lack the knowledge, skills, and levels of health that would enable them to realize their potential as productive members of the society. Only 14 percent of the Malawian labor force holds wage employment, thus, most of its labor force is highly vulnerable to shocks and has limited safety nets. Inadequate sources of livelihood and consequential food insecurity are reflected in the country's poor performance in terms of the Global Hunger Index (GHI),[4] with the country ranking 78 out of 117 countries in 2019. An examination of the country's age structure shows that 75 percent of the population is under the age of 35 years, with the mean age at 17 years.[5] Malawi has a large, youthful, innovative, and enterprising population which can spurt private sector growth if adequately supported.

2. **Malawi has one of the highest rates of adolescent fertility in the world**, with 132 births per 1,000 women between the ages of 15 and 19[6] in 2018. Out of every 100 girls who begin Standard 1 of primary school, only three will enter secondary education. Of those three, only one will enter university[7]. Many girls are stuck in a vicious cycle of school drop-out, poor health, and reduced economic opportunities. Early marriage is widespread, and together with early childbearing, is associated with low household wealth and poverty[8].

3. **The country's stable macroeconomic indicators in recent years are set to be disrupted by the Coronavirus Disease 2019 (COVID-19) global pandemic.** The year-on-year headline inflation rate stood at 8.5 percent in June 2020, compared to an average annual level of 20 percent in 2011–2016. Trade disruptions due to the COVID-19 outbreak, a decline in imported food products and restrictions on in-country and cross-border mobility and transport due to COVID-19, combined with potential speculation and/or uncertainty in the markets or market distortions and significant exchange rate depreciation could escalate prices of imported goods and induce an upward push on the country's inflation rate. The good economic performance in 2019 was expected to continue in 2020; however, due to the potential impact of COVID-19, real GDP growth estimate for 2020 has been revised downward from 4.8 percent estimated

[1] The country has a total land area estimated at 118,484 square kilometers, 20 percent of which is occupied by a lake.
[2] World Development Indicators (WDI).
[3] National Statistical Office. Fourth Integrated Household Survey (IHS 4) (2018).
[4] 2019 Global Hunger Index.
[5] Fourth Integrated Household Survey 2016 - 2017
[6] World Development Indicators.
[7] National Statistics Office Malawi 2017. 2015-16 Malawi Demographic and Health Survey.
[8] Malawi Economic Monitor: Investing in Girl's Education (2018).

in February 2020 to a current estimate of 1.9 percent.[9] These projections are subject to considerable uncertainty and assume a contained spread of the virus in Malawi before the second half of 2020 and limited social distancing policies. Under such circumstances, it implies that the COVID-19 related economic crisis is expected to erase the equivalent of 3.6 percent of output for the year 2020. The real GDP growth projection for 2021 has also been revised downward to 4.5 percent from 5.8 percent estimated in February 2020. The FY2019/20 fiscal deficit is expected to be around 6.5 percent of GDP, almost double the projections earlier in the year. High government borrowing and high profits by commercial banks generated through nonlending activities such foreign exchange business, fees and commissions do not provide incentives for lending to the private sector, which will be further constrained by the impact of COVID-19.

4. **The COVID-19 outbreak poses considerable downside risks for the economy.** Malawi recorded the first three cases of coronavirus on April 2, 2020. Since then, total cases have increased to 3,709 as of July 27, of which 1,939 are active, and there have been 103 deaths. Testing capacity has gradually increased, so that 27,390 COVID-19 tests have been carried out. The COVID-19 pandemic is expected to have considerable negative impact on Malawi's growth in 2020. There has been significant disruption of global value chains especially impacting production inputs from Malawi's main trade partners China and South Africa, increased trade and logistics costs and delays, decreased demand for exports, especially in the European Union (about 32 percent of Malawi's exports), where tobacco sales are down by 17 percent from 2019, although prices have been robust; significant decreases in tourism, and reduction in remittances. Domestic demand and supply shock due to increased risk aversion and social distancing policies are expected to further weigh on growth. In an adverse scenario, COVID-19 could lead to an economic recession. On a monthly basis, domestic taxes have declined from an average of 1.3 percent of GDP pre-COVID to 0.9 percent of GDP in May 2020. The decline is expected to persist through the rest of the year as the pandemic continues affecting the economy. Customs taxes have also registered a decline from a pre-COVID average 0.4 percent of GDP to 0.3 percent of GDP in May 2020. 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. Transport, tourism, accommodation and food services, wholesale and retail trading, and manufacturing sectors are the most hard-hit due to the COVID-19 crisis[10].

5. **The impact on poverty will be particularly acute in urban areas where the sizeable informal services sector is expected to be heavily affected**. Within the services sector, accommodation and food services as well as wholesale and retail trade are likely to be heavily impacted if Malawi experiences wider community-level transmission. The forecasted increase in urban poverty could range from 1.6 percent (representing around 280,000 Malawians) in the baseline growth forecast, up to 4.9 percent (around 880,000 people) in a downside scenario. Given the strong harvest and that the rural economy is heavily agriculture based, in the baseline scenario rural poverty would be expected to see limited impact.

6. **Government response.** The President of Malawi declared a "State of Disaster" on March 20, 2020 and introduced measures covering the deployment of health personnel to points of entry, additional border controls and travel restrictions, the closing of all schools and colleges, restrictions on public gatherings, new health worker recruitments and an increase in health workers' risk allowance. The

[9] The Department of Economic Planning and Development's Assessment of Impact of COVID-19 on the Economy in June 2020.
[10] World Bank Malawi Economic Monitor: From Crisis Response to Strong Recovery (July 2020).

immediate health response, elaborated in government contingency plan costed at US$20.8 million, is supported by multiple donors and two separate emergency budgetary reallocations in late March and early April totaling MWK 5.5 billion. Social protection benefits are also proposed to expand to cover around 35 percent of the urban population while those impacted by COVID-19 in rural areas would also receive a frontloaded top-up cash transfer. The Reserve Bank of Malawi has announced several key initiatives, including establishing an Emergency Liquidity Assistance (ELA) framework to support banks in the event of worsening liquidity conditions, a three-month moratorium on interest and principal payments by SMEs on a case-by-case basis, reducing fees and increasing transaction amounts for mobile money and e-payments, and increasing the Malawi Enterprise Development Fund (MEDF) loans allocation.

## B. Sectoral and Institutional Context

7. **Malawi's economy is predominantly agricultural and rural based.** About 84 percent of the country's population lives in rural areas, where they primarily engage in, or are dependent upon, smallholder, rain-fed subsistence agriculture. The agricultural sector contributes 80 percent of total export earnings and 85 percent of total employment. While the agriculture sector has traditionally been the mainstay of Malawi's economy, the services sector has been accelerating rapidly with its contribution to GDP increasing from 39.4 percent in 2010 to 42.0 percent in 2019 compared to agriculture which contributed 32.0 percent to 29.3 percent of GDP during the same period.

8. **Malawi's private sector is mostly informal with a few large-scale firms capturing most economic opportunities.** Large-scale firms mostly operate in urban areas and are engaged in agriculture, agro-processing, and financial services. The 2019 FinScope Survey estimates that 89 percent of employment in Malawi is in the informal sector, and that 74 percent of the Micro small and medium enterprises (MSME) sector are micro enterprises where most women-led enterprises are concentrated. MSMEs in Malawi suffer from low capacity and face numerous challenges that constrain their ability to access financing and contribute to economic growth and yet they will need to play a significant role in helping the economy recover, including from the potential COVID-19 induced recession. Women (and youth) led enterprises face challenges in growing their businesses from micro to small and medium enterprises and are typically not aware of the process or the importance of formalizing.

9. **The 2019 FinScope Survey estimates that there are only 11 percent female owners of MSMEs** in **Malawi against 89 percent male owners**. Women in Malawi remain disadvantaged in the economic arenas, and therefore more deprived than male-headed households in terms of access to finance. While Savings and Credit Co-operatives (SACCOs) and Village Savings and Loan Associations (VSLAs) provide easier access to finance for women and youth headed MSMEs, their product offerings are limited by the tenure of loans and loan amounts.

10. **Access to finance is a key constraint for MSMEs.** Sourcing capital in Malawi is the leading challenge faced by the MSME sector across all stages of the business life cycle from start-up to enterprise maturity. Only 10 percent of medium enterprises, 5 percent of small enterprises, and 3 percent of microenterprises have credit from a commercial bank.[11] Commercial banks' financial intermediation is low, with a high degree of concentration whereupon an estimated 90 percent of loans are channeled to

[11] FinScope Survey, 2019.

a handful of large corporates. Domestic credit to the private sector as a percentage of GDP is less than 10 percent compared to an average of 34.2 percent for Southern Africa Development Community (SADC) countries and 28.4 percent for Sub-Saharan Africa in 2016.[12] High government borrowing and high profits generated through nonlending activities crowd out bank lending to the private sector, which will be further constrained by the impact of COVID-19 amid banks' low tolerance to high risk and increased liquidity crunch.

11. **High level of inefficiencies, overhead costs, and lack of proper financial infrastructure contribute to high cost of wholesale funding available for microfinance institutions (MFIs) and smaller banks which they pass on to their borrowers.** Since most commercial banks prefer to lend to larger corporations and to the 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, cost of credit for MSMEs remains highly unaffordable; further longer-term bank financing is limited. According to the 2019 FinScope survey, collateral requirement was reported to be prohibitively high by MSMEs further deterring their borrowing further deterring borrowing by MSMEs. The low financing access is compounded by the low number of people and microenterprises with a bank account and lack of requisite skills and aspiration to grow.

12. **Part of the low access to finance by MSMEs relates to the lack of capacity on the part of financial institutions, which do not do much by way of credit intermediation and financial inclusion.** Commercial bank private sector credit to GDP, for example, is only around 6.7 percent as at end-December 2019. The 2018 Financial Sector Assessment Program (FSAP) analysis of banks' income and cost structures across different business lines demonstrates limited profit margins in the deposit and lending business but extremely high profit margins in nonlending, especially in foreign exchange business. Because foreign currency turnover is so high compared to the depth of the banking system, the large trading band contributes disproportionately to banks' profits. As a result, the overall bottom line of banks has increased over the past years, with revenue from government securities decreasing and other revenue sources staying constant. With the impending decrease in trade and exports due to the COVID-19 crisis, expected increase in nonperforming 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 lend to MSMEs will be severely affected.

13. **Size and broader weaknesses in financial sector capacity pose additional challenges to financial intermediation.** According to the 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. About two-thirds of total financial system assets are in the banking sector (29.9 percent of GDP as of 2019). The financial sector is dominated by two commercial banks, namely the National Bank of Malawi and the Standard Bank .[13] The commercial banks' average lending rate (between 13.2 and 25.3 in April 2020)) are very high reflecting high labor costs/high wages, inefficiencies due to shortages in skilled employees, deficient infrastructure, and lack of competition. The microfinance sector, which serves most of the financing needs of MSMEs and the rural population, represents only 0.64 percent of GDP in assets as of 2018. The total number of clients served by licensed savings and credit cooperatives (SACCOs),

[12] World Bank World Development Indicators (WDI).
[13] The two banks account for 46.2 percent of the sector's deposits, 58.1 percent of total loans, and 60.0 percent of total equity capital.

however, has been growing. The cost of credit for MSMEs, however, remains highly unaffordable while longer-term bank financing and equity/quasi-equity/financing is limited.

14. **Capabilities among firms are not developed along dimensions such as attitude/mindset for skills, financial literacy, management practices, business language, market assessment, and other behavioral characteristics of successful entrepreneurs.**[14] MSMEs account for most jobs globally and if supported well, can be an engine of growth. In Malawi, realizing the potential of MSMEs in economic growth has been difficult. The majority of MSMEs in the country are informal, 36 percent do not keep records, and 45 percent lack innovation and diversification.[15] 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 the unbanked perceiving commercial financial intermediaries as not being interested in extending products and services to them. This is a particularly strong deterrent to women-led and youth-led businesses and first-time borrowers.

15. **MSMEs are not properly supported by the limited quantity and quality of business support services available in the country.** According to research[16] almost all training programs find that trained firms implement some of the business practices taught in the training. Studies of microfinance clients found some evidence that training changes the rates of client retention and the characteristics of loan applicants. With limited capacities and low levels of productivity, both public and private business development service providers (BDSs) in Malawi are challenged to provide effective support to MSMEs. Without support to properly adjust operations and delivery of services, especially during the COVID-19 pandemic, most private sector BDS may shut down. The internal operational challenges of BDS providers, has constrained the allocation of resources and resulted in duplication of efforts. To improve the capacities and capabilities of MSMEs, the Government established the Small and Medium Enterprises Development Institute (SMEDI) in 2015. The SMEDI and most of the private BDS providers require support to provide effective services to MSMEs both during the COVID-19 crisis and subsequent economic recovery period.

16. **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 (2016) is not yet fully utilized by banks and their clients. While there has been progress in this area supported by the International Finance Corporation (IFC) advisory projects, more will be required for the bureaus to be fully utilized, improve the quality of reports and generate good credit scores that can help MSMEs get lower borrowing rates (see annex 7). While a robust collateral registry, developed with support from the IFC Advisory Project, is functioning well, its usage by banks and creditors is low. In addition, the inadequate use of the national identification system in the financial system poses a great challenge. 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), thereby constraining growth prospective and potential job creation opportunities.

17. **Alternative forms of financing suited to support innovative high growth potential firms are lacking but there is room for growth.** Despite being a small proportion of MSMEs, literature shows that

[14] These include clear goal setting, long-term involvement, drive and energy.
[15] FinScope Survey, 2019.
[16] David McKenzie and Christopher Woodruff on http://wbro.oxfordjournals.org/ at International Monetary Fund on January 24, 2014

innovative start-ups 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.[17] Malawi has a nascent market of investors in venture capital (VC). However, a large gap in equity financing exists starting at the seed stage all the way through to venture capital, with only a few business applications receiving some form of support. There are currently two private companies that provide equity funding, although investment amounts have been small (approximately US$1,000 to US$250,000). The current equity investment support ecosystem consists mostly of training, business acceleration, and provision of co-sharing spaces. Female-led hubs are helping close the funding and skills gaps for female entrepreneurs and recent secondary and tertiary school graduates. Without follow-on financing and support until they reach the stage where they can raise capital and financing directly from the market, start-ups emanating from these accelerators and hubs will be highly susceptible to failure. The Malawi Agricultural and Industry Investment Corporation (MAIIC) a public-private entity was set up to help facilitate long-term financing including risk capital and guarantees. MAIIC can benefit from additional institutional and technical support to attract private investors.

18. **MSMEs have not been spared from the impact of climate change, most critically in access to energy.** Malawi depends on hydropower and due to sedimentation, siltation, flooding, droughts, and urbanization, the country experiences frequent blackouts and long hours of load shedding negatively impacting operations of firms. Cooling, heating, and all industrial processes that rely on electrical energy continue to be significantly affected. In addition, due to lack of access to finance, combined with regulatory and technology barriers, small and medium enterprises (SMEs) are challenged in adopting energy-efficient and clean technology and practices to address energy unreliability and inefficiency challenges and adopt digital finance services (DFS).

19. **Due diligence conducted by the project team of the regulatory and policy space and the coordinating unit of the Ministry of Finance, Economic Planning and Development (MoFEPD) reveals policy/regulatory/capacity gaps and the need for support to set up an appropriate environment according to best practice to facilitate financial inclusion, entrepreneurship, and MSME growth.** There are gaps in the legal, policy and regulatory framework for mortgage finance, leasing finance and long-term finance which, if properly developed can further facilitate access to financing by MSMEs and help foster their growth. There are also gaps in the implementation and review of strategies and road maps, such as those on financial sector development, financial inclusion, and digitization of government payments. There is a need to build capacity for the ministry to play its role in creating the necessary policy environment to increase financial inclusion and facilitate.

20. **COVID-19 is amplifying the challenges confronting MSMEs and is also damaging otherwise healthy firms that require support to remain viable.** The economic shock is being transmitted through (a) falling demand, (b) reduced and disrupted input supply, (c) tightening of credit conditions and liquidity crunch, and (d) rising uncertainty.

21. **The Government has declared a state of disaster and proposed measures to respond to COVID-19 and is 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

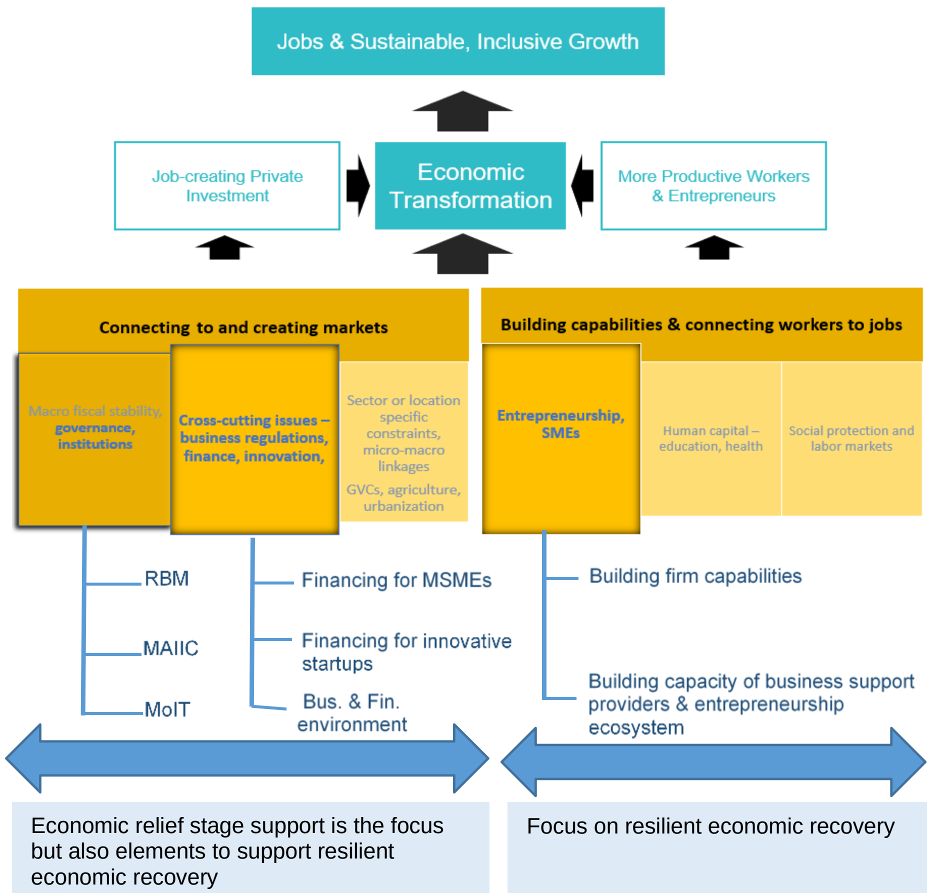
[17] For instance, a World Bank report 'Jobs for Growth' (2015, MENA) showed that younger firms and more productive firms create more jobs in MENA.

distancing and protection measures to help stop the spread of the virus. In April, the Government announced measures mostly aimed at cushioning the private sector from the ensuing economic downturn, including a moratorium on interest and principal repayment of loans by firms, the restructuring of loans, and setting up of an ELA to support banks' continued lending in the face of liquidity shrinkage. In May 2020, the National Association of Small and Medium Enterprises (NASME) suggested the need for a special a bailout package for SMEs to help them cushion against the economic impacts of COVID-19, after observing that the moratorium announced by the Reserve Bank of Malawi (RBM) has not benefitted smaller businesses.

22. **Given these constraints, through this proposed project, the Government of Malawi is seeking to support MSMEs in Malawi, in the short and medium term to weather the COVID-19 effects and in the medium and longer term to support job creation and sustainable inclusive growth.** The project includes interventions to support firms in surviving the COVID-19-induced economic crisis aligned with the Government's announced temporary measures.[18] The support envisages both economic relief as well as recovery dimensions outlined in the World Bank's overall approach to the COVID-19 response using instruments to support liquidity and de-risking. In the short term, the project will support additional buffers and liquidity for financial institutions to continue providing finance and services to MSMEs maintain their payroll, pay their bills, provide continued supply of essential goods and services to the economy, and mitigate risk of failure/bankruptcy. In addition, the project design is suited to support the sector to recover by facilitating opportunities and conditions for MSMEs with potential for growth to thrive and grow over the medium-to-long term, hence contributing to the twin pillars of 'connecting to and creating markets' and 'building capabilities' under the International Development Association (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 (Figure 1). Increasing the supply of financing alongside capacity building to start-ups 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 made to strengthen women's business capabilities to enhance their potential to access financing. The project is also expected to address some of the market failures that are limiting the supply of affordable finance and develop solutions for a more conducive business environment for dynamic business creation, including building capacity of institutions and business development support providers to ensure sustainability of MSME lending and investment beyond the life of the project.

[18] It also aligns with the World Bank's approach for supporting firms during Covid-19 as indicated in the note 'Supporting Firm Resilience: A Firm Support Program for WBG COVID-19 Phase 2 Response'.

**Figure 1. JET IDA Framework for the World Bank Group: Raising Productivity That Is Inclusive and at Scale**




*Source*: Adapted from IDA Special Theme JET paper May 2019; Development Committee Paper on JET October 2019.

## C. Relevance to Higher Level Objectives

23. **The proposed project supports the achievement of the World Bank Group's twin goals of ending extreme poverty and promoting shared prosperity.** In the short term, many individuals and households stand to lose their livelihood and fall further into poverty or abject poverty without support measures to deal with the fallout of COVID-19. The project will support the twin goals by promoting increased access to finance for MSMEs to mitigate job loss and business failure in the short term and promote the creation of more and better jobs over the medium to long term, thereby increasing income opportunities and life quality for households and individuals and supporting both economic relief from COVID-19 and medium-term economic recovery. The proposed project will facilitate the achievement of Outcome 1.2 ('Improved ease of doing business, through better economic infrastructure, regional integration, and access to demand-responsive skills development') of Thematic Area 1 ('Promoting sustainable, diversified, and inclusive growth') of the World Bank Group Country Assistance Strategy for Malawi for 2013-16, ( Report No: 74159-MW), extended to 2017 through the Performance and Learning Review (Report No. 95178-MW). The project supports the delivery of cross-cutting solution areas, including gender and fragility. The

project is also in line with IFC's "3.0" strategy, which defines proactive measures to create markets and support expanded private sector investment activity, based on a recognition of the weakness of existing private capital markets and the need to create space for the private sector. Providing additional liquidity and capacity support to financial intermediaries will allow them to continue supporting the private sector without jeopardizing their capital thereby ensuring the resilience of banks and sustainability of the financial market to continue supporting the private sector.

24. **The project is one important element within a phased World Bank Group response to COVID-19 in Malawi, from relief, through re-structuring, towards ensuring resilient recovery.**[19] As part of the *Relief* phase, with a clear life-saving focus, the Board approved in April 2020 a US$7 million Emergency Response and Health System Preparedness COVID-19 Project (P173806) under the Multi Phased Approach. The project aims to provide flexible support in line with the government's contingency plan, along with other key donors including the Global Alliance for Vaccines and Immunization (GAVI), the Global Fund, United Kingdom Department for International Development (DFID), and the United States of America (US). During this initial phase, the government also requested the release of the remaining US$30 million tranche under the Catastrophe Deferred Drawdown Option (CAT-DDO) (P165056) to help cover fiscal shortfalls impeding a robust response. As discussed above, this project, FInES, also contributes to select elements under the pillar on business growth and job creation of the *Relief* phase.

25. **In the *Restructuring* phase*,* the World Bank is focusing on protecting the poor and vulnerable, while shaping a reform agenda to lay foundations for recovery.** Through a restructuring of the Social Support for Resilient Livelihoods Project (P169198) the World Bank is re-prioritizing US$40 million towards the COVID-19 Urban Cash Initiative (CUCI) covering 185,000 poor households as well as COVID-19 top-ups to rural beneficiaries. To lock in policies for rebuilding better, the Bank is also re-starting its dialogue with the new government on a reform agenda to address short term fiscal shortfalls, while also helping shape critical medium-term structural reform, focusing on fiscal stability, State-Owned Enterprises (including in agriculture and energy) as well as the business climate, and social protection systems.

26. **Finally, to ensure *Resilient Recovery,* the World Bank is front-loading IDA19 for primary education, while also investing in the jobs agenda through FInES and an upcoming project in skills development.** IDA projects approved in FY20 worth over US$250 million are also ready to become effective with works ready to start, offering an important capital injection into the economy in the short term. Meanwhile, IFC is providing technical assistance to enable expedited release and clearance of COVID-19 response imports, while also pursuing investments in agribusiness, energy and financial sectors.

27. **Development partners.** Burden-sharing is well-distributed among donors to the government's response plan to COVID-19 as outlined in paragraph 6. The IMF approved a disbursement of US$91 million under the Rapid Credit Facility in May 2020 to help meet urgent balance of payment needs and it also approved debt relief support for Malawi of up to US$45 million through its Catastrophe Containment and Relief Trust. The African Development Bank approved a US$45 million budget support operation in July 2020. Meanwhile, the government's response plan is supported by the Global Fund, GAVI, DFID and the US.

[19] This framework aligns with the broader WBG framework for responding to COVID-19 across client countries.

28. **The project is also in line with the emerging discussions on a new World Bank Group Country Partnership Framework (CPF) for Malawi for FY21–25.** Electoral uncertainty delayed a new CPF for Malawi; with a new government now installed**,** discussions are re-starting on a new CPF covering IDA19 and IDA20. In February 2020 Malawi's Constitutional Court nullified the results of the contested May 2019 presidential election - a ruling that was then upheld in May 2020 by the Supreme Court, paving the way for a fresh election in June resulting in a clear victory by an opposition alliance. Following a re-run of the May 2019 presidential election, held on June 23, 2020 a new President has been sworn in, and the new Government has signaled a strong willingness to tackle corruption and drive reforms designed to unlock growth and attract investment. The new CPF under preparation will align with the priorities of the new Government and help the country achieve a strong economic recovery from the COVID-19 crisis, as discussed above, while also pursuing structural transformation of the economy, through increased agricultural and firm-level productivity, and higher levels of financial inclusion, especially to benefit MSMEs. The new CPF also builds on recommendations outlined in the Malawi FSAP, which sets the agenda for the further development and reform of the financial sector.[20] The project is also aligned with Sustainable Development Goals No. 1 ('no poverty'), No. 8 ('good jobs and economic growth'), and No. 9 ('industry, innovation and infrastructure'), among others. The Table 1 below shows highlight of the FY21 indicative lending and restructuring program (as of July 29, 2020) that will be finalized in the CPF.

**Table 1. World Bank Indicative Lending and Restructuring Program FY21**

| | Relief | Restructuring | Resilient Recovery |
|---|---|---|---|
| Saving lives | • COVID-19 Preparedness and Response Project (US$7 million, Multiphase Programmatic Approach)<br>• PEF (US$1.2m) | | |
| Protecting the poor and vulnerable | | • ***Social Support for Resilient Livelihoods (restructuring and Additional Financing for US$40million to be redirected to Urban Cash Response)***<br>• *Lilongwe Water Supply and Sanitation (re-prioritization of ongoing works)* | • **Malawi Education Reform Project (IDA US$68 million, GPE US$48.7 million)** |
| Sustainable business growth and job creation | | | • **Financial Inclusion and Entrepreneurship (US$86 million; of which US$22 million is for COVID)** |
| Policies, inst. and inv. for rebuilding better | • Release of Catastrophe Deferred Drawdown Option (US$30 million) | • **New Development Policy Financing series (tbd)** | |

Plain text: already delivered. *Italics: project restructuring or re-prioritization.* **Bold: pipeline**

29. **In addition, the project contributes to the World Bank's Strategy for Africa for 2019-2023**, especially in terms of its impact on empowering women, accelerating the digital economy, and supporting

[20] Planned project activities addressing these recommendations include (a) enhancing MSME access to finance, (b) supporting the development and implementation of long-term financing schemes, and (c) supporting the strengthening of regulatory processes in the banking and pension sectors.

the development of newly established nonbank financial institutions and the Africa approach for COVID-19 response with its emphasis on protecting livelihoods and jobs. The project supports the financial sector's ability to better leverage digital finance technologies for inclusive financial systems and helps promote usage of financial institutions' own funds thereby leveraging resources over and above the project in line with the maximizing finance for development (MFD) agenda.

30. **The project supports the achievement of the broader objectives of the Government's strategies and policies including the government's COVID-19 response objectives and directives**. The Government and the RBM have formulated national strategies to promote the growth of the private sector and to enhance financial inclusion. The Malawi 2017–22 Third Growth and Development Strategy (MGDS III) recognizes the need to improve the financial sector by addressing a number of specific challenges, including: (a) the lack of innovative financial instruments that meet the needs of MSMEs; (b) high interest rates; (c) underdeveloped, narrow, and illiquid capital markets; (d) limited long-term financing; and (e) low levels of financial literacy. The Government's 2016–21 Financial Sector Development Strategy (FSDS) aims to transform the financial sector to enable it to make a more significant contribution to poverty reduction and wealth creation. It is intended to achieve this by developing a more resilient, competitive, and dynamic financial system that would support and contribute to economic growth. In 2017, the RBM began to implement the 2016–20 National Strategy for Financial Inclusion (NSFI), which attempts to address a number of challenges, including (a) the lack of innovative financial instruments that meet the needs of MSMEs; (b) the low level of intermediation by banks to MSMEs; (c) the lack of a unique identification system to address information asymmetries that affect access to finance; (d) low levels of financial literacy; and (e) limited access to long-term financing. The country's MSME policy recognizes the need to tackle a number of constraints affecting the sector, including (a) limited access to finance; (b) lack of appropriate BDS; (c) poor information technology capabilities, skills, and standard; and (d) poor policy implementation that mandates special measures to address the challenges faced by businesses owned by women.

