



Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 09-May-2019 | Report No: PIDC26164

**BASIC INFORMATION****A. Basic Project Data**

Country Malawi	Project ID P168577	Parent Project ID (if any)	Project Name Financial Inclusion and Entrepreneurship Scaling Project (P168577)
Region AFRICA	Estimated Appraisal Date Sep 24, 2019	Estimated Board Date Nov 14, 2019	Practice Area (Lead) Finance, Competitiveness and Innovation
Financing Instrument Investment Project Financing	Borrower(s) Ministry of Finance, Economic Planning and Development	Implementing Agency Ministry of Industry, Trade and Tourism, Reserve Bank of Malawi	

Proposed Development Objective(s)

The Project Development Objective is to enhance private enterprise growth and job creation in Malawi by increasing MSME's access to financial services and improving their capabilities.

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

Total Project Cost	60.00
Total Financing	60.00
of which IBRD/IDA	60.00
Financing Gap	0.00

DETAILS**World Bank Group Financing**

International Development Association (IDA)	60.00
IDA Credit	60.00



Environmental and Social Risk Classification

Low

Concept Review Decision

Track I-The review did not authorize the preparation to continue

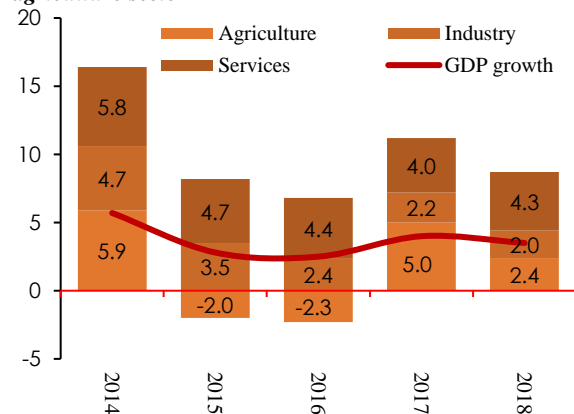
Other Decision (as needed)

B. Introduction and Context

Country Context

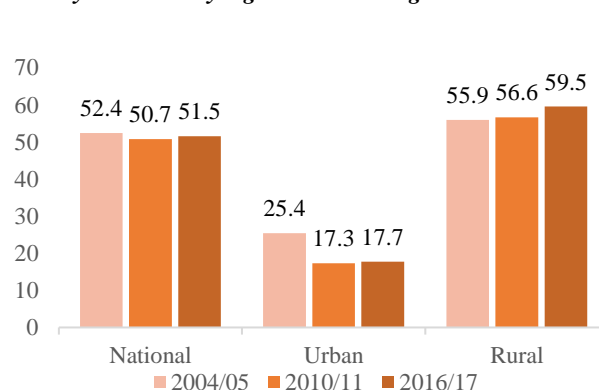
- Malawi is a country located in Southern Africa, surrounded by Mozambique, Zambia and Tanzania.** Landlocked, the country has a total land area estimated at 118,484 square kilometers, a population of about 17.6 million and a population growth rate estimated at 2.8 per cent per annum. Most of the people live in rural areas and engage in and are dependent on smallholder rain-fed agriculture.
- Malawi is a low-income country.** The country’s Gross Domestic Product (GDP) per capita is estimated at US\$338.5. The agriculture sector is the highest contributor to GDP at about 30 percent, while the wholesale and retail trade sector contributes 17 percent, the manufacturing sector contributes 10 percent, the real estate activities sector contributes 8 percent, the financial and insurance services sector contributes 6 percent and the construction sector 3 percent¹. The agriculture sector is the backbone of the economy, accounting for over 60 percent of the total national exports, and is the largest provider of employment. Apart from tobacco, other main export products include tea, sugar and pulses. Crop production is dominated by maize, tobacco, tea, sugarcane and pulses.

Economic growth is slow, and mostly dictated by performance of the agriculture sector



Source: 8th Edition of Malawi Economic Monitor

Poverty is stubbornly high and worsening in the rural areas



¹ The rest are electricity (1 percent), transport (3 percent), accommodation (2 per cent), information (5 percent), education and health (6 per cent), public administration (2 percent), professional and other services about 5 percent).



