Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 23-Jun-2020 | Report No: PIDA29722

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
India	P174292	MICRO, SMALL AND MEDIUM ENTERPRISES EMERGENCY RESPONSE (P174292)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
SOUTH ASIA	30-Jun-2020	Finance, Competitiveness and Innovation	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of India	Department of Financial Services, Ministry of Finance		

Proposed Development Objective(s)

The Project Development Objective of the proposed DPF is to support the GoI in preserving flows of finance to MSMEs through the COVID-19 crisis and lay the foundations for a stronger MSME financing ecosystem in the recovery phase.

Financing (in US$, Millions)

SUMMARY

Total Financing	750.00

DETAILS

Total World Bank Group Financing	750.00
World Bank Lending	750.00

Decision
The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

The operation is based on the GoI's overall strategy to fight COVID-19 through three phases. In the first phase, the GoI intervened to tackle the pandemic through public health measures including imposing a total lockdown of 1.3 billion people as part of its social distancing strategy, and the World Bank (WB) partnered with India in the first phase with a US$1 billion health operation. In the second phase, the GoI invested in an extraordinary social protection program to bridge the needs of the poor and vulnerable communities through the lock down period until a gradual revival of the economy can happen. The GoI invested US$23 billion in this component and the WB partnered with a DPF program of US$1 billion. Both programs are on-going. The third phase of the government's COVID-19 strategy is focused on economic stabilization and reduction of the costs of the lockdown. It includes support to MSMEs and their workers through the lockdown period.

There are around 150-180 million people employed by 75-80 million MSMEs in India.[1] They are estimated to contribute to 40 percent of exports.[2] However, the COVID-19 pandemic and the consequent stoppage of economic activities have severely disrupted the sector, with cancellation of orders, loss of customers, and supply chain disruptions. Affecting the fate of many MSMEs, the pandemic has led to cash flow shortage, liquidity constraints, and further inability or difficulties in accessing finance, leading to potential solvency problems for many MSMEs. In response to such a situation, the GOI has taken a series of policy and regulatory actions to support the MSME sector, committing about 1.5 percent of GDP to MSME finance. As announced in May 2020, the Government's program has been drafted to complement the liquidity provision measures by the Reserve Bank of India (RBI) and focuses on "getting back to work" i.e., enabling businesses, especially MSMEs, to resume operations and ensure workers return to gainful employment. These measures have included setting up of a new window to provide additional lending to MSMEs, fully guaranteed by the government; a debt fund for stressed MSMEs; and a fund of funds to infuse equity into MSMEs. The government has also tried to address the specific liquidity issues of Non-Banking Financial Companies (NBFC) through a special liquidity facility for NBFC debt securities and an expanded partial credit guarantee scheme.

This Development Policy Operation (DPO) supports the GoI's program to provide MSMEs liquidity to overcome the impact of the COVID-19 crisis on their balance sheets, to mitigate against potential solvency problems and job losses, and to lay the foundations for a stronger MSME financing ecosystem in the recovery phase. It supports a set of policy, regulatory, and institutional reforms, that are expected to promote an efficient, resilient, and inclusive ecosystem of financing for MSMEs in India in the short and medium term.

Relationship to CPF

The DPO is part of the WBG strategy to help the GoI address the COVID-19 crisis and its subsequent recovery. In addition, the proposed DPF would help address some of key challenges detailed in the India Systematic Country Diagnostic (SCD), related to MSMEs and their economic and social role, and will contribute to the FY18-22 Country Partnership Framework (CPF) Second Pillar "enhancing competitiveness and enabling job creation". The CPF's Second Pillar identifies the importance of improving the business environment and select firm capabilities, increasing the resilience of the financial sector, improving connectivity and logistics, increasing access to quality, market-relevant skills, and enabling more quality jobs for women. The proposed DPF will directly contribute to these CPF targeted outcomes by enabling an ecosystem where the MSMEs will be able to thrive and lead to more employment generation in the country.