31. **The project will collaborate with activities of a cooling facilities grant program under the Green Climate Fund (GCF).** The World Bank is in the process of establishing a cooling facility that will mobilize climate finance from the GCF to support the uptake of sustainable cooling solutions in developing countries. SMEs are engaged in development sectors such as agribusiness and productive export-oriented farming that may require the use of cooling solutions. As such, the requested grant funding seeks to support SMEs' access to state-of-the-art cooling equipment and infrastructure along with necessary capacity-building activities. Discussions are under way with the GCF National Designated Authority in Malawi and other stakeholders on the World Bank's proposed cooling facility. In parallel, a technical assistance (TA) project is under preparation to seek funding from the Energy Sector Management Assistance Program on Efficient and Clean Cooling to inform the design of the potential GCF grant funding through activities such as market assessment studies, energy efficiency policy gaps, and training. Once the requested GCF grant is approved, it is intended to be considered aligned to this operation as an Additional Financing. This activity will be embedded within Component 2 of the project.

## II. PROJECT DESCRIPTION

### A. Project Development Objective

32. The Project Development Objective (PDO) is to increase access to financial services, promote entrepreneurship and capabilities of MSMEs in Malawi including addressing COVID-19 implications.

33. The PDO-level indicators' progress toward achieving the PDO will be measured through the following key results indicators:

- Value of MSMEs loans provided by Participating Financial Intermediaries (PFIs) through the line of credit and the COVID-19 emergency facility (US$)
    - Ratio of loans from PFIs to women-owned[21] MSMEs (percentage)
    - Ratio of loans from PFIs to youth-owned[22] MSMEs (percentage)

- Value of funds financed by MAIIC for innovative start-ups and SMEs (USD)
    - Ratio of the funds for women-owned enterprises (percentage)
    - Ratio of the funds for youth-owned enterprises (percentage)

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

- Number of MSMEs reporting improvement in capabilities (number)
    - Ratio for women-owned MSMEs (percentage)

34. **In the long term, the project is expected to contribute to the creation of jobs due to spillover effects on the supply and value chains.** Assessing spillover effects is beyond the direct monitoring scope of the project and hence job creation is not included as an indicator. However, the project will work with the Jobs Unit of the World Bank to track the developments on jobs created by the project, through survey tools which will be reflected at the Mid-term review and other project reporting mechanisms such as Implementation Status and Results Reports, directly and indirectly.

35. **Activities for this project will be structured under four mutually reinforcing components:** liquidity enhancement for MSMEs (including via a line of credit (LoC), Technical Assistance (TA), and de-risking/risk capital support); scaling of entrepreneurship and building firm capabilities; enhancement of the enabling environment for supporting the financial inclusion and growth of entrepreneurs; and project implementation support. These components are fully aligned with the World Bank's JET framework as well as its approach to the COVID-19 response. The liquidity enhancement will entail an immediate relief focus for MSMEs through the LoC and partial guarantee fund, making it particularly relevant to the immediate COVID-19 response even while it is also enabled to support medium-term economic recovery

[21] Women-owned enterprises/MSMEs in this case means the main founder owner(s) is/are women and/or women have a majority stake (51 percent and above) in the enterprise.
[22] Youth-owned enterprises/MSMEs in this case means the main founder owner is/are youth (defined as 35 years of age and under) and/or youth a majority (51% and above) in the enterprise

through the TA and risk capital support to create more productive and dynamic firms. All other components support economic recovery aspects through firm capability and BDS and market infrastructure creation. Digital innovation, skills, and entrepreneurship especially for women and youth will be an underlying and cross-cutting element across the four components. As part of the liquidity enhancement for MSMEs, the project will also provide funding to support the RBM's COVID-19 response alongside the RBM's ELA framework.

## B. Project Components

**Component 1**: **Liquidity Enhancement for MSMEs (US$65.0 million equivalent)**

36. **This component aims at increasing the supply of wholesale financing to the project's PFIs and scaling lending and/or investments to MSMEs.** The focus is on providing immediate relief and support for medium-term recovery and resilience of firms. Funding will cover two main interventions organized under the following subcomponents.

*Subcomponent 1.1: Credit line and special support for COVID-19 response for MSMEs, and technical assistance to participating financial intermediaries (US$49.0 million equivalent)*

37. **This aims at increasing the level of wholesale financing to PFIs to facilitate increased lending to traditional MSMEs in key development sectors including in the post-COVID-19 recovery and growth period.** By extending the IDA financing to the banks as well as the MFIs, the project will offer lower-cost funds to the sector and allow the financial institutions to pass some of the savings to MSMEs. Financing to MSMEs will be in the form of an LoC including under the ELA framework by the RBM to eligible PFIs (banks, MFIs, SACCOs), which will pass on this financing to eligible MSMEs in the form of credit for working capital and investment in local currency. The ELA framework was established in April 2020 as one of the measures announced by the Government of Malawi to prevent the spread of the COVID-19 pandemic and to mitigate its negative effects. Eligible MSMEs include those engaged in key development sectors particularly agribusiness and productive export-oriented farming; those with existing links to large commercial enterprises; and those operating in trade, clean energy, and e-commerce. The intention is to create a demonstration effect for lending to the MSME sector, which currently has low levels of access to finance. Through this intervention, the project will focus on SMEs as well as microenterprises seeking to graduate out of the micro space and have the potential to scale up.

38. **The credit line will be extended through the RBM to commercial banks, MFIs, and SACCOs that meet eligibility criteria for on-lending to MSMEs.** PFIs will assume the credit risk for the on-lent funds to MSMEs and, to avoid creating distortions, will set their own commercially sustainable interest rates. Eligibility criteria for the wholesale financier (the RBM), the PFIs, and final beneficiaries as well as the terms for on-lending and the flow of funds arrangements will be consistent with the World Bank's Policy and Guidelines on Financial Intermediaries, as detailed in the Project Implementation Manual (PIM) (see annex 2).

39. **TA amounting to US$2.0 million will be provided to the RBM and PFIs to strengthen their capacity to serve MSMEs, to adopt fintech approaches, and to reinforce the implementation of the lines of credit including under the COVID-19 response window.** TA will be provided to the RBM to strengthen

capacity to administer the LoC and to dig deeper into addressing the persistent high interest rates offered to MSMEs. The World Bank Group capacity-building and training on downscaling will be made available to banks (at the sectoral level), including SME banking training modules covering aspects such as policy, strategy, market segmentation, product development, credit risk management, information technology/management information system, and DFS topics such as credit scoring and psychometrics. The modules also support the piloting of innovative financing methods to address constraints on access to finance, especially in the case of enterprises owned by women (see annex 6). The subcomponent will also provide support to strengthen the capacity of PFIs to manage emerging risks such as the coronavirus. With the continued spread of the coronavirus, the disruption of global value chains, imports, financial capital flows, and trade is likely to negatively impact loan repayments and NPLs. Support will be provided to the RBM/PFIs to address any such concerns and build capacity, including through improved business continuity and contingency planning exercises to manage such emerging risks.

*Subcomponent 1.2: De-risking financing to MSMEs (US$16.0 million equivalent)*

40. **This subcomponent will provide support to MAIIC to play a key role in supporting the medium-term recovery and resilience of firms, although it will also support, through a partial guarantee fund, extension of credit for immediate relief.** Launched in 2018 to provide nonbank financing as well as guarantees to credit issued by banks, MAIIC is a local development finance institution (DFI), developed by the Government in collaboration with the private sector based on a feasibility study conducted with support from development partners including the World Bank. Due diligence was conducted by the project team on MAIIC in terms of its capacity and mandate which revealed the need for support to set up appropriate governance and other systems to ensure that MAIIC is operating according to best practice serving MSMEs. A transparent and fully commercial-based program would enable MAIIC to crowd in private sector investors and partners. Based on this, TA in the amount of US$2 million will be allocated from this subcomponent for MAIIC to continue building its institutional framework based on best practice. The TA will include advisory service (AS) in areas such as, raising capital, project structuring, and legal services on transactions; staff training and knowledge sharing exercises; and structuring of the institutional and governance systems according to best practice.

41. **Beyond the TA, the subcomponent will support** a partial credit guarantee (PCG) fund for MSMEs affected by COVID-19 and equity and quasi-equity financing and concessional debt for innovative start-ups and SMEs, including those that emanate from the training conducted under Component 2 and entrepreneurship ecosystem players (such as incubators, accelerators, tech hubs). Support under this subcomponent will be provided as described in the following paragraphs.

42. **Equity and quasi-equity financing for innovative**[23] **start-ups and SMEs**. MAIIC will invest equity and quasi equity and other flexible debt instruments in innovative high growth potential start-ups and SMEs leveraging other investors for risk sharing and MFD. Investments will be made either directly into start-ups and SMEs alongside other private co-investors or indirectly through investment contributions in seed funds, accelerators' follow-on funds, and VC funds investing in high-growth SMEs. MAIIC will maintain a minority share in all investments, with the MAIIC investment committee (which consists of independent private sector experts in equity finance and entrepreneurship, selected in accordance with

[23] Innovative in this case means new or improved products, new or improved processes and/or business models, and goods and/or services that are new/improved to the Malawi market.

the criteria established in the PIM and with a statement of non-objection by the World Bank) deciding on investments and exits.

43. **MAIIC will also leverage the ecosystem to develop and fund a pipeline of innovative high growth potential start-ups and SMEs.** MAIIC will extend service contracts to ecosystem providers (incubators, accelerators, hubs, and other local or foreign entities based in Malawi) to conduct training and bootcamps to help foster more innovative firms. Concessional loans to a value of no more than US$30,000[24] each will be provided directly to enterprises graduating from these ecosystem programs including those that complete the firm capabilities training under Component 2. Ecosystem providers will be selected on a competitive basis in accordance with criteria established in the PIM. Before extending financing, MAIIC will also conduct an assessment and review of MSMEs that apply based on criteria indicated in the PIM.

44. **MAIIC will also facilitate COVID-19 immediate relief to SMEs[25] through a PCG fund.** A PCG will be provided to eligible SMEs that can provide evidence of being affected as a result of COVID-19. MAIIC has a pilot guarantee scheme to support firms operating in the productive sector, which can be expanded to support SMEs under the project (see annex 5). MSMEs with a good credit history and existing contracts from a reputable corporation or state-owned enterprise or other government agency in good credit standing can use the partial guarantee to apply for credit from banks outside the LoC under Subcomponent 1.1. Firms seeking a PCG will be reviewed by MAIIC for viability and to verify with the RBM that they do not have an existing loan under Subcomponent 1.1. The banks will assume some of the risk of the loan to mitigate against moral hazard and determine whether to extend credit to MSMEs based on due diligence aligned with the RBM's prudential guidelines for extension of credit. The objective is to help lower the collateral demanded by banks. In the case of nonrepayment of a loan, banks will provide evidence of their effort to collect in accordance to criteria established in the PIM before approaching MAIIC for reimbursement. The PCG is intended to facilitate credit to MSMEs that have limited collateral in the form of hard asset but are otherwise revenue generating.

**Component 2: Scaling Entrepreneurship and Building Firm Capabilities (US$7.5 million equivalent)**

45. **This component will facilitate the building of firms' capabilities, with measures to enhance the quality of business support provided by private and public BDS providers.** This component will be delivered by competitively selected service providers (local and/or international). It will enhance firms' internal capabilities and increase their eligibility for financing. Women and youth entrepreneurs stand to benefit the most from the training.

*Subcomponent 2.1: Building Firm Capability for SMEs (US$5.5 million equivalent)*

46. **Through this subcomponent, the project will 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 (see annex 3 for details on the

[24] The exact loan amount will be decided upon by the BDS providers with the MoIT and the RBM based on number of final graduates.
[25] Eligible MSMEs include those engaged in key development sectors particularly agribusiness and productive export-oriented farming; those with existing links to large commercial enterprises; and those operating in trade, clean energy, and e-commerce and financial services.

Three-stage Approach and the training program). Firms' capabilities will be enhanced through 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. Concessional loans will be provided to firms through MAIIC (see Subcomponent 1.2) which will be selected among those who complete the entire training and graduate from the program to incentivize participation in the entire program. Rigorous impact evaluation of intermediate and final outcomes will be an integral part of the subcomponent design, as agreed upon with the government counterparts. Recipients of the concessional loans will include firms that have been affected significantly by COVID-19 but are able to demonstrate sustainability to produce key products during this period in the sectors whose activities have been significantly affected such as pharmaceuticals, tourism, and trading. The key products and eligibility criteria will be outlined in the PIM.

47. **A critical expected outcome of this project is to encourage the participation of youth and women-owned businesses.** Hence, firms will be selected into Stage 1 of the program based on experimental design and stratified by age and gender. In addition, training programs will be customized and will be informed by evidence (firm survey)[26] to meet the needs of the youth and women-led firms, with an emphasis on personal initiative skills training. Some of the other topics that may be covered in the life skills training modules are likely to include a combination of socioemotional skills training and information related to gender-based violence (GBV), returns to education, job readiness, financial literacy, and cross-cutting topics, such as nutrition and civic engagement. To support and facilitate businesses with the public sector, the training programs will include enhancement of MSMEs' capacity to supply goods and services to the public sector and to promote professionalization of the supply chain. The government payment systems supported under Component 3 will facilitate and modernize government-to-enterprises transactions.[27]

*Subcomponent 2.2: Developing Capacity of SMEDI (US$2 million equivalent)*

48. **This subcomponent will provide funding for SMEDI to improve its capacity to provide services to MSMEs and young entrepreneurs beyond the life of the project.** Through competitively selected consultancy firms and individuals, SMEDI will enhance the capacity and training skills of its staff and trainers in providing backstopping services to growth firms and MSMEs focusing on areas such as business development, advisory, and information services, as well as technology adoption and transfer within SMEDI's service provision. This subcomponent will also support purchase of goods, services, and small works by SMEDI such as computers, software, furniture, office refurbishment, Wi-Fi/connectivity, and others to expand SMEDI's outreach in the regions using existing buildings. These activities will facilitate outreach and delivery of services to MSMEs and enhance SMEDI's support to women and youth owned MSMEs in the agricultural sector.

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

[26] At least two firm surveys will be conducted to understand the needs of the firms. One at inception of the activities and one at the mid-term review to inform the design and content of the training programs. Additional surveys may be done depending on participants' evaluations of the workshops/training.
[27] The project will collaborate with the Malawi Digital Project and other projects to support development of e-GP and government e-marketplace systems.

49. **This component builds on activities supported under the Financial Sector Technical Assistance Project (FSTAP) (P122616).** The FSTAP aimed to facilitate increased access to finance by Malawi's unbanked, but bankable, population. The project will finance the implementation of activities that make it possible for MSMEs to access financing from financial institutions and to improve their prospect to grow. Specifically, this component will finance activities to increase use of digital financial services (DFS) for MSMEs; improve the effectiveness of the credit reference, movable asset registry, and business insolvency framework and systems; and increase financial literacy and consumer protection with the aim of increasing eligibility for MSMEs to access finance and grow.

*Subcomponent 3.1: Improving Financial Infrastructure and Regulatory Framework (US$6.0 million equivalent)*

50. **The subcomponent will aim at increasing the use of recently developed digital finance services (DFS) technology and systems in Malawi to expand financial inclusion.** Funds will be made available to facilitate increasing the volume of MSMEs that would be connected to the DFS technology through the national payments system, to facilitate PFIs to innovate and develop financial products that are suitable for MSMEs, and to reduce the cost of borrowing by reducing perception of risk by the PFIs. Funds will be made available to support onboarding of SACCOs and MFIs on to the MFI Hub and to support the MFI Hub to integrate with other third-party systems. This will facilitate secure lending for MFIs to MSMEs, facilitate penetration of financial services, and increase financial inclusion. The subcomponent will also provide support for the improvement of the functionality of central securities depository (CSD) for the stock exchange to facilitate participation of small private sector players on the exchange.

51. **This subcomponent will reduce risks associated with financial institution's lending to MSMEs, hence reduce the cost of funds available to the sector.** The subcomponent will support the integration of 'national identities' into the financial sector through a TA to the National Registration Bureau for the credibility of information being used across financial sector platforms. Through TA to the RBM, the subcomponent will support improvement of the credit reference system with the aim of developing credible credit scoring for the financial sector. Through this subcomponent, the project will also support use of the collateral registry systems to encourage adoption of movable and other assets as collateral by MSMEs. To encourage formalization, the project will collaborate with the Agriculture Commercialization (AGCOM) project (P158434) which is financing the development of a modern business registration system.

52. **Through this subcomponent, TA and capacity building will be provided to the MoFEPD** to review and/or develop suitable regulatory and policy frameworks to facilitate financial inclusion, and entrepreneurship, and help foster new DFS innovations, mortgage finance, leasing and long-term finance, and safety nets. Activities will include implementation and review of strategies and roadmaps on; financial sector development, financial inclusion, the electronic government to person (G2P) and government to businesses (G2B) payments system, and a deposit insurance system.

*Subcomponent 3.2: Increasing Financial Literacy and Consumer Protection (US$3.0 million equivalent)*

53. **This sub-component will provide TA to the RBM to implement financial literacy and consumer protection activities.** Guided by the recommendations from the country's Financial Inclusion Strategy, the

subcomponent will aim at fostering a savings culture, developing and implementing financial literacy awareness and consumer protection programs, and promoting the use of the DFS for MSME owners, particularly for women and young entrepreneurs. This subcomponent will also support the improvement of financial literacy of future entrepreneurs and hence support the broader integration of financial education initiatives at the primary school level.

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

54. **Funds under this component will be used 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 has been 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 ongoing surveys and regular reporting by beneficiaries.

## C. Project Beneficiaries

55. **The primary beneficiaries of this project are MSMEs that face constraints on access to financing for their businesses.** MSMEs will benefit from funds through the LoC extended to PFIs and the COVID-19 ELA. Firms will also benefit from possible access to early-stage financing/VC for innovative start-ups and SMEs that are deemed to be transformative and to have potential for high growth and job creation. These funds will be channeled through MAIIC. MSMEs will also benefit from the training intended to build their capabilities to enable these firms to participate in market links. Other project beneficiaries include those lacking financial literacy skills and the unbanked who will benefit from the financial literacy program. MSMEs that are affected by the COVID-19 emergency and private sector MSME players that normally would not receive payment from the Government for providing goods and services to the public sector due to COVID-19 will also be key beneficiaries.

56. **Government agencies (Ministry of Industry and Trade [MoIT], MoFEPD, RBM, MAIIC, SMEDI, and other financial entities) and ecosystem and BDS providers will also benefit from this project**, with most of this benefit taking the form of institutional strengthening and capacity building. PFIs will also be beneficiaries from capacity-building activities intended to enhance their capacity to adopt and implement innovative tools and DFS to better serve MSMEs.

**Project Cost and Financing**

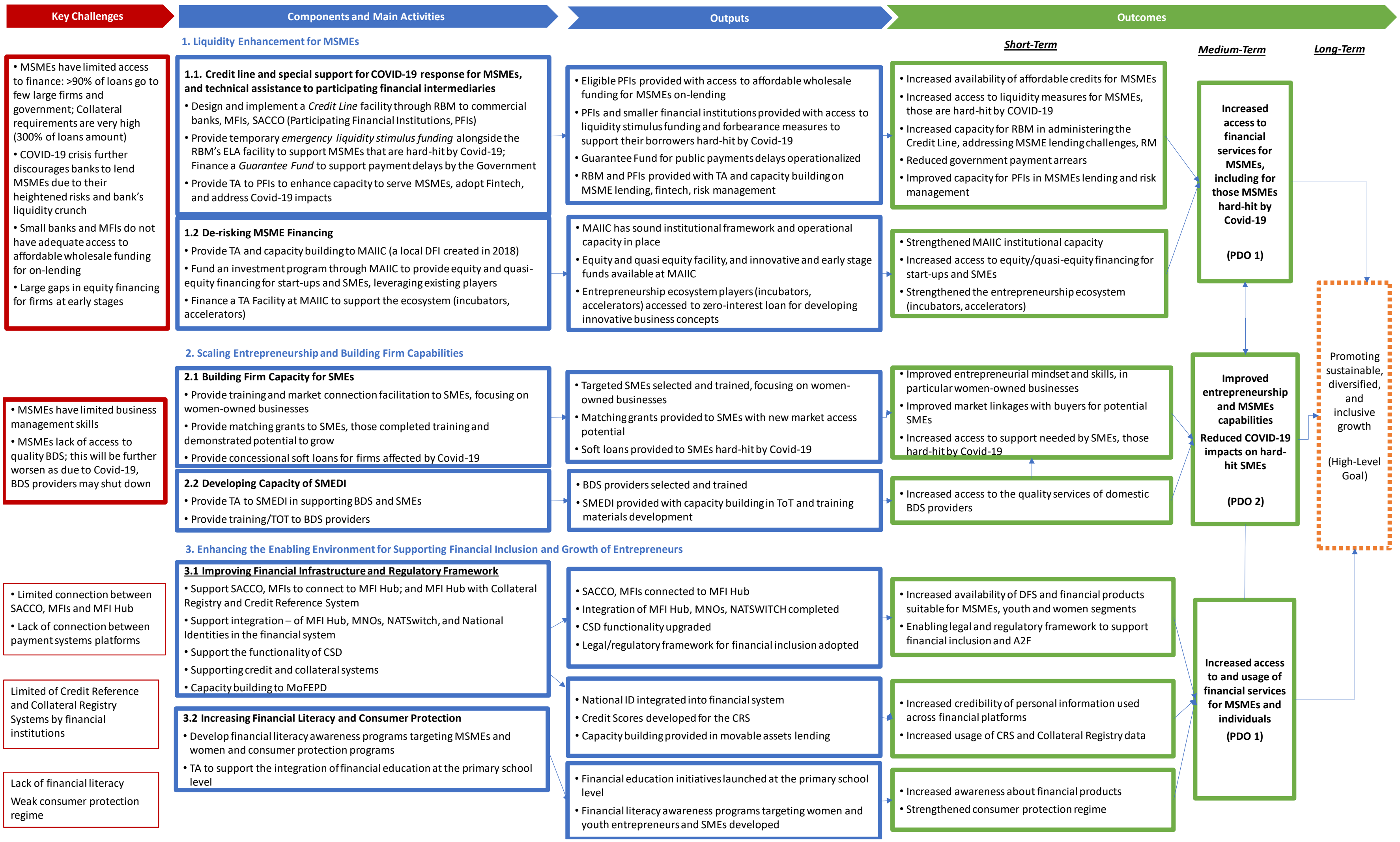
57. The proposed project is an Investment Project Financing (IPF) operation financed by IDA credit (US$86.0 million equivalent) to the Republic of Malawi. Finances are allocated as in Table 2.

**Table 2. Project Cost**

| Project Components | Project Cost (US$, millions) | IDA Financing (US$, millions) | Financing (percentage) |
|---|---|---|---|
| **Component 1: Liquidity Enhancement for MSMEs** | **65.00** | **65.00** | 100 |
| Subcomponent 1.1: Credit line and special support for COVID-19 response for MSMEs, and technical assistance to participating financial intermediaries | 49.00 | 49.00 | 100 |
| Subcomponent 1.2: De-risking financing to MSMEs | 16.00 | 16.00 | 100 |
| **Component 2: Scaling Entrepreneurship and Building Firm Capabilities** | **7.50** | **7.50** | 100 |
| Subcomponent 2.1: Building firm capabilities for SMEs | 5.50 | 5.50 | 100 |
| Subcomponent 2.2 Developing Capacity of SMEDI | 2.00 | 2.00 | 100 |
| **Component 3: Enhancing the Enabling Environment for Supporting the Financial Inclusion and Growth of Entrepreneurs** | **9.00** | **9.00** | 100 |
| Subcomponent 3.1: Improving Financial Infrastructure and Regulatory Framework | 6.00 | 6.00 | 100 |
| Subcomponent 3.2: Increasing Financial Literacy and Consumer Protection | 3.00 | 3.00 | 100 |
| **Component 4: Project Implementation Support** | **4.50** | **4.50** | **100** |
| ***Total*** | ***86.00*** | ***86.00*** | ***100*** |

## D. Results Chain

### Theory of Change



## E. Rationale for Bank Involvement and Role of Partners

58. **There are three interrelated reasons that cause markets to provide less than optimal financing to growth companies thus necessitating public sector intervention:** (a) asymmetric information due to lack of appropriate infrastructure; (b) institutional failures, including in tech-based financial services; and (c) coordination failures where the demand for financing is misaligned with the expectations of suppliers such as banks and investors. Under each case, the Government has a role to play, involving either policy reform or direct other interventions, with the World Bank Group having a role to play in supporting the achievement of the Government's agenda. A World Bank Publication High-Growth Firms: Facts, Fiction, and Policy Options for Emerging Economies (2019) shows that high-growth firms are not only powerful engines to achieve increased job creation and output growth but also to generate positive spillovers for other businesses along the value chain. The report calls for a shift toward policies that improve the quality of firm growth by supporting the development of capacities to innovate, managerial skills, and firms' ability to leverage global links and agglomeration. To help policy makers structure policies that support firm growth, the report proposes a new **ABC** framework to foster growth entrepreneurship, with this framework consisting of improving **A**llocative efficiency, encouraging **B**usiness-to-business spillovers, and strengthening firm **C**apabilities. In addition, a report by the World Bank Group's Independent Evaluation Group (IEG) (The Big Business of Small Enterprises, 2014) states that "a credible theory of change for MSME interventions must be focused on leaving a sustainable supply of the service (such as financing, business development services, or training) by establishing well-functioning markets and institutions, not simply providing a temporary supply of benefits to a small group of firms during a project's lifespan."

59. **The project will support MSMEs by** (a) supporting the implementation of regulatory reforms needed to improve the business environment for MSMEs, (b) addressing institutional weaknesses in financial infrastructure including fintech, (c) supporting long-term finance and de-risking schemes for MSME credit, (d) enhancing firm capabilities, and (e) facilitating the provision of finance to a critical mass of successful growth MSMEs to create a demonstration effect on financial intermediaries and investors. With the World Bank having an established track record of supporting Malawi's financial sector development, it will be able to leverage this experience to continue its efforts to transform the sector and to address remaining and emerging gaps. Following the completion of the FSTAP in June 2018 and of several other projects implemented in collaboration with IFC Advisory, the project will build on lessons learned from these projects and scale up successful interventions. The World Bank Group has strong expertise in the area of MSME financing. Both the IFC and World Bank have supported the development of financial services for MSMEs in several countries in Africa, using the MFD approach. Over the years, the design of these projects has been improved to ensure that PFIs achieve sustainability and that they are able to increase their outreach.

## F. Lessons Learned and Reflected in the Project Design

60. **Reviews conducted by the IEG in 2006, 2014, and 2015 documented several valuable lessons learned.**[28] In particular, these reviews show that LoCs are associated with better outcomes only when proper guidelines are followed. Prerequisites for the effectiveness of LoCs also include a certain degree of

[28] 2006 IEG Evaluation of the World Bank Lending for Lines of Credit; 2014 IEG Evaluation of the World Bank Group Experience with Targeted Support to Small and Medium Enterprises: 2006–2012; and 2015 IEG Evaluation of World Bank Lending for Financial Inclusion.

macroeconomic stability and the presence of a strong private financial sector. With Malawi enjoying a period of macroeconomic stability since 2016 and with its appropriately regulated financial system, it presents a suitable environment for the LoC to thrive.

61. **The Government should foster an enabling environment to ensure the effectiveness and sustainability of the LoCs and other types of financing, with the appropriate legal, regulatory, and institutional frameworks in place.** Evidence from other World Bank supported projects shows that several external conditions should be met to ensure that the project achieves policy objectives, including effective contract administration, good consumer protection systems, adequate private property laws, an efficient and independent judiciary, and a well-defined set of accounting standards and rules. After the implementation of several World Bank-funded LoCs in Turkey, it was found that subsequent measures to reform the business environment had a great impact on the growth of SMEs. The provision of TA to relevant government agencies and ministries will ensure that these conditions are met, leading to the success of the project. This is confirmed by an examination of the case of Mozambique, where in addition to providing loans for small enterprise clients, the project provided training for a Mozambican public-private financial development institution that stimulates SMEs, thus combining financial services with entrepreneurial development and assisting small enterprises with low level of creditworthiness to become bankable.

62. **The appropriate targeting of SMEs is critical to maintain competition and to avoid market failure.** Channeling finance to SMEs, either through intermediaries or directly, if not properly managed can cause market failure, given that all types of SMEs operate in the same environment. Preconditions for such interventions include a small-size economy with a shallow and underserving financial sector, with precautionary measures to prevent any possible market failures. Within the proposed project, targeted support for SMEs is aimed to build and sustain the capacities of the financial sector to meet the demand for credit from SMEs. The project targets finance to MSMEs, including those in rural and remote areas, while building capacity in filtering and selecting appropriate firms, stimulating competition, and creating a demonstration effect.

## III. IMPLEMENTATION ARRANGEMENTS

### A. Institutional and Implementation Arrangements

63. **The Borrower is the Republic of Malawi, represented by the MoFEPD.** The RBM will be responsible for the overall implementation of the project.

64. **A 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 be headed by a qualified project manager (PM), supported by the following key professionals: procurement specialist, Financial Management (FM) specialist, M&E specialist, financial sector specialist, trade project coordinator (PC), and environmental/social development specialist. The PIU staff will consist of experienced professionals recruited specifically for the project. The PIU will report directly to the governor of the RBM. Under the guidance of the Project Steering Committee (PSC), the PIU may hire other specialists or support staff as required for project implementation. A Project Technical Working Group

(TWG) has been established under the PSC to monitor project impact and ensure dialogue with stakeholders is done.