- 3. Poverty remains a key challenge in Malawi.** The overall national poverty rate declined from 52.4 percent to 50.7 percent in the period from 2004 and 2010, then rose to 51.5 percent in 2016. The ‘ultra-poverty’² rate declined from 24.5 percent to 20.1 percent in the period between 2010 and 2016, in large part due to effective social protection programs and the 2016 food security response. Over half of the population in the country remains in “moderate poverty”³. Across districts, poverty ranges from as low as 8 per cent to as high as 83 per cent but is concentrated in rural areas. The Human Development Index (HDI) for the country is estimated at 0.477 in 2017, positioning the country at number 171 out of 189 countries. The country’s economic growth has not been inclusive. In the period from 2003 to 2010, when average GDP growth was relatively high, the high rates of poverty persisted. The Gini index increased during the period, showing growing disparity between the poor and the rich.
- 4. Unemployment is generally high in Malawi.** The 2018 Malawi Country Systematic Diagnostic (CSD) quotes Von Carnap (2016) indicating that unemployment rate has been estimated at 20 percent nationally - although this number is difficult to interpret in the context of most households being engaged in agriculture. The CSD suggests that job relevant skills for out of school youths should be provided through formal and informal systems with private sector involvement, and that critical scientific and technical skills should be built at the secondary and tertiary education levels. The 2018 Malawi Country Economic Memorandum (CEM), cites low levels of education⁴ as a main reason for low formal wage employment, and estimates that the unemployment rate is around 20 percent. The CEM indicates that there has been a shift towards employment in the service sector, but about 54 percent are self-employed, and mostly operating in the agriculture sector. The fourth Integrated Household Survey (IHS-4) indicates that non-farm sector employment is low, with the number of workers employed in the industrial sectors declining in the period between 2004 and 2016. Further, according to the 2014 Enterprise survey, employment growth in Malawi in the period between 2011 and 2013 was only at 3.2 percent, which is much lower than the average for Africa at 6.7 percent growth during the same period, and lower than the 9.5 percent growth in Malawi between 2006 and 2008. Evidence suggests several causes for the declining employment growth, including low productivity returns from the agricultural sector and limited opportunities for non-farm employment.
- 5. Non-farm self-employment presents a promising alternative to reducing poverty.** According to the 2016 World Bank Poverty Assessment Report, rising non-farm self-employment income was the driving force behind the reduction of rural poverty in Malawi in the period between 2010 and 2013. This income was primarily derived from small scale household activities, including trading, craft services, and the sale and processing of agriculture products. These activities however, were unable to translate into sustainable household enterprises given the difficulty in raising seed capital and low/limited access to credit⁵. Addressing access to finance issues, combined with training and improving technical skills, presents an opportunity to develop and scale up self-employment activities, and hence contributing to poverty

² The Government of Malawi has two poverty measures – “moderate poverty” and “ultra-poverty.” The incidence of ultra-poverty is calculated with reference to measurement of the consumption level needed to satisfy daily calorie requirements. Its value is approximatively US\$0.82 in 2011 PPP.

³ The moderate poverty is calculated with reference to poverty line of US\$ 1.32 (2011 PPP). According to the International Poverty Line, people are in ‘extreme poverty’ if they live on less than \$1.90 per day,

⁴ According to the 2018 CEM, two thirds of the labour force have not completed primary education and another 25 percent have not progressed past the primary school education.

⁵ Between 2010 and 2013, access to credit almost doubled (from 12 percent in 2010 to 20 percent in 2013). However, most of the credit did not come from the formal sector as access to formal sources of credit remained critically low. According to the 3rd Integrated Household Survey (IHS 2013), of those who obtained a loan in 2013, only 9 percent borrowed from a commercial bank. The rest relied on family and friends for loans.



reduction. In addition, the establishment and growth of these small private enterprises can contribute significantly to job creation while fostering more inclusive economic growth.

Sectoral and Institutional Context

Private sector is the key to economic growth and job creation in Malawi, but is facing challenges

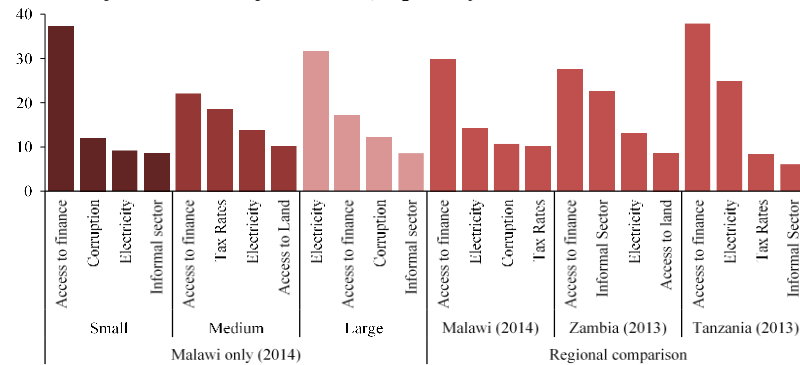
6. **The Government of Malawi (GoM) recognizes the private sector as a key driver of growth, and that development of the sector is important for job creation.** The 2013 International Finance Cooperation (IFC) Jobs Study identified that 90 percent of jobs in developing countries are provided by the private sector and proposed that private sector development should be at the core of any response to unemployment challenges. Recent key government policies and strategies including the National Industrial Policy (NIP), the National Export Strategy (NES), the third Malawi Growth and Development Strategy (MGDS III), the Micro Small and Medium Enterprises (MSME) Policy and the Buy Malawi Strategy (BMS) have highlighted the private sector as a key pillar of growth.
7. **Generally, the Malawi private sector does not perform efficiently.** Malawi's private sector is characterized by a few large-scale firms and many informal micro and small enterprises (MSEs). The large-scale firms are often engaged in agriculture and agro-processing while the MSEs mostly operate in the services sector, notably trading. The Malawian private sector has a noticeable "missing middle" or the absence of thriving middle-sized firms, which is indicative of a difficult environment for small enterprise growth.
8. **The private sector in Malawi is hindered by significant business environment challenges.** According to the 2014 Enterprise survey, the biggest obstacle to the growth of private enterprises in Malawi is access to finance. The 2018 Malawi Business Climate Report by the Malawi Confederation of Chambers of Commerce and Industry (MCCCI) highlights the same, as well as other challenges such as the unreliable utilities (electricity, telecommunication and water), crime and corruption, regulatory uncertainty, and prohibitive and limiting policies, including on taxation. Malawi fares poorly in the World Bank Doing Business (DB) rankings, at 111th place out of 190 countries in 2018. However, the current rank is an improvement over the 164th place achieved in the mid-2000s and reflects the key reforms implemented in recent years, including the establishment of the collateral registry and operationalization of the credit reporting system⁶. The country also ranks poorly on the Global Competitiveness Index (GCI)⁷, at position 129 out of 140 economies in 2018.

