

Malawi

Operationalizing the European Union's External Investment Plan (EIP) and Advancing the European Economic Diplomacy Agenda in Malawi

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Acronyms

AfDB	African Development Bank
CARD	Churches Action in Relief Development
DCAFS	Donors Group on Agriculture
DFI	Development Finance institution
DfID	Department for International Development
EBO	European Business Organisation
EED	European Economic Diplomacy
EFSD	European fund for sustainable development
EIP	External Investment Plan
EU	European Union
EUCC	European Union Chamber of Commerce
EU HQ	EU Head Quarters
ESCOM	Electricity Supply Corporation of Malawi
GIZ	Gesellschaft für Internationale Zusammenarbeit
GOM	Government of Malawi
ICT	Information and Communication Technology
IFC	International Finance Corporation
IFPRI	International Food Policy Research Institution
JGC	Jobs and Growth Compact
JICA	Japan International Cooperation Agency
KfW	Kreditanstalt für Wiederaufbau
MAREP	Malawi Rural Electrification Programme
MCC	Millenium Challenge Corporation
MCCCI	Malawi Confederation of Chambers of Commerce and Industry
MEGA	Mulanje Electricity Generating Agency
MERA	Malawi Energy Regulatory Authority
MGDS	Malawi Growth and Development Strategy
MICF	Malawi Innovation Challenge Fund
MIERA	More Income and Employment in Rural Areas
MSME	Micro Small and Medium Entreprises
NAFSN	New alliance for food security and nutrition
NES	Malawi National Export Strategy
NGO	Non governmental organisation
OPIC	Overseas Private Investment Corporation
PIP	Proposed investment proposals
PPD	Public private dialogue
SAPP	Southern Africa Power Pool
SBU	Single buyer unit
SDG	Sustainable development Goals
TIPSWap	Trade investment Private sector development and sector wide approach
TPSD/E	Trade private sector development Facility

TVET	Technical and Vocational Education ant Training
UK	United Kingdom
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WB	World Bank

EXECUTIVE SUMMARY

Background to assignment

The assignment took place within the context of the EU External Investment Plan (EIP), which aims at catalysing international and domestic private sector investment in partner countries and supporting them in their effort to meet the Sustainable Development Goals (SDGs). It provides for a comprehensive and integrated approach, linking investment mobilisation (pillar 1) with technical assistance (pillar 2) and improving the investment climate (pillar 3) with the objective to remove constraints to private investment in partner country markets and to support priority reforms.

The assignment, conducted through the services of the TPSD/E Facility in Malawi between September and October 2018, had two components and a number of objectives: to analyse how to operationalise the External Investment Plan in Malawi by exploring and identifying investment opportunities under each investment window of the EIP, and to build a strategy for implementation of newly formed European Economic Diplomacy (EED) agenda, with an additional comparison of EED processes within the region.

While the assignment was successful in both identifying ways in which to operationalise the EIP, and creating a forward strategy for EED processes, its limitations included data unreliability and unavailability, time limitations and an overly wide scope between the two components. In terms of the output, information around EU private sector presence and interests within the country was not compiled because of unavailability, and a mapping of bilateral interests not possible.

Implementing the EIP and EFSD guarantee schemes in Malawi

Under pillar 1 of the EIP, the European Fund for Sustainable Development will implement a dedicated financial guarantee mechanism along five dedicated investment windows. These are: Sustainable Energy and Sustainable Connectivity**;** Micro, Small and Medium Enterprises (MSMEs) Financing; Sustainable agriculture, rural entrepreneurs and agroindustry**;** Sustainable Cities; and Digitalisation for Sustainable Development. This mission attempted to analyse the sectors in Malawi corresponding to the investment windows, while identifying possibilities for investment and indicating which guarantee tools may be relevant at present to each sector.

The consultant, after careful consideration, has identified four guarantee tools that are highly relevant for the Malawian context. Two are under the sustainable energy and connectivity window, and two are under the funding MSMEs and Sustainable agriculture window. These are: **Renewable energy support programme for mainly rural areas in Sub-Saharan Africa, and the Desco Financing programme (**for sustainable energy) and **the AfDB SME guarantee programme (designed both to apply for agri-businesses and non) and AGREENFI (specifically designed for agri-businesses).**
Detailed reasoning in regard to the choice of the four is expounded in this report.

Furthermore, the mission analysed the other potentially relevant guarantee tools under each investment window and key findings are expounded in the report.

Sustainable Energy and Connectivity: The consultant analysed the on-grid, mini grid and off-grid space and initiatives, and identified the following potentially relevant guarantees:
For the on-grid space: ***Room2Run***, ***Boosting investment in renewable,*** The ***Africa Green Co***, the ***Renewable energy support programme for mainly rural areas in Sub-Saharan Africa,*** *and* The ***European Guarantee for Renewable Energy***.

For the mini-grid, the most relevant guarantee tool is ***Room2Run.***
For the off-grid, the most appropriate guarantee would be AfDB's **Desco Financing programme.**

Funding MSMEs and Sustainable agriculture, rural entrepreneurs and agroindustry windows were analysed in succession as the vast majority of MSME are either in or relate to the agricultural sector and with the main challenge for agri business being the lack of access to finance. Relevant EFSD guarantee tools in MSME and Agri-Businesses investment window include: ***AfDB SME guarantee programme***, which also applies to Agri-Businesses; the ***EDFI SME guarantee programme***; the ***FISEA EFSD SME investment Guarantee tool*** that also applies to Agri-Business; and the **AGREENFI** to provide access to finance for actors in the agriculture value chain in the country.

Partly relevant guarantee tools in this sector include: the ***"Archipelagos - One Platform for Africa" ("ONE4A")*** which is a tool designed to build on AfDB's experience in developing capital markets in Africa and the lessons learnt through their SME financing programmes. The ***Small Loans and Guarantee Program (SLGP***) by the IFC is relevant for Malawi, but difficult to implement.

Sustainable cities: For this window, it was not possible to ascertain what projects and what space would allow for the use of EFSD guarantee schemes under this investment window. The private sector consulted will not engage with local government under any incentive structure, as they believe local government to be too politically involved and therefore uncertainty crowds any level of engagement. At the time of writing this report meetings scheduled with the construction company and the mayor of Lilongwe had been repeatedly cancelled.

Health and Digital for Development: There are major opportunities in HIV pay-per-test option for private entrants/firms, which would make the testing model more efficient, as well the test machine manufacturers/distributors in-country which can work with maintenance of machinery and distribute larger numbers of cartridges. Additionally, as the ministry is revising the antiretroviral drug regimen, there will be need for immediate viral load testing, which the existing 10 facilities cannot be able to handle efficiently. Therefore, the present ***Digital EU Health guarantee platform*** co-financed by the Bill and Melinda Gates Foundation is relevant and access by private sector players will be discussed and facilitated by the EU delegation.

Advancing the European Economic Diplomacy Agenda in Malawi

Although a clearly defined framework for EU's Economic Diplomacy strategy and agenda is not currently defined, the internationalization of SMEs is a key vehicle used to improve the coherence and effectiveness of EU's external action in its strategy to enhance its economic sphere. To this end, the creation of European Business Organizations groups together with European chambers of commerce and organizations who operate under a clear objective to defend and promote common EU economic interests is a key component of supporting externalisation.
The EU aims to develop a more coordinated and coherent global strategy. Following discussions in December 2017 in Malawi a number of action points have been raised with the aim of promoting efficient use of existing public and private resources, avoiding duplication of existing structures and not superseding member states' responsibilities towards own firms.

MCCCI Key Facts

- Public Private Dialogue forum held 4 times a year through which main dialogue is conducted
- USD 900k grant approved by WB to set up
- Key stakeholders: private sector chief executives, associations, government ministries, Principal Secretaries as policy makers
- Member composition: 280 large companies and associations
- Forum leader: sitting Minister of Industry, Trade and Tourism
- Forum objective: creation of platform for policy dialogue requiring government action

The EU recognizes the Malawi Confederation of Chambers of Commerce and Industry (MCCCI) as the main organ of private sector representation and key avenue for cooperation efforts. Currently, MCCCI is seen as under-representing small firms in its public-private dialogue and is not representing EU specific interests and addressing bottlenecks faced by both in-country investors and those that are coming in to invest. Other initiatives and dialogues that can exist include Trade Investment and Private Sector Development Wide Approach (TIPSWAp); the New Alliance for Food Security and Nutrition (NAFSN). These should be considered to promote efficient use of existing resources.

These dialogue avenues however are specific to either the export space (TIPSWAp) or nutrition and do not address the needs of identifying intervention points for enabling investments by EU private sector participants.

In-depth consultations with various EU private sector participants expressed the following initial conclusions on the creation of a platform

- An interest in establishment of platforms as a means to support their operations, although several questions were raised on how the platform would be shaped with most leaning towards private sector led platforms, not EU-led
- Efforts around advocacy and lobbying are not seen as useful, rather support frameworks should enable increased access to information, markets and technical assistance
- Creation of platform would be a way to increase participation of Malawian companies
- Regulations and legislation changes needed to be compiled and monitored and disseminated to the private sector at large, to enable them to better face the rapid changes.

The presence of strong EU business organization constructed through bottom-up approach is essential, especially in Malawi where EU presence is minimal. Following lessons from other countries, simply lobbying and advocating is insufficient. In the context of Malawi, the proposed EU business network should serve the following:

- Advocacy and visibility
- Building and improving market intelligence
- Build platforms to promote market access

However, while the EU may support the creation of a new support organisation for the long-run that can cater specifically to EU businesses, it may be that a quicker and better dividend is achieved by technical and financial long-term support of institutions like the Malawi Trade and investment centre, which is not efficient for the lack of follow up and long-term support after having been created.

1 INTRODUCTION

1.1 Background to assignment

The assignment took place within the context of the EU External Investment Plan (EIP), officially launched in November 2017 in Abidjan. The EIP aims at catalysing international and domestic private sector investment in partner countries and support them in their effort to meet the Sustainable Development Goals (SDGs). It provides for a comprehensive and integrated approach, linking investment mobilisation (pillar 1) with technical assistance (pillar 2) and improving the investment climate (pillar 3) with the objective to remove constraints to private investment in partner country markets and to support priority reforms. To deliver the EIP, it is necessary for EU Delegations and Commission headquarters to establish a structured and sustained dialogue with the local and European private sectors present in partner countries, to identify the most important barriers to private investment and prioritise the investment climate reform agenda.

Understanding the needs and constraints of local and European sectors and harnessing their potential to contribute to sustainable development, requires stepping up interaction with the private sector, and creating a space for private-public collaboration. The objective of establishing a dialogue with the private sector is to help identify the key constraints to private investment and the priority reforms to improve the business environment and investment climate ultimately to design cooperation actions more efficiently and with greater impact. Structured dialogue is also a good way to support multi-stakeholder partnerships, which are essential for the sustainability of the EU's cooperation actions. It is important for the EU Delegation, therefore, to establish a structured dialogue with the local private sector in Malawi to identify the most important barriers to investment and draw up priorities for reforming the investment climate agenda. This in turn will ensure ownership and engagement by the local private sector in Malawi as the EIP is implemented.

The EU's Malawi Jobs and Growth compact, furthermore, identified enabling business environment and private investment (especially within agricultural value chains) as key areas of intervention and prioritised these. The compact as such acknowledges the fact that there is need to engage in dialogue with other stakeholders, and prioritises dialogue especially between EU Member States and EU businesses, dialogue between the EU Delegation to Malawi with local private sector as well as by the delegation with other donors and the government.

In parallel, the recently announced European Economic Diplomacy (EDD) guidelines invite EU Delegations to initiate dialogue, cooperation and visibility actions to promote EU private sector activities with African countries. Support to European Business Organisations (EBO) activities such as studies on EU economic interests and investment are examples of European Economic Diplomacy.

The TOR for this assignment therefore sought the services of the TPSD/E Facility to conduct further research on pillars 1 (EFSD guarantee operationalization) and 3 (EED process within the context of the SB4A platform) of the EIP in order to guide its further implementation in Malawi.
In the context of the above, a consultant was hired for the month of September 2018 to conduct analysis based on objectives and deliverables as laid out in the below subsections.

1.2 Objectives and deliverables

Purpose and rationale of the assignment (Objectives):

The Terms of Reference clearly stated the purpose of the analysis (objectives), and the outputs expected after the conclusion of the assignment. The assignment, as explained above, had two distinct components: an analysis of the operationalisation of the EIP in Malawi, and a strategy for implementation of the EED agenda in Malawi. As such, it was preliminarily discussed with the EUD of Malawi during the inception meeting with the consultant that a systematic approach would have been taken to assess within the first two weeks of engagement if all objectives could be met and which would otherwise be changed or removed to ensure successful completion of the assignment.

The assignment had three primary objectives which are described below as presented in the original TOR:

> *Objective 1:* Propose approach and actions to implement the EED and SB4A processes in the country, including to identify the main actors in the country (possibly a mapping of the level of investments by the European private sector, in sectors aligned with the Jobs and Growth Compact (JGC) and , in particular, looking at the involvement of the local private sector in European-funded investments as well as an overview of levels of investment in Malawi by other countries e.g. USA, China etc) and propose actions to develop recurrent and structured dialogue.
>
> *Objective 2:* Exploring the EU interests in Malawi and the scope for establishing an EU Chamber of Commerce (EUCC).
>
> *Objective 3:* Supporting the operationalization of the External Investment Plan (EIP) in Malawi through the analysis and identification of investment opportunities within the framework of the EIP.

Within the first two weeks of engagement, it was clear that the objectives set out could not be fulfilled in entirety. In fact, quantitative data that was needed to map out the level of investment by EU private sector, as well as needed for a number of other analyses including the involvement of the local private sector in EU investments, was not present. Therefore, the consultant informed the EU Delegation, and a decision was made to focus analysis around collecting qualitative rather than quantitative data, and to separate and focus on the objectives and deliverables that were possible to be produced. A more detailed account of the limitations encountered is expounded in the subsection "*Limitations to assignment"*.

Expected outputs:

The TOR set out a final output of the assignment based on the objectives described above as an analytical report covering the following aspects:

Objective 1 – OUTPUTS:

(i) A stock-take of processes, experiences, best practices, and lessons learnt from more advanced EED activities in the sub-region.
(ii) Mapping of the local private sector in particular in sectors related to the JGC and looking at their involvement with European companies (e.g. joint ventures, distribution partnerships etc) and the levels of investment by the European private sector in Malawi.
(iii) An operational proposal to establish SB4A process in the country, led by the EU Delegation, taking into account on-going spaces for dialogue with private sector (i.e. Private Public Dialogue Forum or New Alliance for Food security and Nutrition), EED activities in the sub-region, as well as best practices in structured dialogues with the private sector.

Objective 2 – OUTPUTS:

(iv) An overview of EU bilateral interests (current and potential) in terms of trade, investment, and related interests by populating an excel file.

(v) An analysis and proposition of major areas of intervention (sectors or topics) of dialogue and advocacy by the Malawi EED initiative.

(vi) An investigation on the possibility of setting up an EU Chamber of Commerce (EUCC) in Malawi, and if the Chamber is deemed viable, provide a recommendation on the way forward in terms of next steps, as well as proposing operational modalities of the Chamber once established. The investigation would also explore how the EUCC in the context of SB4A could contribute to improve the investment climate and have a more structured dialogue with the local private sector.

Objective 3 - OUTPUTS:

Proposals for potential use of the EFSD guarantee by private sector based on the information available in the Project Investment Proposals in the five EFSD windows. This work should be in line with the main value chains and areas proposed in the Jobs and Growth Compact and development cooperation portfolio for Malawi.

During the inception stage, as the consultant mapped out data sources that could inform and ensure the successful completion of the assignment, it was recognized that a major lack of reliable information on companies, investment origins, and operations of private sector at large is pervasive within the Malawian context. As such, the consultant expressed the need for a more in-depth and dedicated investigation with regards to the expected outputs around assessing/mapping European investments within Malawi, as well as a mapping of local private sector in areas of interest to the EU's Jobs and Growth compact strategy for Malawi engagement, and suggested this be conducted at a later stage.