65. **The RBM will implement components 1,3 and 4 of the Project.**

66. **For subcomponent 1.1 (Credit line and special support for COVID-19 response for MSMEs) the RBM will enter into a subsidiary agreement with PFIs to implement the credit line.** It will also contract qualified service providers and/or short-term consultants to support implementation of the TA to the PFIs. The criteria for the selection of the appropriate service providers/consultants will be indicated in the PIM. (See annex 1 for implementation details and annex 2 for flow of funds under the credit line.)

67. **For Subcomponent 1.2 (De-risking financing to MSMEs ), the RBM will enter into a subsidiary agreement with MAIIC,** which will facilitate (a) establishment of a COVID-19 PCG fund; (b) the equity and quasi-equity financing to innovative start-ups and SMEs; and (b) the strengthening and funding of a pipeline of innovative start-ups and growth-oriented SMEs leveraging the business and entrepreneurship ecosystem support providers. The World Bank has assessed the technical staff and management of MAIIC and found them to be qualified and possessing the necessary experience to fulfil these tasks.

68. **Under Component 2, the MoIT will be the implementing agency**. However, the MoIT will receive its required funding (mostly incremental operating costs) from the RBM where the PIU will be based, and the FM- and procurement-related activities will be centralized at the RBM. The MoIT has appointed a senior officer to ensure ownership and implementation of Component 2. In addition, the PM will ensure coordination between the RBM and the MoIT. The MoIT will employ competitively selected local and/or international service providers to implement the firm support program in accordance with the criteria developed and contained in the PIM. The service providers will determine the best modalities to strengthen and support participating firms/entrepreneurship intermediaries (see details in annex 1). The PIU will implement procurements for SMEDI.

69. **Under Component 3 (Enhancing the Enabling Environment for Supporting the Financial Inclusion and growth of Entrepreneurs), the RBM shall contract short term consultants to support implementation of activities by the RBM.** The PIU will also implement activities under Component 4 directly, using consultants as needed.

## B. Results Monitoring and Evaluation Arrangements

70. **The PM will report on the M&E framework.** With support from the PIU, the PFIs, MAIIC, and MoIT will track both PDO indicators and indicators on gender and citizen engagement through a survey of beneficiaries conducted before the midterm review to determine whether their access to finance has increased and their firm capabilities have improved as a result of the project's interventions. This survey of beneficiaries will also provide data on beneficiaries' income segment. For Component 1, the PFIs will develop reporting and representation mechanisms to collect and monitor information on beneficiaries, with a disaggregation of PFIs' refinancing to compare the impact of new loans to the rollover of existing loans.

### C. Sustainability

71. **The sustainability of this proposed project is enforced through its design, which mandates the creation of a sustainable and dedicated commercially based financing platform to encourage PFIs to deepen outreach to entrepreneurs and to maximize the provision of private financing for development.** The credit line and the equity financing will fulfil a temporary function but will also build capacities in addition to a demonstration effect to show the ability of the financial sector to serve entrepreneurs sustainably. The program design prioritizes the participation of the private sector and includes the integration of financial leverage mechanisms across financing instruments. The TA for PFIs and MAIIC will focus on making their lending and investments strategies balanced to allow achievement of needed returns while meeting the development objective (coverage of costs, maintaining macroprudential norms, plus some margin). Regarding both debt and equity financing, the project prioritizes purely private sector management and evaluation of credit/investment decisions based on market terms, thus ensuring selection of commercially viable recipients. In addition, the co-financing measures will allow the private sector to have a role and thus be incentivized to ensure their selections and portfolio are sound. The program design also prioritizes the achievement of improvements to the capacities of private BDS providers and banks. The training, mentorship, networking, and business that MSMEs will receive will better prepare them for success constituting an important risk mitigation measure against potential default/failure which would in turn contribute to the sustainability of the lenders. All these factors will facilitate strengthening MSMEs' ability to access finance and sustaining the growth of their businesses beyond the life of the project and thus contribute to the economy.

72. **In terms of long-term financing, MAIIC will be able to mobilize private finance beyond the life of the project.** The effectiveness of MAIIC heavily depends on its capacity to implement an effective fundraising and investment strategy, based on a proper governance structure and regulatory framework, among other preconditions which will be incorporated in the project.

## IV. PROJECT APPRAISAL SUMMARY

### A. Technical, Economic and Financial Analysis

**Technical Review of Implementation Arrangements**

73. **The World Bank has assessed the RBM's track record to determine its operational and fiduciary capacities and to ensure that it has the legal mandate to act as the project's lead implementation agency**. The World Bank notes that the RBM has successfully served as the lead implementation agency for several World Bank operations in the past. Through a process of due diligence, the World Bank has found that the RBM's capacities to implement the project are **satisfactory**. The World Bank also finds the RBM capable of implementing the project's COVID-19 response activities, alongside its own ELA framework.

74. **In the context of Malawi's extensive and pervasive development needs and its high levels of poverty, the Government launched MAIIC on November 28, 2018.** MAIIC was incorporated as a Public Company Limited by Shares under the Companies Act (No. 15 of 2013). The Government of Malawi holds 20 percent of the company's equity, while the balance is set aside for private investors, currently held by

The CDH Bank. The objective of MAIIC is to play a key role as a catalyst and mobilizer of resources and to fulfil a bridging function to build partnerships between the public and private sectors. The shareholding structure allows for majority ownership by a private sector institution, with the Government's stake limited to 20 percent (giving it two board seats). The Government has pledged an initial capital investment of US$25 million, half of which has been transferred to MAIIC to facilitate this institution's launch. The World Bank has assessed MAIIC, finding that its core senior management (chief executive officer [CEO], chief financing officer, and directors) is well qualified and has the necessary relevant experience.

75. **In the context of the AGCOM and other projects, the World Bank has assessed the MoIT.** The MoIT has an SME department, with a dedicated official assigned to implement Component 2 of the project. However, the MoIT does not currently have the capacity to effectively manage the fiduciary aspects of the project. The project agreed with the RBM to assign a PC in the PIU to be established at the RBM to follow up and ensure the implementation of Component 2 and to coordinate the monitoring and reporting processes, including those related to fiduciary and safeguards, between the MoIT and the PIU. The RBM will remain responsible for all fiduciary aspects of the project.

76. **The design of the project and its implementation is based on a technical review conducted by the team to determine the challenges that MSMEs face in accessing finance and the constraints on the business environment and firm capabilities.** The design of the project components also builds on the FSAP, which was conducted in 2018 and which identified the various institutional and regulatory failures in Malawi's financial sector. In addition, a literature review (including from the IEG) was conducted to determine what works best to address the gaps and challenges identified. The project seeks to achieve this, with all components either directly facilitating the provision of finance by PFIs to MSMEs or by addressing different aspects of Malawi's nascent entrepreneurship environment (demand for and supply of financing). The TA provided by the project to PFIs, BDS providers, and MSMEs will build market capacities to serve entrepreneurs and MSMEs well beyond the life of the project. A summary of the main findings of the technical review is provided in the following paragraphs.

77. **Component 1 and Component 3 focus on increasing the supply of sustainable financing for MSMEs in the market, improving the financial infrastructure and deepening the financial sector, and increasing financial inclusion and consumer protection.** The project will provide affordable wholesale financing to financial intermediaries (banks, MFIs, SACCOs, and MAIIC) to be channeled to MSMEs. This will be complemented with the provision of capacity-building TA to enable the assessment and management of lending/investment in start-ups and MSMEs and to increase MSMEs' access to finance, albeit temporarily. This will contribute to the following: (a) creating a demonstration effect by producing a critical mass of MSME borrowers/investees that have successfully developed their businesses and increase their returns on investment/credit, thereby encouraging financiers and banks to increase their investment in and lending to this group, and (b) building the capacities of financial intermediaries to serve and manage loans to and investments in MSMEs beyond the life of the project. It should be noted that Malawi's MFIs have an extensive network across the country and that they play a significant role in providing financial services to MSMEs operating in both the formal and informal sectors. They also play a significant role in serving underserved segments of society, such as women and the residents of rural areas. However, MFIs face significant challenges in terms of facilitating access to affordable funding. Thus, they require programs to further encourage innovation and professionalization. By extending affordable wholesale financing and TA to strengthen the capacity of MFIs to serve these segments, the project will

be able to support MSMEs owned and managed by women and youths, particularly first-time borrowers. The project will also provide funding to support the RBM's COVID-19 response alongside the ELA framework.

78. **Investment in potentially bankable individuals (entrepreneurs, women entrepreneurs and youth, including recent university graduates) who do not currently hold an account at a financial institution will increase the number of bank/MFI customers and enable the sector to grow.** A growing customer base will encourage financial intermediaries to invest in products and infrastructure to serve the new customers. MFIs and SACCOs need to increase the value of deposits held at their institutions to ensure their sustainability and ability to extend credit to micro and small enterprises into the future. Expanding the role of credit bureaus, including through increasing the number of registered borrowers and through measures to encourage the effective use of the registry by banks, will enable borrowers to build a credit history, narrow the gap in information asymmetry, and decrease the level of perceived risk associated with making loans to this segment, thereby lowering the cost of borrowing. The development of digital tools and platforms to facilitate the provision of digital financial products and services (especially to MSMEs) will improve customer confidence in DFS and increase access to financing through digital lending platforms. Improving the functionality of the CSD of the stock exchange will encourage listing by companies and will facilitate the deepening of the financial sector by improving the allocation of resources in the system.

79. **Component 2 will address demand-side constraints facing MSMEs, with these constraints limiting their potential for growth and their ability to access financing.** This component will facilitate the building of firm capabilities and enhance the quality of business support provided by public and private BDS providers as well as SMEDI, thus improving the quality and increasing the quantity of viable, growth-oriented enterprises. SMEDI requires support to provide its services effectively and expand its outreach to underserved areas. The training provided through this component will improve the capabilities of firms and enhance BDS providers' capacity to better support MSMEs beyond the life of the project.

**Economic and Financial Analysis**

80. **The project is expected to generate significant benefits for Malawi's economy in the long run while providing liquidity support to firms to weather the COVID-19-induced economic shock in the short term**. Research has shown that improved entrepreneurship can contribute to economic growth by expanding employment opportunities, increasing productivity and innovation, and improving economic and social livelihoods.[29] Gender gaps in entrepreneurship and in female workers' pay affect aggregate productivity negatively, while gender gaps in labor force participation reduce income per capita[30]. Similarly, increasing female participation in the labor force to the same level as that of males could result in increases to GDP of up to 34 percent.[31] Likewise, increasing youth employment through the development of their entrepreneurship skills could yield significant positive economic returns for the

[29] Nasr, S., and A. Rostom. 2013. "SME Contributions to Employment, Job Creation, and Growth in the Arab World." World Bank Policy Research Working Paper WPS6682.
[30] Teignier M., and Cuberes D., 2014. "Aggregate Costs of Gender Gaps in the Labor Market: A Quantitative Estimate." UB Economics Working Papers
[31] Aguirre, DeAnne, Leila Hoteit, Christine Rupp, and Karim Sabbagh. 2012. "Empowering the Third Billion. Women and the World of Work in 2012." Booz and Company.

economy. The proposed project is also expected to contribute to generating positive fiscal returns by increasing the tax and revenues the Government receives from the registration of new businesses and the expansion of existing businesses and by leveraging private sector financing, thereby reducing the fiscal burden associated with government-funded SME finance programs. The COVID-19 ELA framework supported under the project will minimize closure of MSMEs and especially formal enterprises, minimizing the potential tax revenue losses for the Government and sustaining jobs.

81. **Empirical evidence indicates that increasing access to finance leads to job growth, with access to sales credit increasing firm employment growth by 2.6 percent.**[32] Other studies show that increasing MSMEs' access to finance can result in a growth in their sales and profits by more than 10 percent, in addition to contributing significantly to job creation.[33] By providing finance and TA support to facilitate attitude change and skills development, the project is expected to create an environment that enables MSMEs to thrive and grow, thus resulting in the creation of a greater number of more productive job opportunities. Supporting the sustainable creation and growth of women led MSMEs is also expected to result in the generation of increased employment opportunities for women.

82. **Overall, the project is expected to be financially sustainable, and the financing strategy will be designed to bring positive net aggregate return to cover the cost of the Project loan.** Based on the commercially oriented project design and on plausible assumptions regarding investment returns that may be achieved, financial projections and analysis of the project indicate that it will generate an overall positive net return, at least enough to cover the costs of managing the project and to sustain the management of the investments after the project closes.

### B. Fiduciary

#### (i) Financial Management

83. **The RBM will lead the implementation of the project through a PIU established at that institution.** A Financial Management assessment of the existing RBM FM arrangements has been undertaken to determine if the RBM will be able to ensure that (a) the funds will be used for the purposes intended in an efficient and economical manner and the entities are capable of correctly and completely recording all transactions and balances related to the project; (b) the project's financial reports will be prepared in an accurate, reliable, and timely manner; (c) the assets acquired under the project will be safely guarded; and (d) the project will be subjected to auditing arrangements acceptable to the World Bank. The assessment complied with World Bank Directive: Reference material - Financial Management in World Bank Investment Project Financing Operations (Catalogue Number OPCS5.05- ID.02), issued on February 10, 2017.

84. **The assessment shows that the RBM has the requisite FM arrangements for the successful implementation of projects,** as demonstrated by its implementation of the FSTAP, which closed in August 2018. The entity has the appropriate accounting package to conduct project transaction processing and reporting. The required accounting staff are in place, with the appropriate level of qualifications and

[32] Ayyagari, M., et al. 2016, Access to finance and job growth: Firm-level evidence across developing countries, World Bank Policy Research Working Paper 6704, Washington, DC: The World Bank.
[33] Aguirre et al. 2012.

experience. The project's audited financial reports were always submitted on time and with unqualified audit opinions. In the area of project management, the level of control and accountability has been good, as shown by observations in management letters and internal audit reports. Throughout the implementation of the FSTAP, the FM arrangements of the RBM were assessed as satisfactory and with a moderate risk level (see annex 1).

**(ii) Procurement**

85. **Procurement activities under the proposed project will be carried out in accordance with** (a) the World Bank's Procurement Regulations for IPF Borrowers (Procurement in IPF - Goods, Works, Non-Consulting and Consulting Services; July 2016, revised November 2017 and August 2018); (b) the World Bank's Guidelines on Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants, dated July 1, 2016; and (c) other provisions stipulated in the Financing Agreement (FA).

86. **The Borrower has prepared the Project Procurement Strategy for Development (PPSD) to identify the optimum procurement strategies to meet the PDOs, based on which the Procurement Plan for the first 18 months has been prepared**. This Procurement Plan establishes the selection methods to be used by the Borrower to procure goods, works, non-consulting services, and consulting services under the project. The Procurement Plan will be updated at least every 12 months, or as required, to reflect the actual project implementation needs. Each update will require World Bank approval and will be publicly disclosed in accordance with the World Bank's Access to Information Policy. The project will use the World Bank's Systematic Tracking of Exchanges in Procurement (STEP) as a primary tool to submit, review, and clear all procurement plans and conduct all procurement transactions for the project. The PPSD, a summary of which is presented in annex 2, is a living document that should be regularly updated during project implementation to provide necessary justifications for procurement arrangements, procurement plans, and their updates.

87. **Procurement implementation arrangements.** Procurement implementation, contract management, and the related decision-making authority under the proposed project shall be carried out by the RBM. The World Bank carried out a Procurement Capacity and Risk Assessment of the RBM, rating the procurement risk as Substantial. The assessment identified major risks that would adversely affect project implementation if not mitigated, with proposed mitigation measures summarized in the Table 3 below.

**Table 3: Risks and Mitigation Measures**

| No. | Risk | Risk Rating | Mitigation Measure | Time Frame | Responsible Agency |
|---|---|---|---|---|---|
| 1. | Delays in procurement processing due to limited capacity | Substantial | RBM will hire a dedicated Project Procurement Specialist with qualifications and experience satisfactory to the World Bank. | Within three months from signing the FA | RBM |
| 2 | Lack of adherence to procedures due to inadequate understanding | Substantial | RBM staff involved in project implementation will receive training on the | Throughout project implementation | World Bank and RBM |

| No. | Risk | Risk Rating | Mitigation Measure | Time Frame | Responsible Agency |
|---|---|---|---|---|---|
| | of the World Bank Procurement Regulations for IPF Borrowers. | | World Bank Procurement Regulations for IPF Borrowers.<br>The World Bank will also provide constant support to staff to ensure adherence to the Procurement Regulations. | | |
| 3 | Delays and/or unsuccessful completion of contracts due to inadequate contract management capacity | Moderate | Key staff who will be involved in project implementation will undergo contract management training to enhance their capacity; | Within six months of project effectiveness | RBM |
| 4 | Loss and/or unauthorized access to procurement records due to poor record management | Moderate | RBM will put in place an effective and secure record management system, with a dedicated staff to manage the records. | During project implementation | RBM |

### C. Legal Operational Policies

| | Triggered? |
|---|---|
| Projects on International Waterways OP 7.50 | No |
| Projects in Disputed Areas OP 7.60 | No |

### D. Environmental and Social

88. **RBM has extensive experience with risk management and due diligence processes within its operations** (described in the Risk Management Guidelines for Banking Institutions and A Guide to Risk Management Programs). These RBM risk management and due diligence processes have been expanded to incorporate the environmental and social (E&S) coverage through the development of the RBM's E&S Policies and Procedures for the Financial Inclusion and Entrepreneurship Scaling Project. To this effect, the PIU has been established at the RBM to manage the project. To ensure accountability, the RBM has appointed a senior official as PM. The PIU includes a position of environmental/social development specialist that has been created to manage E&S issues, particularly those that relate to the RBM's E&S policies and procedures for the FInES Project and to oversight of the PFIs' Environmental and Social Management System (ESMS). The success of the RBM's Environment and Social (E&S) policies and procedures will be dependent on its ability to screen and assess the ESMS developed and implemented by the PFIs. All prospective PFIs and MAIIC will be required to develop, implement, and maintain with adequate capacity an ESMS to manage E&S risks attendant to their portfolio of MSMEs involved in the project. All MSMEs will be assessed for E&S risks and impacts, in accordance with the PFIs' ESMS. The RBM will assess all PFIs' ESMSs to ensure their compliance. Before the final selection of PFIs, the RBM will

submit the evaluation report to the World Bank, following which the World Bank will issue a certificate of no objection. This will allow the RBM's E&S policies and procedures to be utilized to assess PFIs' ESMSs before any lending to MSMEs occurs. This will enable PFIs to develop their capacities in terms of the comprehensiveness of prospective PFIs' ESMSs and their subsequent ability to monitor the adequacy of their ESMSs and their compliance with the requirements of the Environmental and Social Standards (ESS). In addition, PFIs' ESMSs will include a budget and a framework for monitoring and reporting on the implementation of these ESMSs and on the E&S performance of MSMEs financed through the project. The RBM disclosed Environmental and Social Commitment Plan (ESCP), Environmental and Social Policy Procedures (ESPP), and Stakeholder Engagement Plan (SEP) on its website on June 4, 2020. The World Bank disclosed the ESCP on June 15, 2020, ESRS on February 14, 2020 and the SEP on April 30, 2020.

89. **An analysis of the E&S capacities of potential PFIs identified presents an overall positive, but highly variable, picture.** Larger-scale commercial PFIs as well as MAIIC are generally already incorporating E&S risk assessments into their due diligence processes for lending, as they see the risks as a commercial issue with the potential to affect the viability of their customers, the repayment of loans being provided, and ultimately their own business and wider reputation. The smaller microfinance organizations are generally interested in, but not currently including, E&S issues within their decision-making processes. The RBM will have to undertake a capacity analysis of this group and provide capacity-building support to enable these institutions to develop policies and ensure that loan officers have the necessary skills to identify risks and advise MSME clients on approaches to address them. The project includes provisions for support to PFIs to address capacity constraints on their ability to support MSMEs, including constraints related to E&S issues. MSMEs' exposure to E&S issues is anticipated to be limited, but it will require awareness raising and capacity building to address. Provisions for these activities included in the project structure through the Building Firm Capabilities Component. Facilitating the development of MSMEs' business skills, including skills related to E&S issues, will be significant for MSMEs wishing to access E&S-sensitive supply chains. The project will also provide support to develop skills related to general business readiness, licensing, record keeping, and so on. These activities will also build MSMEs' awareness and ability to address and manage E&S issues. Risks are expected to be **Moderate**. Where risks are identified, PFIs will be able to insist that clients or potential clients improve their E&S performance as a condition for receiving support through the project.

90. **Neither PFIs nor the final beneficiary MSMEs are identified.** The FinScope MSME study provides the most recent comprehensive analysis of MSMEs in Malawi. Unsurprisingly, given the dominant role of agriculture in Malawi's economy, most of the country's MSMEs operate in this sector, followed by wholesale/retail, manufacturing, and services. The project will provide financing to MSMEs and innovative start-ups and SMEs engaged in key development sectors, particularly agriculture and agro-processing, wholesale and retail trading /exports, information and communication technology (ICT), and clean energy, which should allow some inference of potential risks and impacts that can be made. The FinScope MSME study suggests that MSMEs expected to be involved in most project beneficiaries are most likely to be involved in agriculture and retail trade. Potential risks within the agriculture sector may relate to soil and conservation management, crop residue and solid waste management, water management, pest management and the use of pesticides, fertilizer use, and biodiversity and ecosystems. Within the retail sector, issues may relate to solid wastes management, water consumption, wastewater and effluents, energy consumption, and emissions to air. Across all MSMEs, the potential exists for E&S issues relating to occupational and community health and safety. Similarly, across all MSMEs, potential exists for risks

and impacts within the subprojects related to issues such as GBV, use of child labor, spread of HIV, and exclusion of disadvantaged groups. Using the GBV risk assessment tool, the project has been assessed as having a low risk, based on a labor influx risk profile that is considered low and that takes other contextual factors into consideration. Overall, the anticipated risk profiles of MSMEs and the expectation of E&S risks and impacts must be tempered with an understanding of the MSME business profile being small scale and largely (77 percent) household enterprises.

91. **The RBM will ensure that PFIs engage with stakeholders in a manner proportionate to the potential risks and impacts of the subprojects and in accordance with ESS 9 and ESS 10.** Stakeholder engagement provisions, including procedures for external communications in the project's life cycle and a grievance redress mechanism (GRM) that will respond to public enquiries and concerns on time, will be reflected in the ESMS for the PFIs. An ESCP that outlines material measures and actions to be undertaken during project implementation, including capacity building for the selected financial intermediaries, stakeholder engagement processes, and the setting up of a GRM has been developed.

92. **Gender sensitive citizen engagement will be promoted through the project**. The project will support citizen engagement mechanisms for promoting information and feedback flows, including using community radios, mobile phone messaging and by developing a platform for mapping and monitoring the implementation and the allocation of resources to PFIs and target groups. Social accountability tools, including score cards, public procurement and expenditure tracking will be tested and where proven effective and potentially sustainable, will be promoted. Project implementation performance measures will be scrutinized through feedback loops and performance assessment in a number of areas such as the compliance with strengthened governance standards and guidelines for citizen participation and gender responsiveness at key aspects of project implementation; the selection and appraisal of projects to be financed; climate screening and resiliency measures; awarding of contracts and monitoring of their implementation.

93. **The project design includes feedback and redress mechanisms on citizen satisfaction** with the project's provisioning of financial services to MSMEs based on periodic beneficiary feedback survey (disaggregated by gender). The survey will cover four aspects of satisfaction, namely: knowledge on part of citizens; efficiency of implementation; responsiveness to citizen needs; and transparency of process. The survey methodology is stipulated in the PIM.

## V. GRIEVANCE REDRESS MANAGEMENT

94. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service*. For

information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org."

95. **The project will establish a grievance redress management process to respond to communities and individuals who believe that they are adversely affected by the World Bank-supported project**. They will be able to submit complaints through the project-level GRMs or the World Bank's Grievance Redress Service (GRS). In addition, each PFI's ESMS will establish requirements for beneficiary MSME to establish a simple grievance mechanism suited to its risks and needs. Using the existing Appeals Committee and the required internal complaints handling systems, the project's Stakeholder Engagement Plan (SEP) has been developed together with a project-level process to respond to complaints, concerns, queries, clarifications, and feedback from stakeholders, including parties affected by the project. In addition, each PFI's ESMS will outline how each beneficiary MSME will be required to set up a simple, context-specific grievance mechanism that is proportionate to the risks faced. The GRS will ensure that complaints received are promptly reviewed in order to address project-related concerns. Project-affected communities and individuals may submit their complaint to the World Bank's independent Inspection Panel, which determines whether harm occurred or could occur as a result of the World Bank's non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention and after the World Bank management has been given an opportunity to respond (For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service. For information on how to submit complaints to the World Bank Inspection Panel, please visit http://www.inspectionpanel.org).

## VI. KEY RISKS

**Overall Risk Rating and Explanation of Key Risks**

96. While macroeconomic risk and COVID-19 pose substantial risk to project implementation, the overall risk of the proposed project is rated **Moderate.**

97. **Macroeconomic risks (Substantial).** Malawi's private sector development is subject to risks related to the macroeconomic environment, which is characterized by periods of stability interrupted by occasional shocks and economic slowdowns. From 2017 to 2019, Malawi recorded a high degree of stability in exchange rates and inflation rates. Nonetheless, the cost of credit has remained high and the global recession due to the COVID-19 pandemic, risks of development partners reducing support, and risks associated with climatic changes pose a threat to continued macroeconomic stability. Project interventions will ensure increased access to funds within the market and dialogue with the Government in order to lower expenditure and avoid crowding out the private sector. By supporting growth of private sector and MSMEs, the project will contribute to the growing of revenue base for the Government and hence supporting reduction in Government borrowing that is induced by budget deficits.

98. **Under the risk category 'Other', the COVID-19 induced economic recession poses substantial risk to project implementation.** While MSMEs have increased needs for affordable financing to sustain their businesses in the short-term and continue growth during recovery (hence the relevance of the project), PFIs, especially banks, may be hesitant to extend to them credit and may raise collateral

requirements for fear of increased NPLs. In addressing this, the PFIs may apply the highest risk category on all MSMEs by default. To mitigate against this and ensure more accurate/fair risk assessments, the project provides funding to strengthen the bank supervision department at the RBM in addition to capacity building initiatives provided by the RBM to the PFIs alongside the LoC, and activities under the enabling business environment component intended to improve banks' information on MSMEs. The capacity building and other project activities will focus on strengthening banks due diligence methods to accommodate for MSMEs, ensure consistent and proper reporting and use of the credit registry bureaus, and strengthening the systems and frameworks for mobile money transfers and digital banking which can provide for more transparent and easier tracking of borrower credit patterns. The PCG scheme will help mitigate against high collateral requirements.

## VII. RESULTS FRAMEWORK AND MONITORING

**Results Framework**
**COUNTRY: Malawi**
**Financial Inclusion and Entrepreneurship Scaling Project**

### Project Development Objectives(s)

The Project Development Objective (PDO) is to increase access to financial services, promote entrepreneurship and capabilities of MSMEs in Malawi including addressing Coronavirus Disease 2019 (COVID-19) implications.