⁶ These reforms helped Malawi move up the DB rankings in the Getting Credit Indicator, up to rank 8 in 2018.

⁷ The *Global Competitiveness Index* measures the set of institutions, policies, and factors that set the sustainable current and medium-term levels of economic prosperity.



Access to finance is a major obstacle, especially to MSMEs

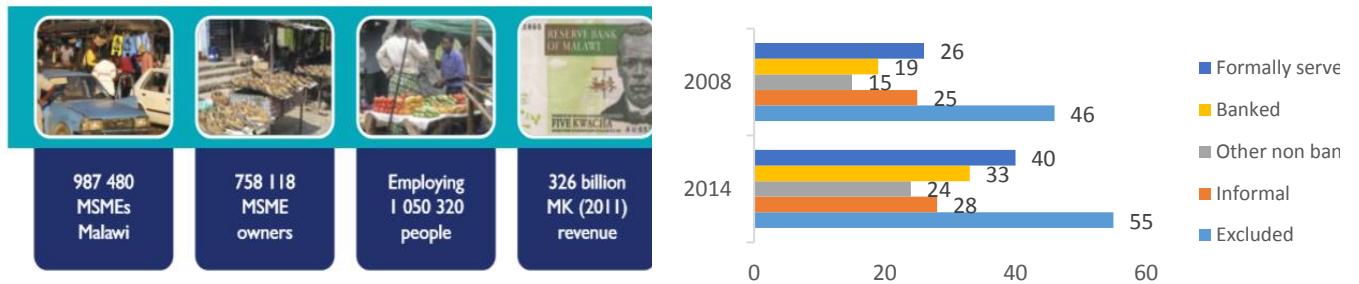


Source: Country Economic Memorandum for Malawi

Limited access to finance, informality and low capacity limits MSMEs growth and bankability

9. MSMEs play an important role in the economy, particularly in ensuring inclusive growth. Although MSMEs mostly operate in traditional and small-scale ventures, their role in the socio-economic development of a country cannot be underestimated. Peterhof, Romeo and Calvey (2014) found out that small and medium enterprises account for 90 percent of all businesses globally, generate 60 percent of employment worldwide, and provide jobs to roughly 80 percent of workforce in the developed world. The 2012 FinScope MSME survey emphasizes the important role that the MSME sector plays in an economy, including boosting government revenue through taxation, providing goods and services to the public, creating employment and reducing poverty. In Malawi, the MSME sector employs over a million people and contributes over 30 percent to the national economy.

While MSME sector remains an important part of the economy... ...they are largely financially excluded, and have low capability



Source: Malawi 2012 MSME and 2014 FinScope Survey

10. MSMEs in Malawi are generally very small, young, mostly located in rural areas, and informal. According to the 2012 FinScope survey, 59 percent of the total number of firms in Malawi are individual entrepreneurs. The remaining 41 percent generate employment, but mostly belong to the microenterprise category. Over 50 percent of existing MSMEs are at startup phase or have existed for less than 5 years. The majority of MSMEs are based in rural areas (85 percent). In addition, only 8 percent are formally registered, as the registration process tends to be cumbersome and slow. Generally, MSMEs tend to lack awareness of the benefits of formalization of their enterprises.



11. Access to finance has been identified as the main business growth constraint for MSMEs in Malawi. According to the World Economic Forum (WEF) Global Index 2016/2017, lack of access to finance is considered the biggest obstacle to doing business, even more than inflation, corruption and inadequate infrastructure. In Malawi, over 90 percent of financing from banks goes to a handful of large firms that dominate the economy⁸. This level of resource capture is much higher than in most countries and significantly limits opportunities for smaller firms to develop and contribute to the economy. Access to finance to MSMEs is limited by multiple supply factors, including high interest rates, short loan tenors, excessive collateral requirements⁹, and limited products tailored to MSMEs. On the other hand, MSME informality, mistrust of banks and lack of awareness of financial sector opportunities affect demand for formal financial services. In all, this makes it difficult for smaller enterprises and some marginalized groups, including women and youth, to access financing for businesses.

12. MSMEs' access to finance is further complicated by weaknesses in the enabling environment and poor financial infrastructure. According to a World Bank Research and Policy Brief in 2017 by F. Abraham and S. Schmukler on "Addressing the SME Finance Problem", difficulties faced by banks in assessing MSME creditworthiness discourage lending to the sector. To mitigate the credit risk, in many cases lenders substitute the lack of information on MSMEs with higher collateral requirements. However, these substitutions may still not sufficiently incentivize banks to lend to MSMEs in environments where contract enforcement is problematic and financial infrastructure is not well developed. The 2017 WB Financial Sector Assessment Program (FSAP)¹⁰ noted the weakness of contract enforcement in Malawi as one of the key impediments to MSME access to finance.

The financial sector lacks the depth needed to adequately foster private sector development

13. Malawi's financial sector is small, shallow and commercial bank-dominated. As of December 2018, Malawi's financial sector assets stood at about 64 percent of GDP¹¹, mostly comprising banking sector assets (at 35 percent of GDP¹²) and institutional investors' assets (29 percent of GDP). There are currently 9 commercial banks currently operating in the country, following three mergers between 2015 and 2017¹³. Two out of these nine banks account for about 46 percent of total banking sector assets as well as deposits. In addition, there are 49 Microfinance institutions (MFIs) with 414,000 clients, 384 Savings and Credit Cooperative Organizations (SACCOs) with 113,000 members, one discount house, and one leasing company. There were only 13 stocks (12 domestic and one foreign) listed on the Malawi Stock Exchange by the end of 2017¹⁴.