Consequently, two specific outputs set out for the assignment in the TOR were not possible to be produced, as primary and secondary data was either not available or not sufficient to create the necessary complete image required for the evaluation in question to be useful. The two components that the consultant was not able to produce effectively are: a) Objective 1 output ii; and Objective 2 output iv. A more detailed account of the rationale behind the decision to forego these outputs can be found in *"Limitations to the assignment"*. However, limited data around these two outputs was retrieved, and what possible shared with the EU Delegation to Malawi. **Nevertheless, the consultant remains of the opinion that the data gathered is highly lacking and therefore a better targeted investigation warranted**. As such, the limited data gathered was not included in this report.

1.3 Analysis framework and methodology

1.3.1 Analysis Framework

On the basis of a meeting held between the consultant and the EU delegation to Malawi on the 27th of August 2018, the kick-off day of the assignment, a framework was developed to guide the consultant in his assessments. As the two components of the assignment were not necessarily fully synergistic, the consultant was careful to separate the two components where necessary, and the assignment was effectively divided into the two separate components and key information sought out according to the intended results of each component.

For the EFSD component, the analysis framework was developed to allow a high-level analysis of the markets under each investment window, and information sought out regarding possible and potential investment projects available that could benefit from the EIPs tools. The consultant assessed also the readiness of the local market (private sector and financial market) to make use of the EIP's new guarantee schemes.

In regard to the EED agenda, firstly definitions of the subject matter were laid out and on the basis of it, private sector and other stakeholders engaged. A clear understanding a priori of the subject matter was important to be able to have productive discussions with the relevant parties. The framework of reference was created following EED process guidelines provided by the EUHQ to the delegation of Malawi, and by the consultant's own research in the subject.

1.3.2 Analysis Methodology

Methods for data collection and sources of information

The collection of data for both components (operationalisation of EFSD and implementation of EED agenda) required a variety of methods and involved different sources and stakeholders. The main methods for data collection involved desk research of secondary data (from online sources and published reports), raw data collected from relevant institutions, and one on one interviews with key informants and stakeholders. For both components the majority of information came from key informants and stakeholders. The prevalent method of primary data collection has been through semi-structured interviews.

In terms of sources of information, the EU delegation to Malawi supplied an initial list of relevant stakeholders to the consultant. Sources for the EFSD component included private sector, donors, financial institutions, government entities, and key informants as identified while conducting the assignment. For the EED processes component, sources were mostly limited to private sector companies owned by EU citizens (or EU foreign direct investor firms), the excellencies representing EU member state embassies, honorary consuls of EU member states, and government institutions. One-on-one interviews were conducted for the most part, and where this was not possible the consultant engaged with informants via phone conversations.

Data analysis methodology

The consultant's findings are based on desktop reviews of reports, online datasets and other relevant documents, and where possible first-hand data obtained through one-on-one key informant interviews. The analysis of both secondary and primary data collected is through qualitative means, and in line with prevalent current research methods. No statistical software, or any other data analysis tool was used in this assignment.

1.4 Limitations to assignment

The consultant in the course of the assignment came across a number of limitations which made it not possible to produce all the expected outputs as per the TOR. The following are the main limitations encountered:

Data unavailability and unreliability: Data around firms' investment origins was sought out and found but it was limited in its completeness. Malawi's company registry at the ministry of trade does not request companies to enter their investment origins, and therefore a mapping of the size of EU presence within the country not fully possible. Similarly, the extent to which local firms engage with EU companies in the form of joint ventures and/or other types of partnerships was not possible to be established. Limited data was collected from the MITC (Malawi investment and trade center), which can give an indication of EU presence vis-à-vis other countries. However, a lot of the figures are outdated and the register in itself not updated. Therefore, while a general figure could be indicated to

the commission and the EU delegation on the size of investments of EU member states in the country, the figure may be incorrect and therefore give false basis on which the delegation or interested stakeholders may initiate various economic/political discussions. It is the choice of the consultant to not include this data officially but leave the decision to the EU delegation on how to use it. Including it in a report would be misleading and ethically wrong.

Time limitations: The consultant had raised his concern around the allocated time to the assessment before starting the assignment. In fact, as pointed out, the assignment suffered from trying to gather as much information on a multitude of subjects and areas in very little time. It is the opinion of the consultant that, although information was gathered that is still valuable, more time would have allowed for higher quality output, as many points of information were not collected due to time constraints.

Wide ranging Scope: The assignment suffered from a too extensive scope. Effectively, the consultant was assessing five different investment windows, each of a different sector with its own peculiarities, policies, investment hurdles, etc, and he was also conducting research and meetings around European Economic Diplomacy, which in and on itself was a very large undertaking. It is of the consultant's opinion that the scope of the assignment could have been more targeted and that the EFSD and EED should have been two different assignments. In particular, the EFSD investment windows require in-depth treatment and not just a summary and surface analysis of potential private sector investment projects. There are many complexities in the regulatory and political environment as well as the maturity of the financial sector, and additional complexities of the sectors under each window that need careful and targeted intelligence and examination to be really useful to both EUD and the commission

2 BACKGROUND and CONTEXT

2.1 Socio-economic context

Malawi is located South East of Africa. Sharing borders with Zambia, Mozambique and Tanzania, it is a landlocked country covering a total land area of 118,484 km^2. About 20 percent of this is water.

Recent data estimates by the World Bank place **Malawi's population at 18 million inhabitants** in the year 2016[1] with 83 percent of this population estimated to be living in rural areas. Malawi's population is young, with approximately 46 percent believed to be below the age of 15 years and up to 73 percent below the age of 35 years[2].

About **84.7 percent of Malawi's population is employed in agriculture** and engages in subsistence farming on smallholder, fragmented and customary land. As such, agriculture is the main economic activity in the country. Crops that contribute significantly to the economy of the country are tobacco, tea, sugarcane and cotton. These crops account for about 75 percent of total exports of the country, with tobacco alone estimated to contribute up to 52 percent.

As of 2017, **Malawi's Human Development Index (HDI) value was 0.477**, ranking the country at 171 out of 189 countries and territories. While this value is still low and places Malawi in the low human development category, the country has in fact experienced a 40.2 percent increase from its very low HDI value of 1990 (i.e. 0.340)[3].

The **Gross National Income (GNI) per capita for Malawi (2011 PPP $) is 1,064**, and the country relies on domestic credit provided by the financial sector for 19.6 percent of its GDP. Only 4.4 percent of Malawi's GDP is net inflows from Foreign Direct Investment, and up to 23.5 percent of Malawi's GDP is from Official Development Assistance (net). At -4.6 percent and 0.65 percent of the GDP respectively, private capital flows and remittance inflows are incredibly low in Malawi[4]. According to the World Bank's 'Doing Business' ratings, Malawi is currently (2018) ranked 110 among 190 economies. This assessment measures quantitative indicators on eleven variables including regulation for starting a business, getting electricity and trading across borders.

Current (2018) estimates indicate that u**p to 82.6 percent of Malawi's employed population earn on average PPP$3.10 a day**, indicating high levels of working poverty. While men and women have the same employment rates, women tended to have a slightly higher rate than men at youth on 15-24 years[5]. In addition, only 11.7 percent of Malawi's total labour force is estimated as skilled[6].

The official minimum wage in Malawi was raised from 317 Kwacha per day in 2012 (approx. US$1.3) to 511 Kwacha per day in 2014 (approx. US$2.1), but these wages apply only to the formal sector. As of 2014[7], out of an estimated total labour force of 7.2 million, experts indicated that the informal economy comprised 89 percent of Malawi's labour force. It is difficult to estimate what the daily wages in the informal sector are.

[1] The Malawi National Statistical Office (NSO) started a Population and Housing Census (PHC) in September 2018 and the preliminary report of the census results is anticipated for release by December 2018.
[2] Malawi Growth and Development Strategy III (2017 – 2022)
[3] UNDP (2018) Human Development Report Statistical Updates (http://www.hdr.undp.org/en/countries/profiles/MWI#)
[4] Ibid
[5] Danish Trade Union Council for International Development Cooperation (2014) Malawi Labour Profile (PDF: http://www.ulandssekretariatet.dk/sites/default/files/uploads/public/PDF/LMP/lmp_malawi_2014_final_version.pdf)
[6] Ibid
[7] More recent data is not readily available.

2.2 Investment and private sector support strategies

2.2.1 The European Union

2.2.1.1 The EU's External Investment Plan (EIP) and EFSD

The External Investment Plan (EIP) is a new EU initiative launched in 2017. It is designed to attract more investment, in particular from businesses and private investors, into countries near the EU ('EU Neighbourhood') and in Africa. The Plan will do so by using public money to lower the risk of investing in key sectors like sustainable energy or lending to small businesses.

The EIP sets out a coherent and integrated framework to improve investment in Africa and the European neighbourhood in order to promote decent job creation and inclusive and sustainable development, and tackle some of the root causes of migration. With the EIP, the EU wishes to go beyond 'traditional' development aid based on grants and instead use innovative financial products such as risk sharing guarantees instruments and the blending of grants and loans to ensure that investments have a major development impact. At the same time, it will encourage an enabling investment climate and business environment, including through promotion of structured dialogue with the private sector.

The EIP is structured around three pillars of interventions:

- **Pillar 1:** investments are mobilised through the European fund for sustainable development (EFSD), which features two existing regional investment platforms and the new, innovative, EFSD Guarantees mechanism;
- **Pillar 2:** technical assistance (TA) is provided to develop bankable projects and help improve the investment climate and business environment in partner countries; and
- **Pillar 3:** the investment climate and business environment are also improved through structured dialogue with the private sector and enhanced policy dialogue.

Its key **innovations** are two-fold:

1. Its new **guarantee mechanism** under the European Fund for Sustainable Development (EFSD),
2. The **integrated framework** under which it will be operationalised, combining blended finance and guarantee mechanisms (Pillar 1 with the EFSD) with technical assistance (Pillar 2) and an increased attention to improving the enabling environment (Pillar 3).

The EIP is an integral part of the EU strategic policy developments, including the 2017 European Consensus on Development, the 2016 EU Global Strategy for the EU Foreign and Security Policy, the 2014 EU Communication on The Stronger Role of the Private Sector, and the 2017 Joint EU Communication For a renewed impetus of the Africa-EU Partnership. The European External Investment Plan (EIP) was officially agreed as a 'new generation instrument for sustainable development' after a full year of preparation and legislative processes.[8]

The EIP therefore has the potential to represent a major shift in EU development engagement in Africa, and Malawi, as the EU seeks to use more strategically its aid and policy-clout to leverage private investments in a fully integrated manner, combining in a common framework financial and non-financial support, and enhancing the investment climate, to foster more and better sustainable investment. The relevance to Malawi of the EIP's instruments is significant, as both the EU's and the GoM's strategies to ensure continued economic growth and development of the country emphasise the

[8] Bilal, S. and Grosse-Puppendahl, S. 2018. *What is the European investment plan really about?* (Briefing Note N.101). Maastricht: ECDPM.

need to spur private sector engagement and investment, and largely focus efforts in enabling the business environment through continued structured and effective dialogue among actors.

2.2.1.2 The EU's Jobs and growth compact (Malawi)

Capitalizing on existing European Union (EU) facilities like the External Investment Plan's (EIP) Pillar 1 investment facility (and EFSD guarantee) as well as the NIP – the EU's Jobs and Growth Compact outlines the priority areas of intervention which the EU Delegation in Malawi will implement to support the creation of jobs and spur economic growth in the country.

Broadly, the compact identifies challenges for Malawi's growth and job creation based on the EU's priority areas of intervention in the country. The three priority areas are policy and regulation, private sector engagement for development and agricultural value chains.

The main challenges that the compact identifies under enabling business environment revolve around the nascent nature of Malawi's private sector. The compact states that Malawi has very few private sector actors, too few MSMEs and the general population has very limited spending power. In addition, there is limited support for the development of the sector, with very little access to finance and broader business development services. All these make it difficult to establish or grow businesses in the country. The main driver of Malawi's economy is agriculture, which itself is very underdeveloped, primitive and not diverse. There is very little manufacturing that takes place locally, and Malawian exports are almost non-existent, especially for finished products. There is poor integration between towns and cities due to limited road networks which also contributes to the challenges faced by stakeholders wishing to create or grow businesses in Malawi, and in addition, erratic energy access makes business stability unpredictable. All of these challenges are compounded by the policy and regulatory environment, which often serves to hinder rather than facilitate business creation in Malawi. Regulatory environment issues such as very high taxes, corruption and the difficulties that businesses face to accessing land for business often serve to block rather than grow businesses.

Secondly, the main challenges identified by the compact under agricultural value chains revolve around the fact that up to 80% of Malawi's food is produced by smallholder farmers. The majority of these farmers engage in subsistence farming, have very little access to inputs and as such produce very little and seasonal based output. The farmers are rural based, with few skills and capacities and as such are limited in their ability to ensure quality and add value to their produce. In addition, most farmers have little market information, which results in weakened market links and also affects their ability to commercialise their produce. Commercialisation is further hindered by unstructured market systems, poor road networks and erratic energy access. Furthermore, capital access is very difficult, with interest rates too high, resulting in many farmers unable to access capital due to limitations in collateral. As such, much of the activity that takes place in Malawi's agricultural sector is informal, resulting in limitations to the growth of the sector as a whole.

To address the challenges identified, the compact prioritises four main pillars of intervention, namely, support for the development of (i) The enabling business environment, (ii) Agricultural value chains and access to finance, (iii) TVET and entrepreneurship, and (iv) Enabling infrastructure – which build on ongoing EU delegation interventions that are focused on agricultural diversification and value-addition. To facilitate the implementation of these priority areas, the compact acknowledges the fact that there is need to engage in dialogue with other stakeholders and prioritises dialogue especially between EU Member States and EU businesses, dialogue between the EU Delegation to Malawi with local private sector as well as by the delegation with other donors.

Broadly, within these priority pillars of intervention, the compact identifies the following as potential areas for the EU Delegation's engagement going forward – continued engagement with Government and other relevant stakeholders to mitigate challenges hindering private sector investment in agriculture and agro-processing; support to improve the functioning of markets in Malawi in relevant crops and

value chains (e.g. maize); support to institutions and processes related to standards and certifications, support to improve the tax environment; support to minimize risks to stakeholders resulting from the large proportion of informal markets; support and facilitate fair competition; support to improve access to finance and; support to operationalize and implement relevant legislation (e.g. the new Companies Act of 2013 and the new Land Bill). The delegation also intends to continue engaging relevant stakeholders to address and minimize corruption in Malawi - which directly hinders private sector engagement in Malawi.

Finally, the compact identifies other sectors which have a lot of potential for job creation and growth – namely tourism, mining and industrial development. In all of the planned and potential interventions, the EU Delegation plans to align their work to government priorities and national development strategies.

2.2.2 Malawi Growth and Development Strategy III and its synergy with EU's JGC

Through the Malawi Growth and Development Strategy (MGDS) III (2017 – 2022), the Government of Malawi (GoM) continues to work towards the attainment of the country's long-term development aspirations as enshrined in the country's Vision 2020 Strategy. The MGDS III prioritises five areas – i) Agriculture, Water Development and Climate Change Management; ii) Education and Skills Development; iii) Energy, Industry and Tourism Development; iv) Transport and ICT Infrastructure and; v) Health and Population – which are expected to spur growth and address the bottlenecks to growth and development that Malawi is currently facing. These five priority areas are complementary to those identified by the EU Delegation to Malawi in its Jobs and Growth Compact, which identifies, amongst others, agricultural value chains, TVET, entrepreneurship and enabling infrastructure as key areas needed to spur job creation and growth in Malawi.