C. Proposed Development Objective(s)

The Project Development Objective is to support the Government of India in preserving flows of finance to Micro,

[1] https://www.power2sme.com/smekhabar/General/8010/%C3%87orona%20Virus%20Will%20Lead%20Indian%20Economy%20to%20its%20%E2%80%98Darkest%20Days%E2%80%99

[2] https://www.cii.in/PressreleasesDetail.aspx?enc=DNPkyvG1Mq9Q7tZI/e3R5yQI1uy1OFZ9g9z8BI070hBmptjZYJG4eGiQ3mQh0XsClZgXnTxwQqz/hPwLKeunyw==

Small and Medium Enterprises (MSME) through the COVID-19 crisis and lay the foundations for a stronger MSME financing ecosystem in the recovery phase.

Key Results

Indicator Name	Baseline	Target
RI 1: Number of MSMEs reached through incremental credit facilities	0 (June 2020)	1.5 million (June 2021)
RI 2: Volume of incremental financing provided to MSMEs	0 (June 2020)	Rs. 1 trillion (June 2021)
RI 3: Number of new guarantees provided to MSMEs	0 (June 2020)	1 million (June 2021)
RI 4: Volume of new guarantee covers extended to MSME loans	0 (June 2020)	Rs. 350 billion (June 2021)
RI 5: Volume of incremental funding to Non-Banking Financial Companies (NBFCs) (through SIDBI and PSB purchases of MSME loan pools, RBI)	0 (June 2020)	Rs. 500 billion (June 2021)
RI 6: A study undertaken to review lessons learned and outcomes from fintech regulatory sandboxes.	0 (June 2020)	1 (June 2021)
RI 7: For better monitoring of Central Public Sector Enterprises' (CPSEs) usage of Trade Receivables Discounting System (TReDS), the Samadhaan Portal* to be updated to track an additional data point with the following details: Number of CPSEs vendors onboarded on TReDS. **(https://samadhaan.msme.gov.in/MyMsme/MSEFC/MSEFC_CPSETReDs_Status.aspx)*	0 (June 2020)	1 (June 2021)
RI 8: Awareness campaign by NCGTC/SIDBI for women entrepreneurs on the schemes under the government's economic recovery program	No campaign (June 2020)	Campaign completed (June 2021)

D. Project Description

The proposed DPF is structured in three pillars: (i) Channeling financing flows to MSMEs; (ii) Supporting Non-Bank Financial Companies (NBFCs); and (iii) Incentivizing and mainstreaming the use of fintech and digital financial services (DFS) in MSME lending and payments. The MSME sector was already grappling with low credit growth in 2019 and early part of 2020, which has been further exacerbated by COVID-19 and the national lockdown. Thus, this operation will support the government in reviving credit to enable the MSME sector to meet business obligations, protect jobs, and avoid insolvency. Importantly, it will leverage private intermediaries in the financial sector thus contributing to GoI's approach to complement and diversify a dominantly public sector financial system.

This DPO is one part of a comprehensive set of interventions to support MSMEs in India to be delivered by the WB and the International Finance Corporation (IFC). Each brings its respective strength and capabilities to offer a holistic approach in designing, participating, and anchoring these interventions and instruments. Building on its extensive analytical and advisory engagement, the WB is bringing risk mitigation funding solutions and regulatory reforms, while the IFC is bringing its substantial MSME portfolio and a network of over 70 financial institutions and decades of successful track record as one of the biggest MSME financiers in India, both in terms of financial mobilization and impact. As a package, these interventions aim to address structural reforms to increase MSME productivity and financing in the economic recovery phase, crowding in private sector financing in the medium term, and tackling long-standing financial sector issues that are holding back the growth of India's real sector.

E. Implementation

Institutional and Implementation Arrangements

The Program will leverage the ongoing knowledge partnerships to track impacts and results. The WB has already been collaborating with knowledge partners such as the Ministry of MSMEs, RBI, SIDBI, Department Of Financial Services (DFS), Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), and Micro Units Development and Refinance Agency (MUDRA) on taking stock of Indian MSMEs' access to finance through ongoing Advisory and Analytical Services. These partnerships shall be critical to track impacts and implementation challenges as the Program moves forward. The WB will rely on four datasets for results: (i) CGTMSE data including number of guarantees, guarantee amounts; (ii) Data on utilization of the NBFC liquidity windows, the Targeted Long Term Repo Operations (TLTROs), and the Partial Credit Guarantee (PCG) Scheme; (iii) Volume of loans on PSB59; and (iv) Volume of invoices discounted on TReDS.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The MSMEs are the key economic lifeline in the Indian economy, contributing to 30 percent of India's GDP and 40 percent of exports. [3] The social and economic significance of these enterprises can also be gauged from the fact that two thirds of the MSMEs are operated by socially vulnerable groups (Scheduled Caste/Scheduled Tribe/Other Backward Classes). [4] Ten percent of MSMEs are operated by women.[5]