14. Institutional Investors are growing rapidly but remain a small segment of the financial sector. The total insurance assets, both general and life, are estimated at MK43.0 billion (representing 0.9 percent of

⁸ According to the 2014 Enterprise Survey, the firms most likely to access private sector credit are large, retail, export oriented, and/or foreign-owned

⁹ Per the Enterprise Survey, on average, firms are expected to hold collateral worth 293 percent of the loan they are taking from the bank

¹⁰ At the request of the Government of Malawi, an FSAP was conducted in 2017 to assess risks and recommend solutions in three pertinent areas, namely, banking sector vulnerability and supervisory issues, financial inclusion for MSMEs, and long-term finance.

¹¹ Increased from 44 percent of GDP in June 2017 at the time of the Financial Sector Assessment Program (FSAP), largely driven by pension and insurance assets.

¹² The regional median in 2016 was 43 percent.

¹³ In July 2017, the RBM cleared the way for First Merchant Bank (FMB) to acquire Opportunity Bank, following the acquisition of Malawi Saving Bank by FDH Bank and Investment and Development Bank by the National Bank in 2015.

¹⁴ ICON Properties Ltd is due to list on the MSE on January 21, 2019 and will be the first new listing since 2008.



GDP) in 2017. But, following the adoption of a new Pension Act, the total pension assets grew by 39.8 percent from MK380.0 billion in 2016 to MK532.2 billion (representing 11.6 percent of GDP) in 2017¹⁵. Life insurance and pension funds' assets stood at MWK 1.4 trillion (about US\$1.9 billion) in December 2018¹⁶. Institutional investors, particularly mandatory pension funds, have been growing rapidly but continue to play a minimal role in the *provisioning* for long-term finance.¹⁷ Pension fund assets have been growing at an annual compounded rate of over 30 percent since 2011 when the mandatory pension scheme was introduced. The country's capital market is at a nascent stage with only 13 listed stocks¹⁸, 8 government securities, and one corporate bond. There is an active private placement corporate debt market and private equity type investments by institutional investors are not uncommon.

15. **Commercial bank penetration is low and banking sector vulnerabilities are high.** The number of commercial bank branches per 100,000 adults for Malawi is estimated at 3.2, compared to an average of 5.3 for Sub Saharan Africa and average of 9.6 for the SADC countries¹⁹. Two out of nine banks account for about 46 percent of total banking sector assets and about half of total deposits. Domestic credit to the private sector as a percentage of GDP was estimated at 10.5 percent in 2016²⁰, compared to an average of 34.2 percent for the SADC countries and an average of 31.8 in Sub Saharan Africa. Domestic credit has been weak in Malawi because of persistently high interest rates, slow down on economic activities, and fewer lending products on the market by the banks, among other factors. According to the 2017 FSAP, banking sector vulnerabilities and risks are high, impacting banks' effectiveness as efficient financial intermediaries. High non-performing loans (NPLs) have been a concern in Malawi. The average sector-wide NPL ratio reached 19 percent in 2018, but this has declined to about 5 percent, largely due to write-offs and recoveries.
16. **Enabling the financial sector to better meet financing needs of the private sector, including for MSMEs, will require the development of long-term finance through capital markets and further diversification of the financial sector.** Many of the characteristics of the Malawian financial system are not conducive to private sector development, particularly the lack of long-term finance. Most of the bank credit is short term in nature as financial institutions rely on short-term deposits to finance lending²¹. Limited maturity transformation affects the provision of longer-term financing that is needed for certain sectors such as agriculture. Capita market is small. Rapid growth of bilateral corporate debt transactions would be better served by more market-based instruments (e.g. on the stock exchange), which foster the development of long-term finance through better risk sharing. There is a need for quality long-term assets to match insurance policy holders' risk-return expectations. Further, specific expertise is needed to support financial deepening and the development of alternative assets that better service the private sector.

¹⁵ Most pension assets are managed by insurance companies on their balance sheet, and therefore there may be an element of double counting of assets between these sectors.

¹⁶ Financial Sector Stability Report, December 2018 (RBM). This is a significant growth from March 2017 when FSAP was being conducted.

¹⁷ Institutional investors' assets are concentrated mainly in the two largest players (Old Mutual and NICO Asset Managers, holding over 80 of the market shares. Old Mutual is one of the largest institutional investors (life insurance and investment management group), offering life assurance products and asset management services while NICO Holdings is group of companies, including Nico Life offering individual and group life insurance products and NICO Asset Managers, which is a portfolio investment manager.

¹⁸ ICON Properties Ltd is listed on the MSE on January 21, 2019 and was the first new listing since 2008.

¹⁹ It is 52.9 in Seychelles, 4.2 in Mozambique, 4.6 in Zambia, 10.2 in South Africa and 1.0 in DRC.

²⁰ It is estimated at 145 percent for South Africa, 34.5 in Mozambique, 14.3 in Tanzania, and 12.0 in Zambia in 2016.

²¹ More than 60 percent of loans in the banking system have a tenure of 12 months or less, 46 percent of loans mature within 6 months, and 18 percent of loans mature within 6 months to 12 months.