The MGDS III anticipates an average GDP growth rate of 6.2 percent for Malawi during its implementation. The Government anticipates an additional investment of up to US$1.2 billion by both the public and private sector which is what is expected to drive this growth. The GoM intends to spur this investment through the creation of a conducive environment which will be created through public sector policy instruments that will encourage private sector participation in the development of the country. Broadly, the GoM's policy implementation of the MGDS III will centre around the development of a vibrant and efficient capital market that is able to fund long term investment needs of both public and private sector to spur long term economic growth and development. This will be achieved by providing a supportive and appropriate policy, regulatory and institutional framework for the sector.

This planned strategy by the government aligns with the challenges identified by the EU delegation and in turn prioritised by the organization as key intervention areas needed to spur job creation and growth in Malawi going forward. As outlined in its Jobs and Growth Compact, the EU plans to continue engaging and leading dialogue with the GoM around policies and reforms that facilitate business, investment and trade in the country. The EU plans to do this through continued engagement in existing or planned structures such as the Donors Group on Agriculture (DCAFS) as well as the New Alliance or its follow up platform. Furthermore, the EU Delegation is considering providing financial support to the Government of Malawi to strengthen the business enabling environment under the AAP2020, which would provide space for the EU to engage the GoM directly on pro-growth reforms identified by the EU as critical.

One of these key areas of policy reform identified by both the MGDS III and the EU's Jobs and Growth Compact is the need to engage in a comprehensive review of all tax legislation as an avenue to facilitate investment in Malawi. On the one hand, the MGDS III identifies four main areas needing intervention around taxing, namely – (i) the need to strengthen the effectiveness and efficiency of the Malawian tax

system; (ii) the need to rationalise and incentivise investment into the country through taxes; (iii) the need to improve the tax refund system and (iv) the need to further exploit the opportunity to broaden the tax base through the inclusion of the informal sector which, to date, has not been adequately involved in the formal tax base in Malawi.

On the other hand, through its PFM programme, the EU is planning to implement activities that will contribute towards the modernisation of tax policy and tax administration in Malawi. The aim of the EU in engaging in this area is to support the GoM in making tax policies and administration more business friendly. Furthermore, through this programme, the EU would support the GoM to regularise the engagement of the informal economy in national tax processes and by doing so, more fairly broaden the tax burden across market participants. In the long run, these actions are expected to contribute to increased tax generation by the country for broader development.

Another area that both the MGDS III and the EU's Jobs and Growth Compact identify as a potential area of job creation and growth is industrialization. The MGDS III notes that industrialization and structural transformation are key if an economy is to grow and maintain that growth in the long run. The strategy notes that industrialization has the potential to raise the per capita income of a country, and among others, create rural jobs.

Industrial development has the potential to spur growth and job creation in Malawi, particularly with regard to agro-processing and agricultural value chains development. Based on the fact that over 80 percent of Malawi's population live in rural areas and are dependent on agriculture for their livelihood, industrialization in this area would certainly lead to the creation of rural jobs and growth in Malawi. However, despite this huge growth catalysing potential, the EU Jobs and Growth compact notes that the prospects for Malawi's industrial development are very weak, mainly due to crippling infrastructural challenges and business environment constraints.

To effectively implement the ambitious goals of the MGDS III, both the GoM and the EU recognise the need for efficient public private partnerships as a conduit to facilitate its implementation. To facilitate this, the MGDS III is very clear of the need to increase Public Private Partnerships to further strengthen the engagement of the private sector towards its successful implementation. Similarly, the EU plans to continue facilitating dialogue for collaboration between the government, development partners and – amongst others – EU businesses. For instance, the EU has plans to continue engaging in existing structured dialogue platforms like the Public Private Dialogue (PPD) forum, the Trade, Investment and Private Sector Development Sector Wide Approach (TIPSWAp), and the New Alliance for Food Security and Nutrition (NAFSN) – all of which enable dialogue between the GoM and stakeholders to improve the business operating environment for private sector in Malawi.

2.2.3 Member States of the European Union

At the time of writing this report, there were no comprehensive and overarching support strategies for attracting investments and enabling the business environment by member states. Private sector development programmes are mostly formulated from a cooperation standpoint and directed towards the support of local businesses in areas. Notably, member states have sector specific strategies and/or cooperation programmes (in the form of support of agricultural enterprises for example), but no comprehensive and overarching support strategy for investments and private sector development in Malawi. The U.K, Germany, and Ireland are the three only member states with active embassies in Malawi and are involved in private sector development action under their respective aid and cooperation plans.

The United Kingdom

The United Kingdom has been engaged in a local Private sector Development programme since 2013. DFID Malawi has been delivering a Private Sector Development programme with the following activities that support individual firms with high growth potential, grow key sectors and improve the environment for business more generally:

- Business Enabling Environment Programme (BEEP) CLOSED - £2.7m. Improvements in policy and regulatory environment through a number of initiatives including Research on strengthening agricultural markets and breaking the cycle through IFPRI
- Malawi Oil Seed Sector Transformation Programme (MOST) - £7.39m CLOSED. Market systems programme focused on value chain development in the sunflower, soya, groundnut, sesame and cotton markets. Supports private sector actors to test and scale interventions aimed at increasing smallholders' access to critical inputs, including seed, chemicals and inoculant, and creating more lucrative links to markets for farmers as well as improving the enabling (policy/regulation) environment for this growth.
- Malawi Innovation Challenge Fund (MICF) - £5.9m. Direct support to innovative businesses through matching grants and technical assistance. So far we have supported three Investment windows (17 companies) in Agriculture, Agribusiness and Manufacturing and Irrigation.
- Business Innovation Facility - £1m Market systems programme providing support to businesses and other stakeholders in the pico solar, rice and pigeon peas value chains.
- AgDevCo (£18.6m) grant, debt and equity investments in inclusive agri-business projects in Malawi

DFID Malawi is currently in the process of designing a new economic development programme, and as such is one of the partners supporting the Finscope MSME Survey of 2019.

Germany

The German government has in place a support programme to local private sector through its cooperation arm. The name of the programme is "More income and employment in rural areas" (MIERA). In German Development Cooperation there is a quite strict differentiation between technical cooperation (mainly TA; implemented by GIZ) and financial cooperation (mainly larger investments; implemented by KfW).

Private Sector Development in Rural Areas has been a focal area of Malawi-German cooperation since 2014. It is guided by Malawi´s National Export Strategy (NES) and the Trade, Industry and Private Sector Development Sector Wide Approach (TIPSWAP). The support provided through the More Income and Employment in Rural Areas (MIERA) Programme aims at income and employment creation, especially for smallholder farmers, women and the youths. MIERA focuses on the development of agricultural value chains (oil seeds, cassava, rice, macadamia, chilli/paprika), particularly the down-stream part of the value chain (processing, aggregation and marketing) , on the tourism sector and on the eco-friendly construction materials industry. Within the programme Germany supports the Malawi Innovation Challenge Fund (implemented by UNDP) and financing of market infrastructure.

In technical cooperation, MIERA departs from market opportunities and private sector interests and has two main components:
1) Promotion of inclusive business models (IBMs), service provision and stakeholder dialogue: MIERA supports committed companies to set up inclusive business relationships that are beneficial for both the producers (smallholder farmers) and the companies. Models such as contract farming provide high-quality input loans and extension (so-called embedded services) and are tied to the contractual commitment to deliver the commodity at a fair price and at a specified quality and quantity. MIERA also supports service providers to increase smallholder adoption of its marketing services such as warehousing, collateral finance and a trade platform. In the tourism sector MIERA supports the

provision of better vocational training. The programme also supports dialogue and networking platforms among value chain stakeholders to improve cooperation and framework conditions.
2) Supporting the business capacity of farmer organizations (FOs) and MSMEs: MIERA develops and delivers training and coaching packages for smallholder farmers, farmer organisations and MSMEs. The trainings are geared towards building business, organizational and management capacity, increase local value addition, and to offer and benefit from improved services. MIERA also addresses the development of regulatory and institutional framework conditions imple¬mented by governmental and non-governmental bodies and institutions which safeguard the interests of small and medium economic actors.

Through financial cooperation, Germany supports two components of MIERA:

Component 1 involves the Financing of Market Infrastructure in the districts through the National Local Government Finance Committee. This support allows smallholder farmers and owners of small and medium sized enterprises to trade and commercialize their produce, in order to strengthen domestic markets and their supply as well as to promote exports.

Component 2 involves support to the Malawi Innovation Challenge Fund (MICF) through UNDP. The MICF is a competitive, transparent mechanism that provides matching grant finance for innovative business projects of the private sector in Malawi which have a potential for delivering large positive social or environmental impact.

Closely linked to Private Sector Development in Rural Areas is the support provided through the German Government´s ONE WORLD - No Hunger Initiative that aims at improving food and nutrition security. The Green Innovation Centre for the Agriculture and Food Sector (GIAE), promotes the dissemination of agricultural innovations along three of the MIERA supported value chains (the oil seeds soya and groundnuts as well as cassava). The Aquaculture Value Chain for Higher Income and Food Security in Malawi (AVCP) fosters fish production from aquaculture.

Through financial cooperation, the German Government's One World –No Hunger Initiative supports the Matching Grant Facility (MGF). Under this facility, Germany supports farmers, MSME, farmer cooperatives and other farmer organisations working in the agricultural sectors of oil seeds and cassava with matching grants for value addition and technical support for improving bankability and financial access.

Funds for Private Sector Development in Malawi
(excluding funds provided through ONE WORLD - No Hunger Initiative)

- **Technical Cooperation:**

Volume of ongoing programmes: EUR 17,3 million EUR, (plus EUR 15,5 Mln. currently under preparation).
Thereof co-financing by the European Union with EUR 7 million and 13 million EUR under preparation

- **Financial Cooperation**

Eur 7 million for market infrastructure
Eur 8 million for MICF

2.2.4 Other Donors

In terms of support of private sector and involvement in private sector development, the consultant was able to meet with the UNDP and the Norwegian embassy only. These two are involved in support of local private sector growth through various initiatives that will be expounded further below. The consultant is aware of the presence of the Japanese state both in terms of an embassy and of its development and cooperation arm JICA but was unable to gather more information as to their support of private sector. USAID, the World

Bank, and the AfDB are also involved in some measure in supporting private sector development, but further information was not collected because meetings with relevant departments were not conducted due to time constraints and schedule clashes.

UNDP and Royal Norwegian Embassy

Over the last four years, UNDP has engaged over 500 companies across Malawi of various sizes and across all sectors of the economy through the implementation of the Malawi Innovation Challenge Fund (MICF). The MICF is a matching grant facility established by UNDP Malawi to provide co-financing to the private sector for innovative inclusive business initiatives in the agricultural, manufacturing and logistics sectors. The MICF de-risks the investment by providing affordable risk capital. The instrument sets "challenges" to the private sector to bring ideas to life by allocating financial support to innovative projects, to improve incomes of the poor and test the long-term commercial viability of bringing an idea to market. The MICF has proven an effective investment instrument for innovative private sector ventures and has attracted financial contributions from several partners, including **DFID**, IFAD, **KfW** and the **Royal Norwegian Embassy**. Through matching financing from each private sector grantee, it has also been able to leverage over 60% of private sector funds for individual projects, allowing donor funds to be stretched further and achieving a greater risk share with private companies.
Building on the appetite demonstrated by earlier stage companies for financial and technical support, UNDP launched in mid-2018 the first Growth Accelerator Entrepreneurship Challenge to help Malawian ventures to grow and scale through access to risk capital and business acceleration support (e.g., technical assistance, access to equity finance, peer-to-peer learning for young entrepreneurs). The review of 200+ applications submitted to the first Entrepreneurship Challenge revealed that the programme attracted a variety of entrepreneurs from various sectors and stages of growth, all with potential to scale. The Growth Accelerator seeks to find early-stage entrepreneurs that are ready for hands- on technical skills and mentorship, married with risk capital to take their business to the next level. Overall, the Growth Accelerator will catalyze growth of the entrepreneurial space in Malawi. It will promote an entrepreneurial agenda and fill an important gap in the start-up development continuum where there currently are no accelerators supporting business growth beyond incubation.

2.3 Obstacles to private investment in Malawi

The World Bank's 'Doing Business' ratings indicate that in 2018, Malawi ranks 110 among 190 economies. This is due mainly to the fact that as outlined above, there are numerous limitations that hinder the development and growth of businesses in Malawi generally, and specifically, also limit private sector investment in the country. For instance, data indicates that only 4.4 percent of Malawi's GDP is net inflows from Foreign Direct Investment, meaning there is very little investment that is coming into the country. Furthermore, there are a number of difficulties that create bottlenecks to local private investment as well, which prevent both capital formation and net capital accumulation, as capital is not invested in the production of goods and services, but rather pulled out of the economy. It is of particular importance to single out two obstacles: access to power and finance. The local investors that have the liquidity to invest in new ventures often do not do so because of the high cost of capital and the difficulty in accessing power for large scale projects (especially in manufacturing). Adding to these hurdles is an almost draconian bureaucracy that burdens the efficient performance of most firms.

2.3.1 Access to power and Access to Finance

Access to power and access to finance remain two of the biggest hurdles to growth of private sector investment domestically and to the increase of foreign direct investment into Malawi.

Access to Power

The other main barrier to entry for investors into Malawi is erratic and unreliable energy access. Estimates suggest that as of 2018, only 10% of Malawi's population have access to grid electricity. While this is extremely low, grid electricity has in fact increased in Malawi from 1031.8 to 1887.7 GWh between 1999 and 2011, representing an average annual increase of 6%. Between 1996 and 2011, the average maximum demand for electricity increased from 190.2 MW to 277 MW[9].

Despite these increased, in 2015, the system average peak load was around 300 MW, while the available capacity was around 255 MW representing a deficit of 14%. Under the business as usual (BAU) scenario, the projected electricity demand is expected to be 598 MW in 2015, 874 MW in 2020, 1193 MW in 2025, and 1597 MW in 2030. Further, an estimated step load increase of 37 MW per year is expected for up to 2020. The load forecasts also expect an average demand increase of 5 MW per year in the residential sector alone due to increased electrification[10].

Access to Finance

The other main barrier to private investment in Malawi is the cost of capital, which, as stated above, is one of the highest in the region with taxes and interest rates of over 30 percent respectively. The high cost of capital makes it difficult for MSMEs to enter the market because most of them cannot afford to buy capital at these rates. This limits competition and has contributed towards keeping the market small and dominated generally by large corporations.

A recent study shows that these limitations to accessing finance for MSMEs have resulted in up to 59 percent of them being financially excluded while up to 20 percent of business owners have resorted to the use of informal mechanisms for managing business finances[11]. Generally, formal systems are not conducive and are non-responsive to the needs of small business, with requirements like the need for collateral to access loans limiting the number of small enterprises that can apply to begin with because many of them do not own such collateral.

2.3.2 Other issues

The policy and regulatory environment generally makes it difficult for investors to come into the Malawian market. For instance, out of 190 economies assessed in 2018, the World bank's 'Doing Business' rates Malawi number 96 both for registering property and protecting minority investment, number 134 for paying taxes, number 151 for enforcing contracts and number 138 for resolving insolvency.

The ratings on enforcing contracts, resolving insolvency and paying taxes are particularly worrisome and can be linked directly to preventing external investors from coming into the country. For instance, with an estimated total tax rate on commercial profits of 34,5%, tax rates in Malawi are among the highest in the SADC region, and present a very unattractive environment for investors.

Furthermore, corruption is a huge barrier to entry for investors as it becomes difficult to accurately predict costs and revenue streams. In 2015, Transparency International ranked Malawi number 120 out of 176 countries on its Corruption Perception Index.

[9] Taulo, John L; Gondwe, Kenneth J; Sebitosi Adoniya B. (May 2015) 'Energy supply in Malawi: Options and Issues' , Journal of Energy in Southern Africa • Vol 26 No 2 (Accessed 22 April 2017)
[10] Ibid
[11] Finmark Trust and UNCDF study, Making Access Possible (MAP), Malawi: Demand, Supply, Policy and Regulation – Financial Inclusion Summary Report.