### Project Development Objective Indicators

| Indicator Name | PBC | Baseline | Intermediate Targets | | | | End Target |
|---|---|---|---|---|---|---|---|
| | | | 1 | 2 | 3 | 4 | |
| **To increase financing to MSMEs** | | | | | | | |
| Value of MSME loans provided by Participating Financial Intermediaries (PFIs) through the Line of Credit including the COVID-19 emergency facility (Amount(USD)) | | 0.00 | 21,000,000.00 | 12,000,000.00 | 7,000,000.00 | 7,000,000.00 | 47,000,000.00 |
| Ratio of loans from PFIs to women-owned MSMEs (Percentage) | | 0.00 | 30.00 | 30.00 | 35.00 | 35.00 | 40.00 |
| Ratio of loans from PFIs to youth owned MSMEs (Percentage) | | 0.00 | 20.00 | 20.00 | 20.00 | 20.00 | 20.00 |
| Value of funds financed by MAIIC for innovative start-ups and SMEs (Amount(USD)) | | 0.00 | 1,000,000.00 | 2,000,000.00 | 2,000,000.00 | 1,000,000.00 | 6,000,000.00 |

| Indicator Name | PBC | Baseline | Intermediate Targets | | | | End Target |
|---|---|---|---|---|---|---|---|
| | | | 1 | 2 | 3 | 4 | |
| Ratio of the funds for women-owned enterprises (Percentage) | | 0.00 | 30.00 | 30.00 | 35.00 | 35.00 | 40.00 |
| Ratio of the funds for youth owned enterprises (Percentage) | | 0.00 | 20.00 | 20.00 | 20.00 | 20.00 | 20.00 |
| **To scale up entrepreneurship** | | | | | | | |
| Number of new firms established through the project support to incubators and accelerators (Number) | | 0.00 | 250.00 | 300.00 | 350.00 | 450.00 | 500.00 |
| Ratio of which are women-owned (%) (Percentage) | | 0.00 | 30.00 | 30.00 | 35.00 | 35.00 | 40.00 |
| **To scale up entrepreneurship and skills support for MSMEs** | | | | | | | |
| Number of MSMEs reporting improvement in capabilities (Number) | | 0.00 | 400.00 | 400.00 | 1,000.00 | 1,000.00 | 1,000.00 |
| Ratio for women owned MSMEs (Percentage) | | 0.00 | 30.00 | 30.00 | 35.00 | 35.00 | 40.00 |

### Intermediate Results Indicators by Components

| Indicator Name | PBC | Baseline | Intermediate Targets | | | | End Target |
|---|---|---|---|---|---|---|---|
| | | | 1 | 2 | 3 | 4 | |
| **Increasing financing available to MSMEs** | | | | | | | |

| Indicator Name | PBC | Baseline | Intermediate Targets | | | | End Target |
|---|---|---|---|---|---|---|---|
| | | | 1 | 2 | 3 | 4 | |
| NPLs on project portfolios (Percentage) | | 0.00 | 10.00 | 8.00 | 7.00 | 6.00 | 5.00 |
| Increase in citizen satisfaction with the project's provisioning of financial services to MSMEs based on periodic beneficiary feedback survey (percentage) (Percentage) | | 0.00 | 15.00 | 15.00 | 20.00 | 23.00 | 25.00 |
| of which: women citizen satisfaction (percentage) (Percentage) | | 0.00 | 4.50 | 4.50 | 7.00 | 8.05 | 10.00 |
| Value of PCG under the project (Amount(USD)) | | 0.00 | 500,000.00 | 1,000,000.00 | 1,500,000.00 | 1,700,000.00 | 2,000,000.00 |
| **Scaling Entrepreneurship and Building Firm Capabilities for MSMEs** | | | | | | | |
| Number of project beneficiaries who successfully complete stage 1 of the training program (Number) | | 0.00 | 500.00 | 500.00 | 0.00 | 0.00 | 1,000.00 |
| Number of project beneficiaries who successfully complete the stage 2 of the program (Number) | | 0.00 | 250.00 | 250.00 | 0.00 | 0.00 | 500.00 |
| Number of project beneficiaries who successfully complete the stage 3 of the trainign program (Number) | | 0.00 | 0.00 | 0.00 | 125.00 | 125.00 | 250.00 |
| Number of female entrepreneurs trained through the project (Number) | | 0.00 | 30.00 | 30.00 | 30.00 | 30.00 | 120.00 |
| **Enhancing the Enabling Environment for Supporting Financial Inclusion** | | | | | | | |
| Financial Literacy rate, | | 37.00 | 40.00 | 45.00 | 50.00 | 55.00 | 60.00 |

| Indicator Name | PBC | Baseline | Intermediate Targets | | | | End Target |
|---|---|---|---|---|---|---|---|
| | | | 1 | 2 | 3 | 4 | |
| disaggregated by gender (Percentage) | | | | | | | |
| Credit bureau coverage (Percentage) | | 2.00 | 4.00 | 6.00 | 10.00 | 12.00 | 15.00 |
| MFI Hub Membership (Number) | | 22.00 | 30.00 | 40.00 | 60.00 | 70.00 | 80.00 |
| MSME satisfactory rate with project implementation, disaggregated by gender (Percentage) | | 0.00 | 20.00 | 40.00 | 60.00 | 70.00 | 80.00 |

| Monitoring & Evaluation Plan: PDO Indicators | | | | | |
|---|---|---|---|---|---|
| **Indicator Name** | **Definition/Description** | **Frequency** | **Datasource** | **Methodology for Data Collection** | **Responsibility for Data Collection** |
| Value of MSME loans provided by Participating Financial Intermediaries (PFIs) through the Line of Credit including the COVID-19 emergency facility | This indicator captures the value of MSMEs loans through the line of credit including the COVID-19 facility | **Semi Annual** | Project reporting | PIU Data Base | Project PIU |
| Ratio of loans from PFIs to women-owned MSMEs | Ratio of loans from PFIs to women-owned MSMEs | Semi Annual | Project reporting | PIU Data Base | Project PIU |
| Ratio of loans from PFIs to youth owned MSMEs | Percentage of loans from PFIs to Youth Enterprises | Annual | RBM | Bank Supervision | PIU/RBM |

| | | | | | |
|---|---|---|---|---|---|
| Value of funds financed by MAIIC for innovative start-ups and SMEs | This indicator captures the value of funds from the project that MAIIC used for equity and quasi equity financing for innovative start-ups | Semi Annual | RBM Financial Stability Report/ RBM Bank Supervision Report | RBM | PIU |
| Ratio of the funds for women-owned enterprises | Ratio of funds financed by MAIIC for innovative start ups, to women owned enterprises | Semi Annual | RBM Financial Stability Report/ RBM Bank Supervision Report | RBM | PIU/RBM |
| Ratio of the funds for youth owned enterprises | Ratio of Youth Owned Enterprises | Annual | RBM data Base | Survey | RBM/PIU |
| Number of new firms established through the project support to incubators and accelerators | This indicator captures the new firms established through the support to incubators and accelerators | Three times | Baseline, mid and endline survey | Survey | RBM |
| Ratio of which are women-owned (%) | New firms established through the support to incubators and accelerator, ratio for women owned enterprises | Three times | Baseline, Mid and endline surveys | Survey | PIU |
| Number of MSMEs reporting improvement in capabilities | This indiator captures the number of MSMEs reporting improvements in their firms' capability after receiving | Semi Annual | Project reporting | PIU Database | Project PIU |

| | | | | | |
|---|---|---|---|---|---|
| | support from the project (disaggregated by gender) | | | | |
| Ratio for women owned MSMEs | ratio of women owned MSMEs reporting improvement in capabilities | Annual | Survey | PIU | PIU/RBM |

| Monitoring & Evaluation Plan: Intermediate Results Indicators | | | | | |
|---|---|---|---|---|---|
| **Indicator Name** | **Definition/Description** | **Frequency** | **Datasource** | **Methodology for Data Collection** | **Responsibility for Data Collection** |
| NPLs on project portfolios | This indicator captures the level of NPLs ratio to gross loans for the project loan portfolio | Annual | Project reporting | PIU Database | PIU |
| Increase in citizen satisfaction with the project's provisioning of financial services to MSMEs based on periodic beneficiary feedback survey (percentage) | Survey to cover 4 aspects of satisfaction with implementation of FInES: knowledge on part of citizens; efficiency of implementation; responsiveness to citizen needs; transparency of process. | 3 times. Baseline, midline and endline surveys | Project reporting | Survey | Project PIU |
| of which: women citizen satisfaction (percentage) | | | | | |
| Value of PCG under the project | The amount of PCG capitalization | Annual | PIU | Survey | RBM/PIU |
| Number of project beneficiaries who successfully complete stage 1 of the training program | This indicator captures the number of beneficiaries that complete the first stage of the training program | Annual | Project reporting | PIU database | PIU |

| | | | | | |
|---|---|---|---|---|---|
| Number of project beneficiaries who successfully complete the stage 2 of the program | This indicator captures the number of beneficiaries that completes the second stage of the training program | Annual | Project reporting | PIU database | PIU |
| Number of project beneficiaries who successfully complete the stage 3 of the trainign program | The indicator captures the number of beneficiaries that completes the third stage of the training program | Annual | Project reporting | PIU Database | PIU |
| Number of female entrepreneurs trained through the project | This indicator captures the number of female entrepreneurs that are trained by the project | Annual | Project reporting | PIU database | PIU |
| Financial Literacy rate, disaggregated by gender | This indicator tracks the level of financial literacy in Malawi, including for women | At the beginning of the project, midway through implementation and at the closure of the project | Project reporting | Survey | PIU |
| Credit bureau coverage | This indicator measures the ratio of population of adults coverage of credit bureaus to total population | Semi Annual | RBM Financial Stability reports/Bank Supervision Reports | RBM/PIU | |

| | | | | | |
|---|---|---|---|---|---|
| MFI Hub Membership | The indicator measure the growth of membership to the MFI Hub | Annual | PIU database | PIU | |
| MSME satisfactory rate with project implementation, disagregated by gender | This indicator measures the project satisfactory rate by the MSMEs | Annual | Project reporting | Survey | PIU |

## ANNEX 1: Implementation Arrangements and Support Plan

COUNTRY: Malawi
Financial Inclusion and Entrepreneurship Scaling Project

A. **Implementation Arrangements**

1. **The Borrower is the Republic of Malawi, represented by the MoFEPD**. The RBM will be responsible for the overall implementation of the project. In terms of specific project interventions and activities (Components 1-4), the implementation arrangements will be as follows:

**Component 1**

2. **Subcomponent 1.1 (Liquidity Enhancement for MSMEs):** The RBM will implement credit line in accordance with the Financial Intermediary Financing framework in Annex 2, and TA to PFIs as explained in Annex 2. With regards to the training of PFIs the RBM will contract qualified experts in the relevant topics. For each topic/TA needed, a minimum of three resumes/proposals should be short-listed and evaluated by the RBM, with the selection decision properly reflected and filed/documented – these must be made available to the World Bank if/when requested. A temporary emergency liquidity stimulus funding targeting MSMEs that will be hard-fit by COVID-19 alongside the RBM's ELA framework will be provided through this subcomponent.

3. **Subcomponent 1.2 (De-risking financing to MSMEs):** For the early stage equity financing and to support development of long-term-finance, the RBM will sign a subsidiary agreement with the MAIIC, which will be responsible for extending equity and quasi-equity financing and TA to seed and early stage funds as well as VC funds to invest in and support development and growth of innovative start-ups and SMEs with potential for high-growth and job creation, establishing a PCG fund and extending concessional financing to MSMEs that graduate from the firm capabilities training and other programs by BDSs, incubators, accelerators and other entrepreneurship support entities. Alongside the credit line and the COVID-19 response, the project will finance a PCG fund to support payment delays for goods and services covering the period of the COVID-19 crisis. The subsidiary agreement between RBM and MAIIC will detail the responsibilities of MAIIC in accordance with criteria indicated in the PIM. The MAIIC's responsibilities will include, amongst others, managing the sourcing, review and making investments in, and extending TA to, eligible ecosystem partners as decided by an independent investment committee composed of private sector specialists to be established at MAIIC in accordance with criteria indicated in the PIM. The selection of the investment committee members will require a statement of non-objection by the World Bank. Neither the MAIIC Board of Directors (BOD), RBM, MoFEPD, the World Bank nor any government entity will play a role in the selection and sourcing of investments. The MAIIC BOD, the RBM, MoFEPD will maintain an arms-length monitoring role to ensure MAIIC management and the investment committee are implementing the related activities in accordance with the PDO and criteria indicated in the PIM and that MAIIC management is ensuring proper fiduciary and safeguards management and reporting to the RBM. Any changes to the investment committee criteria, governance and investment process, and the investment strategy, requires World Bank approval.

4. **For the TA and other experts MAIIC may contract qualified experts as needed.** For each topic/TA needed, a minimum of three resumes/proposals should be short-listed and evaluated by the RBM, with the selection decision properly reflected and filed/documented – these must be made available to the World Bank if/when requested.

5. **PCG fund:** A PCG of a maximum of or other share defined in the PIM will be provided to eligible SMEs that can provide evidence of being impacted as a result of COVID-19. MAIIC has a pilot guarantee scheme to support firms operating in the productive sector which can be expanded to support SMEs under the project (see Annex 5). MSMEs with a good credit history and have existing contracts from a reputable corporation, or State-owned-enterprise or other government agency in good credit standing can use the partial guarantee to apply for credit from banks outside the LoC under Subcomponent 1.1. Firms seeking a PCG will be reviewed by MAIIC for viability and to verify with the RBM that they do not have an existing loan under Subcomponent 1.1. The banks will assume some of the risk of the loan to mitigate against moral hazard and determine whether to extend credit to the MSMEs based on due diligence aligned with the RBM's prudential guidelines for extension of credit. The objective is to help lower the collateral demanded by banks. In the case of non-repayment of a loan, banks will provide evidence of their effort to collect in accordance with criteria established in the PIM before approaching MAIIC for reimbursement. The PCG is intended to facilitate credit to MSMEs that have limited collateral in the form of hard asset but are otherwise revenue generating.

(a) **Criteria for selection of start-ups/SMEs seeking equity/quasi equity and concessional debt financing from MAIIC.** To be eligible for financing from MAIIC either directly or indirectly, a Start-up/SME must have a presence in Malawi with the locus of its operations conducted in Malawi even if their product target market is external. This includes companies with foreign shareholders but who include Malawians and/or legal residents. Eligible SMEs may not be engaged in any of the activities or sectors included in the negative expenditures list described in the project PIM. When evaluating a proposal, the following should be taken into consideration: Team; Stage of investment; Market size; Comparative edge; Market validation; Business model and unit economics; Risk; Valuation; Exit; Track Record including annual audited financial statements (the audit report must be void of any adverse or disclaimer opinions in the last three years); Due diligence reports for investments will be made available to the World Bank upon request.

(b) **Broad Investment Parameters.** Table 1.1 provides high level guidelines for MAIIC based on a total capital investment of around US$5 million mobilized during the first five years. Table 1.1. is indicative and the investment strategy and budget is subject to adjustment and re-allocation to meet the market demand. The MAIIC may also decide to apply the fund of funds model and use the allocation to invest in funds (contributing capital as well as management fees) with a similar investment strategy and targets as proposed in the table below. Based on best practice MAIIC will make co-investments in Start-ups and SMEs as a minority shareholder but with equal terms '*pari passu*' alongside private investors who have skin in the game and are equally convinced through their own due diligence of the potential viability of the investment. Another best practice is for MAIIC to invest alongside a lead investor that has the capacity to fully support the investee develop its business and make it successful. This addresses the capacity constraints in MAIIC to follow-up closely on each investment since they have a lean structure. Any key changes to the investment strategy and allocations will require MAIIC BOD and World Bank approval within the project life and the BOD's approval after the World Bank-financed project closes.

**Table 1.1. Broad Investment Parameters of the MAIIC over the Project Life (five years)**

| Type | Direct Investments | | | Total |
|---|---|---|---|---|
| Stage (average investment ticket size) | Seed (below US$200,000) | Early Stage (US$200,000-US$500,000) | Venture (US$500,000 - US$1.5 million) | |
| MAIIC Allocation | US$700,000 | US$1.8 million | US$2.5million | US$5 million |
| Sectors | Opportunistic with focus on Tech, Media, Telecom, Agricultural, Health, Manufacturing, financial services/fintech, and green energy | | | |
| Players | Accelerators / Incubators + Seed Funds | Accelerators / Incubators + Angel Funds / networks/Early Stage VC funds | Early stage and VC Funds, family offices and other corporate investors and investment banks | |
| Target number of companies (appx.) | 7 | 5 | 1-2 | 13-15 |
| Private leverage x1.5 min. (approximation) | US$1 million | US$2.7 million | US$3.75 million | US$7.45 million |
| **Total investment Allocation** | **US$1.7 million** | **US$4.5 million** | **US$6.25 million** | **US$12.45 million** |

**(a) Investment Guidelines**

(i) The company will need to have a co-investor(s) as MAIIC will only contribute a part of the overall capital raise – refer to Table 1.1.
(ii) The lead investor in the opportunity will need to provide all Due Diligence to MAIIC.
(iii) The opportunity should yield a projected IRR of at least 12 percent
(iv) A company can only apply up to two times for MAIIC investments across its lifecycle. If the company is applying for a second investment, the company must meet most of their base case assumptions under the first investment.

**(b) Investment structure**

(i) Equity: At its simplest, a straightforward equity investment in the target firm with MAIIC subscribing to share capital in the entity at the agreed valuation. This straightforward structure may be modified so that the investment is made in tranches (steps). The steps may be benchmarked against targets, milestones or a specific timeframe. The subscription price may also be adjusted up or down if milestones are not achieved or forecasts are exceeded.
(ii) Convertible Debt: MAIIC provides financing to the enterprise as a loan at an agreed interest rate, but the loan becomes convertible into equity in the target business (sometimes automatically, at other times upon election of MAIIC).
(iii) In most cases, as approved by the Investment Committee, MAIIC would look to sign a term sheet highlighting the overall structure of a deal. The purpose here is to highlight the intent and the

overall perceived structure. This is non-binding and is subject to change based on the outcome of the due diligence process.

(iv) Regardless of the structure of the investment, and if applicable under the Malawian Law, certain standard protective provisions will need to be included in the various agreements. These include standard industry terms which will be defined in the PIM, such as drag and tag rights, rights of first refusals, audit rights, board seats, targets, non-compete, good leaver and bad leaver clauses and various reserved matters. These terms are determined on a case by case basis and are mainly there to protect MAIIC's downside risk.

**(c) Investment Committee**

(i) The Investment Committee (IC) will be composed of seven members including the MAIIC CEO. The purpose of the IC is to formulate the investment strategy, evaluate, approve, and review all capital deployments by MAIIC under this project. The MAIIC Board of Directors may delegate to the IC the selection of approval of all investments under the project. The IC will also oversee all exits and all restructurings across the areas that MAIIC is involved in through the project. Establishment of the IC is a condition for disbursement to MAIIC.

(ii) The MAIIC CEO will propose IC members to the Board who will appoint the IC in accordance with criteria in the PIM and on a non-objection from the World Bank.

- To be eligible as a member of the IC, an individual must:
  - Be non-governmental.
  - Possess Experience in VC/investment.
  - Possess Experience in the entrepreneurial ecosystem – either as an investor, or as an entrepreneur.
  - Have limited or no conflict of interest – see paragraph e (i) below on conflict of interest.
  - Possess strong analytical and operational experience.

- Tasks and Obligations of the IC include:
  - Formal approval of Investments
  - Understanding the MAIIC investment goals and objectives under the project.
  - Adopting, reviewing and revising MAIIC's investment policies and guidelines.
  - Establishing a strategic framework within the overall MAIIC's strategy for capital deployments.
  - Authorizing all capital deployment activities within the set guidelines and framework.

- Monitoring and reviewing performance of investments including taking necessary corrective actions as needed.

- Approving all exits.
  - Administrative: other functions the IC may undertake based on best practice include:
  - Review and approve annual budget that is to be shared and approved by the Board.
  - Monitor capital deployment and MAIIC's annual budget.

**(d) Investment Selection Process**

(i) A meeting agenda including dossiers of each application shall be prepared and circulated by the MAIIC CEO to IC members at least five business days before each meeting to enable the Committee to make informed decisions. A simple majority vote will result in a resolution being passed. The Chairperson will have a casting vote if the vote is tied. If the Chairperson is absent from the meeting, the remaining members will elect one of their number as Chairperson of that meeting.
(ii) The IC shall maintain clear minutes or other records of meetings and activities of the Committee, which must be circulated to all Committee members within ten business days for approval and subsequent signature. Once signed, the minutes shall be distributed to all members and the MAIIC Board.
(iii) Decisions made by the IC will be evidenced by resolutions passed at a meeting and recorded in the minutes of the respective meeting, or by a written resolution (including unambiguous email approval) signed by all members of the Committee.
(iv) The IC shall be responsible for the appointment, compensation and oversight of the work of any independent counsel or other advisers retained by the IC, and the MAIIC shall provide appropriate funding for payment of reasonable compensation to any such independent counsel or other advisers retained by the IC.

**(e) Conflict of Interest**

(i) **The BOD, MAIIC management, and the IC members will adopt a code of conduct, conflict of interest policies and procedures, and enforce several measures to mitigate conflict of interest that may arise.** The details of these policies and procedures as well as the mitigation measures are detailed in the PIM. The Committee and Board members and any other person present at an investment selection meeting (Invitees) must declare any actual or potential conflicts of interest in any investments at the start of each meeting or, at a minimum, before discussion of the relevant agenda item or topic. All details of any conflict of interest must be documented in detail in the minutes of the relevant meeting. Before discussing the relevant agenda item or topic, the Committee must determine by majority vote (excluding the meeting member with the potential conflict of interest) whether the relevant member or Invitee has a real or perceived conflict of interest and whether that member or Invitee shall be excused from the deliberations on the conflict of interest. All actual or potential conflicts of interest shall be reviewed with MAIIC's designated Legal Counsel.

**Component 2**

6. To facilitate the firm capability improvement process, the program will adopt an inclusive approach and train a large set of firms in soft skills through a process intended to change their mindset (see Annex 3 for detailed description of this component). During the first stage, the screening criterion will be determined by the number of firms interested in participating in the program. The second stage trainings will be more customized and tailored to meet the needs of the firms and their markets, with some higher threshold for firm capabilities and capacity to grow. The final stage of the program would be highly customized for an even smaller number of firms, with grants provided to participants that graduate

from the program and with the provision of support to establish linkages between these graduates and potential markets and buyers.

7. **Since Component 2 falls under the mandate of the MoIT, the MoIT will be responsible for all the TA relating to Component 2 (evaluation and call for proposals, selection of consultancies, and M&E of results).** The PM will ensure coordination between the RBM and the MoIT and the RBM will delegate within the PIU established at the RBM, a dedicated PC who will assist the RBM to coordinate with the MoIT and to work to ensure proper inter-ministerial coordination for the project. The MoIT will assign a focal person for Component 2 who will work with the PM PC. Since the MoIT is new to World Bank fiduciary and safeguards processes, the RBM/PIU would still undertake and be responsible for the fiduciary and safeguards aspects of all consultancy contracts including under Component 2 and monitor and evaluate technical implementation of Component 2 through the dedicated PC.

8. **The PC for Component 2 at the PIU will be a technical specialist with substantial experience leading related and similar projects, nationally or internationally.** The PC will report directly to the PIU PM and to the head of SME department at the MoIT. The responsibilities of the PC will include, among others: (i) overseeing, coordinating, and managing the day-to-day implementation of Component 2 with the MoIT; (ii) managing the procurement, FM, disbursements, and safeguards aspects of Component 2; (iii) coordinating the preparation, adjustments, and use of the project management tools, including the PIM, annual work plans, Procurement Plan, and disbursement projections related to Component 2; (iv) coordinating with key stakeholders on the technical aspects of Component 2; (v) monitoring progress toward the PDO and intermediate indicators of the Results Framework; (vi) preparing project reports; and (vii) acting as the main point of contact with the World Bank. Knowledge and understanding gained on how these elements work in a context of a World Bank project will be an added value to the MoIT.

9. **For the training on firm capabilities, the MoIT will issue a competitive call for proposals (based on criteria listed in the PIM) and document/file the short-listing, evaluation, and selection process/decision to be made available to the World Bank if/when requested.** The call for proposals will be flexible to allow the bidders to determine the best modalities to strengthen and support participating firms/entrepreneurship intermediaries given their knowledge, capacity and experience in other countries as well as in Malawi. The selection of the firm (or firms[34]) assigned to deliver the firm capabilities training will criteria including (but not limited to) the following:

(a) A reputed firm, with a good track record of delivering trainings for SMEs in Malawi and other developing countries (a local-international partnership delivery model is preferred);
(b) Experience in delivering personal initiative skills training, the training offered in Stage 1 of the program is essential;
(c) Experience in delivering customized training to special focus groups such as women entrepreneurs is highly desirable; and
(d) Experience in delivering other related skills training such as financial literacy, management skills, digital skills etc. is essential.

[34] When selecting multiple firms, the MoIT must avoid having multiple firms deploying in the same areas or duplicating activities. The idea behind selecting more than one firm is to ensure adequate geographic coverage is achieved or gaps in specific expertise/topics are addressed.

10. **The training of BDS providers will be in the form of TOT as well as bringing in experts and consultants for workshops on how the BDS can improve their targeting and effectiveness through a sustainable model.** Bidders will also need to provide if they can, a development and implementation strategy to provide support to the MoIT in attaining internal competencies to manage a program to support SME business development and other programs with similar elements. The MoIT will issue a competitive call for proposals (based on criteria listed in the PIM) and document/file the short-listing, evaluation, and selection process/decision to be made available to the World Bank if/when requested. The selection criteria for selecting firm/consultants include:

(a) Specialized firm support training courses;
(b) Sharing software tools that may be useful for managing firm support programs;
(c) Sharing, discussion and appropriation of operations manuals, methods of ensuring transparency in processes, among others;
(d) MoIT members presenting the program internally, to partners and to potential applicants to develop their understanding of the program and to respond to questions that may arise; and
(e) Any other capacity building ideas from the experience of the national or international independent firm/consortium of firms, including visits to other programs in other countries, if this is feasible within the Project budget.

11. **Funding will be provided to improve SMEDI's capacity** to provide services to MSMEs and young entrepreneurs beyond the life of the project as well as bringing experts and competitively selected consultancy firms or individuals to enhance the capacity and training skills of its staff and trainers. This subcomponent will also support purchase of goods, services, and small works, and by SMEDI such as computers, software, furniture, office refurbishment, Wi-Fi/connectivity and others to expand SMEDIs outreach in the regions using existing buildings. The selection criteria which will be details in the PIM for selecting firm/consultants include:

(a) Specialized firm support training courses.
(b) Supporting the preparation or sharing, discussion and appropriation of operations manuals.

12. Any other capacity building ideas from the experience of the national or international independent firm/consortium of firms, including visits to other programs in other countries, if this is feasible within the Project budget. **For the TA and other experts MAIIC may contract qualified experts as needed.**

**Component 3**

13. **The RBM will implement all activities under this Component through the deployment of qualified service providers/consultancies.** With the competitive selection of service providers, the RBM will be responsible for implementing the TA on financial inclusion, and TA activities to support the development and improvements of DFS, CSD and credit reporting systems and to address institutional and regulatory issues to facilitate the emergence of a more enabling environment to support increased entrepreneurship and access to finance for MSMEs. Selected service providers/consultants will be required to meet the criteria in terms of technical expertise and established track record, together with any other criteria established in the PIM.

**Component 4**

14. **The RBM will be responsible for all activities under this Component.** The PIU will oversee day-to-day project implementation; monitor progress; coordinate the utilization of project funds; and establish mechanisms to account for this utilization. To fulfil these roles, the RBM will deploy a qualified PM at the PIU, as well as the required technical and fiduciary experts in accordance to criteria established in the PIM. Specifically, the PIU will be headed by a qualified PM and include the following key professionals: procurement specialist, FM specialist, M&E specialist, financial sector specialist, trade PC, and environmental/social development specialist. The PIU staff will consist of experienced, competitively recruited professionals to work specifically in the PIU for the duration of the project. The PIU will report directly to the Governor of the RBM. With the agreement of the PSC, the PIU may hire other required specialists or support staff to enable it to fulfil its defined obligations under the project.

**Project Oversight**

15. **The 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 membership of the PSC consists of the Secretary to the Treasury (ST); the Principal Secretary for Ministry of Industry, Trade and Tourism; the Principal Secretary for MoFEPD; the Deputy Governor of the RBM; the President of the Economics Association of Malawi (ECAMA); the President of Financial Market Dealers Association of Malawi; the President of the Bankers Association of Malawi (BAM); the President of the Insurance Association of Malawi; the President of the Malawi Confederation of Chambers of Commerce and Industry (MCCCI); the President of the Microfinance Network; the Executive Director of the RBM; and the PC. The PSC will be chaired by the Secretary to the Treasury and co-chaired by the Governor for the RBM. The PSC will not be involved in the management of the project nor in the decision-making processes related to project financing. The PSC will be a high-level oversight body responsible for providing general policy guidance for the project. The PC will serve as secretary to the PSC, which will meet bi-annually.

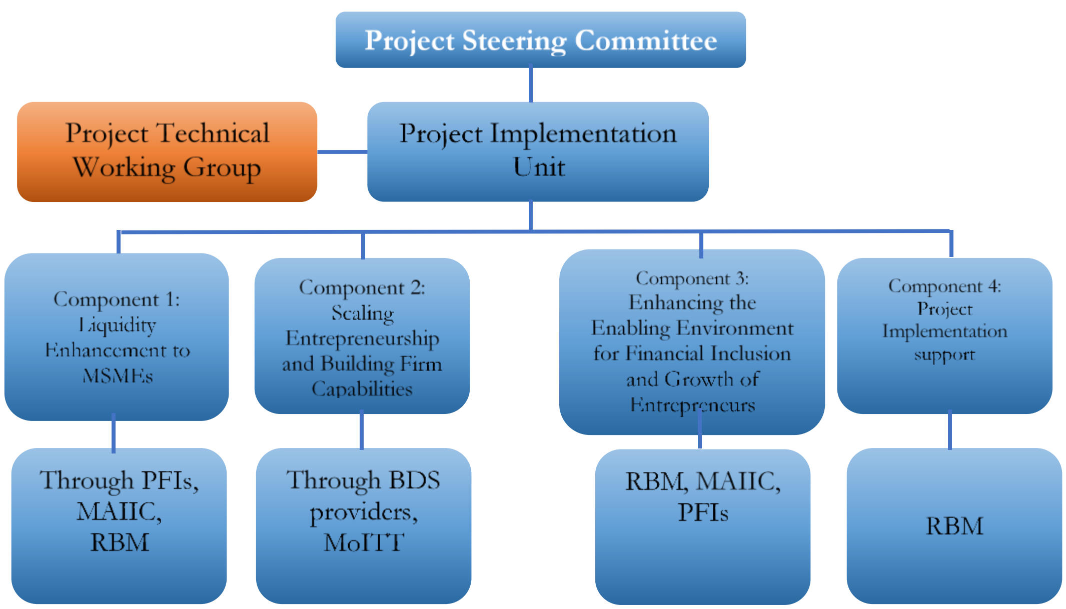
16. **A Project Technical Working Group (TWG) has been established under the PSC to monitor project impact and ensure dialogue with stakeholders is done.** The TWG will report to the PSC. Members of the TWG consist of the PM (Chairperson), the Director of Pensions and Financial Sector Policy, the Director for Debt and Aid Management, the Director of Public Finance Management Services, the Director of Bank Supervision, the Director of Micro-finance and Capital Market Supervision, the Director of National Payment System, the Director of Economic Policy Research, the Director of Accounting and Finance, the Director of Financial Markets, the Director of Financial Sector Regulations and the Director of Cooperatives and SMEs. The PIU will function as the secretariat for both the PSC and the TWG. The TWG will meet on a quarterly basis in the early years of the project, with a shift to biannual meetings later. The project will utilize existing policy dialogue forums to improve dialogue and coordination. These platforms include the Joint Sector Reviews (under TIP-SWAp), TWGs involved in the development of Tip-SWAp, and other relevant TWGs under the National Export Strategy and the Financial Inclusion Strategy. The project will also utilize the existing PPD Forum and other relevant commodity platforms.