17. **A recent joint GoM and private sector initiative to mobilize longer term financing is expected to address some of these issues.** In November 2018, the Government, in collaboration with the private sector, launched a development finance institution (DFI), the Malawi Agriculture and Industrial Investment Corporation (MAIIC). This institution is expected to mobilize long-term finance, initially for agriculture and manufacturing projects, but will expand its scope (after 2-4 years) to other sectors such as infrastructure. MAIIC has been incorporated as a public limited company, with an initial capital of US\$ 25 million from the GoM²². Most of the capital is expected to be raised from the private sector²³. The MAIIC institutional design includes features drawn from global lessons on DFI performance, and if it is well governed and managed, the institution could become a vehicle for channeling domestic long-term funds for infrastructure in future, leveraging the broader financial system.

Financial Inclusion and Advances in Digital Financial Services (DFS)

18. **Financial inclusion remains a challenge in Malawi.** According to a World Bank Group's Universal Financial Access (UFA2020) agenda, financial inclusion is a critical building block for poverty reduction and economic growth. The 2014 Malawi FinScope Survey reports that 77 percent of adult Malawians are unbanked. The Malawi Financial Literacy and Consumer Protection Household Follow-up Survey (2018) reported that only about 29 percent of the population in Malawi have access to formal financial services. However, most of the people have access to semi-formal or informal products and services due to the growth of village savings and loans associations (VSLAs) and other similar recent innovations. These entities can be used to reach small scale enterprises and the people living in the rural remote areas of the country.
19. **Malawi has made significant progress in the rolling out of DFS.** According to the 2017 Global Findex, between 2012 and 2017, the country witnessed strong growth of mobile money accounts from less than 1,000 accounts to 1.8 million active accounts. A survey²⁴ by the RBM indicates that the percentage of households with access to finance increased between 2014 and 2018, from 34.0 percent to 39.7 percent. These developments in part reflect technological advances that aim at improving usage and demand for financial services and products. These include the proliferation of Point of Sales (POS) terminals, Auto Teller Machines (ATMs) and transactional products/services such as e-money and mobile banking as well as the growth in mobile money agents. The subscriber base for Mobile Network Operator (MNO)-led payment schemes has expanded.
20. **Despite these developments, the preference for cash remains strong in Malawi, which limits the potential impact of DFS on financial inclusion.** In terms of usage, mobile money services continue to be used predominantly for airtime purchases and cash in/cash out transactions. Cash out transactions alone account for over 30 percent of the total value of mobile money transactions, which is an indicator of Malawians' heavy reliance on cash for most of payment transactions. Further, the geographical distribution of the mobile money services remains a challenge as most of them are spread in the urban and semi-urban areas, leaving the rural areas with fewer access points. As a result, the active agent ratio and

²² GOM's shareholding will be capped at 20 percent and only two out of 13 members will represent the GOM in MAIIC's Board Directors.

²³ Up to \$80 million is expected to be mobilized from the domestic private sector in the next two years while up to \$895 million is expected to be mobilized from international investors, including international finance institutions (IFIs), in the next 2-10 years.

²⁴ The Malawi Financial Literacy and Consumer Protection Household Follow up Survey (2018)



the rural spread of agents remains low²⁵.

Policy and institutional reforms

21. **Cognizant of the need to promote MSMEs in Malawi, both the GoM and the private sector players have put in place various initiatives to promote and support small-scale businesses.** There have been notable efforts over the years to establish a network of institutions to support the MSME sector with technical and financial support, or using a multi-pronged approach.²⁶ However, the multiplicity of these entities as well as the internal operational challenges have constrained resource allocations and resulted in duplication of efforts. Recent government actions have focused on streamlining these entities through mergers and restructurings to improve their operational efficiency and effectiveness. On the other hand, MSMEs have formed associations to improve the public-private dialogue (PPD) and to pool resources for capacity building.²⁷
22. **The GoM has implemented measures to modernize the country's financial infrastructure and improve the enabling environment for financial services.** Some of these efforts were supported by the World Bank Financial Sector Technical Assistance Project (FSTAP) that closed in 2018 and include the following: (i) improvements of the digital infrastructure to enhance payment settlement systems; (ii) introducing ATM and POS interoperability and integration of banks, MNOs and MFIs; and (iii) developing a centralized core banking system for the MFIs - the Microfinance Institutions Hub (MFI Hub). While these updated systems have been put in place, additional support is required to make them fully utilized and sustainable. There is also scope for further investment in digital infrastructure to facilitate transactions across various systems, such as business registration and credit reporting, and developing digital payment, savings and investment solutions that will facilitate increased financial inclusion.
23. **Some of the Development Partners (DPs) in the country have initiated interventions to foster the development and growth of entrepreneurship, but gaps remain.** For the most part, these programs have focused on specific value chains and/or sectors with limited demographic coverage - for instance targeting graduates of the Technical and Vocational Education Training (TVET) and hence have not had a national level reach and impact thus far. To ensure that these initiatives have a significant impact on the country, the successful components of these programs need to be scaled up and the outreach extended to a wider pool of beneficiaries. With the proposed World Bank operation, such efforts can be undertaken. In addition, through such a project, the World Bank can refine and customize these programs to better accommodate the current context and address issues faced by targeted beneficiaries, such as youth and women.

²⁵ Greater interoperability between the mobile money services is expected to be achieved now that the mobile network operators have been integrated into the National Switch, which will then allow wallet to wallet transfers between the providers.