3 IMPLEMENTING THE EUROPEAN UNION'S EXTERNAL INVESTMENT PLAN

3.1 EFSD and the five investment windows

The new European fund for sustainable development (EFSD) is the financial part of the EU External Investment Plan. It's expected to attract further financing of at least €44 billion by 2020, in particular from the private sector.

It combines:

- **Blending** - the EU's existing so-called 'blending' programmes (€2.6 billion budget), which mix loans and grants
- **Guarantees** - a dedicated financial guarantee mechanism (€1.5 billion). The guarantee mechanisms are meant to:
    - attract financing for some of the initial capital ('equity' or 'risk capital') a project needs to get off the ground
    - serve as a pledge (guarantee) to pay back part or all of a loan if a borrower incurs losses and defaults on it.

In this way the guarantee reduces the risks involved in investment projects and can absorb potential losses. For example, in renewable energy projects, it can help to alleviate short-term liquidity problems and this way encourage investors to get on board. The following instruments are covered in terms of risk (Art. 10, EFSD regulation): a) loans, including local currency loans; (b) guarantees; (c) counter-guarantees; (d) capital market instruments; and (e) any other form of funding or credit enhancement, insurance, and equity or quasi-equity participations.

The EFSD will be implemented along five dedicated investment windows, based on key cross- cutting objectives, such as local currency financing, focus on fragile states, and not-distorting market competition:

a. "**Sustainable Energy and Sustainable Connectivity**": targeting sectors such as renewable energy, energy efficiency and transport, enhancing energy security and sustainable development, while addressing climate change risks and helping countries deliver on their commitments to implement the Paris Agreement.
b. "**Micro, Small and Medium Enterprises (MSMEs) Financing**": addressing the main constraints hampering MSMEs development by adopting a differentiated approach, whilst promoting the progressive graduation of businesses from the informal economy.
c. "**Sustainable agriculture, rural entrepreneurs and agroindustry**": responding to the lack of financing mechanisms adapted to farmers and agri-entrepreneurs, particularly for smallholders, cooperatives and agribusiness MSMEs, in the aim of promoting inclusive and sustainable growth.
d. **"Sustainable cities":** exploring innovative mechanisms to address the challenges of sustainable urban development faced by partner countries.
e. "**Digitalisation for Sustainable Development**": focusing on innovative digital solutions, especially those addressing local social needs and financial inclusion and promoting decent job creation.

3.1.1 First round of allocated guarantees to Project Investment Proposals under each Investment window

Proposals for projects (called project investment proposals PIPs) were submitted under the EFSD by development finance entities by the end of March 2018. In July 2018 the strategic board of the European Fund for Sustainable Development allocated €800 million of the €1.5 billion available for guarantees under the fund, to support 12 guarantee tools (programmes), for proposed project investment proposals in four investment windows: [12]



Figure 1 List of Guarantee tools presently awarded under each investment window

A review of proposals to directly support agriculture (beyond MSMEs operating in the ag space) was postponed as officials acknowledged they were not sufficiently "mature."

Of these 12 guarantee tools, 6 cover Sub-Saharan Africa and the EU Neighbourhood, 2 are specific for Sub-Saharan Africa and Africa at large respectively, and the other 4 guarantee tools are specifically for the EU neighbourhood. Hereunder a summary of the most relevant ones for Sub-Saharan Africa:

Table 1 Detailed list of guarantee tools covering Africa and Sub-saharan Africa allocated in the first round

Guarantee tool	Investment Window	Region	Target	How	Lead Financial Institution	Accessed through
NASIRA Risk-Sharing Facility	MSMEs	Sub-Saharan Africa and The Neighbourhood	Underserved and Displaced entrepreneurs	Gives local financial institutions portfolio debt guarantees	FMO	Indirectly through local banks, microfinance institutions and other non-banking financial institutions; Directly via FMO
African Local Currency Bond Guarantee Programme (ALCBGP)	MSMEs	Sub-Saharan Africa and The Neighbourhood	MSMEs active in the below sectors: • renewable energy and energy efficiency • agriculture • waste management and other urban infrastructure • healthcare and education • low-income housing • leasing	Investments in local currency bonds issued in African countries primarily by local financial institutions, utility companies, or state-owned enterprises (SOEs).	KFW	Directly through the ALCB Fund and KfW
InclusiFI	MSMEs	Sub-Saharan Africa and The	MSMEs created by Diaspora in home country; Migrant entrepreneurs and businesses established by migrants' families;	Debt, guarantee, equity, technical assistance to local financial institutions	AECID (Spain) COFIDES	Indirectly through banks in partner

[12] European Commission, EU External Investment Plan, https://ec.europa.eu/europeaid/policies/financing-development/eip_en, (accessed 10 October 2018)

		Neighbourhood	Innovative financing solutions specific to Diaspora; receive lower cost remittances		(Spain) CDP (Italy)	countries or lead FIs, directly via the lead FIs
Africa GreenCo	Renewable energy Generation	Southern Africa Development Community	GreenCo's initial target project size is 5-50MW, in Southern African countries (Zambia, Zimbabwe, Botswana, Namibia and other SAPP connected countries)	Set up of GreenCo - independently managed power intermediary. GreenCo will buy electricity from renewable electricity generation companies, and sell such electricity to both state-owned and private sector companies that buy electricity ('offtakers') mitigating the risk of payment defaults.	Agence Française du Développement (AFD)	Via GreenCo and AFD
DESCO Financing Programme	Sustainable energy	Sub-Saharan Africa	MSMEs involved in pay-as-you-go (PayGo) solar power systems for use at home that has recently emerged in East Africa.	Debt (receivable financing) DESCO will guarantee so called 'rent-to-own' agreements via a receivable financial model. Customers will buy a solar power system through monthly fixed payments over a period of 24-36 months.	The African Development Bank (AfDB)	Indirectly through local banks and directly via the AfDB
Room2Run	Sustainable energy – renewables, energy efficiency and clean cooking	Sub-Saharan Africa EU Neighbourhood	• large-scale, renewables-based solar power producers, which provide electricity to the national grid • distributed renewables-based programmes, which are not connected to the national grid but supply particular communities or areas.	Debt (loans), equity, guarantees The EFSD Guarantee supports a securitisation structure that enables private investors to invest in and existing AfDB project portfolio by taking credit risk on a defined tranche of the private sector portfolio. Through the EFSD-enabled transaction, capital that was previously tied to covering the bank's own risks on their balance sheet is now realeased and re-deployed to new renewable energy projects	The African Development Bank (AfDB)	Indirectly through the AfDB
Boosting investment in renewable energy	Sustainable energy	Sub-Saharan Africa EU Neighbourhood South and East	The development of multiple private, renewable energy projects	Guarantee cover to debt private investors co-financing alongside EBRD/EDFFI - Enable renewable energy investments by addressing barriers to finance of otherwise viable projects and to crowd-in the private sector.	The European Bank for Reconstruction and Development (EBRD) + Association of European Development Finance Institutions (EDFI)	Via EBRD and EFDI
Resilient City Development (RECIDE)	Sustainable cities -Urban Infrastructure	Sub-Saharan Africa, EU Neighbourhood	• energy efficiency • environment – particularly improved flood protection and sewerage • public transport • water supply and sanitation and the management of solid waste.	Debt, Public Private Partnerships and Land Value Capture transactions - help cities develop public-private partnerships and lower the risks for private investors involved in financing urban infrastructure	AECID (Spain)	Directly through RECIDE, AECID and The World Bank Group
European Health Guarantee Platform for Africa	Digital for development window - Health diagnostic services	Africa	Mobilising investment from private providers in international-standard laboratory facilities that will provide timely, cost-effective and accurate diagnostic services for diseases such as tuberculosis, HIV, and malaria.	Guarantees for payment of services (off-take guarantees)	European Investment Bank (EIB) (developed together with the Bill and Melinda	Directly through the platform, the EIB and the Bill & Melinda Gates Foundation

					Gates Foundation)	

While on surface these guarantee tools cover geographically Malawi, it is important to note that these tools may not be accessible or applicable to the country for various reasons. Firstly, most are accessed through local banks, which would require the lead financial institution to enter in a negotiation with local banks to ensure that the programmes can be accessed. In a country where there is little presence of DFIs, it will be highly unlikely that those not already present would allocate resources to building that relationship by committing new personnel or offices.

Furthermore, DFIs in question may already have a set scope and target geography as well as an indicative strategy which may not include involvement within Malawi (KfW, who was consulted in Lilongwe, for example, is not looking to invest in sectors beyond those in which the German government through its cooperation arms has set as priority areas for Malawi, and which do not include renewable energy projects, MSMEs funding, or local currency financing). This makes it almost impossible for Malawi to access therefore some of the guarantee tools already set up. While it is difficult to create a guarantee tool that can be beneficial to every country, it is nonetheless important that a discussion at the highest levels between EU delegation, commission, and DFIs around ensuring better access to guarantee tools (and proposed programmes) for the countries that could be considered economically more disadvantaged than others in the region, such as Malawi, is warranted.

3.1.2 Second round of allocated guarantee tools to Project Investment Proposals under each Investment window

Project investment proposals by DFIs were submitted in a second round, and these were under review by the board of the EFSD when this mission was undertaken. These project investment proposals were submitted for the allocation of the remaining EUR 900 million under the EFSD guarantee schemes for the five investment windows. In November 2018, the remaining funds were allocated to a number of the additional PIPs that had been submitted and an added 16 guarantee tools created. Of these, 13 have Sub-Saharan Africa or Africa as a geographic scope.

In this second round a major focus was given to the MSMEs window, as it became clear that a majority of DFIs had submitted PIPs to address the access to finance bottlenecks pervasive in the continent for small enterprises, many of these agri-businesses. As a result, the agriculture investment window was merged with the MSMEs lending window (becoming intermediated lending for MSMEs and Agribusinesses), and a direct support to agriculture left to other EU and DFI programmatic priorities. Furthermore, the continued and major risks associated with borrowing in hard currency by financial institutions were discussed and an additional category was created for guarantee tools for local currency financing. Hereunder the summary of the relevant tools:

Table 2 Detailed list of guarantee tools covering Africa and Sub-saharan Africa allocated in the second round

Guarantee tool	Investment Window	Region	Target	How	Lead Financial Institution	Accessed through
EDFI AfDB Joint SME Guarantees for Inclusive Growth and Job Creation	**MSMES**	Sub Saharan Africa	Small and medium-sized enterprise financing, including agribusiness	Guarantees, loans, quasi-equity, lease	EDFI AfDB	Through lead Financial Institutions, co-investors and local lenders, microfinance institutions, leasing institutions

AGREENFI	**MSMES**	Sub Saharan Africa Neighborhood	Agribusiness and Agriculture financing	Loans, Guarantees	AFD	Through Local Financial Institutions
Small Loans and Guarantee Program (SLGP)	**MSMES**	Sub Saharan Africa	Small and medium-sized enterprise financing, including agribusiness	This is done through 50:50 risk sharing facilities for SME loan portfolios originated by local Financial institutions	IFC	Through local financial institution
FISEA EFSD SME Investment Guarantee	**MSMES**	Sub-Saharan Africa and the Neighbourhood	Small and medium-sized enterprise financing, including agribusiness	Loans, equity, mezzanine, guarantees	AFD	Through AFD, FISEA 'plus' funds
"Archipelagos - One Platform for Africa" ("ONE4A")	**MSMES**	Africa 100%	Small and medium-sized enterprise financing	Guarantee and on-lending schemes	CDP AfDB	Through CDP and AfDB
European Guarantee for Renewable Energy	**Sustainable Energy and Connectivity**	Sub-Saharan Africa	IPPs in renewable energy projects	Co-Guarantees , off-take guarantee	AFD CDP EIB KfW	Directly through lead FI
Renewable energy support programme for SSA	**Sustainable Energy and Connectivity**	Sub-Saharan Africa	IPPs in renewable energy projects	Debt cover (on grid) Debt and equity cover (mini/off grid)	AECID COFIDES	Directly through lead FI
Sustainable Cities Investment Fund Platform	**Sustainable Cities**	Sub-Saharan Africa, EU Neighbourhood	Urban infrastructure	Investment guarantees into regional investment funds providing loans, equity, mezzanine, guarantees	EIB	Though Urban infrastructure investment funds
European Guarantee to increase local govt access to finance	**Sustainable Cities**	Africa	Municipal infrastructure projects	Guarantee and loan	AFD	Through AFD and indirectly through local banks
Ventures Programme	**Digitalisation**	Africa	Start-ups, scale-ups offering tech-enabled solutions in: financial services renewable energy agribusiness education, healthcare mobility and transport digital and business infrastructure e-commerce	Direct and indirect investment (covertibles, (preferred) equity)	FMO	Directly through FMO
Social Impact Fund for Africa	**Digitalisation**	Sub Saharan Africa EU-Neighborhood South	MSMEs engaged in digital innovation applied to healthcare, education, agriculture, energy, water and financial inclusion	Equity, quasi equity	AfDB	Directly: through social impact funds Indirectly: through AfDB

TCX Concessional and Collateral Facility (TCXCCF)	**Local Currency Financing**	Sub Saharan Africa	Sustainable energy and connectivity	Loans, bonds; derivatives (cross currency swaps etc.); guarantees	KFW	Loans, bonds: Through lead FIs, local lenders Derivatives: TCX N.V. (Amsterdam).
The EFSD Local Currency Guarantee	**Local Currency Financing**	Sub Saharan Africa	Micro-, small and medium-sized enterprise financing	Loans, bonds; derivatives (cross currency swaps etc.); guarantees	AfDB	Loans, bonds: Through lead FIs, local lenders

Note that the list may change as some programmes may merge. An updated list will be found at DEVCO C7.

3.1.3 Considerations on EFSD guarantee tools and contribution to Malawi's needs

This assignment sought to contribute relevant information to ensure that Malawi's case be included in the various DFIs' scope of engagement once the guarantee tools had been allocated.

Furthermore, consultations with the EU commission have indicated that pointing out the ways in which some PIPs/guarantee tools can be relevant to the Malawian context will help in the commission possibly prompting DFIs to engage Malawi more, rather than leave it outside of their investment project scope as it is happening already. In fact, in many of the guarantee tools and project investment proposals Malawi is not included whatsoever in investment and project pipelines. Though it may be too late to do so, it is possible by pointing out the relevance of some of the guarantee tools to make a case for some of the DFIs who have been allocated guarantees to re-consider their strategies. This could be in the form of for example specifically and explicitly including Malawi in the PIP strategies and scope/portfolio, or in deploying TA to assess viability of the investment window sectors. The DFIs are the only ones that can in fact adjust the PIPs and their indicative scope, such that Malawi can directly benefit. In the next few sections an indication of possibilities for investment and why engagement through the DFIs would be beneficial will be expounded, so that the EU can enter into negotiation with relevant DFIs to ensure that Malawi is accounted for.

It is extremely important that this happens, and allowances by the DFIs made for Malawi, as it is the opinion of the consultant that there is a bias towards better placed countries in the region within both the PIPs that have received guarantee tools, and PIPs that were under consideration at the time of writing this report. Administrative complexities, non-presence of DFIs in the geography, small ticket sizes of potential projects, lack of maturity of the financial sector, high risks and in general a difficult political, economic and bureaucratic environment that creates a multitude of uncertainties make Malawi an unfavourable target for most DFIs.

The premise of the guarantee tools is to veer away from direct aid and cooperation and spur private sector investment to ensure development and growth. The guarantees are built to ensure that DFIs take the risks and invest in expanding their capabilities to engage with countries, private sector, and local banks that need these investments. Heavy technical assistance funds have been set aside to help DFIs build the capacity of possible targets for the very reason that the capacity of the local private sector or financial sector may not be present. DFIs SHOULD NOT have a predilection for easier environments/countries.