17. **The project will be implemented in collaboration with the IFC and other development partners**. The IFC will provide AS related to agribusiness' operations, transport and trade, business environment improvement; and the required tools to ensure the establishment of effective linkages between

entrepreneurs and off takers. The World Bank and the Government of Malawi will undertake joint implementation support missions on a bi-annual basis to provide guidance to the project implementation teams.

18. **In order to facilitate project implementation, a detailed PIM will be finalized by the time that the project will become effective**. 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 interim financial report (IFR) formats; M&E 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.

**Figure 1.1. Overall Implementation Arrangements**




B. **Fiduciary Management**

**Financial Management**

19. **An assessment of RBM's FM arrangements was conducted to determine if the entity would be able to ensure that**: (i) the funds will be used for the purposes intended in an efficient and economical manner and the entities are capable of correctly and completely recording all transactions and balances related to the project; (ii) the project's financial reports will be prepared in an accurate, reliable and timely manner; (iii) the assets acquired under the project will be safely guarded; and (iv) the project will be subjected to auditing arrangements acceptable to the World Bank.

20. **The assessment concluded that the RBM has the requisite FM arrangements to successfully implement projects**, as demonstrated by implementation of FSTAP, which closed in June 2018. The entity

has an appropriate accounting package for project transaction processing and reporting. It has the appropriate accounting staff, with the right qualifications and experience. The audited financial reports of the projects with which it was involved were always submitted on time and with unqualified audit opinions. Control and accountability have been good regarding project management, as shown by observations in management letters and internal audit reports.

21. **Throughout the implementation of FSTAP, the RBM's FM arrangements were satisfactory and risk was moderate**. The current FM environment is the same.

22. **Budgeting:** The project budget will be activity-based, with the RBM having experience using this approach, as demonstrated by the implementation of FSTAP. The project budget cycle will follow that of RBM's, running from January to December. The budget will also be incorporated in the accounting software, which will be used to monitor and control project expenditure.

23. **Accounting:** RBM has a computerized accounting system to manage project transaction processing and reporting. The reporting under FSTAP was timely and accurate. The same accounting system will be used for the proposed project.

24. **Internal Control and Internal Audit:** PIM will have a full section representing an FM manual with details on policies, procedures and controls to be followed in the use of project funds. This will be cleared by the World Bank prior to effectiveness of the project. During FSTAP implementation, there was compliance with controls, with both internal and external audit reports not finding any serious control and accountability issues.

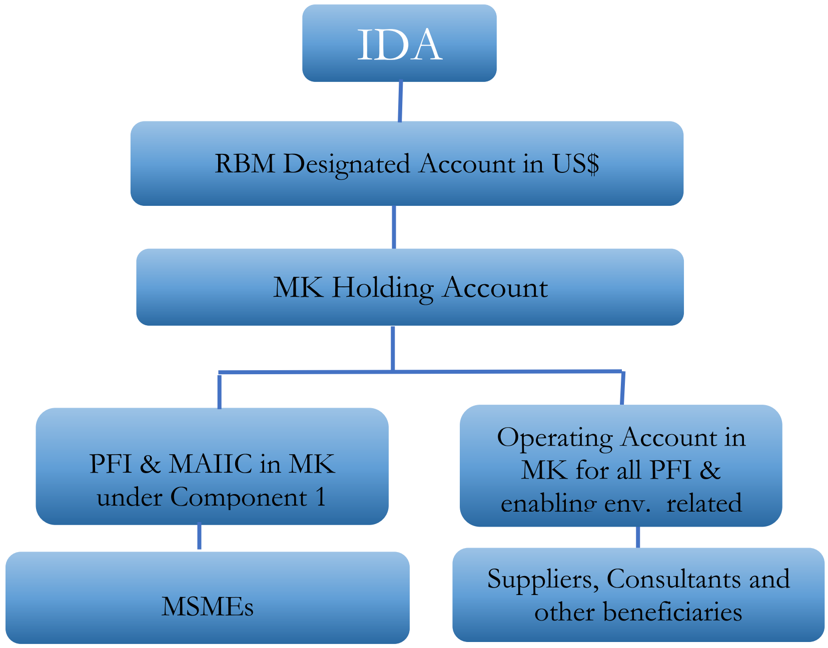
25. **Funds Flow:** (1) The RBM will open a designated US$-denominated account, which will be used to receive funds from IDA for both the LoC and other project activities. The RBM will also open a kwacha-denominated operating account, which will be used to pay suppliers and other project beneficiaries; The LoC and funding for equity/quasi-equity investments will be extended to the PFIs and MAIIC in Kwacha.

26. **Report Based Disbursement**: The disbursement of funds will be based on a six-month funds forecast, which will be revised quarterly. The RBM will retire the funds by accounting for them through the quarterly IFRs. The IFRs will provide adequate information on the source of funds and how the funds have been utilized. The IFRs will be used to document expenditure. The format of the IFR will be agreed upon between the RBM and the World Bank and will be included in the PIM which will be cleared by the World Bank prior to implementation.

27. **Disbursement Letter**: The World Bank will issue a disbursement letter as part of the FA with the recipient. The disbursement letter will set out and summarize all disbursement arrangements and procedures under the project.

28. **Reporting:** The RBM will be responsible for submitting quarterly unaudited IFRs no later than 45 days after the end of the calendar quarter. The IFR, as agreed upon with the World Bank, will consist of a financial report on the source and use of funds in summary, with a detailed list of expenditures broken down by Component, both for the quarter and cumulatively since the project began. It will contain a detailed reconciliation of the Designated Account, clearly showing opening and closing cash balances.

**Figure 1.2. Funds Flow Chart for All Project Activities**




29. **External Audit:** The RBM auditors will also audit the project financial statements based on terms of references (ToRs) to be agreed upon with the World Bank. The auditors will be required to express an opinion as to whether the financial statements show a true and fair view of the project's transactions. In addition to the opinion, the auditors will be required to submit a management letter containing detailed observations and comments. The RBM will submit both the audited financial statements and the management letter (together with management responses) to IDA no later than six months after the end of the financial year. The project will cover all reasonable costs related to the auditing process.

30. **Governance and Anti-Corruption:** The RBM will ensure that all reasonable measures to mitigate corruption are implemented. The RBM has a robust anti-fraud and an anti-corruption whistle blowing policies that will also apply to the project.

31. **Risk Rating and Implementation Support Plan:** The overall risk has been assessed as **moderate**. There will be two formal supervision missions of one week each per year. In addition, there will be desk reviews and meetings with project FM staff.

**Procurement**

32. **Procurement activities under the proposed project will be carried out in accordance with:** (i) the World Bank's Procurement Regulations for IPF Borrowers (Procurement in IPF – Goods, Works, Non-Consulting and Consulting Services; July 2016, revised November 2017 and August 2018); (ii) the World Bank's Guidelines on Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants, dated July 1, 2016 and; (iii) other provisions stipulated in the FA.

33. **Institutional Arrangements for Procurement:** The RBM will conduct procurement under this project. The World Bank conducted a procurement capacity assessment of the RBM in October 2019. The assessment found that RBM has a history of successfully implementing World Bank-funded projects as a procuring entity. In compliance with the Public Procurement and Disposal of Assets Act (PPDA), 2017, the RBM is a procuring entity with a PDU and an IPDC. The PDU is headed by a Director of Procurement and Stores, who is supported by a Procurement Manager and five other staff, most of whom have formal training in procurement. However, even though the RBM implemented the closed FSTAP, which was funded by the World Bank, its mainstream procurement staff have limited experience in World Bank-funded procurements, as they were not directly involved in the implementation of the closed project, which was facilitated by the PIU. Additionally, most of the PIU staff who implemented the previous World Bank-financed project, including the Procurement Specialist, are no longer employees of the RBM, thus weakening the RBM's procurement capacity to implement the proposed FInES project. The RBM's procurement capacity will therefore need to be strengthened through the deployment of a dedicated Project Procurement Specialist within the PIU, with this individual having a level of qualifications and experience to be satisfactory by the World Bank. The Procurement Specialist will assist the RBM to ensure that procurement under the project is conducted in accordance with the World Bank's Procurement Regulations.

34. Given the scope of procurement and magnitude of the identified associated risks, the assessment identified the following weaknesses that could adversely influence the project implementation if not mitigated, with proposed mitigation measures.

**Table 1.2. Procurement Risk Assessment and Mitigation Action Plan**

| No. | | Risk Type | Mitigation Measure | Time Frame | Responsible Agency |
|---|---|---|---|---|---|
| 1. | Delays in procurement processing due to limited capacity | Substantial | RBM will hire a dedicated Project Procurement Specialist with qualifications and experience satisfactory to the World Bank. | Within three months from signing the FA | RBM |
| 2 | Lack of adherence to procedures due to inadequate understanding of the World Bank Procurement Regulations for IPF Borrowers. | Substantial | RBM staff involved in project implementation will receive training on the World Bank Procurement Regulations for IPF Borrowers.<br>The World Bank will also provide constant support to staff to ensure adherence to the Procurement Regulations. | Throughout project implementation | World Bank and RBM |
| 3 | Delays and/or unsuccessful completion of contracts due to inadequate contract management capacity | Moderate | Key staff who will be involved in project implementation will undergo contract | Within six months of project effectiveness | RBM |

| No. | | Risk Type | Mitigation Measure | Time Frame | Responsible Agency |
|---|---|---|---|---|---|
| | | | management training to enhance their capacity; | | |
| 4 | Loss and/or unauthorized access to procurement records due to poor record management | Moderate | RBM will put in place an effective and secure record management system, with a dedicated staff to manage the records. | During project implementation | RBM |

35. **Procurement activities under the proposed project will be carried out in accordance with:** (i) the World Bank's Procurement Regulations for IPF Borrowers (Procurement in IPF – Goods, Works, Non-Consulting and Consulting Services; July 2016, revised November 2017 and August 2018); (ii) the World Bank's Guidelines on Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants, dated July 1, 2016 and; (iii) other provisions stipulated in the FA.

36. **Filing and record keeping:** The Procurement Manual (which will be a part of the PIM and will be ready prior to project effectiveness and cleared by the World Bank) will establish a detailed set of processes to provide readily available access to project procurement records, in compliance with the FA. The RBM will assign one person with the responsibility for maintaining the records. This person will also maintain the logbook of the contracts (with a unique numbering system).

37. **Commitment control system**: The signed contracts contained in the logbook will be reflected in the commitment control system of the RBM's accounting system or books of accounts. These contain a list of commitments, with an updated record of payments, with reference made to the payment voucher. This will serve as a complete record system whereby the contracts and related payments can be corroborated.

38. **PPSD:** As part of project preparation process, the RBM has prepared its PPSD, using inputs taken from a market survey and analysis of potential consultants and suppliers available for the proposed procurement scope, with an assessment of operational context, of their institutional capacities and a procurement-related risk analysis. Through these analytical assessments, the PPSD made recommendations related to procurement arrangements under the proposed project. The associated Procurement Plan addresses how procurement activities would support the achievement of the PDO and deliver the best value for money under a risk-managed approach.

39. **Summary of procurement arrangements:** The World Bank has reviewed the outputs of the PPSD developed by the RBM and agrees with the proposed procurement arrangements under the project. The procurement method and review thresholds may be subject to the World Bank's review and modification throughout the project period, based on the procurement performance and the risk rating of the project. The World Bank will provide official notice regarding any such changes in a timely manner to ensure smooth implementation.

40. **Procurement templates:** The World Bank's Standard Procurement Documents will be used for the procurement of goods, works, and consulting and non-consulting services under the International Competitive Procurement. National Bidding documents may be used under national open competitive procurement, subject to the exceptions stipulated under paragraph 5.4 of the Procurement Regulations.

41. **National procurement procedures:** National open competitive procurement procedures may be used to approach the national market. National open competitive procurement processes will be conducted in a manner that meets the requirements stipulated in the Procurement Regulations. Other national procurement arrangements (other than national open competitive procurement) that may be applied by the Borrower (such as limited competitive bidding, request for quotations, direct selection) must be consistent with the World Bank's Core Procurement Principles and must ensure the application of the World Bank's Anti-Corruption Guidelines and Sanctions Framework and contractual remedies set out in the Legal Agreement. However, the request for bids/request for proposal documents will require that bidders/proposers submitting bids/proposals present a signed acceptance at the time of bidding, to be incorporated with any resulting contracts, confirming the application of, and compliance with, the World Bank's Anti-Corruption Guidelines, including without limitation the World Bank's right to sanction and to apply inspection and audit rights. The Procurement Documents must include provisions intended to adequately mitigate against environmental, social (including sexual exploitation and abuse and GBV), health and safety risks and impacts, as agreed upon with the World Bank.

42. **Procurement Thresholds.** The Table 1.3. below shows the Thresholds and Procurement Methods to be used under the Project, given a risk rating of **Substantial**.

**Table 1.3. Procurement Thresholds Methods and Prior-review Thresholds**

| **Prior-review Thresholds** | | **Thresholds for Procurement Methods** | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Procurement Type** | **Substantial Risk (US$`000)** | **Works** | | | **Goods, IT & Non-Consulting Services** | | | **Shortlist of National Consultants** | |
| **Works** | 10,000 | Open International or ICB (US$'000) | Open National or NCB (US$'000) | Request for Quotation or National Shopping (US$'000) | Open international or ICB (US$'000) | Open National or NCB (US$'000) | Request for Quotation or National Shopping (US$'000) | Consulting Services (US$'000) | Engineering & Construction Supervision (US$'000) |
| **Goods, IT & Non-Consulting Services** | 2,000 | ≧ | < | ≦ | ≧ | < | ≦ | < | ≦ |
| **Consultants (Firms)** | 1,000 | 7,000 | 7,000 | 200 | 1,000 | 1,000 | 100 | 200 | 300 |
| **Individual Consultants** | 300 | | | | | | | | |

*Note:* *These thresholds are for the purposes of the initial procurement plan for the first 18 months. The thresholds will be revised periodically.

43. **Procurement plan:** The RBM has prepared a Procurement Plan for the first 18 months of the project, based on the findings and recommendations of the PPSD. The Procurement Plan is subject to public disclosure and will be updated on an annual basis or as needed. The updates or modifications to the Procurement Plan will be subject to the World Bank's prior review and will require a statement of no objection. The World Bank will arrange for the publication of the Procurement Plan and any updates on the World Bank's external website directly from STEP, while the RBM will be responsible for the publication on its website.

44. **Monitoring by STEP:** STEP will be used to prepare, clear and update procurement plans and conduct all procurement transactions for the project. With the RBM's mandatory use of STEP, the World Bank will be able to consolidate procurement and contract data to facilitate the monitoring and tracking of all transactions related to procurement. Using STEP, comprehensive information related to all prior and post review contracts for goods, works, technical services, and consultants' services awarded under the project will be available automatically and systematically on a real time basis whenever required, with the information provided including, but not limited to: (i) the reference number as indicated in the Procurement Plan and a brief description of the contract; (ii) the estimated cost; (iii) the procurement method; (iv) timelines of the bidding process; (v) the number of participating bidders; (vi) the names of rejected bidders and reasons for rejection; (vii) the date of contract award; (viii) the name of the awarded supplier, contractor, or consultant; (ix) the final contract value; and (x) the contractual implementation period.

45. **Publication of Procurement Information:** The project will follow the World Bank's policies on the publication of procurement information, as set forth in the World Bank's Procurement Regulations.

46. **Fiduciary oversight by the World Bank:** The World Bank will conduct prior reviews of contracts, as stipulated in the procurement plan. Contracts below the prior-review thresholds will be subject to post reviews on an annual basis by the World Bank, as mandated by the procedures set forth in World Bank Procurement Regulations. The rate of post review is initially set at 20 percent. This rate may be adjusted periodically, based on the performance of the Procuring Entity. In addition, a World Bank procurement specialist will regularly participate in implementation support missions to assist in monitoring procurement procedures and plans.

47. **Training, Workshops, Study Tours, and Conferences:** Training activities will consist of workshops and other activities, based on individual and group needs, including on-the-job training. These activities will also involve the hiring of consultants to develop training materials and to conduct training activities. The selection of consultants for training services follows the requirements for the selection of consultants, as outlined above. All training and workshop activities (other than consulting services) will be carried out on the basis of approved Annual Work Plans / Training Plans that identify the general framework for training activities for the year, including: (i) the type of training or workshop; (ii) the personnel to be trained; (iii) the institutions that will conduct the training and the reason for selection of this particular institution; (iv) the justification for the training, focusing on how it will lead to effective performance and implementation of the project; (v) the duration of the proposed training; and (vi) the estimated cost of the training. Reports by the trainee(s), including completion certificate/diploma upon completion of training, will be provided to the PC and will be maintained as parts of the records. They will be shared with the World Bank if required.

48. **Training Plan:** A detailed plan of the training/workshop describing the nature of the training/workshop, number of trainees/participants, duration, staff months, timing and estimated cost will be submitted to IDA for review and approval prior to initiating the process. The selection methods will be determined by the activity requirement, schedule and circumstances. After the training, the beneficiaries will be requested to submit a brief report indicating what skills they have acquired and how these skills will contribute to enhancing their performance and to attaining the project objective.

49. **Operational Costs:** Operational costs financed by the Project will include incremental expenses, including office supplies; the operation and maintenance of vehicles; the maintenance of equipment; communication; rental expenses; utilities; consumables; transport and accommodation; per diems; supervision; and salaries of locally contracted support staff. These needs will be procured according to the procurement procedures specified in the PIM, as approved by the World Bank.

50. **Procurement Manual:** Procurement arrangements, roles and responsibilities, and methods and requirements for carrying out procurement processes under the proposed project will be described in detail in the Procurement Manual, which will constitute a section of the PIM. The PIM will be prepared by the Recipient and must be approved by the World Bank prior to project effectiveness.

C. **Environmental and Social (including safeguards)**

51. **The E&S risk is deemed to be moderate**. While prospective PFIs and MSMEs have not yet been identified (the key target sectors will be MSMEs operating in agriculture & agri-business and agro-processing, trade/exports, ICT, and clean energy) the likelihood of adverse high or substantial risks is limited given the nature of MSMEs' businesses and the oversight which will be provided by the PFIs' ESMSs over their MSME clients and by the RBM on the comprehensiveness and performance of the PFIs' ESMS.

52. **The FinScope MSME study provides the most recent comprehensive analysis of MSMEs. The largest proportion of MSMEs (44 percent) operate within the agricultural sector, followed by wholesale/retail (40 percent); manufacturing (12 percent); and Services (4 percent)**. Within this spread, further analysis shows that 41 percent of agriculture MSMEs grow and sell produce while 43 percent buy/sell/repackage. Only 4 percent of MSMEs involved in agriculture are engaged in livestock rearing. The wholesale/retail sector is dominated by MSMEs who simply resell or repackage and resell goods (63 percent). Manufacturing is dominated by the processing of natural resources (57 percent), including the cooking or preparing foodstuffs such as beer and cakes (with the strong involvement of women entrepreneurs), with only 4 percent involved in construction work. The service sector is dominated by businesses providing transportation and catering services (41 percent). However, with 78 percent of MSMEs based in rural areas and engaged in the agriculture sector and with the high level of use of natural materials (largely agro-produce) in the manufacturing sector, the dominance of agriculture and agriculture-related sectors is clear. Some inference regarding the potential risks and impacts can be made from available knowledge.

53. **The above MSME profile suggests that it is expected that most of the MSMEs involved in the project are most likely to operate in the agriculture sector and related value chain.** Potential risks within the agriculture sector would include risks related to soil and conservation management; crop residue and

solid waste management; water management; pest management and the use of pesticides; the use of fertilizer; biodiversity and ecosystems. Although a small proportion of MSMEs engaged in agriculture are involved with livestock, they nonetheless have the potential for localized impacts. The risks facing this grouping include those related to the management of waste materials; wastewater and effluents; air emissions; hazardous materials management; and the spread of animal diseases. Farm management plans (even very simple ones) can serve as an underlying framework for the management of E&S risks and impacts. The use of simple plans, guidelines, and codes of practice have been shown to be beneficial in terms of improving the E&S performance of MSMEs involved with cocoa, palm and timber in West Africa, South America and Asia. Within the other sectors (trade, ICT, clean/solar energy etc.), risks include those related to solid wastes management; water consumption; wastewater and effluents; energy consumption and emissions into the atmosphere. Across all ESMEs, the potential for E&S issues relating to occupational health and safety, labor and community health and safety exists. Similarly, across all MSMEs, the potential exists for risks related to issues such as GBV; the use of child labor; the spread of HIV; and the exclusion of disadvantaged groups. The project's overall GBV risk has been assessed using the GBV risk assessment tool. This assessment shows that the risk of GBV is low, based on a low labor influx risk profile and taking into consideration other contextual factors.

54. **Overall, the anticipated risk profiles of MSMEs and the expectation of E&S risks and impacts must be tempered with an understanding of the MSME business profile, with 74 percent of MSMEs have 1-4 employees and a turnover of under US$5 million; 50 percent are women-led; and 77 percent are household enterprises.** While exceptions must always be anticipated, the typical MSME involved in the project is not expected to be associated with high or substantial risks, particularly given loans to individual MSMEs will be capped at a maximum value of US$30,000. Thus, risks are expected to be **moderate** or **low**. Where risks are identified, PFIs will be able to request improvement to E&S performance as a condition for receiving support under the project. While MSMEs' exposure to E&S issues is expected to be limited, handling these issues will require activities to promote awareness-raising and capacity building. These activities are included in the project structure through the Building Firm Capability component, which provides MSMEs with the business skills for business development. This component will include E&S issues, which will be important for MSMEs intending to access supply chains with E&S-sensitive actors, particularly international markets and/or markets requiring certified inputs. The provision of training to improve general business readiness, licensing, record keeping etc. will also support the MSMEs awareness of and ability to address and manage E&S issues.

55. **Larger-scale, commercial PFIs are generally already including an assessment of E&S risks in their due diligence processes for lending**. While some admitted this was at the behest of support and business partners, others reported that E&S issues were seen as a commercial issue that is likely to affect the viability of their customers and their ability to repay their loans, thus ultimately posing a risk to their own business and its wider reputation. The smaller PFIs, particularly the microfinance organizations, are less well prepared to address E&S related risks and impacts. Each of the PFIs will have its own ESMS and perform its own separate E&S due diligence processes. It is anticipated that some support will be required, particularly in the case of smaller PFIs, to ensure PFIs' ESMSs are appropriately developed and put into practice. Support will also be required to ensure that MSMEs are able to adequately manage E&S issues. The RBM will have to undertake an analysis of the capacities of this group and to provide capacity building support to help develop policies and to ensure that loan officers have the skills to identify risks and to advise MSME client on approaches to address them. The project includes provisions for capacity support

for PFIs including MAIIC to address capacity constraints affecting their ability to support MSMEs, including in areas related to E&S issues.

56. **The RBM has extensive experience with risk management and due diligence processes within its operations** (described in the Risk Management Guidelines for Banking Institutions and A Guide to Risk Management Programs). These RBM risk management and due diligence processes have been expanded to incorporate the E&S coverage through the development of the RBM's E&S Policies and procedures for the financial inclusion and entrepreneurship scaling project. To this effect, the PIU has been established at the RBM to manage the project. To ensure accountability, RBM has appointed a senior official as PM. The PIU includes a position of Environmental/Social Development Specialist that has been created to manage E&S issues, particularly those that relate to the RBM's E&S policies and procedures for the FInES Project and to oversight of the PFIs' ESMS. The success of the RBM's E&R policies and procedures will be dependent on its ability to screen and assess the ESMS developed and implemented by the PFIs. All prospective PFIs will be required to develop, implement and maintain with adequate capacity an ESMS to manage E&S risks attendant to their portfolio of MSMEs involved in the project. As noted in the PAD, before the final selection of PFIs, the RBM will submit the evaluation report to the World Bank for a statement of no objection, which will require the RBM E&S Policy and Procedures in assessing PFIs ESMSs to be considered before any lending to MSMEs occurs.

57. **The RBM will ensure that the participating PFIs engage with stakeholders in a manner proportionate to the risks and impacts associated with the subprojects and in accordance with ESS 9 and ESS 10**. Provisions related to stakeholder engagement, including procedures for external communications throughout the project's life cycle and a GRM that adequately responds to public enquiries and concerns in a timely manner is outlined in RBM's SEP and E&S Policies and Procedures and will be reflected in the individual PFIs' ESMSs. The SEP was developed and publicly disclosed on May 11, 2020 by the WB.

58. **The project has prepared an ESCP that outlines material measures and actions to be undertaken during project implementation**, including capacity building for the selected financial intermediaries (including MAIIC), stakeholder engagement processes and the setting up of a GRM. The ESCP was publicy disclosed on June 15, 2020 by the World Bank.

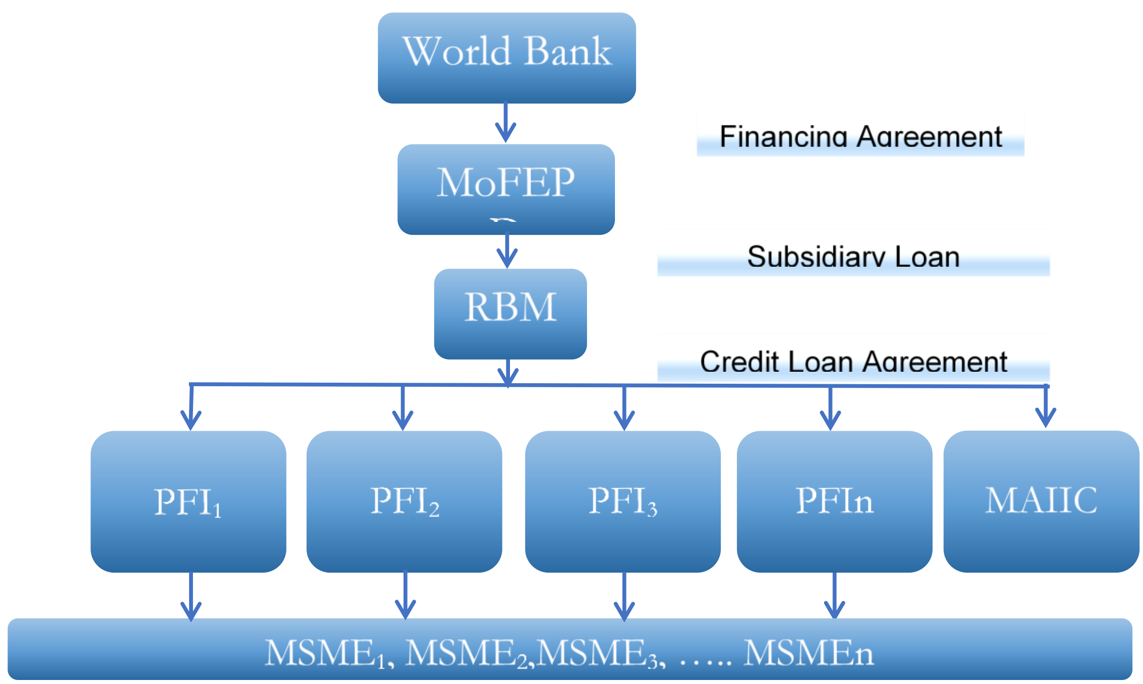
## ANNEX 2: Financial Intermediary Financing

**COUNTRY: Malawi**
**Financial Inclusion and Entrepreneurship Scaling Project**

### I. Details of the Flow of Funds to PFIs and MSMEs under the credit line (Subcomponent 1.1)

1. **Flow of Funds**: The flow of funds for the credit line will be regulated by: (i) Legal Agreement (LA) entered into between the World Bank and the MoFEPD; (ii) Subsidiary Loan Agreement (SFA) entered into between the MoFEPD and the RBM; (iii) Credit Loan Agreements (CLAs) entered into between the RBM and the PFIs; and (iv) the operations manual chapter related to LoC implementation. These agreements will specify the terms and conditions for the use of the LoC as agreed between the MoFEPD, the RBM and the World Bank and will be subject to the World Bank's approval (no objection). The fund flow chart is presented in Annex 1.

**Figure 2.1 Flow of Funds Chart to PFIs and MSMEs**




### II. Eligibility Criteria for the Wholesale Financer and PFIs

**Wholesale Financier**

2. **The RBM will be the wholesale financer, as it is the institution best positioned to provide wholesale financing to PFIs in Malawi**. The RBM has a track record of managing World Bank-funded projects, including the FSTAP. It also has the legal mandate to extend wholesale financing to PFIs for on-

lending to MSMEs. Moreover, the RBM's banking and MFI supervision functions give it an added advantage in terms of its ability to manage the implementation of the LoC.

3. **In line with RBM's objective of promoting the stability of Malawi's financial system, it has two supervision departments, which will together be responsible for supervising the PFIs involved in this project.** These are the Banking Supervision department (responsible for regulating and supervising banks and other financial institutions in Malawi) and the Microfinance and Capital Markets Supervision department, (responsible for regulating and supervising MFIs, financial cooperatives and capital markets financial institutions). These two departments will ensure that the RBM adequately fulfils its role of protecting the public interest by administering a regulatory and supervisory regime and by maintaining a good supervisory oversight over the PFIs involved in this project. The supervision departments will maintain their functions and not be involved in the PIU to ensure PFIs benefitting from the project funds maintain all requisite macroprudential norms and conflict of interest is mitigated.