²⁶ These institutions include: Malawi Rural Finance Company (MRFC), Malawi Industrial Research and Technology Development Centre (MIRTDC), Small Enterprises Development Organization of Malawi (SEDOM), Development of Malawian Entrepreneurs Trust (DEMAT), Malawi Entrepreneurs Development Institute (MEDI), Youth Enterprises Development Fund (YEDF), Malawi Rural Development Fund (MARDEF), and recently, Malawi Enterprises Development Fund (MEDF), Malawi Investment and Trade Centre (MITC – formerly Malawi Investment Promotion Agency and Malawi Export Promotion Council) and Small and Medium Enterprises Development Institute (SMEDI).

²⁷ The most prominent of these associations are the following: National Association for Small and Medium Enterprises (NASME), National Association of Business Women (NABW), and Small and Medium Enterprises Association (SMEA).



Relationship to CPF

Links with World Bank Country Strategy

Links with World Bank Country Strategy

- 24. By promoting increased access to finance and targeting underserved households and MSMEs in rural and remote areas, the proposed project supports the World Bank shared prosperity agenda.** The proposed project will aim at directly supporting the achievement of the objective outlined by the Malawi Country Assistance Strategy (CAS)²⁸ on ‘promoting a supportive environment that would enhance inclusive private sector growth and competitiveness’²⁹, which falls under the thematic area on “Promoting sustainable, diversified and inclusive growth”. The project will increase access to finance for start-ups and existing MSMEs and improve their capabilities to promote sustainable private enterprise growth. Through its focus on supporting the growth of medium sized firms, the proposed project is also in line with the proposed theme for the upcoming Country Partnership Framework (CPF) on supporting the creation of a middle-income cadre in Malawi through SME growth. This would address the notable “missing middle” gap. The project would also implement measures aligned with the “diversifying the economy and creating jobs” pathway set out in the Systematic Country Diagnostic (SCD) to advance the World Bank’s twin goals. These measures include supporting the creation of sustainable MSMEs that create jobs in a variety of economic sectors.
- 25. This project also aims to implement recommendations highlighted by the Malawi FSAP.** The FSAP was prepared by the World Bank at the request of the GoM to set the agenda for further financial sector development and reforms. Planned project activities addressing these recommendations include: (i) enhancing MSME access to finance, (ii) supporting the development and implementation of long-term financing schemes, and (iii) supporting the strengthening of regulatory processes in the banking and pension sectors.

Links with Country’s Development policy

- 26. The country’s overarching development strategy, MGDS III, recognizes the need to improve the financial sector.** It singles out key financial sector challenges such as: (i) the lack of innovative financial instruments, particularly those targeting MSMEs; (ii) the high interest rates; (iii) the underdeveloped, narrow and illiquid capital markets as well as limited long-term financing; and (iv) the low levels of financial literacy. The planned project is aligned with these aspirations given its focus on access to finance, which is a critical binding constraint to the attainment of the strategy’s key priority areas.
- 27. The project is designed to support activities identified by the country’s strategies related to the financial sector,** including the National Financial Sector Development Strategy (FSDS) and the National Strategy for Financial Inclusion (NSFI). The FSDS provides a blueprint on the strategic direction for the development of the financial sector for the 2016 – 2021 period. It rests on five pillars, namely: (i)

²⁸ The CAS covered the period FY 13 to FY 16 but was extended to FY 17 through a Performance Learning Review (PLR). Currently the Country Office is developing a new Malawi Country Partnership Strategy.

²⁹ Some of the key the goals under outcome 1.2 were to increase the number of Malawians enrolled in the banking sector and increasing access to finance by SMEs.



developing and deepening financial systems; (ii) financial inclusion; (iii) financial literacy and consumer protection; (iv) creating an enabling policy, legal and regulatory environment; and (v) increasing the participation of the financial sector in critical growth sectors. The 2017 NSFI identifies gaps that the proposed project intends to address such as (i) the lack of innovative financial instruments, especially those geared towards MSMEs; (ii) the low intermediation by banks to MSMEs; (iii) the lack of a unique identification system that improves information asymmetries affecting access to finance; (iv) the low financial literacy; and (v) the limited access to long term financing.

- 28. The recently approved MSME Policy highlights the GoM's focus on MSME development.** This policy aims to tackle factors that limit MSME growth by: (i) enhancing policy implementation and integration; (ii) increasing access to finance; (iii) improving business development services; and (iv) improving information technology, skills and standards. The policy is also expected to pay special attention to the challenges faced by women-owned businesses³⁰. The planned project will be in line with this as well as the new Private Sector Strategy (currently in draft form), which recognizes the need to improve access to finance to create entrepreneurship, jobs and reduce poverty³¹.

Links and Complementarity with other Bank projects

- 29. The proposed project will be national in scope and designed to complement the overall World Bank Group (WBG) program for Malawi.** The proposed project aims at addressing some of the gaps identified by the SCD, and would be implemented in complementarity with current and prospective Bank projects in the country, including the following:

- The Agriculture Commercialization Project - which seeks to increase commercialization of agriculture value chain products. This project includes two financing instruments for the private sector namely a Partial Credit Guarantee (PCG)³² and a Matching Grant (MG) facility³³.
- The Shire Valley Transformation Project - which seeks to irrigate 43,000 hectares of land in the Shire Valley to increase the productivity and output of agricultural commodities. This project also has PCG and MG components.
- The Malawi – Digital project, which aims to increase access to affordable, high quality internet services for government, businesses and citizens and to improve the government's capacity to deliver digital public services.
- The project will complement IFC advisory projects, including those related to: (i) investment climate, ii) trade facilitation, (iii) credit reporting, and (iv) the collateral registry³⁴.
- The Southern Africa Trade and Transport Facilitation Project (SATTFP), which is implementing key trade facilitation activities.
- The Lilongwe Water and Sanitation Project which is investing in water infrastructure in Lilongwe city to increase access to improved water services and safely managed sanitation services in the City.