If DFIs don't engage to ensure that happens, regardless of perceived administrative difficulties and operational hurdles, then this "new" development paradigm has failed.

3.2 Operationalising the EIP and access to EFSD guarantee scheme

The consultant was given access to the detailed list of the guarantee proposals submitted to the EFSD by DFIs in both the first and second rounds. An assessment was made on the suitability of the guarantee tools allocated in the first and second rounds vis-a-vis the local context and according to the market environment under EACH investment window. **Of all the tools investigated and analysed, four in particular came out to be of high importance:** some because of their structure, some their target and some the lead financial institutions involved. Two are under the investment window for "sustainable energy" and two are under the "MSME and agri-business financing", one of which is specific to agribusinesses. The EUD in Malawi should put its resources in negotiating with the lead financial institutions concerned for the implementation/putting in operation of these four guarantee tools, as these in the opinion of this mission are the most relevant to the context.

The following box delineates the tools and gives a short description of their relevance.

INVESTMENT WINDOW 1 - Sustainable energy and connectivity

Renewable energy support programme for mainly rural areas in SSA (AECID COFIDES) - The tool is built to cover a debt portion of private sector IPPs, while guaranteeing a number of risks of the projects via the EFSD guarantee. This is particularly relevant for IPPs in Malawi as they are finding it difficult to risk adjust their projects, especially around risks tied to country uncertainty. Additional to financial risks, in fact, the tool also covers Political and Country Risks including: Expropriation, War and Civil Disturbance (WTCD), Regulatory risk (REG) and Exchange rate risk.

DESCO Financing Programme (AFDB) - The DESCOs Financing Program's overarching goal is to catalyse the mobilisation of local currency financing for DESCO to support the accelerated expansion of their activities in African countries. For Malawi this is particularly relevant as the access to electricity is at 10% nationally. The support for DESCOs should be a primary concern of all donors and interventions, as this would have major development outcomes, given that reach of the main power grid to the majority of the population will take decades to materialise.

INVESTMENT WINDOW 2 - MSME and Agribusiness financing

AFDB SME guarantee programme - This guarantee tool is built to address all the needs and peculiarities of both the financial institutions and the MSME borrowers. The tool is comprehensive and quite relevant also for **Agribusinesses** as it is holistic in nature.

AGREENFI (AFD) - The tool is comprehensive in nature and is designed to support and catalyse the growth of actors within agricultural value chains at every level. The tool also foresees credit facilities to microfinance institutions at very low rates which is particularly important for Malawi. The tool is complementary to EIB's Kulima guarantee scheme that has been negotiated already with a local bank.

Box 1 Most relevant EIP-EFSD guarantee instruments for Malawi

In the following subsections tables summarising and prioritising the guarantee tools analysed under each investment window will be presented. Each table under the investment window will have a short description of the guarantee tool and its priority will be given according to the context and analysis conducted. Priorities given are from very high to very low. For those that are seen to be non-relevant, this is flagged specifically. Following the tables a high-level consideration on the sector and context within each investment window is discussed, including challenges, private sector investments and other pertinent information. Furthermore, the presence of possible and viable investment potentials was investigated. For some of the investment windows, guarantee tools were only partially relevant, and a discussion on how DFIs could engage in Malawi or extend their geographic scope and operations to Malawi so that these could become relevant is included.

3.2.1 Sustainable energy and connectivity

INVESTMENT WINDOW 1 – SUSTAINABLE ENERGY AND CONNECTIVITY

Guarantee tool	Lead Financial Institution	PRIORITY AND RELEVANCE
Renewable energy support programme for mainly rural areas in SSA	AECID COFIDES	**VERY HIGH** The tool is built to cover a debt portion of private sector IPPs, while guaranteeing a number of risks of the projects via the EFSD guarantee. This is particularly relevant for IPPs in Malawi as they are finding it difficult to risk adjust their projects, especially around risks tied to country uncertainty. Additional to financial risks, in fact, the tool also covers Political and Country Risks including: Expropriation, War and Civil Disturbance (WTCD), Regulatory risk (REG) and Exchange rate risk, A heavy emphasis on a TA component, which includes the support to the partner country in its capacity to structure the kind of complex legal arrangements needed in PPP arrangements. WHILE THE DFIS ARE NOT IN MALAWI, IT IS ABSOLUTELY IMPORTANT THAT THIS TOOL IS PURSUED FOR MALAWI.
DESCO Financing Programme	The African Development Bank (AfDB)	**VERY HIGH** The DESCOs Financing Program's overarching goal is to catalyse the mobilisation of local currency financing for DESCO to support the accelerated expansion of their activities in African countries. The main objectives of the programme are to: crowd in local financial institutions and increase their appetite to provide local currency financing to the off-grid market/DESCOs and develop securitisation/receivables-based financing structures in order to achieve debt instruments with lower risk of non-payment than conventional loans directly to DESCOs, and thereby decrease the perceived and real credit risk for local lenders
Boosting investment in renewable energy	The European Bank for Reconstruction and Development (EBRD) + Association of European Development Finance Institutions (EDFI)	**HIGH** This tool is designed to allow private sector crowding in large scale renewable projects by ensuring a 1st loss guarantee of private investors' co-finance of investments through equity and loan arrangements alongside the lead financial institutions. Private sector co-investors can be commercial banks, pension funds, insurance companies, private investment funds etc. TA component is included **RISK:** Private sector may not be interested in coming into large government renewable projects because of perceived uncertainties and bottlenecks.
Room2Run	AfDB	**LOW** Relevant for both large scale and distributed energy – it is innovative and the AfDB already is in Malawi. However, it is not a direct guarantee, and it is unclear how AfDB wants to redeploy their capital. A TA component is not envisioned. Not enough information is available. Given some resources, a conversation with AfdB can be had, but the likelihood that AfDB would include Malawi in its pipeline is low, given there was no indication in the PIP.
European Guarantee for Renewable Energy	AFD CDP EIB KfW	**VERY LOW** The structure of the guarantee is relevant. it effectively de-risks perceived liquidity and investment risks tied to possible off-taker defaults or arrears in payables However, it foresees a counter-guarantee arrangement with host government or an agreement for a claim against the off-taker. This is not viable in Malawi
Africa GreenCo	Agence Française du Développement (AFD)	**NOT RELEVANT** not directly relevant to Malawi at the moment because the country is not connected to the SAPP. However, if GreenCo is set-up, because it will be an entity that will operate in the region long-term, once the interconnector to Mozambique is operational, it will allow the entity to purchase power from IPPs and sell back to ESCOM, effectively addressing the current risks tied to the state-owned off-taker's increasing payment arrears and the reliability of ESCOM going forward

In regard to the sustainable energy and connectivity window, the consultant was able to gather a considerable amount of information[13], which presented a particular difficulty to analyse and describe in a short summary for use by the EUD and the commission. Summarising in just a few pages the issues and peculiarities of the power sector in Malawi, such that one can make informed decisions, does not do justice to the extreme complexities and realities of the sector. Involvement through EFSD guarantees in the power sector goes hand in hand with serious political engagement and stakeholder coordination of any effort and involvement foreseen. Furthermore, each PIP has specific features that need an in-depth analysis vis-à-vis what the investment environment requires. While a surface analysis was made, especially along the suitability of some of the PIPs, a complete and in-depth one was not made, as the scope of this assignment is not specific to the power sector. Nevertheless, a more thorough engagement of the EUD with the power sector is warranted, in line with country and other stakeholder priorities going forward. Furthermore, the EU can influence greatly policy changes in the sector, without which successful investments will not be possible, although these are extremely necessary for the growth of the country.[14]

3.2.1.1 On-Grid

As of February 2018, Malawi's total installed generation capacity was 507.6 MW which was split between 427.5 MW of grid-connected generation capacity (84 percent) and 80.1 MW of off-grid generation capacity (approximately 16 percent, includes industrial self-generators).

Malawi's 427.5 MW of grid-connected power generation is dominated by hydropower plants (HPPs) representing 350.8 MW of this amount. The most recent HPP (Kapichira II, 64.8 MW) was commissioned in 2013. No new HPPs have been commissioned in the last five years, but 21.7 MW of light fuel oil (LFO) generation was installed by state owned utility company ESCOM and later by the newly created (2017) and state-owned generation company (EGENCO) from 2016 to 2018. An additional 55 MW of LFO generation was installed by the IPP Aggreko, which has a two-year PPA with the state-owned transmission and distribution company ESCOM.

Development partners provide critical assistance to Malawi's power sector across the value chain, including facilitation of power sector reforms. Key development partners include AfDB, BIF, DFID, EU, GIZ, IFC, JICA, KfW, MCC, the Scottish Government, UNDP, UNICEF, United Promise, USAID and the World Bank.

The MCC compact in particular has been instrumental in updating the transmission infrastructure of the country. The MCC Compact with Malawi is a USD $350.7 million program focused on improving Malawi's power sector and increasing the availability, reliability and quality of electricity supply. The program is cross-cutting, with funds devoted to three key areas: infrastructure development, power sector reform, and environmental and natural resource management. The programme is in its conclusion and has been very successful in its infrastructure development part, having rehabilitated multiple substations, constructed the "backbone" of transmission infrastructure between Phombeya-Lilongwe and several other infrastructure updates. However, the reforms that were foreseen under the power

[13] USAID, under the Power-Africa programme and through SAEP, has conducted a comprehensive study on the state of the sector in Malawi. At the time of writing this report, this study is not yet publicly available but is accessible to the EUD via the donor energy stakeholders committee. The consultant was able to have a discussion with the authors of the study and has summarised some of the key findings in the next subsections. A number of other studies were shared by the MCC, and information shared by the World Bank. Key findings relevant to private sector investment challenges, and access to possible guarantee tools have been included. There may be other possibly relevant information that has been omitted due to limitations in scope of the assignment. The reader is invited to further consult some of the publicly available information as per the bibliography included in this document.

[14] The energy sector is not a focal area of EU engagement in Malawi, and therefore presently it does not engage in policy work in the sector. However, as the MCC programme is closing, the energy sector should become a focal area of engagement given the major impact it can have in terms of development. Without taking on the gargantuan task the MCC took (and the resulting failures in addressing legislative and policy reform) the EU can and should work towards a more active role in the space. For example, influencing the energy strategy formulation and lobbying for better policy and legislation around distributed renewable energy subsector can perhaps go a long way towards achieving energy targets within the country.

sector reform component have not yet been implemented and constitute a hindrance to further development of the sector.

In terms of power generation, the below are the main developments to come:

WB: 365MW Mpatamanga Hydropower Station (committed $127m) and 216MW Lower Fufu Hydropower Station (while plans are going forward, the WB is reviewing its commitment to these projects, as it looks to ensure government compliance to support commitments, in view of the MCC project not having reached its milestones as per agreements set out. Furthermore, it is having difficulty in formulating the PPPs because of lack of negotiation capacity on government side)
WB: Bagasse cogeneration studies (50MW) from Nchalo and Swangwa Illovo sugar mills (still under consideration. A 9MW co-generation agreement was being taken forward at the time of interview)
USAID: Analysis on Solar PV to be integrated into grid in 2018-2022 from 4 proposed solar facilities – 4 IPP tenders launched. Only one company signed PPA.
AfDB: Kholombidzo 100MW hydroelectric power plant feasibility study, for construction 2018 - 2021 (could not get further data)
China EXIM: Financing Kammwammba coal 258 MW (MOU signed with GOM for $600M)

The government's integrated resource plan lists the below as its priority generation plans:

Kanengo (diesel)	2018	19 MW	Committed
Mapanga (diesel)	2019	19 MW	Committed
Tedzani IV (hydro)	2019	18 MW	Committed
Kammwamba (coal)	2019-21	258 MW	Committed
Mpatamanga (hydro)	2023	308 MW	522 mil $ investment
Kapichira III (hydro)	2024	112 MW	139 mil $ investment
Solar (4 sites)	2018	40 MW	70 mil $ investment

In terms of other infrastructure needs, the World Bank sponsored three new projects that were yet to be released at the moment of writing this report:

- Preparation of a comprehensive geospatial analysis to guide the creation of a least-cost electrification model. This work is intended to form the basis of the GOM's National Electrification Strategy. The outcome of this analysis is intended to identify areas that would be most cost effective to electrify through extension of the grid, as well as areas where alternative electrification options would be more suitable (e.g., mini-grids)
- Preparatory work and technical assistance to the GOM with the development of a National Electrification Strategy
- Preparation of an off-grid market assessment to determine the potential for off-grid electrification in Malawi based on the geospatial analysis.

In line with this, the transmission plan includes a 400-kV interconnector from Phombeya to Matambo in Tete, Mozambique to facilitate an inter-regional connection and effectively connect Malawi to the Southern Africa Power pool (SAPP). The project has been funded by the World Bank (feasibility studies) and the European Union (EU) via KfW, through the provision of grants to the governments of both Mozambique and Malawi. The Phombeya substation is being prepared for the transmission interconnector to Mozambique. Stakeholder discussions indicate that the contractors will only complete the construction of the interconnector in 2021 (the IRP anticipates the interconnector will be in service by 2019 already). The integration into the domestic grid requires significant effort in terms of the system. The ESCOM network operates at a 132kV system, which makes the experience of ESCOM personnel inadequate to operate the 400 kv interconnected system. When this interconnector will come

online, it will allow considerable cross-border import options to meet the rising demand, and will allow export of extra electricity during off-peak periods.

The World Bank indicated that, while they are committed to furthering their commitment to the interconnector, they are now reviewing their engagement in the sector further to the studies they have commissioned. The World bank is also looking into a further interconnector from Malawi to Tanzania with a 400kV line from Nkhoma in Malawi via Songwe to Tanzania, to connect to the Southern Africa Power Pool, and via Tanzania to the East African Power Pool.

An important note to make is that the WB foresees that the results of the GeoSpatial analysis will indicate that the best investments to ensure that electrification goals of the country are met are on-grid investments and further expansion and upgrade of the transmission and distribution infrastructure. To their knowledge, evidence from their own internal studies[15] suggests that the majority of the population lives within a short distance (2.5km) from the grid and therefore a targeted effort to develop the on-grid capacity and the distribution infrastructure will yield higher returns in terms of electrification for the near future.

Challenges in sub-sector.

A number of challenges plague the sector and create a difficult environment for private sector investments into grid-connected renewable energy generation.

Malawi's average tariffs are not cost reflective for the state-owned utility companies. The current analysis conducted by stakeholders of EGENCO and ESCOM's cost-base indicates that it should be much higher to ensure sustainability of the utility companies (both the generator and off-taker), but also ensure that there is long term adequate sector-financing. Their cost bases are deteriorating rapidly, increasing faster than the revenues the companies are able to generate. One of the objectives of the MCC compact has been moving towards a cost-reflective tariff, although this has been a challenge. While the power utility companies have applied for a tariff hike in the near future to the regulatory body, this increase in tariff will not be seen anytime soon. Many stakeholders expect that an increase in the tariff will depend on political events (e.g., Malawi's presidential elections in May 2019). IPPs have also encountered issues in negotiations with the off-taker. The tariffs that ESCOM is negotiating and willing to agree to pay the IPPs remains very low, pushing some of the possible private sector investors to remain on stand-by until a reasonable tariff base can be negotiated that would ensure their own investment margin targets are met.

There is a need to invest further in the transmission infrastructure, which is still short of capacity to cater to the planned expansion by 2030. Additionally, while updates have been done on the network to be able to integrate intermittent technology (especially solar PV plants), there is need for more upgrading. In fact, the four IPPs that were solicited had a capped combined maximum output of 70MW generation capacity due to grid constraints. Technical capacity of ESCOM staff is also lacking (according to stakeholder interviews, and not necessarily reflective of reality as consultant was not able to have conversations with ESCOM staff). Any investments by IPPs into Solar PV require the transmission and distribution infrastructure and human resource capacity to be adequate to handle incoming technology and ensure seamless grid integration.