**Eligibility Criteria for PFIs**

4. **The RBM will select PFIs according to the criteria agreed upon between the RBM and the World Bank and subject to the latter's approval (no objection).** PFIs will submit expressions of interest to participate in the project, with the RBM PIU responsible for assessing their eligibility, checking their standing with the supervision departments, and selecting them. Before the final selection of the PFIs, the RBM PIU will submit an evaluation report to the World Bank, together with a request to include the specified PFIs in the project. The World Bank will review the RBM's assessment and, if it approves, provide a statement of no objection for each PFI's participation. The RBM will send a detailed statement of the proposed PFIs financial records to the World Bank within 90 days of the end of the fiscal year (TBC) to ensure that the selected PFIs continue to meet the required criteria throughout the life of the project. A statement of no objection will not be required for the continued participation of the PFIs.

5. **All PFIs will be assessed in terms of the following criteria:**

(a) The PFI must be duly licensed in Malawi and have been in operation for at least two years.
(b) The PFI's owners should be determined to be "fit and proper" persons. The PFI must have qualified and experienced management, adequate organization, and the necessary institutional capacity for its specific risk profile.
(c) The PFI must meet all national prudential and other applicable laws and regulations, remaining in compliance at all times.
(d) The PFI must maintain capital adequacy at the levels prescribed by the national prudential regulations.
(e) The PFI must have adequate liquidity at the level prescribed by the national prudential regulations.
(f) The PFI must classify its assets and make adequate provisions. The quality of its portfolio must be adequate, with an appropriate NPL ratio as percentage of total assets in line with prudential regulations.
(g) The PFI must have positive profitability (adjusted for the receipt of any subsidies) and an acceptable risk profile.
(h) The PFI must have adequate internal audit and control systems for its specific risk profile.
(i) The PFI must have adequate management information systems.

(j) The PFI must agree to and have previous experience lending out to MSMEs, preferably with a focus on businesses owned by women.

(k) The PFI must have adequate managerial autonomy and a commercially oriented governance system.

6. In case where a proposed PFI does not fully meet all the proposed eligibility criteria and where the RBM still wishes it to participate in the project, the PFI shall submit a proposed institutional development plan, including a set of time bound monitorable performance indicators to ensure conditional eligibility.

**III. On-lending terms**

**On-lending terms from RBM to PFIs**

7. **Determining interest rates, costs, and loan tenures under the project will be specified in the PIM and will be adjusted to market changes and linked to a formal reference rate.** The LoC makes funding available to eligible financial intermediaries for on-lending to eligible MSMEs on terms that ensure sustainability; avoid perpetual dependence on government facilitated resources; and prevent the emergence of conflict of interest. The RBM will assume the risk of on-lending to PFIs[35] and will determine interest rates and other terms for the wholesale finance, adjusted to market changes. Overall, the wholesale pricing strategy should serve the purpose of attracting eligible PFIs to participate in the scheme at a sufficient margin, while enabling the provision of more affordable finance to MSMEs. The significant market advantage to PFIs and final borrowers will be on maturity, by facilitating the provision of longer-term finance to MSMEs without PFIs taking on maturity mismatches.

8. **Maturity:** Considering the time lag between the disbursement of wholesale finance from the RBM to PFIs' on-lending to MSMEs, the RBM may reserve the option to include a grace period of no more than twelve months for its loans to PFIs, based on criteria to be agreed upon with the World Bank and defined in the PIM. Participating MFIs are expected to receive steady cash flows from clients relatively soon after disbursements are made.

9. **Allocation of the loan amount to PFIs:** The loan amounts for the PFIs will initially be credit capped, based on their financial strength and perceived absorptive capacity. Loans will be provided on a first-come, first-served basis, until the LoC is exhausted.

10. **On-lending arrangements**: The RBM would on-lend the funds to the selected PFIs based on a six-month lending forecast provided by the PFIs to the RBM on a semi-annual basis. PFIs may be eligible for advance payments from the RBM against a loan demand schedule to be prepared by the PFI in advance. Subject to approval by MoFEPD, the RBM will be responsible for channeling the reflows back to selected PFIs to extend additional sub-loans to MSMEs. Once the allocated amount is drawn down, the PFI will be expected to recycle the loans to finance MSMEs.

[35] this include force majeure events that affect the PFIs (TBC after consulting with RBM)

**On-lending terms from PFIs to final beneficiaries**

11. **Interest rates:** The PFIs funded by the RBM will assume the full credit risk for their MSME portfolio under the project and will be free to determine the price of the sub-loans. The retail pricing terms offered by PFIs will be based on local lending market conditions to avoid market distortions and to reflect PFIs' cost of borrowing/funds, administrative expenses, and estimated loan losses. The terms should also provide a sufficient spread to enable the PFI to make a reasonable profit, thus ensuring sustainability over the medium term. Imposing a margin that adequately reflects PFIs' cost and risk would allow them to build a capital base which could then be reinvested in new loans to eligible SMEs. However, the project will support greater transparency regarding MFI interest rates, with MFIs being required to disclose the rate build-up and the effective interest rate to borrowers on their websites. The RBM will monitor this disclosure regularly to ensure that the information is up-to-date and accurate. This interest rates will be transparently disclosed and included in the loan contracts entered between the PFIs and borrowers.

12. **Eligible sub-borrowers:** The sub-borrowers will be creditworthy private sector MSMEs seeking to transform/scale their current business and are operating in key sectors such as agribusiness, exports and trade, clean energy, and e-commerce. A full list of excluded sectors and businesses not eligible for financing under the project will be included in the PIM. Ineligible sectors include, among others, drugs, armaments, liquor, and tobacco. The PFIs will develop their own assessment criteria and will determine the granting of finance among eligible MSMEs.

13. **Loan amount:** The maximum loan size to any MSME shall not exceed: (i) the single exposure limit by the PFI (currently 25 percent for banks and for MFIs), or (ii) 20 million Kwacha; whichever is the lower. Subject to this limit, the actual loan size will be determined by the PFI.

**Monitoring and Evaluation**

14. **Monitoring and Evaluation**. An M&E system has been developed to monitor and track the progress of the project, including the LoC and portfolio quality, including the level of NPLs of the project portfolio. The M&E activities will include updating the baseline data using ongoing surveys.

## IV. Market Efficiency Issues

**Context**

15. **Malawi is a small,[36] low-income landlocked country in south-eastern Africa, with most of its people living below the poverty line.** Malawi's population stands at 17.6 million with a GDP per capita of US$411.2 (2019 estimates), making it one of the poorest countries in the world. Close to 70 percent of the country's people live below the international poverty line of US$1.90 per day.[37] Malawi ranks 172nd out of 189 countries[38] in the HDI (2018). The country's poor standing on the HCI at number 125 out of 157 countries in 2018, implies that most Malawi's citizens lack the knowledge, skills, and levels of health that would enable them to realize their potential as productive members of society. Inadequate sources of

[36] The country has a total land area estimated at 118,484 square kilometers, 20 percent of which is occupied by a lake.
[37] National Statistical Office. Fourth Integrated Household Survey (IHS 4) (2018)
[38] 2017 HDI and World Bank World Development Indicators (2018)

livelihood and consequential food insecurity are reflected in the country's poor performance in terms of the GHI,[39] with the country ranking 78 out of 117 countries. An examination of the country's age structure shows that 75 percent of the population is under the age of 35 years, with the mean age at 17 years.[40] Malawi has a large, youthful, innovative, and enterprising population which can spurt private sector growth if adequately supported.

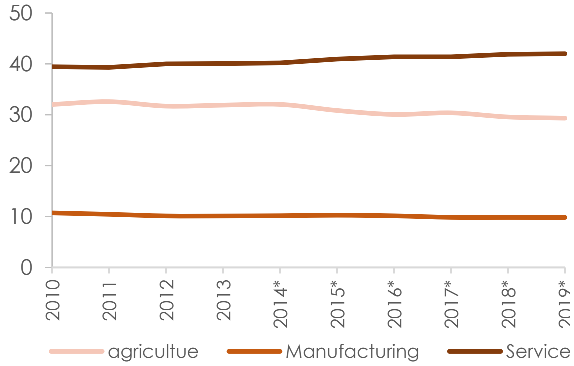
16. **Poverty rates have declined only slightly in recent years mainly due to the prevalence of the population working in subsistence agriculture and low productivity sectors.** About 84 percent[41] of the country's population lives in rural areas, where they primarily engage in, or are dependent upon, smallholder, rain-fed subsistence agriculture. Overreliance on the agriculture sector leaves Malawians vulnerable to events such as droughts, floods and other related disasters. In 2016, the agriculture sector employed more than half (64 percent) of the Malawi population[42]. The wholesale and retail trade sector provided employment to 16 percent and the manufacturing sector provided employment only 4 percent to the total.

17. **Agriculture sector has traditionally been the mainstay of Malawi's economy**, contributing about 80 percent of total export earnings and to 85 percent of total employment. The agriculture sector's contribution to the total GDP has declined somewhat from 32.0 percent in 2010 to 29.3 percent in 2019. Similarly, the manufacturing sector's contribution to GDP has declined from 10.7 percent in 2010 to 9.8 percent in 2019. The services sector has expanded rapidly, with its contribution to GDP increasing from around 20 percent in the 1970s, to 39.4 percent in 2010, and to 42.0 percent in 2019. This reflects the strong growth of the financial and insurance services sub-sector (which accounts for 39 percent of the services sector) and of the wholesale and retail trading sector (which accounts for more than 40 percent of the services sector) (see Figure 2.2).

[39] 2019 Global Hunger Index
[40] Integrated Household Survey. Date?
[41] National Statistical Office. 2018 2050205 and Housing Census, 2018
[42] Malawi Labor Market profile 2016

**Figure 2.2 The Service Sector Is Growing Faster Than Agriculture and Manufacturing Sectors**

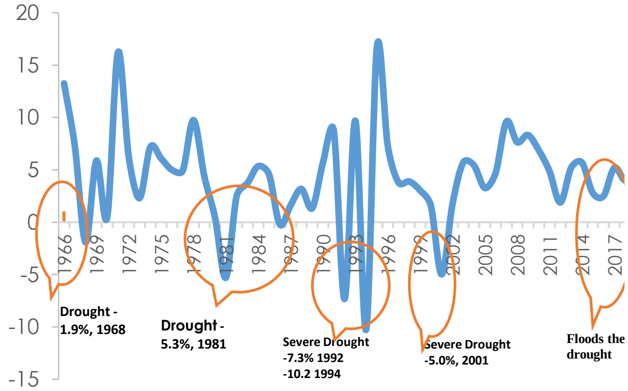
Sectoral contribution to GDP (percent)




*Source:* World Bank Calculations based on RBM data

**Figure 2.3. Economic Growth Is Frequently Disrupted by Climatic Shocks**

GDP Growth rates (percentage)




*Source:* World Bank Calculations based on RBM data

18. **The global COVID-19 pandemic has interrupted Malawi's trajectory for a third straight year of faster growth.** Growth improved to an estimated 4.4 percent in 2019, up from 3.5 percent in 2018, reflecting a rebound in agriculture production. Improved agricultural production supported stronger performance in the industrial and service sectors. The uptick in growth also indicated resilience in Malawi's economy in light of the impact of Cyclone Idai and considerable political uncertainty. The economy was on a trajectory for its third consecutive year of faster growth in 2020 before the onset of the COVID-19 pandemic.

19. **The Government has made significant initial steps to address the health and economic impact of the epidemic.** It has announced measures including a health response plan, expansion of social protection, fiscal and monetary measures, as well as steps to support the financial sector and the expansion of mobile money services. The immediate health response has focused on detection, treatment and prevention, supported by two separate emergency budgetary reallocations in late March and early April 2020 totaling MWK 5.5 billion. Social protection benefits have been expanded to 172,000 urban households (around 35 percent of the urban population) and frontloaded four months of the rural cash transfer program. The Government through the RBM has already announced several key initiatives to support this agenda, including establishing an ELA framework to support banks in the event of worsening liquidity conditions, a moratorium on interest and principal payment for MFIs, facilitating mobile money and e-payments, and establishing a liquidity fund for SMEs, and increasing the MEDF loans allocation by MK2 Billion to help SMEs.

20. **Malawi's private sector is predominantly informal, consisting mostly of micro and small enterprises, with a few large-scale and medium size firms.** The large-scale firms are often engaged in agriculture, agro-processing, and financial services, such as banking, with most of these businesses operating in urban areas. The majority of Malawi's MSMEs operate in the informal sector, with most of them primarily engaged in wholesale, retail, trade, and business services.

21. **FinScope MSME Malawi 2019 reports that there are 1.1 million businesses classified as MSMEs in Malawi.** A microenterprise is defined as one that has one to four employees, a turnover of up to MK5 million and an asset value of up to MK1 million. A small enterprise has five to 20 employees, a turnover of between MK5 million and MK50 million and maximum assets value of MK20 million (MSME Policy, 2018). A medium enterprise has 21 to 99 employees, turnover of between MK50 million and MK500 million and maximum asset value of MK250 million. Microenterprises comprise the majority with 846,288 businesses (74 percent), followed by 257,734 small businesses (23 percent), and 37,645 medium businesses (3 percent). The sector provides employment to about 1.8 million people which are comprised of full-time, part-time, and seasonal workers.

22. **FinScope survey further indicates that about two thirds (69 percent) of MSMEs operate in the wholesale and retail sectors**. Thereafter, 16.5 percent of MSMEs reported to be in the primary agriculture and farming sector. The remaining 15 percent of MSMEs were split between manufacturing, mining, agro-processing, business services, tourism and construction.

23. **The MSME sector faces numerous challenges.** Only 10 percent of medium enterprises, 5 percent of small enterprises and 3 percent of microenterprises have credit from the commercial banks. The low financing access is compounded by lack of requisite skills, capacity and aspiration to grow and be eligible for formal financing. MSMEs have poor perception of banks, with those not banked perceiving banks as not being interested in extending products and services to them. This is a strong deterrent to women-led and youth-led businesses and start-ups.

24. **Informality is another key challenge.** The majority of MSMEs (89 percent) are informal, some do not keep records (36 percent), and they lack innovation and diversification (45 percent). Most women and youth-led entrepreneurs are said to be unaware of the process or the importance of formalizing. 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; drive and energy; among others.

**Macroeconomic Environment**

25. **Macroeconomic risks related to the rate of inflation and its volatility are particularly significant for the LoC operation, as these factors are the key determinants of lending rates and spreads.** Countries that have relatively high, volatile inflation rates tend to have higher nominal and real interest rates, and higher spreads. This has been the case in Malawi. After years of high double-digit, volatile inflation, Malawi's average annual inflation rate declined to the single-digit range in 2018. The decline in the inflation rate was followed by a reduction in average lending interest rates and interest rate spreads. The average bank lending rate has gradually declined from 36 percent in 2016 to 30 percent in 2017, and to 24 percent in 2018. Similarly, the average interest spread declined from 24 percent in 2016 to 21 percent in 2017, and to 17 percent in 2018.

26. **The country's stable macroeconomic indicators in recent years will be disrupted by the COVID-19 global pandemic.** The year-on-year headline inflation rate stood at 8.5 percent (June 2020) compared to an average annual level of 20 percent in the period from 2011-2016. Trade disruptions due to the

COVID-19 outbreak, a decline in imported food products and restrictions in in-country mobility due to COVID-19, and potential speculation or market distortions and significant exchange rate depreciation could escalate prices of imported goods and induce an upward push on inflation. 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 4.8 percent estimated in September 2019 to a current estimate of 2.0 percent[43]. These projections are subject to considerable uncertainty and assume a contained spread of the virus in Malawi before the second half of 2020 and limited social distancing policies. Under such circumstances, it implies that the coronavirus is expected to erase the equivalent of 3.6 percent of 2020 output that would have been attained without it. Because the COVID-19 crisis is still evolving, the current outlook is uncertain, and the downside potential is strong. In a scenario with an extensive spread of the disease in the country and a protracted global health crisis, the economy could contract by up to 3.5 percent in the current year. In turn, this would cause a severe contraction in disposable income and private consumption. An expected rebound in 2021 will depend critically on an effective containment of the pandemic and a recovery in domestic demand, as well as the implementation of effective economic measures. High government borrowing and high profits generated through non-lending activities will crowd out bank lending to the private sector which will be further constrained by the impact of COVID-19.

27. **On the other hand, macro risks stemming from lower growth can lead to higher NPLs**, which in turn results in higher lending rates as financial institutions tend to make allowances against expected and unexpected losses arising from credit and other risks. In addition, a substantial offer of high yield low risk debt securities on the domestic market incentivizes investors and banks away from lending to riskier MSME sector. This behavior in turn results in tighter lending conditions and increases the competition for funds among MSMEs which further drives up the price. Although showing strong signs of improvement recently, the past unstable macroeconomic situation reflected in high interest rates and government arrears has severely impacted MSME access to finance and the willingness of the financial sector to lend to this segment. The design of the current operation addresses these risks through proper TA provided to both the PFIs and the MSME's to mitigate their risk of failure and potential for non-payment of loans. TA to RBM will support full implementation of credit and collateral system, as well as the implementation of policies such as on insolvency.

**Financial Sector Framework**

28. **Overall, Malawi's financial sector is small[44] and dominated by its highly concentrated banking sector.** Malawi has nine commercial banks, one leasing company, one discount house, eight insurance companies, two development finance institutions (DFIs), an immature but rapidly expanding microfinance industry, and a nascent capital market. All of Malawi's commercial banks are privately owned. The overall value of commercial bank assets stood at a modest 29.9 percent of GDP as of June 2019. Of the total value of financial sector system assets, which stands at US$1.5 billion, two thirds are held by the commercial banking system, with the remainder held by insurance companies and securities firms. In terms of the value of their assets, private pension funds managed by life insurance companies constitute a significant proportion of the latter, with assets to a value of US$300 million. This rose rapidly to about US$900 million

[43] World Bank Malawi Economic Monitor: From Crisis Response to Strong Recovery (July 2020)
[44] About US$1.5 billion in total assets (2018)

as at the end of 2018. [45] In terms of market share, two banks continue to dominate the sector, with these two banks combined controlling 46.0 percent of the sector's total assets as of December 2018. The two banks also accounted for 46.2 percent of the sector's deposits; 58.1 percent of total loans; and 60.0 percent of total equity capital.[46]

29. **Despite the stability of the banking sector, the level of financial intermediation is very low**. The industry-wide total Capital Adequacy Ratio stood at 20.4 percent in June 2019. The NPL ratio to gross loans stood at 4.3 percent in June 2019 (compared to from 12.7 in June 2018). This improvement reflects improved recoveries and write offs. Liquidity asset ratio stood at 59.1 percent and Return on equity stood at 2.8 percent as of June 2019. Despite these improvements, domestic credit to the private sector as a percentage of GDP remains low, at less than 10 percent. This compares to an average level of 34.2 percent for SADC countries and of 28.4 percent for SSA countries in 2016[47]. The challenging business environment, particularly due to ongoing energy shortages and burdensome tax and regulatory requirements, negatively impacts Malawi's credit growth.

30. **With relatively wide outreach in rural areas, Malawi's microfinance sector is expanding rapidly.** This sector consists of forty microcredit agencies; eight non-deposit taking micro finance institutions (MFIs); and one deposit taking MFI. These institutions serve a combined total of about 39,000 clients (2018). At the same point in time, there were 37 licensed SACCOs, an increase from 34 in 2017. The total number of clients served by SACCOs has been growing over recent years, with the growth rate standing at 17.1 percent in 2018, at which point the SACCOs served 359,166 borrowers. While the number of clients served by the non-deposit taking MFIs is also growing, the total value of these institutions assets is declining, indicating that most of the growth in clients is coming from clients who make low-value transactions. A range of government-owned institutions offer loans products to small-scale farmers and entrepreneurs, while several commercial institutions now offer deposit and payment products to low-income and rural customers, often using smart cards and points of sale devices.

**Interest Rates**

31. **The cost of credit is high in Malawi.** Despite a significant decline in inflation rates, as of January 2019, the minimum commercial lending rate stood at 21.0 percent, while the maximum rate stood at 32.3 percent. As of May 2019, these had dropped to between 13.9 and 24.7 percent respectively, with most MSMEs charged the higher rate. In January 2019, the RBM reduced the policy rate to 14.5 percent and directed commercial banks to peg their base lending rates to the Lombard rate, which stood at 14.9 percent. Nominal lending rates declined to an equivalent of the Lombard rate plus about 10 percent for the banks. In May 2019, the policy rate was further reduced to 13.5 percent, with the base lending rate set to a weighted average of the Lombard rate, the Interbank rate, the 91-day Treasury bill, and the Savings rates. Following these developments, average lending rates have been on a declining trend.

32. **However, the declining inflation rate has not been fully passed through to the interest rates quoted to MSMEs.** Based on interviews with providers of MSME finance, the rates have declined to an average of 40 percent, after previously reaching up to 100 percent per annum for short-term microloans.

[45] 2018 RBM Financial Institution Supervision Annual Report.
[46] Ibid
[47] World Bank WDI

Despite the decline, these rates are still very high, making it difficult for MSMEs to gain access to finance to run their business operations.

33. **Loans typically carry a short tenure, at 12 months or less. About 41 percent of loans mature in less than three months, with 28 percent of loans maturing within three to 12 months**. Collateral requirements are very high, with the value of required collateral at times reaching close to 300 percent of the loan amount, which discourages borrowing by SMEs. This results in their heavy reliance on internal resources to finance investments. Women-owned SMEs are particularly disadvantaged in terms of access to finance for entrepreneurship, because their businesses tend to be relatively small and because there are relatively strong constraints on access to internal resources compared to their male counterparts.

34. **Although Malawi's average lending rates and interest rate spreads have declined over the last two years, its lending interest rates are still amongst the highest in the world.** With Malawi's MSMEs being charged lending rates at around 24 percent it is still considerably higher than the average SSA lending rate. In the context of generally high interest rates, the rates are particularly high for MSMEs, due to the high perceived level of risk associated with this sector.

35. **In addition to the macro-variables discussed above, Malawi's high interest rates can be attributed to high operating cost ratios, high NPLs, and the lengthy time required to resolve insolvency.** The overhead cost to asset ratio for Malawi stands at 8 percent, more than double the average SSA ratio of 3.9 percent (Finstat, 2019). These high overhead costs exert upward pressure on interest rate spreads, which translates into higher lending rates. The lack of a well-functioning insolvency regime and the lengthy period required to resolve insolvency also drives lending rates higher. The loan recovery rate in Malawi stands at a low 12.5 percent, with the average time taken to recover a loan standing at 2.6 years (Doing Business, 2019). This inefficient insolvency regime also exerts upward pressure on interest rates. The ratio of banking industry NPLs to gross loans has remained an issue of concern, despite an observed decline (from 12.7 percent in June 2018 to 4.8 percent in June 2019), with this decline being largely due to write-offs and recoveries.[48] In addition, the judicial system does not have adequate capacities to support loan recoveries; the credit reporting system is not fully functional; and levels of financial literacy are low.

36. **Directed lending:** The credit line will target MSMEs operating in key development sectors such as agribusiness, Trade & exports (including e-commerce), ICT and clean energy. The project will pilot innovative financing methods to address constraints on access to finance, especially for enterprises owned by women, based on the lessons learned from the implementation of credit lines under the Women Entrepreneurship Development Project (WEDP) (P122764) in Ethiopia. Lending to women-owned businesses will be monitored and measured as a project indicator.

[48] RBM Financial Stability Report, 2018

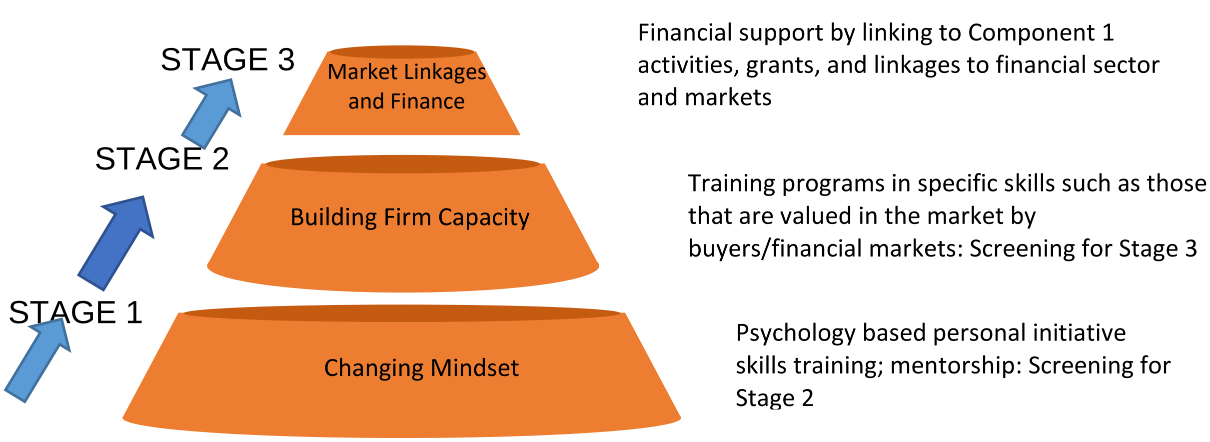
**ANNEX 3: Building Firm Capabilities**

**COUNTRY: Malawi**
**Financial Inclusion and Entrepreneurship Scaling Project**

1. **Component 2 of the project will facilitate the building of firm capabilities and enhance the quality of business support delivered by BDS providers.** This Component will be delivered through competitively selected service providers (local and/or international), who will also determine the best modality for delivering the training (although the most sustainable ones use the TOT approach). The goal is intended to enhance the internal capabilities of firms, thus increasing their likelihood of being eligible for financing. Component 2 will focus on developing the internal capacities of micro and small enterprises and enterprises owned by women, as these are deemed to stand to benefit the most from this training

2. **The training will be conducted through a three-stage approach encompassing the provision of psychological training and technical skills training, followed by measures to establish linkages between graduating firms and markets**. This will be achieved by enhancing the skills of firms using a graduated approach, with firms that show significant improvements in their mindset and capabilities qualifying for categorization as "transformative" rather than "subsistence" enterprises and moving to the subsequent stages of the program. A critical expected outcome of this project is to encourage the participation of women-owned firms. Hence, the selection process for firms participating starting in Stage 1 of the program and their progress will be stratified by gender. Figure 3.1 summarizes the three stages.

**Figure 3.1. Three-stage Approach**




3. **Stage 1: Building firm capabilities:** This involves psychology-based personal initiative training that is intended to encourage entrepreneurs to seize opportunities and grow. The activities intended to change the aspirations of entrepreneurs by inculcating a mindset of self-starting behavior, innovation, identifying and exploiting new opportunities, goal setting, planning and feedback cycles, and overcoming obstacles. This will encourage firms to adopt better practices; to practice self-discipline; and to take risks to seize

growth opportunities. Links will be established with mentors who will provide more practical and hands-on knowledge to implement the training. There are two unique features of this training: (i) it will be provided to a large population of firms applying for support, subject to some minimum threshold screening criterion; (ii) it will be specifically tailored to ensure the maximum participation by women-led firms. The firms of entrepreneurs who achieve substantial changes in their mindset and demonstrate higher levels of personal initiative will graduate to Stage 2 of the program.[49]

4. **Stage 2: Firms entering Stage 2 will be selected for participation in specific skills development programs**[50] (e.g. management practices, business language, financial literacy, group consulting, digital upskilling; supply chain management). The training needs of SMEs will be assessed in consultation with the SMEs. This information will be supplemented with the firm-level survey being implemented in collaboration with the National Statistical Organization of Malawi (with funding support from CIIP). Firms that demonstrate improved capabilities as a result of the Stage 2 training programs will graduate to Stage 3, as per the program design.

5. **Stage 3 will support the development of market linkages by enabling the SMEs to interact with potential buyers.** Once firms are equipped with better capabilities, they will be offered support to enable them to establish linkages with buyers through their participation in networks or similar instruments, as per the program design. During this stage, they will also be offered a grant to be utilized to improve their readiness to raise financing from the market such as contracting services for a market assessment, proof of concept/market testing and other. The modality of establishing market linkages will be informed by local conditions, which will be assessed through an ongoing firm-level survey conducted in parallel by the World Bank in collaboration with the National Statistics Organization (NSO). Financial instruments such as grants, matching grants, performance contracts etc. This Component will absorb some share of the cost, with the remainder being channeled to establishing linkages. The exact allocation on these two activities will depend on the number of firms that graduate to Stage 3.

**What Is the Evidence on the Proposed Firm Support Programs? And How Much Do They Cost?**

6. **The World Bank Group's initiative to strengthen its provision of support to SMEs is informed by a growing body of evidence regarding the effectiveness of the interventions.** Recent research shows that SMEs are characterized by a high level of heterogeneity, with some performing at a subsistence level and with limited potential to grow. By contrast, others perform at a transformative level, with good prospects for growth. As a result, the paradigm for the development of SME is shifting from a focus on policies related to the size of the business, to a focus on their potential productivity and growth.