³⁰ The planned project aims to focus on this gender dimension and plans to complement other DP efforts to implement this objective.

³¹ The PSD Strategy suggests that more needs to be done, especially in relation to structural issues within the market and a fundamental problem within the market relates to a lack of information on borrowers.

³² The project shall follow the principles spelt out in the World Bank report titled, "Assessing Implementation of the Principles for Public Credit Guarantees for SMEs".

³³ The matching grant facility will be guided by the review report titled, "How to better Make Grants a Better Match for Private Sector Development".

³⁴ Through these advisory projects, the country has credit reference act, a personal properties and securities act, and a warehouse receipt act in place. The systems are in place but not fully functional, and therefore requiring some support.



- Some prospective projects will include activities complementary to the planned project focus, including the Nacala Corridor Regional Trade Project, the Malawi Electricity Access Project, the Malawi Platform for Social Support Project, and the Mpatamanga Hydropower Project, and, and the Lilongwe Bulk Water Supply Guarantee.

Background Analytical Work

- 30. The proposed project is anchored by strong diagnostic work.** This includes the Financial Sector Assessment Program (FSAP), the FinScope Survey, the Enterprise Surveys, the Investment Climate Assessment (ICA), the Doing Business reports, the Systematic Country Diagnostic (SCD), the Country Economic Memorandum (CEM), the WB Poverty Assessment report and the upcoming Country Partnership Framework (CPF) currently under preparation. An MSMEs FinScope survey which will be carried out during the financial year is expected to provide the project with data and baseline on MSMEs. The feasibility study on Special Economic Zones (SEZs) currently being conducted, will have synergies with the project. A feasibility study on agriculture insurance and agriculture finance will complement the project. An analytical work under the Competitive Industries and Innovation Program (CIIP) on MSMEs technology adoption readiness³⁵, and a project preparation advance (PPA) on the entrepreneurship ecosystem in Malawi will provide valuable inputs and baseline to the proposed project. The Mobilizing Long-Term Finance for Infrastructure Advisory Services and Analytics (ASA), aims to identify financial and non-financial constraints limiting availability of long-term finance especially for infrastructure in Malawi.

Some Lessons from Similar Programs

- 31. World Bank Kenya Industry and Entrepreneurship Project:** This project aimed at focusing on building intermediaries' capacity by using competitive performance contract elements to attract the best startups and talent, in addition to hosting industry-academia platforms, and supporting SMEs to improve their managerial and technical skills as well as usage of access to technology.
- 32. World Bank India's MSME Growth Innovation and Inclusive Finance Project:** This project supported solutions and products that promote the scaling up of innovative models of financing to leverage on appraisal parameters of business viability and cash flow assessment rather than collateral as a primary criterion for eligibility, resulting on the inclusion of more MSMEs.
- 33. IFC Digital Economies for Africa Diagnostic Tool:** This supports a comprehensive digital entrepreneurship ecosystem involving the following domains: (i) policy, (ii) financial capital, (iii) infrastructure and supports, (iv) markets, (v) culture, and (vi) human capital. At the center of digital entrepreneurship is digital skills, which are not only a foundational requirement for developing vibrant digital economies, but also for obtaining jobs in growing sectors. Government can facilitate the supply of appropriate skills by creating an enabling environment for incubation and success.
- 34. Umbrella Facility for Gender Equality (UFGE):** To better understand how to make technology boot camps more inclusive, the World Bank conducted a global assessment of women-centered boot camps



and digital skills programs under the Umbrella Facility for Gender Equality (UFGE)-funded ‘Coding Bootcamps for Female Digital Employment’ activity. Some of the lessons learned include: (a) the importance of designing the right recruitment strategy (that is, avoiding language that is hyper-individualistic and masculine, building family and community support, and profiling other women in tech to leverage the role model effect); (b) fighting attrition with thoughtful program design that addresses care and transportation constraints and incorporates soft skills training designed to boost self-confidence; and (c) creating links to mentors, networks, and the job market through structured mentoring programs, vetted networking opportunities, and job placement initiatives.

- 35. Policy Brief - Financial Inclusion in Developing Asia:** Policy efforts must give due regard to the last mile, not just the broadening of access to finance but also inducing the actual beneficial use of finance. Interventions may include financial literacy and other financial education programs, encouraging banks and other institutions to design simple-to-use financial products for poor clients with little education; and the use of debit cards/mobile phones to facilitate conditional cash transfers (as done in Pakistan and the Philippines).
- 36. World Bank Mobile Internet Ecosystem Project:** The introduction of an open innovation platform can connect startups with traditional industries based on similar platforms in Chile, Colombia, and Lebanon designed and/or implemented by the World Bank that introduced open innovation and connection between startups and municipal governments and the private sector. For example, in Lebanon, the Mobile Internet Ecosystem Project developed a series of workshops and activities between technology startups and entrepreneurs as well as with legacy industries that have not widely integrated technology into their production processes. This project also created a startup-university platform with an emphasis on mobile internet applications and services.