The MCC compact helped form a Single Buyer Unit (SBU), and a System and Market Operator (SMO) within ESCOM, following the unbundling of the state utility into ESCOM and EGENCO in 2017 and defining a new market structure. IPPs therefore are now allowed to supply electricity. However, the SBU is yet to be staffed properly, and both SBU and SMO are yet to receive the proper licensing and

[15] These studies have not yet been fully finalised, and therefore it should be understood that this assertion and position may change and was shared by WB staff only as a highly probable truth, not an official statement.

be operationalised such that the envisioned reforms and market structure works as it was designed to. Their correct operationalisation would enable the SBU to undertake IPP procurement (both solicited and unsolicited), thus furthering private sector involvement and allow the SMO to guarantee that all generation companies have fair and non-discriminatory access to the transmission system, thus further stabilising perceived risks by possible IPPs.

Furthermore, ESCOM's ability to pay and its reliability as an off-taker discourage private sector investments. The state-owned company has a number of receivables in arrear, and increasingly a multitude of payables. The company has also been under heavy scrutiny after scandals around mis-management of internal funds. Private sector investors are reluctant to enter in agreements with the utility company because of the risks perceived around ESCOM's solvency, and increased operational costs following new diesel generation capacity installed. Private stakeholders are therefore unwilling/reticent to invest unless the tariff reflects the utility companies' cost-base going forward, which would marginally address some of the cashflow issues it has encountered. In fact, IPPs consulted pointed out that even when off-taker guarantees can be accessed through a third party, the continued deterioration of the cashflow of the utility company, and the growing arrears in payables, increases the probability of a long term non-honouring of financial obligations to the IPPs, effectively leaving the IPPs strapped for liquidity, and the guarantees not covering the entirety of arrears by the public utility company. Moreover, off-taker guarantees are difficult to access or are not existent in the Malawian context. The World bank has some off-taker guarantees in place but can only give these pursuant to the tariff becoming cost-reflective. Another issue is the feed-in tariff that the government is negotiating. Even with a risk-adjusted project proposal, the feed-in tariff that the government is willing to agree on is too low to warrant and investment, since the returns that investors are looking for may not be met. The 4 IPPs have, in their financing arrangements, been asked for sovereign guarantees that the country has not been able to supply (understandably so). To be able to mitigate risks two of the IPPs have approached IFIs and DFIs (OPIC and IFC) to arrange for 1st and 2nd loss guarantees to the loans/financing they are raising for the projects. Access therefore to guaranteed loans as those provided by the EFSD through DFIs may be useful. There seems to be a general reluctance to invest in GOM related projects, and in dealing with ESCOM due to a perceived risk of government interference.

Additionally, the expected presidential elections may have (in the consultant's opinion), an impact on the Power sector's legislation environment, which is in a constant state of variability. If the ruling party / government is unseated it may very well be that the new incumbent will push for new legislation and/or reforms to the sector as "consultations with/speculation by" some institutions have indicated. The new legislation under the National Energy Policy is looking to enact a Malawi energy strategy that is yet to be concretised.

No additional pipeline for large-scale projects by Donors, IFIs, DFIs and GOM were discovered at the time of consultations.

Potential private sector investments

A number of consultations with private sector in Malawi brought to light that there are companies and individuals that are waiting to invest in large scale renewable projects and would be interested to in fact access financing that is backed by guarantee tools such as the ones provided by the EFSD. Presscorp, for example, one of the largest corporations in the country, has had plans to build renewable energy projects (solar power) that can feed into the grid. Specifically, they have acquired land around a number of substations, and are looking to supply 20 to 27MW per substation, for a total of 100MW to input into the grid (for a total of circa 100-115 million $ investment). The company indicated that they're discussing with five or six partners that are interested in investing, and guarantee schemes that can cover the risks associated with payments from the off-taker would be ideal for the envisioned projects. The only obstacle to the investments being realised are the non-cost-reflective tariff, ESCOM's ability to

pay, and investing international institutions asking for sovereign guarantees that the country is unable to offer.

A second local private investor, who wished to remain anonymous, also has indicated plans for investing on solar power. The envisioned investment is of 10MW, and the most conducive location has been already identified. Financing for this project has been sought out through IFIs (main ones being IFC and AfDB), and discussions are in place. However, unless a cost-reflective tariff and the sustainability of the off-taker are ensured going forward, this project is unlikely to materialise in the short term. A third local private investor, RAB processors, one of the country's big Ag conglomerates, indicated that they are willing to invest in renewable energy generation to off-set the energy requirements of their manufacturing plants. Some bottlenecks in negotiation with various stakeholders prevents them from taking these plans forward.

CDH investment bank on the other hand, the only pure investment bank in the country, is looking to invest in a 40MW renewable energy plant, mandated by some of its investors, and is in discussion with various counterparts to investigate feasibility of financing and investment in the space.

The 4 IPPs that have been solicited are also still in discussion with the government. Of these only one has signed a PPA. In discussions with one of them, Voltalia, and with the World Bank, some particular barriers to investments came to light: financing of these projects is often pursuant to sovereign guarantees being issues or some other loan guarantee to backstop commercial lenders; Negotiation capacity on the government side for both IPPs and PPPs is limited and therefore project RFPs (request for proposal) or EOIs (expression of interest) lack the necessary information that allows for IPPs to submit competitive quotes and proposals based on a packaged solution that the government indicates; Multiple bureaucratic hurdles in regards to site allocation and securing both land rights and finance; negotiations with ESCOM around off-taker agreements under the SBU are complex and not conducive to a win-win agreement that reflects an ideal solution that ensures IPPs are able to eventually profit; there are severe inadequacies in terms of staff both at the utility companies and the regulatory bodies in relation to contract formulations, negotiations, and other related tasks.

The above are some of the most glaring issues in the sub-sector which may be addressed through TA components of DFIs and PIPs to ensure that private actors are in fact able and willing to eventually be comfortable in investing in the sector. However, without a cost-reflective base, and the capacity of the transmission network to be able to take on variable renewable energy sources, investments in the sector that can supply to the national grid will not be possible. The on-grid investments space needs to be monitored nonetheless, and the EUD should continue its engagement with the GOM in pushing for regulatory environment changes, and tariff hikes, to enable the above-mentioned investments. Coordination with other stakeholders is required, as too many initiatives are in place and the GOM seems overwhelmed by multiple engagements of donors and other stakeholders.

Relevant Guarantee tools

Room2Run is a highly innovative new tool that has been hailed as the future of models of complex securitization. The novelty of this tool lies in how the guarantee is used. In fact, the tool does not guarantee new investments directly. Rather, it foresees, by using the EFSD guarantee, to effectively transfer the credit risk of a selected existing portfolio of operating and well performing Project Finance and Financial Institution (FI) loans on the AfDB's balance sheet to other investors via a significant risk transfer (SRT) transaction. By doing so, the bank's risk capital that is now tied to those projects will be released, effectively freeing up much needed capital for impact financing and allowing the bank to re-deploy it by optimising its balance sheet. The AfDB has committed to use the re-cycled and freed-up capital from tranching to finance new renewable energy and transmission projects in Sub-Saharan Africa, including projects in low income and fragile countries. The projects will be in line with the European Union's commitments on climate action, renewable energy and resource efficiency in

Africa. However, as the tool foresees investments by the AfDB into large-scale renewables that will be part of its own private sector investment portfolio, it may be that the sizes of investments into IPPs' projects in Malawi are too small for the bank to touch. Furthermore, current AfDB conditions for investment in renewables projects may not be met by current and future IPPs in Malawi. Vice-versa, IPPs in Malawi may find that the bank may not have satisfactory conditions for them to consider requesting financing (i.e. there may be no direct 1st or 2nd loss guarantees as the EFSD guarantee covers a different portfolio of the bank). Notwithstanding, while international IPPs and local investors in Malawi that are looking to invest in the sector may not benefit directly from a first loss or second loss guarantee provided by the EFSD through this tool, IPPs may want to discuss various credit risk facilities or other types of financial vehicles for their financing needs which the AfDB could provide through the newly mobilised capital once R2R is put into action. A possibility is that the AfDB, given its new released capital, could be a co-financier with other IFIs to which IPPs have reached out to.
The most important relevance of this tool to Malawi, however, is the possibility of the AfDB investing in large scale government infrastructure: for example, the Kholombidzo 100MW hydroelectric power plant, the feasibility study of which the bank is already conducting. Similarly, the bank can invest in the northern connector to Tanzania, or any number of other large-scale projects that are much needed in the country, and are unlikely to be developed by IPPs. **At the moment of writing this report the consultant is not privy to information on how AfDB intends to re-deploy freed up capital (i.e. pipeline of renewable energy projects) once R2R is put into action. However, some of Malawi's power sector investment needs should be met by the bank given the HIGH need of developing the electricity space.** The AfDB operates in Malawi, and a discussion with the EU and relevant departments within the DFI are in fact warranted to ensure that Malawi is considered as a possible investment destination by the bank given its commitment to fragile and low-income countries. Should the bank have an already pre-approved pipeline, it is necessary to enter into negotiations at the highest levels to shift some of the released capital from the R2R transaction towards Malawi, a country whose power needs may well outweigh that of other low-income economies in the region. A TA component is not envisioned, which would be required to be provided by the AfDB or by other Donors to aid the GOM in negotiations.

Boosting investment in renewable energy *(Framework to Scale-up Renewable Energy Investments)* is particularly viable for Malawi, because of the bottlenecks in the sector that have been addressed in the previous subsection. A big chunk of the renewables projects are being realised with the help of MDBs and DFIs. However, when it comes to private sector involvement, there have not been as of yet projects where the private sector has invested alongside the public sector. This tool, in contrast, is designed to allow private sector crowding in by ensuring a 1st loss guarantee of private investors' co-finance of investments through equity and loan arrangements alongside the lead financial institutions. Private sector co-investors can be commercial banks, pension funds, insurance companies, private investment funds etc. As the tool is designed for both Sub Saharan Africa and the Neighbourhood, it is structured so that EBRD will cover the Neighbourhood and EDFI (a consortium of 15 European DFIs) will cover Sub-Saharan Africa. While many of the EDFIs do not have a presence in Malawi, and Malawi has not been included in the indicative geographic scope of the PIP, there is ample space to negotiate with the EDFI association to consider projects in Malawi. In fact, the PIP describes as example the 300MW wind farm in Kenya as being a project that would have been developed with more participation of the private sector if guarantees of this kind were available. It is quite possible that private sector actors would prefer co-financing investments alongside the public-sector, rather than investing in IPPs themselves in Malawi. There is a strong pipeline of projects that the government is pushing forward, and will be pushing forward, to meet energy targets for the next 5 to 10 years. This tool is therefore well designed to benefit Malawi. A TA component is included so the EDFI can deploy experts to ensure that due-diligence as well as any shortfalls from other stakeholders (such as negotiation capabilities of government for PPPs) are addressed when entering into agreements with investors. Awareness of the presence of this tool needs to be raised to ensure that private sector enter in discussion with relevant

departments when projects are identified. The EU should lobby the institutions to include Malawi in its pipeline.

The ***Renewable energy support programme for mainly rural areas in Sub-Saharan Africa*** aims to foster the establishment of sound PPP structures that shall be beneficial for partner countries involved and also attractive for private investors in order to crowd-in their participation. The tool is built to cover a debt portion of private sector IPPs, while guaranteeing a number of risks of the projects via the EFSD guarantee. This is particularly relevant for IPPs in Malawi as they are finding it difficult to risk adjust their projects, especially around risks tied to country uncertainty. The proposal of this guarantee tool had in fact a wide-ranging scope and covered a number of risks that are usually asked to be covered by the host government. In terms of financial risk coverage, the main idea is to transfer the risk tied to the off-taker, in case the off-taker is unable to honour its financial obligations (reduced payments, inability to pay, not paying on time). Moreover, the guarantee tool also covers the possible default of a project, up to a certain percentage, effectively lowering the risk profile for private investors. Additional to financial risks, in fact, the tool also covers Political and Country Risks including: Expropriation, War and Civil Disturbance (WTCD), Regulatory risk (REG) and Exchange rate risk, which is one of the greatest challenges facing infrastructure investment in partner countries in Africa. This is particularly important for Malawi, as the Malawian Kwacha has seen a number of fluctuations, which have then impacted the ability of the country to meet its foreign debt obligations. For the IPPs in Malawi, this guarantee tool is particularly important, as it covers a much larger chunk of the project risks, and in a country where no other types of guarantees are available, a tool like this one would be beneficial. A first indicative pipeline did not include Malawi. However, the lead financial institutions are very open to recommendations by the European commission, and open to revising the geographic scope according to the PIP itself.
An important complementary aspect of this PIP is the heavy emphasis on a TA component, which includes the support to the partner country in its capacity to structure the kind of complex legal arrangements needed in PPP arrangements. As the World Bank described in consultations, Malawi's ability to negotiate the right arrangements with IPPs is one of the reasons that PPAs have not gone forward so far, and a TA component will be beneficial.

Partially relevant guarantee Tools

The ***European Guarantee for Renewable Energy*** is relevant because it effectively de-risks perceived liquidity and investment risks tied to possible off-taker defaults or arrears in payables. The idea is not to fully replace the payment obligations of the off-taker vis-à-vis IPPs, but to give the investors of IPPs enough comfort on the potential liquidity risk to allow them to invest. The tool foresees a liquidity buffer that will come into place if the off-taker is in arrears, and once it defaults the guarantee will be called upon. Providing a guarantee will de-risk the project, thereby enabling financing to take place that wouldn't have happened otherwise and helping to extend the debt tenor to better meet the project needs.
A key point in the tool is that the guarantees will be tailor-made to address the specific transaction risks perceived by each investor. The terms and conditions of each guarantee scheme will be the result of negotiations between investors, commercial lenders, the public utility, the European guarantors and the host government if involved. It is a great scheme for Malawi, given each investor that the consultant spoke to had very different perceptions of risks involved, especially when it comes to the difference between local and international investors. Notwithstanding, it may be that in Malawi the risk adjusted returns that private sector financiers would require would still make the feed in tariffs requested to the off-taker unaffordable in the present situation ESCOM finds itself.
A market study that is assessing the gaps in terms of financial instruments available and geographical coverage is still under way, and pilot countries are yet to be chosen. Malawi is yet to be included in the pipeline but given the very relevant issues around off-taker risks, it is a tool that would benefit the country to attract private sector investment.
However, **a major bottleneck to this happening may be the fact that the tool in effect foresees either a counter-guarantee arrangement with the host government or an agreement for a claim**

against the off-taker, depending on the country context. This may largely be impossible in Malawi given the host government is unlikely to want or be able to supply a counter-guarantee because of general economic and political uncertainties, and a claim against the off-taker would be an unlikely possibility because of the aforementioned difficulties ESCOM finds itself in (i.e it is marred with solvency issues and payables arrears). This tool foresees a considerable package of TA including the support of tendering processes, supporting the enabling environment and improving the regulatory framework and dialogue. However, considering the failures of the MCC project, it may well be that the TA may be called upon only for specific tendering and/or negotiations with the various stakeholders in the scheme.