7. **Firms face several different constraints, which could partially explain why many targeted programs intended to support firms, involving only entrepreneurial skills trainings, have not been highly effective in improving firm outcomes**. However, a small number of programs have been established to

[49] Specialized survey instruments will be deployed to assess the motivation of firms and the impact of the training program on motivation and skills.
[50] Firms entering the program at stage 1 will be filtered through the process and graduate to subsequent stages. At this point, we are not considering the possibility of letting firms enter at different stages. However, if not enough firms graduate with quality, we could consider the approach where firms that have a threshold level of personal initiative skills would be allowed to fill-in empty spaces.

address multiple constraints among firms, including both supply-side (access to finance) and demand-side (firm capabilities) constraints. Recent interventions that attempted to address both skills constraints and constraints on access to finance have had at least a modestly positive impact on firms. For example, in Tanzania, a field experiment was conducted to provide business training and grants to micro firms, with the objective of addressing constraints on both human and financial capital[51]. The study found that while providing either training or grants alone had an insignificant impact, when both interventions were combined, they had a positive impact on entrepreneurs' performance in terms of sales, profits and happiness in both the short and long-term, facilitating business expansion into more profitable sectors and improvements in business practices. Similar experiments involving the combined provision of business training and financial grants or loans have been conducted in Uganda, Sri Lanka and Pakistan[52]. These studies found that the provision of training had positive effects on business knowledge for entrepreneurs. Given the encouraging evidence that providing combined interventions is more likely to improve the effect of these interventions than if they were provided individually, the proposed program will address capabilities constraints in Stage 1 and Stage 2 and market access and financial constraints in Stage 3.

8. **Stage 1 training**: A randomized control trial conducted in Togo found that both personal initiative skills and traditional business training programs had positive effects in terms of entrepreneurs' adoption of standard business practices and on improving entrepreneurial mindset; using capital and labor inputs; innovating and diversifying; and accessing finance. However, it was found that personal initiative trainings had a more significant impact than other forms of training, with personal initiative training leading to a drastic increase in sales and profits. By contrast, the traditional business training had insignificant effects on firm performance measures, in line with previous literature impact on business profitability were mainly driven by changes to mindsets rather than increased knowledge of business practices. Indeed, while the training increased the average levels of entrepreneurial self-efficacy, personal initiatives and the control of own business activity and the business environment, no effect was found on record keeping and marketing.

9. **The cost of these programs varies according to the country context and the environment, and the extent to which outreach efforts are required to ensure firms' participation**, particularly participation by women-owned firms. In addition, the cost also depends on the frequency of follow-up visits required by expert consultants and trainers. In the case of Togo, for instance, the cost of this training for micro firms was US$750 per firm, with this program including mentoring support to firms for a period of four months after the training. In the case of Malawi, it is expected that costs will be higher because of the high extent of micro and small firms, which will require a lot of engagement; (ii) additional screening and specialized training to support women; and (iii) length of the program to enable firms to improve their capabilities to a degree sufficient to enable their graduation to Stage 2. In addition, focus group

[51] Berge, L. I. O., B. Kjetil, B. Tungodden, 2015. Human and Financial Capital for Microenterprise Development: Evidence from a Field and Lab Experiment. Management Science, 61, 4, 707-722.

[52] De Mel, S., D. McKenzie, C. Woodruff, 2014. Business training and female enterprise start-up, growth, and dynamics: Experimental evidence from Sri Lanka, Journal of Development Economics, 106, C, 199-210.
Fiala, N., 2018. Returns to microcredit, cash grants and training for male and female microentrepreneurs in Uganda, World Development, 105, C, 189-200.
Giné, X., G. Mansuri, 2014. Money or ideas? A field experiment on constraints to entrepreneurship in rural Pakistan, Policy Research Working Paper Series 6959, The World Bank.

discussions with firms and BDS providers in Malawi suggest that the outreach activities could be expensive.

10. **Stage 2 trainings**: Technology, extension support, and AS programs advise firms on process improvements, workforce training, supply chain development, customer acquisition, exporting, and technology transfer. Some of the better-known examples include the Manufacturing Extension Partnership in the United States; the Fraunhofer Institutes and Steinbeis Centers in Germany; Japan's Kohsetsushi Centers and Productivity Centers; and SPRING and A*STAR in Singapore. These initiatives enable firms to resolve information asymmetries regarding their own capabilities. For example, a study[53] has shown that firms often do not seek out consulting services because they do not know how these services may benefit their business. Firm capabilities programs also address shallow markets for BDS. For example, the quality of available consulting services may vary, and firms may have difficulty distinguishing between potential suppliers, whereas extension programs often provide some consulting inhouse and use their networks of private sector providers for others. These programs improve access to services that the firms may not be able to purchase on their own.

11. **There is strong evidence to show that firms in developing countries do not implement standard business practices to the degree that firms in developed countries do**, with these business practices including records keeping, separation of business and household finance, marketing activities, quality control, etc. Therefore, to address this, business training program are amongst the most common form of support provided to firms in developing countries by governments, international organizations and NGOs. In this context, there is overwhelming evidence from India and Mexico on the effectiveness of one-on-one management consulting trainings. In Kenya and Tanzania, field experiments related to business training programs, including those involving Kaizen practices, yielded positive effects on value added and profits, rather than on sales. In South Africa, the impact of two types of training programs (marketing and finance) is explored by disentangling the mechanisms involved. The analysis shows an increase in profits for firms receiving the two alternative trainings. While the marketing training program adopted a growth focus, the finance training program adopted an efficiency focus. While the marketing training effects were greater for firms with less initial exposure to different market contexts, the finance training effects were greater for firms that were initially at a higher level of established business.

12. **In terms of the cost of trainings in Stage 2, these vary significantly for a wide range of approaches and activities that might potentially be considered**. For example, in Indonesia, the cost of a light touch management consulting training process stands at around US$200 per firm for micro firms, while good quality one-on-one management skills trainings processes for medium-size firms in India cost around US$75,000 per firm. In the intermediate range, group consulting training provided to auto producers in Colombia cost about US$10,000 per firm, while management intervention in Mexico cost around US$12,000 per firm. In Malawi, the cost of second stage training will be contingent on the number of firms that graduate from Stage 1 and their level of readiness. This cost is likely to be in the mid-ranges noted above.

13. **Stage 3: Accessing markets:** Strengthening the vertical linkages between large and mid-size firms (e.g., exporters, foreign firms) and domestic suppliers through various programs such as a supplier

[53] Bloom, N.; B. Eifert, A. Mahajan, D. McKenzie and J. Roberts (2013) "Does Management Matter? Evidence from India", Quarterly Journal of Economics, 128, 1: 1-51

development program (as in Chile, Costa Rica), exporter development programs (as in Tunisia, Egypt) is beneficial not only for the large or mid-size buyer firms (which benefit from improved access to the input market) but also for the suppliers (which benefit from improved access to the output market). In addition to expensive and elaborate programs such as these, simple business networks can also be an effective means to improve firm performance, as evidenced by cases in China, where a field study organized experimental business associations for owner-managers of young and small firms. The potential establishment of market linkages is the most critical factor motivating firms to upgrade their capabilities. Stage 3 of the program will include interventions to enable small firms to connect with mid-size and large firms; and medium-size firms to connect with large firms, exporters or foreign firms. These programs could cost something in the range of US$5,000-10,000 per firm (not counting possible grant).

**Financial Incentives: Rationale and Costs**

14. **In addition to failures to establish market linkages, small firms often face significant financial constraints**. Focus group discussions with firms in Malawi suggest that they are unlikely to be interested in attending trainings, usually because they are not aware of the importance of improving skills and capabilities. To entice firms to participate in the program, the financial instrument contained in Stage 3 of the program will provide incentives for firms to participate and to successfully complete all three stages. The filtering mechanism established under the program can be viewed in the same light as a business plan competition conducted in Nigeria (*Youwin!* Program), with this model now having become the most common means of promoting entrepreneurship in developing countries. Nigeria's national business plan competition offered a grant to an average value of US$50,000 to entrepreneurs willing to establish a new firm or to expand existing firms. This competition had significant positive effects on both winners looking to establish new firms and on those aiming to expand existing business. Existing firms and start-ups that received grants displayed higher levels of improvements in firm performance (in terms of innovation, sales and profits) than did the control group, with the improvements resulting mainly from a larger use of capital and labor. In the case of Malawi, it is expected that the average value of grants that may be provided to graduating firms could stand at US$20,000, contingent on firm size, local conditions and experimental design.

**Cost Considerations for Subcomponent 2.2: Developing Domestic Capabilities for Business Development Service**

15. **With the lack of demand for services to develop firm capabilities being identified as an important constraint on firm growth and productivity, the key factors for the success of these interventions include measures to ensure the consistent quality of advice and services provided**. To this end, the proposed program envisages interventions to develop domestic capabilities to deliver good quality BDS. The training of BDS providers is not expected to be expensive. On average, these trainings are expected to cost in the range of US$500-1,000 per firm. Given Malawi's size, it is expected that 200 BDS providers will receive training under this program on matters relevant to the implementation of the program and consistent with its objectives.

## ANNEX 4: Mapping of Business Support Programs in Malawi

COUNTRY: Malawi
Financial Inclusion and Entrepreneurship Scaling Project

1. **In May 2019, the World Bank conducted a review of business support programs in Malawi**. This review involved an examination of different areas of business support provided by various development partners and other stakeholders. These initial findings are based on interviews with these stakeholders and some literature reviews. While the review is not exhaustive, it focuses on the main programs currently being implemented, and will be updated further during implementation. The project will compliment and coordinate with activities implemented by these entities. Their beneficiary enterprises who are found eligible, will be able to benefit from the firm capabilities training, as well as from the financing under the project.

**European Union (EU) Programs**

2. **The EU is planning to implement *Zantchito – Skills for Jobs* program, running for a period of seven years from 2020**. This program is intended to promote entrepreneurial culture; sustainable enterprise creation; the increased creation of productive job opportunities; and improved access to employment by TEVET graduates. The program allocates EUR20 million to the entrepreneurship component, which will target 7,000 beneficiaries across a number of subcomponents, namely: strengthening business incubation and BDS; concessional loan support; a policy dialogue platform involving duty bearers (including Ministries, Departments and Agencies), rights holders and the civil society organizations representing MSME interests; and a framework for enhancing entrepreneurial culture through various forums, including the media.

**Norwegian Embassy**

3. The Royal Norwegian Embassy reported that private sector development support efforts were mainly conducted through the United Nations Development Program (UNDP), with some of the activities detailed below.

**UNDP**

4. The UNDP uses two key instruments, as follows: (i) The Growth Accelerator Entrepreneurship Challenge; and (ii) the Malawi Innovation Challenge Fund (MICF).

5. The Growth Accelerator Entrepreneurship Challenge: Established in 2018, the Growth Accelerator Entrepreneurship Challenge is intended to provide innovative, impactful and early-stage entrepreneurs across Malawi and across industries with technical support, mentorship and financing through private equity and matching grants. The program is implemented by MHub in partnership with Growth Africa, Accesserator, and Kweza Equity Partners, with support from UNDP and the Royal Norwegian Embassy.[54] The program is cohort-based, providing six months of business development support and TA and three

[54] MHub is Malawi's first innovation hub and incubator, and Growth Africa is a leading African accelerator, while Accesserator is a Dutch investment firm.

months of mentorship to selected ventures (a total of nine months). The first round was pegged at US$484,000, with the second round being launched in mid-2019. The initiative will run to December 2020.

6. MICF: This is a US$24 million competitive mechanism funded by UK Aid, IFAD (through the PRIDE program), and the Federal Republic of Germany through *Kreditanstalt Für Wiederaufbau* (German Development Bank) (KFW). Running from 2013 to 2022, the MICF seeks to provide grant financing for innovative projects proposed by the private sector, particularly those active in Malawi's agricultural, manufacturing and logistics sectors.

**African Development Bank (AfDB)**

*7.* The **AfDB's Malawi Nacala Rail and Port Value Addition Project** is a US$1.1 million project running through 2017 to 2020 to improve the efficiency and competitiveness of local businesses situated in the Nacala corridor. The Malawi Investment and Trade Centre is responsible for implementing the project, which includes capacity building for champion SMEs and farmer groups; facilitated access to markets through the identification of market linkages; and facilitated access to finance linkages.

8. **AfDB's Promoting Investment and Competitiveness in Tourism Sector program**: This program is implemented under the Tourism Promotion and Competitiveness Support Project, with a project cost of UA 7.764 million (UA 7.0 million from AfDB and UA 0.764 million from the Government). The Project's implementation timeframe is from 2018 to 2021. The Project's broad development objective is to create an enabling environment for investment in the tourism sector through enhanced capacity in planning and business management, and improved governance in management of natural resources.

9. **Agricultural Infrastructure and Youth in Agribusiness Project**: Running from 2016 to 2021, the project is estimated to cost US$27.50 million (UA19.36 million). It is financed by African Development Fund ADF loan to a value of UA16 million; a European Union (EU) grant to a value of EUR2 million (parallel financing, about UA1.6 million); and Government contributions in kind to a value estimated at UA1.7 million. It is intended to increase agricultural productivity and incomes at the household level; to develop agribusiness enterprises owned and managed by youth; and to reduce poverty in the project area. The project is in Nkhota-kota (Dwambazi) and Nkhata-Bay (Linga) Districts. Among others, the project provides revolving loans, training and support to develop market linkages to facilitate the growth and expansion of agribusiness enterprises owned by youth. It utilizes youth networks, cooperative societies and exchange programs as vehicles to facilitate transitions from smallholder subsistence farming to commercial farming.

10. **Malawi Jobs for Youths**: This project is a UA9.7 million instrument financed by AfDB implemented over a period of four years, ending in December 2021. The project strives to facilitate the economic empowerment of young women and men; to ensure their improved employability in productive, appropriately remunerated work; and to promote sustainable entrepreneurship in Malawi through entrepreneurship education and sustainable enterprise development, skills development for employability, and institutional support and project management.

11. **Meridian's Soft Commodity Value-chain Operations in Southern Africa**: This project is a US$20 million-Soft Commodity Finance Facility to finance Meridian's operations in Malawi, Mozambique and Zimbabwe. Specifically, the facility will provide funding to purchase farm inputs (mainly fertilizer), which

will be supplied to 10,000 farmers in the three countries to ensure the consistency and quality of the commodities available to Meridian, a regional aggregator established in 1970 with focus on the production and supply of agricultural inputs and outputs through a chain of vertically integrated subsidiaries in a number of southern African countries.

**USAID**

12. **United in Building and Advancing Life Expectations**. This project is a five-year, US$63 million, USAID-funded development food assistance project that is managed by Catholic Relief Services in Blantyre Rural, Chikwawa and Nsanje districts. The project is intended to facilitate improved access to markets for farmers and financing to enable increased participation in value chain activities through savings and lending clubs. It also contains a marketing component, with activities under this component involving 66,970 households through 306 marketing clusters.

13. **NJIRA: Pathways to Sustainable Food Security**: This project is a US$30 million Food for Peace-funded development food aid program aimed at addressing the underlying causes of food insecurity in 80 communities across Balaka and Machinga districts. One intervention under this project has involved the creation of Women Empowered/Village Savings and Loans (WE/VSL) groups. Graduating groups are linked to the Government Cooperatives Community Savings and Investment Promotion (COMSIP) initiative, with members able to buy shares and invest in bigger enterprises. As of 2018, it was reported that 2,655 farmers have established linkages with formal markets and successfully sold 135 metric tons of produce, which generated profits of US$42,006. In addition, 33,473 individuals were participating in the WE/VSL groups, which have collectively saved more than US$1.6 million.

14. **Malawi Feed the Future Agriculture Diversification Activity (AgDiv**): This project is a USAID-funded activity slated to run from 2016 to 2021. It is intended to sustainably reduce poverty, hunger and malnutrition among 150,000 smallholder farmers in Malawi by facilitating the establishment of robust market linkages and ensuring improved agricultural productivity in value chains such as soy, groundnut and sweet potato. AgDiv is implemented by a consortium of organizations led by Palladium International, with the consortium including the Women's Legal Resources Center (WOLREC), which supports women's financial literacy and empowerment; the Farm Ratio Trust (FRT), which provides radio and ICT-based extension services to farmers; Practical Action, which supports resilience building and climate-smart agriculture activities; YONECO, which leads youth entrepreneurship activities; Agland (a U.S. small business from California), which adapts existing agricultural production training materials to meet local needs; and Atethemis, Inc. (a woman-owned company), which conducts gender assessments and promotes gender empowerment activities. In terms of geographical coverage, AgDiv targets eight Central and Southern districts, these being Machinga, Mangochi, Balaka, Ntcheu, Mchinji, Dedza, Lilongwe Rural and Blantyre Rural.

**US African Development Fund (USADF)**

15. USADF Malawi is currently providing support for two projects: The **Organizational Assistant Grant** (OAG) and the **Economic Enterprise Expansion Grant** (EEG). USADF implements the instruments with Umodzi Consulting, mostly to facilitate capacity building, including in areas related to business expansion; management practices; and technological adoption. Non-matching grants are provided mainly to

businesses involved in agriculture, with special focus on businesses owned and operated by marginalized members of the community, mostly women and youth living in rural areas. The grants are awarded to young firms and start-ups (operating for two years or more). Micro and small enterprises are targeted with grants of between US$50,000 and US$100,000 and the OAG, while the EEG focuses on small enterprises, with grants ranging from US$100,000 to US$250,000.

**International Fund for Agricultural Development (IFAD)**

16. IFAD directly supports the **Financial Access for Rural Markets, Smallholders and Enterprises (FARMSE) projec**t, a seven-year Government program that is slated to run from 2018 to 2025, at a total cost of US$57.7 million. It is financed by IFAD, Government and private sector participants. FARMSE's development objective is to increase access to, and use of, a range of sustainable financial services by rural households and by MSMEs. It has a nationwide geographical coverage, except for Likoma Island.

**AgDevCo**

17. AgDevCo is a social impact investor and fund manager that invests flexible, long-term capital in African SME agribusinesses that work with smallholder farmers. The project is involved in the transformation of agriculture in Africa, facilitating a transformation from subsistence farming to a modern, commercial farming. This is achieved by investing debt and equity and by providing hands-on support to establish and develop commercial-scale agribusinesses. About five investments supported businesses in Malawi as of June 2019, with the value of these investments standing at around US$11.8 million in initial outlays at different points in time.

**Government of Flanders and Tradeline Corporation**

18. **Tools for Market Access Project implemented by Tradeline Corporation (TLC) Ltd**: This project is financed by the Government of Flanders. Three projects related to business support were reported to exist at TLC: the Tools for Market Access Project; the SMEs Value Chain Financing Project; and SMEs Capacity Building and Enterprise Expansions Project (by USADF).

19. **Tools for Market Access**: This EUR1.6 million, five-year initiative (2018-2023) is intended to expand smallholder farmers' access to markets in Mzimba South and Kasungu. It aims to achieve this by enhancing the efficiency and competitiveness of marketing organizations (MOs) and thereby to increase the value and volumes of trade in pulses, legumes, cereals and grains and horticultural products. The project conducts interventions through the application of financing, TA and marketing tools.

20. **SMEs Value Chain Financing**: This is a US$300,000 project that seeks to increase access to finance, with a stated goal of achieving a 50 percent participation rate by women. It aims to increase productivity in agriculture by improving feedstocks, packaging and storage, and solar powered irrigation facilities. The funding provided to finance service providers, such as cooperatives, ranges from MK5 million to MK15 million.

**GIZ**

21. **The MIERA Contract Farming Facility** (GIZ financed project)**:** The primary objective of this instrument is to enable businesses to develop sustainable, inclusive and incentive-based contract farming models. The project is slated to run for ten months until October 2019, with a budget of US$130,000. Beyond the project's slated end date, there are plans to contract a German firm that will mainly focus on providing TA, with a EUR1 million budget.

*22.* **MSME Business Training and Coaching Loop** (MSME Loop): This is an individualized acceleration program adapted to meet the needs of informal enterprises operating in rural and peri-urban areas. It is intended to enhance the entrepreneurial competencies of business owners of existing MSMEs, enabling them to create a greater number of employment and income opportunities for poor people. The Loop also facilitates the establishment of business linkages and access to services, including finance. In 2018, the Loop targeted 375 MSMEs in 15 classes in Lilongwe, Salima, Nkhotakota, Kasungu and Mchinji.

**Malawi Confederation of Chambers of Commerce and Industry**

23. The MCCCI has recently launched an SME and business development unit to provide support including the establishment of linkages between SMEs with larger businesses and with regional and global markets (through participation in national and international trade fairs, among others). It also provides support for business incubation.

**AfriCUBE**

24. AfriCUBE is a business services product and an investment pipeline developed by Foster Lewis, a business advisory firm that focuses on the provision of financial services. AfriCUBE facilitates the establishment of connections between global capital and African enterprises (through the afriCUBE.com platform). The main goal of the initiative is to link investors and financial services to business owners or prospective entrepreneurs by enabling investors to identify feasible projects for funding and business entities with proposals. Funding for the platform is sourced internally from the fees paid by business entities that upload their proposals. To date, about 65-70 business entities have benefited from funding obtained through the platform, two thirds of which were engaged in the agriculture sector. A typical proposal uploaded through the platform is for about US$50,000.

**The mHub Malawi**

25. **The mHub Malawi**, Malawi's first innovation hub, seeks to leverage the power of emerging technologies to train and empower entrepreneurs and innovators to build solutions and businesses that provide social benefits. Three instruments intended to enable the provision of business support are under implementation, as follows: The Growth Accelerator (under UNDP – see para 4 above), Uniterra Grow Fund (from WUSC Malawi) and the Youth and Women Economic Empowerment initiative.

26. **Uniterra Grow Fund**: This fund promotes access to finance and BDS for young entrepreneurs. With assets to a value of MK22.5 million, the Uniterra Grow Revolving Fund is being implemented by Uniterra in partnership with mHub; the Associated Center for Agro-based Development and Youth

Entrepreneurship Support (ACADES); the National Youth Council of Malawi (NYCOM); and the SMEDI. The instrument is slated to run for a one-year period up to March 2020. The initiative contains provisions for BDS, soft loans, mentorship, coaching and business and market linkages, with a target of five to 10 business finalists with existing registered small businesses. Currently, the Fund operates only in the Central region districts of Mchinji, Nkhotakota, Dedza and Lilongwe.

27. **Youth and Women Economic Empowerment:** Funded by the Royal Norwegian Embassy and UN Women, the Youth and Women Economic Empowerment instrument is implemented by mHub in rural areas of Karonga, Salima, Mulanje, Dedza, Mangochi and Mzuzu, with the initiative slated to run to July 2019. The initiative, which mainly works through District Youth Offices and District Councils, aims to provide 100 percent grants to start-up businesses owned and operated by youth and women, mainly those engaged in agriculture and manufacturing. The initiative has a budget of US$37,000 and works with non-innovators who may receive a maximum amount of MK1.5 million in grants.

**DFID**

28. **Business Innovation Facility (BIF)**: This is a five-year project implemented by IMANI Consultants that ran to 2019. BIF identifies and addresses constraints in selected markets, providing TA (and some grant funding) to businesses and other market players. The project provided support to develop and replicate business models that make markets more inclusive.

**TEVETA**

29. The Technical, Entrepreneurial and Vocational Education and Training Authority (TEVETA) conducts business support activities, as mandated by the strategic objectives in its Entrepreneurship Development Strategy (2019-2024). These objectives mandate measures to improve institutional capacities to deliver experiential entrepreneurship; to conduct innovative, creative product development; and to increase the number of sustainable business start-ups. As of mid-2019, the authority did not utilize direct business support instruments. With funds to a value of MK127 million for FY2019/20, TEVETA plans to implement activities, including attaching entrepreneurship instructors to BDS providers; conducting trainings of instructors; setting up a knowledge hearing e-hub; coordinating innovation and creativity awards and setting up entrepreneurship and innovation centers.

**UNESCO**

30. In collaboration with the EU, UNESCO supports the Skills and Technical Education Program (STEP), an initiative to empower youth; to enhance job creation; and to increase access to skills development opportunities. STEP is a four-year (2016-2020) program focusing on the construction sector, partially implemented by UNESCO (EUR9 million) and partially by the Government of Malawi and grant beneficiaries. The overall objective is to empower the technical, entrepreneurial, vocational education and training (TEVET) sector and to enhance its capacity to satisfy the economy’s need for professionals through to improvements to equitable, gender-balanced TEVET.

**SMEDI, Food and Agriculture Organisation (FAO) and NEPAD**

31. SMEDI, a parastatal organization under the MoIT, supports trainings (in business start-up, financial analyses, business planning, saving culture and financial literacy) and activities at their centers in Mponela (Dowa), where SMEs are trained to achieve higher levels of value addition in their production of tomatoes, gemstones, briquettes and waste management. The SMEs are also able to use machinery and other facilities at the center.

32. Promoting Decent Rural Youth Employment and Entrepreneurship in Agriculture and Agribusiness: This is a NEPAD and FAO-funded project implemented by SMEDI that commenced implementation in 2017. It focuses on promoting decent rural youth employment and entrepreneurship in agriculture and agribusiness. It also provides support for incubation (in particular business plan development). Trainings at Mponela focus on the theoretical aspects of the project, with a particular emphasis on personal entrepreneurship characteristics (PECs) and mindset change. Successful participants are then introduced to mentors. As of the FY2018/19, about US$375,000 was budgeted to provide direct support.

## ANNEX 5: Development Finance Institutions in Malawi

COUNTRY: Malawi
Financial Inclusion and Entrepreneurship Scaling Project

**Malawi Agricultural and Industrial Investment Corporation**

1. The Malawi Agricultural and Industrial Investment Corporation (MAIIC) is a private sector led development finance entity intended to meet the needs of MSMEs and enterprises engaged in infrastructure and agriculture. MAIIC was incorporated as a Public Company Limited by Shares on 23rd November 2018 under the Companies Act (No. 15 of 2013). The Government of Malawi holds 20 percent of the company's equity, while the balance is set aside for private investors, currently held by CDH Investment Bank. Though not a commercial bank, MAIIC is expected to provide financial institutions access to long-term credit to increase their capacity to meet MSMEs' demand for medium and long-term finance. It will also provide funding and loan guarantees at attractive interest rates so that financial institutions can on-lend to firms through co-financing arrangements with commercial banks along value chains in the agriculture and agribusiness sector (including cooperatives).

2. The MAIIC was established on consideration of the findings from two feasibility studies, conducted respectively in 2013 and September 2018. These studies revealed that while MFIs, commercial banks, life insurance and pension funds, and capital markets are the key financial players in Malawi, huge financing gaps remain, with constraints on access to finance for start-ups, SMEs and even large corporates, particularly when it involves long-term debt funding, mainly due to perceptions of risk and the borrowers' lack of traditional collateral. To address these issues, MAIIC is intended to play a role as catalyst and mobilizer of resources, conducting a bridging function to build partnerships between the public and private sectors. This is intended to support the development of key priority sectors, as defined in the MGDS III, and thus to address extensive and pervasive development needs and to reduce levels of poverty. By doing so, MAIIC ably performs the long-term finance intermediation roles previously conducted by DFIS.

3. The MAIIC offers a range of products. These include a high-risk loan tranche, equity and Tier 1 direct lending to high-value SMEs and corporates in high impact sectors; services and TA for start-up and existing enterprises; transactional guarantees for banks, suppliers and partners; and Tier 2 lending to MFIs and banks. Only potential projects that entail an investment of US$2.5 million or more can receive direct financing from the MAIIC. Smaller projects, particularly those related to smallholder/cooperative agriculture, agro-processing, manufacturing sectors, may be considered for financing through a wholesale financing facility or facilities that channel funds through intermediaries, including MFIs and commercial banks. Funds to a value of US$35 million have been provided for these facilities.

4. Based on their experience, number of outlets and governance structure, the MAIIC selected various MFIs and cooperatives as collaborating partners. These include COMSIP, Vision Fund, CUMO, MEDF, MUSCO, FINCA, Getbucks, Select Financial Services, Easy Loans and Microloan Foundation. The targeted institutions have a combined total loans portfolio to a value of MK44.5 billion, with a capacity to double this sum if financial resources were made available. It is the role of these MFIs to identify

borrowers; to train the borrowers in business and FM skills; to make a funding request to MAIIC based on the potential borrowers screened; and to make, monitor and collect the loans.

5. The main challenges facing the entity include access to capital and credit, institutional autonomy, and access to skilled human resources, among others. More strikingly, heavy government involvement in the entity could cripple its operations. In this regard, the effectiveness of the entity depends heavily on its enhanced capacities in areas related to fundraising, governance structure and regulatory framework, among others. By channeling TA support to the MAIIC, the FInES project will ensure that the long-term finance market is deepened, enabling it to support infrastructural development. Further, the Government's stake in the entity is limited to 20 percent, with the merit-based selection of board members contributing to MAIIC's good performance. Govt's initial 20 percent stake (US$25 million) will decline over time, with the stake of private/international investors increasing after about a year.

6. Apart from the defined pro-market ownership structure, MAIIC's good governance practices are also noteworthy. Such practices include clear definition and agreement between management, the Board of Directors and board committees in areas related to responsibility and decision-making; performance contracting (board to shareholder; management to board); and easy to interpret memorandum and articles of association, among others. MAIIC also adopts international best practices for corporate governance, including in areas such as strategic leadership and oversight, independence, accountability and transparency.

7. MAIIC Pilot Guarantee fund***:*** The MAIIC business plan (section 5.1) includes a range of products that will be offered to clients in Malawi. One of the products is Transactional Guarantees where the target clients are banks, suppliers and other partners. Under this product category, MAIIC will provide guarantee support to banks to encourage lending or to suppliers, pending commercial funding being approved, or claims on government contracts being settled. The proposed tenor for this product is 12 months maximum, preferably with collateral being provided to back the transaction.