C. Proposed Development Objective(s)

- 37.** The following indicators will measure progress towards the PDO:
- Number of MSMEs that receive long and short-term financing through the project (disaggregated by gender, youth, size, and location);
 - Number of new enterprises supported by the project (disaggregated by gender, youth, size and location);
 - Number of new entrepreneurs adopting digital technology for business (disaggregated by gender, youth, size and location);
 - MSMEs portfolio of participating financial institutions (PFIs) as percentage of total portfolio;
 - Net NPLs for MSME Portfolio of PFIs (Portfolio at Risk); and
 - Number of jobs created by MSME beneficiaries of the project.
- 38.** The key intermediate result (IR) indicators will be fine-tuned during project preparation.

D. Concept Description

- 39.** The project will address the PDO mostly through a private sector and market-led approach. Activities under this project will be structured under four mutually reinforcing components, namely: (a) Increasing financing available



to MSMEs; (b) Developing entrepreneurship and firm capabilities for MSMEs; (c) Developing alternative MSME financing by enhancing structures and instruments for long-term finance; and (d) Enhancing the financial infrastructure and strengthening the environment for supporting MSMEs. Digital innovation, skills and entrepreneurship especially for women and youth will be an underlying and cross-cutting element across the four components.

(a) Increasing Financing available to MSMEs: This component will focus on increasing MSMEs access to affordable finance, targeting women and the youth. Activities to be covered under this component will include the following: (i) a Line of Credit (LOC) to provide affordable funds to eligible financial intermediaries for on-lending to creditworthy MSMEs and entrepreneurs as well as export-oriented SMEs that require longer term financing to fund investment and working capital; (ii) A Partial Credit Guarantee (PCG) to support the underwriting of guarantees to financial institutions that are extending credit to MSMEs; and (iii) Technical Assistance (TA) support to PFIs that access the LOC and PCG financing support, and to strengthen the PFIs' ability to meet MSME credit demand using appropriate, innovative, sustainable, and efficient products and services.

(b) Developing entrepreneurship and firm capabilities for MSMEs: This component will facilitate the improvement of entrepreneurship and firm capabilities through demand side interventions. Activities covered under this component will include the following: (i) Strengthening the entrepreneurship and firm capabilities ecosystem to improve the survival and growth rates of entrepreneurs and MSMEs by developing a stronger innovation and entrepreneurship ecosystem and talent base. This subcomponent will administer matching grants, challenge funds, performance contracts, and capacity building through TA to MSME/Entrepreneur support intermediaries, including support to business incubation and/or acceleration Hubs. (ii) Capacity building support to entrepreneurs and MSMEs to improve the survival and the growth rates of entrepreneurs and MSMEs in Malawi through direct capacity building support to MSMEs: This will administer business plan competitions, matching grants, challenge funds, and other capacity building support for entrepreneurs and MSMEs through participating intermediaries. Entrepreneurs and MSMEs who graduate from the project support with viable business plans, will be linked to PFIs. Entrepreneurs will be linked with business mentors that can provide more practical and hands-on professional knowledge. Communities of Practice for women and youth will be established, where necessary, to facilitate these linkages. (iii) Supporting financial literacy (FL) schemes and Entrepreneurship awareness initiatives, targeting entrepreneurs, MSMEs and the general populace, including supporting integration of financial education in primary school and primary teacher training curricula and the development of financial literacy (FL) awareness programs for women and youth: To broad FL initiatives, support will specifically target educating women and people living in rural areas. Entrepreneurship awareness programs will aim at increasing the visibility of entrepreneurship opportunities and supporting larger businesses in fostering entrepreneurship. Further support will be provided to raise awareness about financial consumer protection rights. (iv) Establishing market linkages for MSMEs to improve the currently limited or non-existent access to markets: This will focus on identifying and implementing specific mechanisms to target women and youth. In addition, the project will explore the use of ICT technologies for market price information to address the price information asymmetries affecting efficient access to markets among farmers.

(c) Developing alternative MSME financing by enhancing structures and instruments for long-term finance: This component will support activities aiming at deepening the financial sector so that it can play a more significant role in the provisioning of long-term finance for MSMEs and long-term private sector investment projects, including for infrastructure projects. Activities covered under this component will include the following: (i) supporting the development of institutional channels for long-term finance; (ii) enhancing the LTF enabling environment; and (iii) market deepening through long-term/infrastructure demonstration transactions.

(d) Enhancing the financial infrastructure and strengthening regulatory environment for supporting MSMEs: This



component will aim at facilitating the financial inclusion and to increase access to finance for MSMEs by improving the infrastructure underlying the financial sector and the regulatory environment. It will build on the activities that were implemented under the FSTAP. Activities covered under this component will include the following: (i) Enhancing the financial infrastructure and increasing financial institutions' ability to expand their financial products and services, as well as building the capacity of stakeholders and users of these systems to encourage financial product uptake. Specifically, this will support the ensuring sustainability of operations of the MFI Hub by supporting its expansion through continued onboarding of MFIs and facilitating their linkage to the Hub; capacity building to support product development and increased usage of movable collateral registry, including through the promotion of financial literacy; strengthening the credit reporting system and promoting financial literacy initiatives to improve consumers' understanding and utilization of the system; developing a web-based portal for the Central Securities Depository (CSD), supporting integration of the national identification (ID) system as an enabler of financial inclusion, and supporting the national payment system and the Electronic Fund Transfer (EFT) system. (ii) Leveraging the potential of Digital Financial Services (DFS), to expand the delivery of financial services to the underserved populations in a cost-efficient manner. (iii) promoting wider usage of digital financial services.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

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

Note To view the Environmental and Social Risks and Impacts, please refer to the Concept Stage ESRS Document.

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