Presently Non-relevant guarantee tools (possible in the future)

The ***Africa Green Co*** guarantee tool on the other hand is not directly relevant to Malawi at the moment because the country is not connected to the SAPP. However, if GreenCo is set-up, because it will be an entity that will operate in the region long-term, once the interconnector to Mozambique is operational, it will allow the entity to purchase power from IPPs and sell back to ESCOM, effectively addressing the current risks tied to the state-owned off-taker's increasing payment arrears and the reliability of ESCOM going forward. IPPs in this case have low (to no) risks as the risk is transferred to GreenCo, which will be the entity that effectively enters into off-take agreement with the public utility company. Malawi is not included in GreenCo's current phased geographic scope. Phase 1 focuses on Zambia, and it may effectively not be included also in the expansion phase of the project - Phase 2. Regardless, there is space of negotiation going forward, as the perceived risks by IPPs in relation to off-take arrangements in Malawi need to be addressed more so than in neighbouring countries. IPPs can be encouraged to directly negotiate with GreenCo when looking for finance, and a successful arrangement with the entity may result in IPPs being able to quickly raise finance for new projects in the country and not requiring any other type of guarantee backed credit facilities. The entity is being set-up, and while it will be operating long-term, there may not be ample time to negotiate inclusion of Malawi into its geographic scope once the country is connected to the SAAP. A point of note: GreenCo remains a physical entity that needs to produce value for its shareholders. The Malawian context is fraught with issues, both regulatory and of the market, which may keep GreenCo from entering in agreements with the government as it may perceive the risks too high, even in the face of the EFSD guarantees and other structures it has put in place to mitigate risks.
The difference of this tool to the **European Guarantee for Renewable Energy** is that the latter guarantees through a liquidity buffer and traditional 1st loss guarantee (via a DFI) the IPP or a financial intermediary involved in the scheme, while the former is effectively a new instrument and company that has the ability to mitigate risk through various central features in its structure such as the fact that it can potentially divert defaulted power to an alternative willing buyer on the regional power pool in the eventuality of an off-taker default; or the fact that a diversified portfolio lowers the risk on the pool of investments as opposed to a concentrated risk facility to one investment. Additionally, the physical presence and direct engagement with host governments, and other stakeholders it will allow it to drive reform and develop the market further, actively benefiting (presumably) the countries in question. Given the complexity and lack of evolution of energy policy environment and of the power sector in general in Malawi, it may well be that if the European Guarantee for Renewable Energy is extended to Malawi, the lead financial institution in both tools (AFD) may limit the involvement of GreenCo opting for a more targeted engagement by the former tool that would be in effect more indicated.

3.2.1.2 Mini Grid

A variety of mini-grid initiatives exist in Malawi: Mulanje Electricity Generating Agency (MEGA), supported by Mulanje Renewable Energy Agency (MuREA) and Practical Action, is a social enterprise established with the mission to provide affordable electricity to villages using micro-hydro power technology. MEGA has constructed one micro-hydro scheme and has two more schemes in the pipeline in nearby communities. The privately-owned Lujeri Tea Estate operates a 1MW hydro mini- grid for

commercial purposes. It is reported that other tea and commodity estates are exploring such renewable energy systems with the possibility of connecting local communities, although implementation is considered some way off. DOEA installed twelve 21 kW wind-solar hybrid mini-grids in Mzimba, Nkhata-Bay, Nkhota-Kota, Ntcheu, Chiradzulu and Thyolo, each of which can serve about 150 households. None are currently functioning.

There are a few areas where small solar mini-grids are installed, notably by Churches Action in Relief Development (CARD) and Environment Africa (both have made use of EU-donated funds to develop their mini-grids). CARD manages two mini-grids of 1 x 30 kW and 1 x 15 kW, with the intention of enabling and empowering rural communities to fund expansions themselves through productive use of energy. The mini-grids are complemented by several kiosks which promote use of portable solar lamps and rent these out. Environment Africa manages two mini-grids of 15 kW each
Community Energy Malawi are in the process of developing an 80kW Solar mini-grid in Sitolo, and Practical Action have completed a feasibility study for a 100kW hydro mini-grid in Usingini serving coffee producers as anchor loads. Similarly, Practical Action and CARD have implemented the Sustainable Energy for Rural Communities (SE4RC) in Chikwawa, a solar mini-grid providing domestic energy and irrigation services.[16] Developing business models that will allow transformation to scale-up from pilot projects within the mini-grid sector remains challenging.

UNICEF just adopted its renewable energy strategy for Malawi to address the significant losses incurred because of lack of refrigeration of vaccines at district and rural levels. Health outcomes are not achieved because of the considerable waste incurred because of power shortages. The entity is looking to integrate mini-grids into community infrastructures such as schools and hospitals and are slowly testing the space. They've provided 700 solarised refrigerators and are looking to equip 50 health facilities with solar power, which could potentially extend to the communities at large (creating micro-grids). Sustainability of these solutions is a question, and therefore models in which they are able to push blended finance with local players for the maintenance and provision of such solutions are being explored. Similarly, The GOM has installed PV solar systems in schools and hospitals throughout the country in cooperation with development partners. The Ministry of Health has recently embarked on a USD $3.7 million project to install PV solar installations in 85 health centers across the country, with assistance from the Global Fund. USAID and DFID are supporting GOM in procuring 230 modular, prefabricated solar PV pharmacy storage units rated between 3 to 5 kW for public health facilities.

To be successful, any business model for commercially viable mini-grids must address the needs of three key stakeholder groups: Customers need a guarantee of service that they can afford and are willing to pay for; Power suppliers need to be able to guarantee a rate of return to their investors while covering all operational costs; and investors need to be confident of the risks they are taking. A Key challenge to achieve the successful and viable business models is support in terms of financing. Capital for investment is a key challenge in Malawi as energy business models are not commonly understood by Malawian banks, and financial players tend to be risk averse. Financing needs and ticket sizes for mini-grids are small therefore DFIs and international players tend not to engage in the space. Local players will not divert their liquidity into fully financing mini-grids as they have no understanding of mini-grid business models.

The MAREP levy subsidises the ESCOM billing system; if made accessible to independent players, the outreach would be recognisable as many areas would have independent power generation schemes. Such projects could even feed into the national grid and supply many areas. A main issue here is the demonstration effect that mini-grids would have in terms of customer willingness to pay: from very anecdotal discussions, it was pointed out by various individuals that if customers will be willing to pay at a higher rate than that of ESCOM, then the tariff hikes that the MERA is yet to allow would be seen

[16] The study by USAID on the state of the energy market that will be released, as well as the one commissioned by the WB will have a more in-depth list of all mini-grids and off-grid projects and installations as of yet in Malawi. This assignment was not able to gather the full list.

as possible and would have to be accepted, which is not something the regulatory authority or various government counterparts would be happy with as it would be a proof that customers would have no issue with hikes in tariffs.

Off-grid electrification policies are inexistent and delayed until the NEP is finalised. Therefore, private players are reticent to enter in the space knowing that policies can vary. At the time of writing this report MERA was in the process of consulting stakeholders on a draft regulatory framework for mini-grids in Malawi, but it is yet to properly define it. Additionally, license fees are prohibitive for smaller grids, standing at $2500.

Private sector investments

From discussions with various private actors, there is high indication that tea estates and other Ag players would like to get into this space if allowed to borrow at lower rates and supported with technical assistance from international renewable energy power generation companies. One of the players in the Ag space, RAB processors, one of the biggest trading/ag related companies in Malawi, has indicated willingness to create 5 MW small mini-grids to address its requirements of processing plants. They would like to use that generation to off-set costs that they incur with on-grid electricity consumption. On another note, a construction firm that was consulted, also indicated that they are looking at creating their own mini-grid for agro-processing related use to expand and diversify their business portfolio, but have not been able to go further because of policy bottlenecks – MERA, the Malawi energy authority, has not given the go-ahead for projects the firm has been studying together with a South African renewables energy company as their counterpart.

Furthermore, some local players consulted were also interested in creating a company that would engage in turnkey project consulting and building of mini-grids for various private actors, including the tea estates. The indication from consultation was that should access to affordable capital be provided, private sector is willing to invest partly from own funds. These investments are pursuant to the regulatory framework creating clear benchmarks and policies that will be conducive to such investments and giving a green light to requests received by various players. Financing is the key issue beyond regulatory frameworks.

Relevant Guarantee tool

Room2Run is open to distributed renewables-based programmes that are not connected to the national grid. As explained in the previous sub-section, if AfDB releases its risk capital and is willing to re-deploy it in distributed renewables-based projects, it may be possible for private actors looking for financing to access such capital swiftly. However, as explained in the sub-section before, investors may not agree to the conditions that the AfDB sets for financing arrangements or may want a guarantee or other type of credit risk arrangement that the AfDB may not be able to provide (note: remember that the EFSD is not directly guaranteeing the renewables projects), and therefore financing of these projects will not be viable. Although a pipeline of projects may already have been set, because the AfDB has committed to address power needs in low income countries and fragile countries, and given its presence in Malawi, it may agree to re-deploy part of the capital that will be released after R2R is put into action into projects in Malawi either directly or through a local intermediary. For this to happen, a discussion between EU HQ, EU delegation to Malawi, and AfDB is warranted to negotiate a possible involvement of AfDB.

Potentially relevant guarantee tool

None of the other guarantee tools under the energy investment window cover off-grid solutions. The only indication that was found was in the summary note of all guarantee tools by the European

Commission on the guarantee tool ***Renewable energy support programme for mainly rural areas in Sub-Saharan Africa,*** *which* indicated that the tool covered off grid projects. However, in assessing the detailed PIP, the consultant was not able to find information in relation to this being true or as to how this tool promoted off-grid projects.

Other considerations: In terms of guarantees for off grid solutions, business models of distributed renewables and mini-grids have yet to bare fruit across the continent. The consultant had various consultations with one off-grid investors in Zambia where the subsector is more mature, as well as with GIZ's Endev initiative. The unanimous agreement was that although there are well functioning small scale off grid energy solutions, none were too sure of the sustainability of the business models going forward, and most importantly of the ability of these projects to re-pay investor commitments. Their view was that the issue is common among the majority of off-grid solutions around the continent, and those that are successful are generally found in environments where the regulatory and policy framework is particularly conducive to investments in off-grid, and investors do not perceive risks in investment in the power sector too high and therefore their risk adjusted return requirements are feasible.
This may not be possible in Malawi, where the very subsector is not legislated and fraught with uncertainty and controversy. Therefore, it may be advisable to find blending facilities with a grant component that may allow pilot projects and testing of business case, rather than guarantee facilities through DFIs. In fact, MEGA, the one off-grid solution that can be taken as an example, is yet to be financially sustainable. Revenues generated from the 550 households connected to the mini grid only cover operational costs. Without donor support, MEGA would need to access local commercial debt, likely at very high interest rates, making the project financially not viable.

3.2.1.3 DESCOs

Off-grid distributed energy services are mostly found in terms of rooftop solar installations, boxed solar home systems (SHS) and pico solar products. The market remains relatively undeveloped despite receiving support from several development partners. Development partners working in the space are the WB, UNDP, DFID, PowerAfrica through SAEP, GIZ. The Endev initiative of GIZ is so far the largest in terms of household reached, but still short of its 100,000 lamps/SHS provided. Power Africa plans to reach 300,000 households by creating a kick-starter programme that would allow for a foreign company to come in and be supported in major distribution of these systems.

Pico solar and boxed SHS systems are just starting in the country. Relatively low volumes of SHS products and photovoltaic installations are installed nationwide. The SAEP power Africa programme estimated that approximately 27,000 SHS units are installed in Malawi and at least 118,000 pico products sold since 2009. The only major players on the ground are Sunny Money, and Total which supplies PayAsYougo solutions. There are other local companies present, like Zuwa energy, but these are not servicing a large market size. There is a notable absence of international and regional players in the market.

There are four main challenges in the sector, which the consultant discussed with SAEP:

Financing: This challenge is especially applicable to SHS as Pico solar products are mostly cheaper one-off purchases. Accessing cheap financing presents difficulties for both suppliers and end-users. Local banks have really high interest rates, which makes inventory stock-up very expensive for suppliers. Pay-as-you-go plans are not widely available, and equipment provided to households difficult to monitor in case of non-honouring of financial obligations. Therefore, suppliers tend to not enter the space. End-users also face high interest rates when borrowing to purchase SHS systems.

Supply chain: Distribution and route-to market of local players are well designed. However, product acquisition is an issue, and quality has been proven to be inconsistent. Because regulation is not strong,

a lot of lower quality products from the far east are imported and distributed at higher prices from local traders. Service and maintenance agreements are rare, and customers must often deal directly with suppliers if problems arise after installation. Support in rural areas is even more challenging.

Customer acquisition: The inconsistent quality of products on the market affects end-users' perceptions and limits uptake.

Regulating environment: The policy around duty exemption for renewable energy products is inconsistently applied. Therefore, companies are reticent to import, and stocks are limited. Higher stocks would drive prices down, and uptake up.

While SAEP's kick-starter programme may reach its targets because it is in effect trying to solve some of these issues, it may potentially create considerable distortion of local market by killing the growth of local players. The programme proposes to attract qualified international SHS players who commit to a volume target in return for access to a support package, which is provided/funded through multiple development partners (which the EU could be part of). The support package will consist of a working capital loan, results-based financing, operational support, and a national public awareness campaign. Because of economies of scale, and ability to negotiate with GOM, international companies will be able to drive prices down on Pico solar and SHS systems. Local MSMEs need to be safeguarded, and therefore a particular attention to the programme by donors should be given. Nevertheless, the kick-starter programme calls for integrating existing local retailers or logistics partners into planned distribution networks, as international players would benefit from the on-the-ground knowledge of local MSMEs. Additionally, it may be the only way that demand for distributed energy products from consumers graduates from just PICO solar and SHS systems to higher voltage products, effectively opening up for other types of electricity consumption.

The WB is in discussion with local banks in view of supplying guarantees for financing of DESCOs, and to create consumer financing schemes. However, as it has launched a comprehensive study on the off-grid market, it is yet to continue conversations.

While the demand for Solar home systems is high, the lack of a dedicated funding strategy for local players has created a stifling growth. Both consumer financing and company financing models are not available, which creates issues around growth of distribution. However, if capital were available to DESCOs in Malawi through a DFI, or other vehicles, the local players would not have the capacity to absorb big amounts of capital without heavy technical assistance. It is partly what pushed SAEP to consider attracting international players in the market, rather than developing the local MSMEs.

One model should be noted: the cooperative financing institution FINCOOP received 350k from AECF (DfiD) to reach out through its cooperative and village and savings group consumer finance model. This initiative is very successful. However, to reach a large number of households, considerable additional capital would be needed, as well as increase in level of membership. In fact, SACCOs do not supply consumer financing and SHS to non-members, and therefore reach is limited.

There is a dilemma for donors between supporting the local DESCOs ecosystem or pushing for international companies to enter the market and rapidly reach a large number of people, effectively addressing the very low coverage of electricity access. However, the most effective approach would be two-prone: the international companies would reach a large number of people but would still be heavily short of the needed reach; Local companies and cooperative finance institutions have the distribution networks and understanding of the local specificities and difficulties, as well as understand how to build a consumer finance model for rural households.

Therefore, the most viable approach would be to allow SAEP to bring in a couple of international companies, but limit their geographic coverage while ensuring that they work with local companies in

distribution and maybe a partnership/commission based model, and then push for the creation of a green fund to which various local players have access that would allow them to grow considerably their operations, adding heavy technical assistance for refining their model. However, this is beyond the scope of the guarantee tools and a discussion amongst the donor energy group around this issue is suggested. A direct investment into the DESCOs is needed, as capital through local FIs would be too expensive even when guaranteed by an EFSD guarantee tool.

A few companies are also exploring the development of PayGo models in agriculture – i.e. through the development of solar PV-based irrigation solutions that can be sold on a lease-to-own basis. These "productive uses of electricity", as the AfDB calls them, provide opportunities for increasing household income. One such company is Wala, a start-up that is still developing its business model in the sub-sector.