8. Over the past few months, MAIIC has been in discussions with the Government on structuring a guarantee to commercial banks to unlock financing to private sector companies engaged in agricultural commodity buying. During the harvest season, companies will be able to buy produce on behalf of government agencies that expect funding from the budget. MAIIC will issue a guarantee to participating commercial banks confirming that payment will be made by the government within a specified time period. This gives comfort to banks to extend credit to companies. However, the issued guarantee will not cover risk of default of the private companies, which may be required to provide a performance bond.

9. Drawing of loan funds by private companies will be restricted to 25 percent of the approved facility so that MAIIC's maximum exposure would be in the range of about MK3billion at any given time. Companies will deliver the stock to designated storage facilities under a warehouse receipt system whereby the physical stock (of produce) will serve as collateral for the transaction, while the banks await repayment from the Government. An independent collateral manager will be hired to administer the warehouse receipt system.

10. There is a very high demand for such a credit guarantee scheme in Malawi, particularly for SMEs. MAIIC's current level of capital is a constraint on rolling out the scheme to other sectors. To have an

impact, MAIIC should have about US$10million dedicated to the guarantee scheme but management is working on the basis of a much smaller scheme during this pilot phase. As such this may limit the participation of smaller companies working in other sectors that have been negatively impacted by the COVID-19 pandemic. Additional World Bank funding could be focused on broadening access to SMEs, and to other sectors aligned with World Bank criteria included in the PIM. This is expected to improve access to finance, particularly credit to SMEs and lower the cost of collateral.

**National Bank of Malawi (NBM) Development Bank**

11. The NBM Development Bank is a wholly owned subsidiary of NBM that offers long-term finance to start-ups and growing businesses. These segments are currently underserved by the banking sector, due to their limited collateral endowments, business skills and operating history. The Development Bank is expected to offer either **direct equity capital** or **long-term loans** (mezzanine finance). NBM expects to capitalize the Development Bank with funds to a value of up to US$1.5 million (MWK1,080 billion).

12. The Development Bank is expected to offer loans to a value ranging from MK15 million to MK150 million (US$20,833 to US$208,325), with interest rates ranging from 15 to 18 percent. The bank will also offer a grace period of up to two years before loan repayments become due.

13. The NBM Development Bank also seeks to act as a one-stop-shop that offers **ancillary** BDS to prospective MSMEs. For example, the NBM Development Bank will work with the NBM to facilitate services such as deposit-taking and short-term financing, if the project requires it.

14. This type of innovation is welcome in a sector that faces constraints on the provision of financing to MSMEs. However, challenges will need to be overcome to achieve significant scale. This will include:

(a) The effective targeting of MSMEs that would benefit the most from this long-term financing;
(b) The staffing of the institution with seasoned professionals who can provide useful skills to businesses in cases where direct equity is provided and skillful asset-liability matching that does not stress the operations of NBM Bank.

*Source:* Malawi Agricultural and Industrial Investment Corporation (MAIIC) Business and Operational Manual, 2018 to 2023, and MAP MSME Diagnostic Report, 2019

## ANNEX 6: Innovative MSME Financing

COUNTRY: Malawi
Financial Inclusion and Entrepreneurship Scaling Project

1. **By learning from experiences with the implementation of other World Bank credit lines, such as the WEDP in Ethiopia,** FInES **will introduce novel lending methods to address the constraints on access to finance facing MSMEs in Malawi**. The project will pilot innovative, disruptive, and potentially transformative approaches by leveraging emerging financial technologies. Potential financial products to be introduced as part of the project would include:

2. **Psychometric testing**: High and fixed collateral requirement is one of the major constraints that MSMEs face to access credit from financial institutions. Alternative credit worthiness assessment tools, such as psychometric testing, can reduce the need for high requirements for fixed asset collateral. Psychometric testing helps identify traits that make it possible to select loan applicants who can generate enough cash flow to service their debt and who are willing to repay their debt. The WEDP in Ethiopia piloted a psychometric testing system as an alternative to fixed collaterals, proving it to be a viable way to predict and manage credit risk. Building on the experiences from WEDP, this project will also introduce psychometric testing as an alternative screening tool to assess the credit worthiness of potential clients. To mitigate the credit, regulatory and reputational risk, the project will integrate such innovative solution into the credit reporting system.

3. **Big Data Solutions**: The rise of 'big data' solutions to address information asymmetries affecting the provision of finance to MSMEs is beginning to occur. FInES would explore the potential of tapping into existing large-scale data sources to develop predictive models for loan repayment behavior, which could be used by financial institutions to screen borrowers. Sources of big data could be external to the financial institution, such as the bill repayment behavior of potential borrowers with national telecommunications or energy providers, or it could draw on existing databases within the financial institution.

4. **Angel Investing**[55]: While early stage financing and angel investment has played a catalytic role in the growth of innovative and start-up enterprises around the world, it remains nascent in SSA. Connecting existing angel investors and firms with high-growth potential MSMEs in Malawi could have a transformative impact by providing an alternative to formal bank financing for MSMEs that have good potential but still un-bankable.

5. **Invoice Financing**: This scheme uses a financial structure and a technology platform to purchase accounts receivable from large companies that supply many MSMEs. Doing so frees up working capital that the suppliers can use to extend more credit to MSMEs, helping to facilitate increased access to finance. The scheme leverages the close relationships between large suppliers and their MSME customers. The suppliers can provide credit to MSMEs at relatively low risk because suppliers visit their clients often to deliver goods and services, making the additional cost and risk associated with providing finance low relative to other arms' length financial transactions. The accounts receivable portfolios of these large suppliers can then be diversified. These qualities (close relationships, frequent monitoring, and portfolio

[55] An angel investor (also known as a private investor, seed investor or angel funder) is a high net worth individual who provides financial backing for small startups or entrepreneurs, typically in exchange for ownership equity in the company.

diversification) are the building blocks for the financing scheme and have a great potential to enable SMEs to expand their businesses and to enhance their payment behavior.

## ANNEX 7: World Bank Group Projects in Malawi Supporting Private Business

**COUNTRY: Malawi**
**Financial Inclusion and Entrepreneurship Scaling Project**

**IFC Advisory Projects**

*Malawi Investment Climate (IC) Program, 2016 - 2019, ID: 599814, IFC AS*

1. The project was intended to support the implementation of 3-5 priority DB reforms and thereby to improve the investment climate. It provided TA to facilitate the enactment of laws and the promulgation of five operationalizing regulations that most significantly impact principal business environment challenges. Most of these reforms have been achieved, with capacity building conducted as planned.

*Malawi Warehouse Receipt Program, 2014 - 2019, IFC-00600331, IFC AS*

2. The project was intended to fill gaps in Malawi's financial markets by supporting the development of a regulated warehouse receipt system that is fully integrated with the Commodity Exchange to provide increased direct access to finance for downstream buyers and financiers. The project provided support to the Government to draft, consult, enact and implement good practice Warehouse Receipts legislation and regulations.

*Secured Transactions and Collateral Registries Malawi, 2013 - 2018, IFC-00599868, IFC AS*

3. The project aimed at developing legal, regulatory and institutional framework for movable assets-based lending and establishing a secured collateral registry, a web-based centralized registry for security interests in movable property. The web-based collateral registry (Personal Property Security Registry System, "PPSRS") was launched, and is housed at the Department of Registrar General's office.

*Malawi Credit Reporting Project, 2017 - 2020, IFC-00601844, IFC AS*

4. The project aimed at establishing an improved credit reporting system that targeted the system's key constraints affecting the availability and quality of data. In the longer term, the project was intended to address stakeholder capacity constraints. The project provided support to finalize the development of common data reporting templates with validation rules; to ensure the incorporation of the credit reporting into the National Financial Literacy Program; and to ensure that the bureaus are able to provide credit scores to reduce the risk for borrowers from the financial institutions.

**Some of the World Bank Financed Projects**

*Malawi AGCOM Project (P158434)*

5. AGCOM's focuses on commercialization and diversification to support the transformation and modernization of the smallholders' farming system and to promote rural growth. It addresses two key

constraints on private sector development, these being access to finance (partial credit guaranteed and PCG for producer alliances) and the business environment and policies. It is also supporting the establishment of a business registration system.

*Energy Malawi Electricity Access Project (P164331)*

6. Malawi Electricity Access Project aim to development objective of the project is to increase access to electricity in Malawi.

*Southern Africa Trade and Transport Facilitation project (SATTFP) (p174343)*

7. SATTDPO provides financing to support improvements to some of Malawi's road infrastructure, border posts and border management systems on the North-South Corridor to enhance access to ports and ultimately to reduce trade and transport costs for agricultural exports and regional imports.

*Digital Malawi Program (P160533)*

8. Digital Malawi is a two-phased program that aims to lay the foundations for a digitally enabled economy, society and government.

**ANNEX 8: Gender and Human Capital**

**COUNTRY: Malawi**
**Financial Inclusion and Entrepreneurship Scaling Project**

**Gender Gap**

1. **A large proportion of girls in Malawi have experienced early marriage and childbearing.** The World Development Indicators show that Malawi has one of the highest rates of adolescent fertility in the world, with 132 births per 1,000 women between the ages of 15 and 19[56] in 2018. Early marriage is widespread, with 28 percent of adolescent girls surveyed in the 2013-14 Malawi Multiple Indicator Cluster Survey (MICS) reporting that they were currently or previously married. Out of every 100 girls who begin Standard 1 of primary school, only three will enter secondary education. Of those three, only one will enter university.[57]

2. **Malawi has a significantly high number of girls who are stuck in a vicious cycle of school drop-out, poor health, and reduced economic opportunities**. Malawi's high rate of early marriage and childbearing is associated with factors such as low household wealth and lower decision-making power once girls become adults. Nearly four in ten girls marry before the age of 18, and three in ten girls have their first child before the age of 18. As a result, the completion rate for secondary school for Malawian girls remains very low. The Malawi Economic Monitor: Investing in Girl's Education (2018) Notes significant negative impacts resulting from the persistently high rate of child marriage and the lack of education for girls, with these impacts including lower earnings for women, higher rates of population growth, substantial health risks, higher rates of intimate partner violence, and higher levels of poverty. As a result of these impacts, Malawi loses hundreds of millions of US$s in benefits.

3. **Girls do not perform as well as boys in school.** Data from the Southern and Eastern Africa Consortium for Monitoring Educational Quality (SACMEQ) shows that in Malawi, female literacy rates (59 percent) remain significantly lower than male rates (73 percent) (WDI, 2017). Further, the proportion of female-headed households with at least one member of their household having completed primary or secondary school is lower than that of their male counterparts.[58]

4. **There is no strong drive to reduce the gender gap in tertiary education.** The inequality in access to education at higher levels contributes to the female disadvantage in productivity. While more females than males perform well in secondary school examinations (46 percent males and 58 percent for females in 2015), only one female for every ten males is completed tertiary education, indicating that significant barriers exist that limit opportunities for females to pursue and attain higher education.

5. **The 2019 FinScope Survey estimates that there are 11 percent female owners of MSMEs in Malawi against 89 percent male owners.** It also identifies that 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. SACCOs and VSLAs provide easier access to finance, particularly for

[56] World Development Indicators
[57] *National Statistics Office Malawi 2017. 2015-16 Malawi Demographic and Health Survey.*
[58] *World Bank 2016. Malawi Poverty Assessment. Washington D.C.: World Bank*

women and youth-led businesses. The product offerings are however limited by the tenure of loans and loan amounts. Develop training such as in FM and reporting, developing business plans and strategies, and assistance with how to formalize for start-up and growing enterprises to help for support women and youth owned businesses given their challenges in growing from micro and small to larger businesses.

6. **Malawi's women encounter discrimination due to many factors, including discriminatory customary practices**. The Constitution recognizes that men and women enjoy equal rights; it mandates equal parental responsibility for husbands and wives; and prohibits polygamy. In addition, the Deceased Estates Act (promulgated in 2011) gave female spouses and children the right to inherit the marital estate in the case of the death of a husband. However, the implementation of the legislation is still limited due to prevailing gender norms and cultural barriers. This leads to women's inability to own, dispose of, and inherit property, which in turn results in women's economic dependence on men, entrapping them in polygyny and abusive relations, which, amongst other negative impacts, increases the risk of HIV infection and reduces their ability to get treatment.[59]

7. **Malawi's women remain disadvantaged in both the economic and political arenas**. Female-headed households constitute a quarter of poor households and are relatively more deprived than male-headed households in terms of access to public services, finance, improved housing conditions and asset ownership. Women's limited access to and control over productive resources has direct implications on women's productivity.

8. **The poverty headcount rate for female-headed households is around 5 percent higher than for male-headed households**. Women tend to be less productive than men in agriculture and in the non-farm sectors as a result of their limited ownership of assets and their limited access to credit. Agriculture labor activity is, on average, 44 percent lower on female-managed plots, with 34 percent of this gap explained by differences in access to labor markets and 29 percent explained by differences in access to credit.[60] Analysis shows that closing the gap in agriculture productivity could reduce the overall poverty rate by an estimated 2.2 percent, lifting about 200,000 people out of poverty each year.[61]

9. **The Government has reiterated its commitment to promoting gender equality.** To fulfill this commitment, it has established a National Gender Policy (2015), with an associated National Gender Program for the implementation of the policy. It has signed several regional and international conventions on protecting women and children. The MGDS III provides midterm planning tools for the implementation of gender policy. It has also provided for Gender Transformative Approaches, which aim to create opportunities; to actively challenge gender norms; and to address inequities between persons of different gender. This approach includes increasing equitable access to, and control and utilization of, social and economic services by women.

[59] World Bank 2018. Systematic Country Diagnostic: Breaking the Cycle of Low Growth and Slow Poverty Reduction. Washington D.C.: World Bank

[6060] Palacios-Lopez, Amparo; Christiaensen. Luc; Kilic, Talip. 2015. How much of the labour in Africa agriculture is provided by women? Policy Research working paper; no. WPS 7282. Washington DC.: World Bank Group

[61] World Bank. 2015. The cost of the gender gap in agricultural productivity in Malawi, Tanzania, and Uganda. Washington DC.' World Bank group.

**Human Capital**

10. **Despite recent improvements in the areas of child mortality, fertility, primary school enrollment and stunting levels, Malawi's level of human capital development remains limited.** Malawi's 2017 HCI stood at 0.41, means that a child born today will only be 41 percent as productive as in a situation where the child had completed basic education and was in good health. In the period from 2010 to 2015, infant and under-five mortality declined from 63 per 1000 live births to 42. Over the same period, the average for SSA countries declined from 83 per 1000 live births to 56. The maternal mortality ratio is 439 per 100,000 childbearing age women, compared to an average of 547 for SSA, while the total fertility rate is 4.4, compared to an average of 4.9 for SSA. With 56 percent of the population below 19 years of age; with 29 percent of girls becoming mothers by the age of 19; and with a stunting rate of 37 percent of children under five, Malawi must make great strides to facilitate a positive demographic transition.

**Gender Activities in the Project**

11. **The Africa Region Gender Action Plan FY18–22 identifies gender gaps in schooling, entrepreneurship, access to jobs, and agricultural productivity among SSA countries and other areas**. The FInES Project places a strong emphasis on addressing the gender gaps in access to finance and access to entrepreneurship capability. Its two core interventions (provision of financing and improving firm capabilities) include plans to target women.

12. **In terms of the employment rate broken down by gender, 47.3 percent of men are categorized as 'employed,'** compared to only 31.9 percent of women.[62] Despite that, 51 per cent of total population is represented by women in Malawi[63]. The project recognizes that most women and youth-led entrepreneurships are said to be unaware of the process, or the importance of, formalization. It also recognizes that women-led entrepreneurships in the country have a poor perception of banks, with those not banked perceiving the banks as not being interested in extending products and services to them. The project will also provide support to MFIs (and SACCOs and VSLAs) since they tend to provide more financing to MSMEs particularly for women and youth-led businesses, who are limited to accessing only short-term loans, offered in limited value amounts and at high financing costs. Digital innovation, skills and entrepreneurship, especially for women and youth, will be an underlying and cross-cutting element across the project's components.

13. **The project focuses on closing the gender gap through the following specific activities:**

(a) The project will provide funding for an LoC, which will focus on firms owned by women. Special funding to a value of US$2.0 million will be allocated for TA to complement and reinforce the project implementation of the LoC. This will also target MSMEs owned by women and youth.

(b) The project will pilot innovative financing methods to address the constraints related to access to finance, especially for enterprises owned by women, based on lessons learned from the implementation of World Bank credit lines for the WEDP in Ethiopia.

[62] World Bank WDI estimated as at 2017
[63] National Statistical Office Population Census (2018)

(c) The project will provide training to entrepreneurs and firms through a three-stage approach encompassing the development of psychological and technical skills training, followed by measures to establish linkages between participants and markets and FIs. The training will be specifically designed to ensure the maximum participation of women-owned firms. Firms with experience in delivering customized training for special focus groups, such as women entrepreneurs, will be given preference in the selection process to deliver the TOT program. This will focus on developing the capabilities of micro and small enterprises and those owned and managed by women, with this segment group standing to benefit the most from the training.

(d) The project will provide funds to facilitate the achievement of higher levels of financial literacy through awareness programs for MSMEs, particularly for women and youth. The project will provide TA and capacity building to the RBM and PFIs to expand their delivery of DFS; to facilitate their adoption of fintech approaches; and to design financial literacy and consumer protection initiatives that meet the needs of youth and women.

**Monitoring Gender Activities**

14. These activities will be monitored in the Results Framework, with a gender disaggregation of beneficiaries in various components, as follows:

**PDO Level**

- Value of MSME loans provided by PFIs through the Line of Credit including the COVID-19 emergency facility (Amount(US$))
  - Ratio of loans from PFIs to women-owned MSMEs (Percentage)
- Value of funds financed by MAIIC for innovative start-ups and SMEs (Amount(US$))
  - Ratio of the funds for women-owned enterprises (Percentage)
- Number of new firms established through the project support to incubators and accelerators (Number)
  - Ratio of which are women-owned (Percentage)
- Number of MSMEs reporting improvement in capabilities (Number)
  - Ratio for women owned MSMEs (Percentage)

**Intermediate Level**

- Increase in citizen satisfaction with the project's provisioning of financial services to MSMEs based on periodic beneficiary feedback survey (disaggregated by gender) (Percentage)
- Financial Literacy rate, disaggregated by gender (Percentage)
- MSME satisfactory rate with project implementation, disagregated by gender (Percentage)

## ANNEX 9: Climate Co-Benefits

COUNTRY: Malawi
Financial Inclusion and Entrepreneurship Scaling Project

1. **Background**: Malawi is vulnerable to a range of severe natural disasters, including droughts, flooding, and earthquakes. Throughout Malawi's history, these have led to significant financial losses and serious economic and social consequences. An increase in the frequency and intensity of these disasters in recent years has been attributed to climate change, among other factors. According to the Malawi Disaster Risk Financing Strategy, (2017): "Between 1949 and 2017, six major droughts have affected approximately 26.4 million people. In 2016 alone, drought related damages and losses to the economy amounted to US$370 million, with the agricultural sector being the most impacted. Flooding is a recurring hazard, with damages and losses due to floods amounting to about US$335.0 million in 2015 alone." Irish Aid concurs, stating: "With projected increases in temperatures, more erratic precipitation patterns, and increasing frequency and intensity of extreme weather events, already distressed economic and social systems in Malawi are likely to become more strained." (2018). In April 2019, the Government of Malawi adopted the Disaster Risk Financing Strategy.

2. **Statement of purpose or intent**: As agriculture is one of the target sectors for this intervention and given that it accounts for 30 percent of Malawi's GDP and for 64.1 percent of employment, the project aims to reduce the vulnerability to climate change of project beneficiaries engaged in agriculture and other sectors. The project aims to enable MSMEs to manage risks related to climate change by facilitating access to finance for water-efficient agricultural technologies and practices; by promoting climate resilient farming; and by facilitating the development of agricultural insurance products.

3. **Link to project activities:** As part of Component 2 activities, the project could finance water-efficient technologies like treadle pumps, supplemental irrigation, drip irrigation and other technologies that reduce the risk of large crop failures. The project will also finance the production and trading of fodder crops, which will help to reduce the vulnerability of livestock production in times of rain shortage. In addition to the LoC, the project envisages the provision of de-risking tools, such as agricultural insurance. Agricultural insurance as a risk-management mechanism that can contribute to increased productivity in agriculture and other related sectors by managing climate-related risks; improving access to credit for farmers and SMEs; and contributing to macroeconomic stability. The project will carry out a feasibility study that will analyze the current state of agricultural insurance markets/programs, identifying any barriers to growth and exploring potential opportunities to expand crop and livestock insurance in Malawi.

4. On the other hand, off-grid solar manufacturers/importers/distributors/retailers will be eligible for participation in the LoC operation, with the project financing actors along the value chain. In addition, as part of the project's activities, it will identify venture ideas that have the potential for market success. This may include ventures that help to mitigate climate change (such as the production and distribution of energy saving cooking stoves).

## ANNEX 10: Financial Outreach/Performance of the Financial institutions

COUNTRY: Malawi
Financial Inclusion and Entrepreneurship Scaling Project

1. FinScope Malawi 2019 reported that the total value of credit or finance extended to MSMEs stood at US$82 million in 2018. Of this, banks provided 68 percent, followed by the MFIs (18 percent) and the donor agencies (8 percent). Most of the MSMEs in Malawi are served by MFIs, whose focused products and offerings have been a key attraction to MSMEs. Agriculture and the trading sector receive up to 60 percent of the overall loans provided by MFIs, with 60 percent of the MFIs' loans portfolios consisting of loans from micro and small enterprises. The banks generally focus on the formal small enterprises, which constituted very small proportion of the MSME sector. However, banks are showing increased interest in the MSME sector and are establishing dedicated units to develop financial products for this segment.

**Table 10.1 Financial Institution Assets, Loan Sizes, and Lending to MSMEs**

| | Number of entities in 2018 | Key financial Service Products | Assets (US$, millions) | | Loans and Leases (US$, millions) | | Average Loans to Asset ratio (%) | Lending MSMEs (%) | Remarks |
|---|---|---|---|---|---|---|---|---|---|
| | | | 2013 | 2018 | 2013 | 2018 | | | |
| Banks | 9 | credit/finance, savings/investment, payments, BDS, Insurance | 900 | 1,975 | 357 | 591 | * | 55.6 | Trade, agriculture and manufacturing sectors account for about 60 percent of the bank loans |
| MFIs | 49 | credit/finance, savings/investment, payments, | 16 | 48.2 | 9 | 24 | 52 | * | MFIs have higher appetite for overall loan extension compared to banks |
| SACCOS | 37 | credit/finance, savings | 5.9 | 22.6 | 3.7 | 15.4 | 65 | 2.6 | Easier to access loans only when associated with savings and existing relationship |
| VSLAs | * | credit/finance, | * | * | * | * | * | 2.6 | VSLAs are |

| | Number of entities in 2018 | Key financial Service Products | Assets (US$, millions) | | Loans and Leases (US$, millions) | | Average Loans to Asset ratio (%) | Lending MSMEs (%) | Remarks |
|---|---|---|---|---|---|---|---|---|---|
| | | savings | | | | | | | largely supported by several donor agencies (for example Care Malawi, Action Aid, OXFAM and World Vision) |
| Donor Agency interventions | Numerous | credit/finance, BDS | * | * | * | * | * | * | Financing is often coupled with TA |
| Government Agencies | * | credit/finance, BDS | * | * | * | * | * | * | |
| MNOs | 2 | savings/investment, payments, | * | * | * | * | * | * | |

*Note:* * data not readily available.

A. **Banks**

2. **The banks' key financial products are summarized below:**

- **Term loans:** Short-to-medium-term loans (i.e. ranging from one to three years). In 2018, the average reported interest rate charged by the five sampled banks ranged from 25 percent to 31 percent.

- **Vehicle and asset finance:** These products include finance leases (i.e. where the bank maintains ownership of the asset while the lessor uses it for the duration of the lease agreement), usually accompanied by an option to buy the asset at the end of the contract); operating leases (i.e. where the ownership of the asset does not transfer to the MSME); and sale and leasebacks (i.e. where a bank buys back an asset at an agreed price and leases it back to the business). In 2018, the average interest rates charged ranged from 23 percent to 30 percent. The average tenure of the loan was from one to five years.

- **Trade financing:** These products include invoice or contract factoring and discounting. In total, 67 percent of the interviewed banks that submitted data returns offered these products. The spreads of reported interest rates charged were narrower, ranging from 25 percent to 28 percent in 2018. All banks reported offering only one-year tenures for these loans.

- **Working capital:** These products consist of short-term loans provided to enable businesses to meet their day-to-day needs. The average interest rates charged ranged from 20 percent to 30 percent.

- **Specialized agriculture loans:** These products are offered by 83 percent of interviewed banks. They are often concentrated in structured value chains, such as tobacco, maize and sugarcane, and could range from financing for input, asset or working capital. Other value chains were underserved.

- **Credit cards:** Only one of the interviewed banks reported offering credit cards to MSMEs.

3. **The key challenges for banks when it come to providing credit to MSMEs are summarized below:**

- A lack of robust lending models results in the reliance on traditional forms of collateral, the availability of which is often limited for MSMEs. As such, banks continue to perceive MSMEs as being too risky a client segment.

- The low literacy levels of MSME owners and entrepreneurs inhibits MSMEs from meeting the requirements to access formal finance. This means that even credible businesses are unable to present the relevant financial history to meet the requirements of the banks.

- There are no obvious MSME financing product gaps from the banks' perspective. However, there seems to be a lack of well-trained sales personnel, particularly in rural areas, that can understand consumer needs and adequately match them with bank products and services. Similarly, stakeholder consultations identified the time taken to process loans as being too long. Where possible, the automation of processes may help to overcome this.

- Credit information sharing through credit reference bureaus remains in its infancy. This limits the effective use of this mechanism.

- The uptake and usage of the collateral registry system remain limited, partly because of the limited availability of consumer education related to this system.

B. **MFIs**

4. **The key lending products MFIs offer to MSMEs include:**

- Term loans: These products consist of short to medium-term loans with tenures of between six to 24 months to finance business operations.

- Agricultural loans: These products include loans to purchase inputs and equipment for agricultural enterprises.

- Savings group linked loans: these products involve the provision of loans to groups that may be formal or informal, but the value of loans is linked to the groups' savings.

- MFIs also offer savings/ investments, payment products and BDS.

5. **The key barriers faced by MFIs in extending credit to MSMEs include the following:**

- The weak capital bases of MFIs affect their ability to extend credit, apart from cases involving a deposit-taking MFI and a donor-linked MFI that can raise capital internationally. However, the RBM is currently exploring avenues to channel more funds to MFIs. If addressed, this may allow MFIs to offer longer-term loans to a greater number of clients.

- MFI products and services are mainly generic and retail-focused, limiting their suitability for businesses. As discussed above, this is in part related to the limited capital bases of MFIs, and to a lack of capacity to develop more complex products, such as asset finance.

- MFIs' limited risk management capabilities have resulted in the sector facing high default rates. This results in low levels of working capital and undermines their ability to lend out the funds to additional customers.

- MFIs' high operating costs result from the high cost of funds, poor infrastructure, and high administration costs.

- A directive from the RBM has in effect created an interest rate cap, with MFIs not permitted to charge more than 6 percent interest per month, which according to the industry is insufficient to cover the cost of funds, operating expenses and price for risk.

C. **SACCOs**

*6.* **The total value of SACCO assets has grown from US$5.9 million in 2013 to US$22.6 million in 2018**. Total MFI loans and leases have also grown from US$3.7 million to US$15.4 million. As with MFIs, this suggests that Malawians and their businesses are increasingly relying on less formal mechanisms to meet their financial service needs

D. **VSLA*s***

7. **In Malawi, VSLAs are largely supported by several donor agencies, such as Care Malawi, Action Aid, OXFAM and World Vision), each of which has a specific sectoral focus, ranging from food security and nutrition, women empowerment, health and HIV, education and community resilience to climate change**. VSLAs are mainly focused on meeting the needs of smallholder farmers and groups, and therefore are not generally well suited to serve MSME clients. Loans are generally short term and micro in size. There is increasing interest from other financial institutions, such as banks, to expand wholesale lending

to VSLAs by reducing rates to encourage VSLAs to on-lend to their customers. This, coupled with the large rural reach of VSLAs, has the potential to extend the reach other forms of financial services, such as agricultural insurance and payments.

8. **The key barriers faced by VSLAs' in extending credit to MSMEs include the following:**

- VSLAs charge interest rates of up to 20 percent per month for low-value loans (microloans). This limits the potential impact for MSMEs due to the costliness of the loans.
- While VSLAs would be interested in investing their excess cash, access to formal financial networks is difficult due to their rural locations.
- The high degree of financial and implementation support offered by donors means that any change in their funding cycle or area of focus could interrupt VSLA operations.
- Less than 20 percent of VSLAs grow to become SACCOs or MFIs, suggesting a lack of adequate support to ensure sustainability and scale.

E. **Donor Agencies**

9. **In Malawi, donor agencies offer both direct and indirect forms of financing to MSMEs.** The direct forms of financing include grants, matching grants and business plan competitions to businesses within a few sectors, including agriculture, manufacturing, and agribusiness. Current examples of these include the MICF and the Growth Accelerator Entrepreneurship Challenge.

10. **The key barriers faced by donor agencies in extending credit to MSMEs include the following:**

- Financing is linked to specific programs that run the risk of being discontinued if funders' objectives change.
- Donor financing develops "donor darling" businesses that win multiple rounds of financing by continually adapting their business models to suit the specific financing window requirements. This runs the risk of concentrating financing within a few businesses, limiting the overall impact.
- There are a limited number of staff members to provide the TA offered, with this limiting the ability to scale coverage.