With the onset of COVID-19, the MSME sector of India is now facing significant cash flow shortages and liquidity constraints. With no cash inflows, firms are not able to pay their staff, suppliers, and lenders. If left unsupported, the economic slowdown related to COVID-19 and liquidity constraints could put a large number of MSMEs at risk, with many facing viability issues in the current environment.

Against such a backdrop, the overall Program will be positive for the economy and the society, by ensuring adequate flows of finance to MSMEs through the COVID-19 crisis and laying the foundations for a stronger MSME financing ecosystem in the recovery phase. With channeling of financial flows directly to MSMEs, supporting incremental finance to NBFCs for further financing of MSMEs, and by incentivizing the use of fintech/DFS, the program will provide a much-needed stimulus for not only the growth of the MSME sector but also for sustainable and inclusive growth of the economy.

[3] https://loksabha.nic.in/Members/QResult16.aspx?qref=70754
[4] https://msme.gov.in/sites/default/files/Annualrprt.pdf
[5] http://documents.worldbank.org/curated/en/475971489991126947/pdf/113596-WP-IN-Womenownedbusiness-PUBLIC.pdf

Environmental, Forests, and Other Natural Resource Aspects

The policy and institutional reforms under the DPF have no significant positive or negative environmental effects. These reforms are directed towards channeling financing to the MSMEs either through the NBFCs or banks and improving fintech solutions that will enable efficiencies in loan processing and in availing/receiving funds due to them. There will be no direct environmental effects from these reforms.

When these financing flows reach MSMEs, they are expected to be used primarily for relief such as meeting the working capital requirements in the COVID-19 situation that they are facing. These are not likely to have any significant positive or negative environmental aspects. For any incidental effects, there is a well-developed legal and institutional context for environment, forests and other natural resources management. The Ministry of Environment, Forests and Climate Change (MoEFCC) is the nodal agency in the administrative structure of the Central Government for the planning, promotion, co-ordination and overseeing the implementation of India's environmental and forestry policies and programs and provides the statutory environmental framework under which MSMEs operate. The Central Pollution Control Board also provides technical services to the MoEFCC on the compliance and monitoring of various environmental legislations. As the state level, there are similar agencies (the Department of Environment and its associated authorities, and the State Pollution Control Board), which are responsible for implementing various national and state laws and regulations that are relevant to environmental protection.

G. Risks and Mitigation

The operation carries substantial risks, which are not dissimilar from the risks faced by multiple governments and WB operations around the world in the current COVID-19 environment, and also are adequately mitigated. Due to the unique and unprecedented nature of the COVID-19 pandemic and the economic crisis brought by it, the Program supported by the DPF comes with extremely high uncertainty about the outcomes of the crisis and the shape of the economic recovery. The uncertainty makes it very hard to assess, with any degree of precision, the cost-benefit balance of the deployed emergency financing measures. Key risks to the Program outcomes include (i) the potential negative impact of the high incremental allocations of public funding to address the impact of the crisis to public debt sustainability (due to the expected increase of the total combined liabilities of GoI and RBI, including direct public debt and contingent liabilities); and (ii) efficiency of the allocated financing, which may either miss its viable targets or, on the contrary, support unviable enterprises, resulting in socially suboptimal outcomes. The risks of the Program are, however, mitigated by (i) the incremental approach of the authorities, deploying the measures in sequence based on the best assessment of the needs of the Indian economy as well as benefiting from the emerging collective global knowledge of the crisis response approaches; (ii) sunset clauses included in most of the deployed emergency response measures; and (iii) prudence in direct incremental fiscal budget outlays, relying substantially on the RBI measures and public guarantees instead.

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APPROVAL

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