Relevant Guarantee tool

Desco Financing program guarantee tool would tremendously benefit Malawi as the country's electricity access needs are certainly higher than other countries. While AfDB may have already allocated the guarantees to other regions, it is important that the EU commission enter in discussion with the DFI to support and prompt it to consider the Malawian landscape. The DESCOs Financing Program's overarching goal is to catalyse the mobilisation of local currency financing for DESCO to support the accelerated expansion of their activities in African countries. The main objectives of the programme are to: crowd in local financial institutions and increase their appetite to provide local currency financing to the off-grid market/DESCOs and develop securitisation/receivables-based financing structures in order to achieve debt instruments with lower risk of non-payment than conventional loans directly to DESCOs, and thereby decrease the perceived and real credit risk for local lenders. The market in Malawi is in its infancy, but the biggest reason of why it's not growing is in effect the access to finance hurdles DESCOs encounter and the issues in their ability to structure successful "pay-as-you-go" models, by using digital/mobile platforms to collect system payments. A securitisation of the credit risk of DESCOs to allow for local private commercial banks to participate in the market would be extremely beneficial to the growth of the sector. The tool can be used both by international and local players, throughout various types of solutions – SHS, Ag related PV for irrigation, home appliance leasing, etc – The EU should coax the AfDB to consider Malawi, especially given that the biggest potential for access to electricity in Malawi are DESCOs
However, because local banks will be integrated in the scheme, a considerable TA component should be tied to ensure that banks understand the segment and can give financing to the MSMEs at better conditions. The Tool does foresee engagement with local FIs, but an emphasis should be put on the TA component. The securitisation model that the AfDB bank uses should in theory allow for the banks to lower their lending rate. The AfDB should include with the TA a strong emphasis on helping banks create the appropriate products and therefore lower the risk incidence on their balance sheets.

Other possible guarantee tools that are relevant:
While in the list of guarantee tools in the energy investment window there aren't any direct DESCO financing programmes beyond the AfDB's, many of these companies can be classified as being MSMEs and therefore eligible for investment/access to guarantee tools through the MSME window. Therefore, the appropriate PIPs have been discussed in the next section, and the same considerations apply to DESCO companies.

3.2.2 MSME Financing, specifically for sustainable agriculture, rural entrepreneurs and agroindustry

INVESTMENT WINDOW 2 – MSME financing, specifically for sustainable agriculture, rural entrepreneurs and agroindustry

Guarantee tool	Lead Financial Institution	PRIORITY AND RELEVANCE
AFDB SME guarantee programme	AfDB	**VERY HIGH** This guarantee tool is built to address all the needs and peculiarities of both the financial institutions and the MSME borrowers. The tool foresees a three-pronged approach: 1) Supplying liquidity in local currency to local FIs at favourable terms through various liquidity products or 2) Providing a range of guarantee products to local FIs; both come with 3) TA/capacity building support to FIs and their SME clientele under the SME Programme. **AGRIBUSINESS** – THE TOOL IS HOLISTIC SO APPLIES TO AGRI-BUSINESS AS WELL
AGREENFI	AFD	**VERY HIGH** The tool is comprehensive in nature and is designed to support and catalyse the growth of actors within agricultural value chains at every level, from micro- to middle, as well as involving sectors that are not necessarily directly related to agriculture but are found within rural areas. In this manner it brings a holistic approach to rural economic growth and supports rural ecosystems by allowing the creation of enterprises that can feed into, and thrive from, the agricultural sector. **MICROFINANCE:** The provision of credit lines to microfinance institutions and other possible relevant specialised financial institutions, in a country where they face high cost of capital themselves, would benefit the agriculture sector and Agri-entrepreneurs who may be able to access finance at lower rates.
FISEA EFSD SME Investment Guarantee	AFD	**HIGH to MID** FISEA 'plus' initiative aims at catalysing high impact SMEs and sectors through investing into high Impact SME funds and social business funds. It will also consider investment funds that are looking into two new high-risk/high-impact strategy segments: innovative, digital and early stage investments, and riskier geographic zones. This tool also foresees a pre-investment TA envelope, and a post-investment TA service. This tool is very important for Malawi where SMEs find it almost impossible to access finance through commercial lending, and the TA component is particularly relevant to SME needs.. **RISK (resulting in MID priority):** SMEs in Malawi may be too small for some of these funds to invest in them. However, given the target (high risk, high impact), it may be that some funds in the FISEA portfolio will be able to invest in Malawi. Since investments by the AFD have not yet been made into SME funds, it is difficult to ascertain the relevance of the tool without knowing the SME portfolio target of the investment funds. **AGRIBUSINESS –** There are viable agri-businesses in Malawi that are unable to access commercial loans. Some of the funds of the previous FISEA programme invested specifically in the agri-sector. Worth waiting to see which funds will be in the new portfolio, and resources permitting invite them to scope Malawi.
EDFI SME GUARANTEE PROGRAMME	EDFI	**VERY LOW** This tool is relevant for Malawi, as it is structured such that various EDFIs can venture into geographies they do not operate in, and be complementary to programmes on the ground, maybe investing in Malawi under different targets, therefore maximising impact. However, it is unclear from the PIP how the various DFIs decide on the geographic scope or on target countries. It is also not clear if all DFIs have to keep to a limited number of instruments (in this case risk sharing facilities) to be able to access the EFSD guarantee. Risk sharing facilities are an option for the EDFIs, which would not work in Malawi, as local banks are highly risk averse. A TA component is missing, which would be needed for Malawian banks' capacity development
Small Loans and Guarantee Program (SLGP)	IFC	**VERY LOW** The tool is designed to give risk sharing facilities to Local financial institutions, and foresees a TA component to banks giving them operational and technical support to manage the reporting requirements and to develop and enhance products, services and underwriting standards for the riskier SME sector. as per conversations with all of the Malawian banks that this mission was able to conduct, risk sharing facilities of 50:50, which the tool foresees, is not something they would accept, even with considerable TA. It is highly unlikely that banks would lower lending interest rates to SMEs as a result of the risk sharing facility, which is one of the main factors for exclusion of SMEs from accessing financing from banks.
"Archipelagos - One Platform for Africa" ("ONE4A")	CDP AfDB	**VERY LOW** The tool is designed to accelerate the accessibility of domestic capital markets financing for high growth SMEs in SSA. African capital markets chosen are those that are liquid and with an active SME participation ((Nigeria, South Africa, Kenya, Morocco, Egypt, Ivory Coast, Cameroun). The latter will be used as hubs and expected to mentor and share capital markets development knowledge and their experience with other neighbouring nascent capital markets, and thus ensuring the development of the less functioning capital markets on a regional division programme basis. A TA component will support this programme through AfDB's and CDPs experience of working with the Association of African Stock Exchanges This may be really useful for Malawi, but not a priority at the moment for EUD, as the Malawian capital market is too small, and faces major structural issues (including a difficult regulatory environment).

Guarantee Facility 'NASIRA'	FMO	**NOT RELEVANT** Designed to support financing of young entrepreneurs and irregular migrants, through a second loss position. It is not practical and useful given the Malawian Financial sector context and its risk aversity
InclusiFI - Financial inclusion driven by diaspora	AECID (Spain) COFIDES (Spain) CDP (Italy)	**NOT RELEVANT** this tool is focused on enabling better connection of diasporas and diaspora associations in the EU with investment opportunities in origin countries. It is better used for countries where migration flows to are larger, and their strong diaspora communities may be found in EU countries.
African Local Currency Bond Guarantee Program (ALCBGP	KFW	**NOT RELEVANT** not relevant to Malawi at this moment. There are a number of structural problems of the capital markets, as well as the non-sovereign institutions that are supposed to issue bonds. The primary activity of the ALCB fund is to make investments in local currency bonds issued by non-sovereign entities in African countries.

Before analysing the MSME sector, it is important to underline the definition of MSMEs in Malawi, vis-à-vis those that the development finance institutions that have applied for EFSD guarantees have. The division of enterprises into micro, small and medium category varies from country to country. Inherently, the comparison between size of firms in Malawi and that of other places in the region will be different. Likely a medium enterprise in Malawi may be micro or small in a more advanced (larger) economy. There will be in fact incongruences with the definition of MSMEs by DFIs which tend to define the segment according to more advanced contexts. It is important therefore that the EU emphasizes this and makes sure that the DFIs that has received guarantee tools will approach each geography with the necessary flexibility and assortment/variety of products designed to respond to the contextual needs of countries. In Malawi, the draft MSME Policy proposes the following categorisations according to the number of employees as in the table below. The policy also extends the definitions by including turnover thresholds.

Enterprise Size	No. of Employees	Annual Turnover in Equivalent approximate Euro (Malawian Kwacha)
Micro	1 - 4	Euro 5,920 (up to MKW 5,000,000)
Small	5 - 20	Euro above 5,920 to Euro 59,200 (MKW 5,000,000 to 50,000,000)
Medium	21 - 99	Euro above 5,920 to Euro 590,000 (MKW 50,000,000 – 500,000,000)

However, the categorisation of firms by turnover in the draft MSME policy is one that takes the base of 2015 in MKW and the susceptibility of such definitions to currency and inflationary dynamics renders it unstable for comparisons over time, and may have also changed as macro-economic realities have shifted. In addition, categorisations become blurred in instances where the business earns high turnovers but with a very small number of employees as is typical with the service sector. This mission also found that these turnover projections may not reflect the reality on the ground. In fact, from brief conversations with about 20 MSMEs and with the banks, it was found that the annual turnover figures are about 5 times lower for micro and small enterprises and about 10 times lower for Medium enterprises. The upcoming Finscope survey of 2019 will be able to give more accurate data to the reality on the ground.

Nevertheless, Micro Small and medium-sized enterprises (MSMEs) play an important role in the economy of many developing economies and Malawi is no exception. Evidence[17] shows that there are almost a million MSMEs in Malawi, although there is a smaller number of business owners vis-à-vis number of firms, an indication that a lot of owners have more than one business. According to the same findings, 59% are individual entrepreneurs who employ no other people, while the remaining 41% of businesses generate employment; MSMEs make up about 1.5 million people in employment, equivalent to about 18% of Malawi's total working age population. The sector is largely youthful with 46% of the businesses owned by youth (18-30 years). Most of the employees generally experience poor conditions

[17] Malawi Gemini MSE Survey, 2000 & Finscope Malawi SME Survey 2012

of work, have low skills and earn low income, with no social security benefits. Overall, this sector generates an income of around 326 billion Malawian Kwacha (close to €480 million) making it a significant contributor to Malawi's economy.

However, the majority of them are micro businesses, with around 87% being retailers, particularly of agricultural products. The remaining 13% of MSMEs render services, e.g. professional services (accountant, lawyer, consultants) and skilled services (hair salon, plumber, and mechanics). The large 85% are located in rural areas. Given the fact that the majority of MSMEs are micro businesses, the net profit of many businesses is relatively low. MSMEs mainly operate either from a trading centre/market or from home. Many of those businesses are in the growth phase (3 – 5 years of existence). This phase of a business requires special attention with regards to expansion and support. The large majority of MSMEs trade informally (91%), being neither registered nor licensed. The 2014 Global Entrepreneurship Monitor (GEM) report[18], rated Malawi as one of the countries with the highest entrepreneurial activity rates among 9 Sub-Saharan African[19] countries surveyed. The country recorded the second highest youth[20] entrepreneurial propensity at 52.3%. The report also found that the impact that Malawian entrepreneurs have on job creation is minimal, with the majority of enterprises being own account ventures.

Of much concern to policy makers and the economy was the general finding that almost 40% of MSMEs were started because of necessity: entrepreneurs couldn't find employment. Accordingly, about 49% of business owners responded by closing down their business in favour of paid work. Additionally, business owners venture into business as a supplement of farm income. As a result, most businesses are seasonal and tend to follow the cycle of death and resurrection any time there is need or a shortfall from agricultural income.

The above data, though not current, is still indicative of the major role that MSMEs and entrepreneurs play in the Malawian economy, and therefore the need of dedicated policies and development partner strategies to target and address the continued growth of the MSME sector. The 2012 Finscope Malawi MSME survey is in fact the last most accurate economy wide survey conducted of the sector in terms of available quantitative data.

An accurate quantification of the number of MSMEs is difficult at this point, although it is estimated that even though the growth rate has increased, because of high level of failures the total number of MSMEs in operation hasn't increased too much since 2012. In terms of distribution percentages, the numbers from the 2012 Finscope Most of them are largely still operating small businesses and can be found largely still in agriculture. The number of organisations supporting this growing number of small businesses has also increased.

While the majority of MSMEs are owned by men, a large proportion is still owned by women (46%), with a higher incidence of the businesses being individual entrepreneurs in the latter's case. MSMEs are predominantly the only source of income for the household. Major findings are around the acquisition of business skills. Most business skills are acquired informally (40% self-taught, and around 30% through the family).

Support institutions and support programmes

Both the government and the private sector understand the need to have initiatives and support structures in place that can help the MSME sector thrive. To this avail, the government, or rather

[18] https://www.gemconsortium.org/report

[19] The 9 countries include Angola, Botswana, Ghana, Malawi, Namibia, Nigeria, South Africa, Uganda, Zambia.

[20] The GEM defines youth as people in the age bracket of 18 – 34 years old.

successive governments, have put in place multiple initiatives in the past and present including the establishment of such institutions as Malawi Rural Finance Company (MRFC), Malawi Industrial Research and Technology Development Centre (MIRTDC), Malawi Investment Promotion Agency (MIPA), Small Enterprises Development Organisation 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) and Small and Medium Enterprises Development Institute (SMEDI). Generally, all these institutions were established to provide technical and financial support towards the SME sector. On their part, the MSMEs have also been reorganizing themselves by forming associations, prominent ones being National Association for Small and Medium Enterprises (NASME), National Association of Business Women (NABW), and recently the Chamber of small and medium enterprises.

In a study that USAID conducted of agricultural MSMEs in 2014[21] it was found that most owners were unaware of existing institutional support structures but relied instead on broader religious and community groups. This was in line with this mission's own findings from consultations with SMEDI and the chamber of small and medium enterprises, who confirmed that a major difficulty they find in supporting SMEs is either that these do not have knowledge of the support structures in place to support them, or do not understand in what way they can in effect benefit even if they do know the presence of these structures, and therefore do not approach them to be supported.

Business development services

There are a number of BDS service providers in the country, but by and large the BDS market is not developed. Those that are present can be private, public or NGO sector providers. Both FinScope and the USAID Ag MSME surveys found limited current demand for BDS. Evidence of service use was that it was in fact low. This mission's consultations with market actors and MSMEs all pointed out to a fragmented, subpar environment within the business development services space. There is also a proliferation of non-relevant and non-qualified providers that are providing services to MSMEs, often for a fee, and not creating value. This has created an environment whereby MSMEs are reluctant to use these services because of negative experiences.

Most providers of BDS services tend to be urban based and reliant on subsidies. The majority focus on capacity training and capacity building, in line with much of the work of development actors. These are privately owned management or business consultancy firms that provide business advisory or development services. The majority of these firms are managed by one or two people and serve a range of clients across different sectors. For example, UMODZI Consulting, Tools for Enterprise and Education Consultants (TEECS) and Business Consult Africa (BCA) are the better known business and management consultancy firms targeting SME development. NGOs play a significant role in the use of these privately owned companies and in the development of MSMEs. NGOs offer services in the area of capacity building through training and provide credit facilities to MSMEs. Through them, MSMEs in the margins are targeted successfully. Without them, it is rare to find business, technical and developmental services in the districts, other than lower-level technicians (e.g. vehicle/equipment mechanics) and accountants, the latter serving more the medium enterprises. More developmental service use is occasionally found, such as training/capacity building and business planning, but these tend to be used by larger SMEs and often, as pointed out above, with development partner support.

In fact, in the context of Malawi, both government and development partners give support to MSMEs in terms of technical assistance and capacity building around entrepreneurship development. Therefore,

[21] 2014, USAID, *Agribusiness SMES in Malawi: Assessment of small and medium enterprises in the agriculture sector and improved access to finance in Malawi*; LEO - Leveraging Economic Opportunities Report #5

BDS service provision is particularly focused on training and technical assistance, partly because service delivery is donor-funded and therefore donors usually focus on training delivery, and partly because entrepreneurs' major bottlenecks are represented by their internal capacity and skills in enterprise management. Training and technical assistance is mostly in the form of business plan and financial management skills training and lacks a comprehensive approach to entrepreneurship skills development. The fragmentation of provision of training, and the materials used by the various institutions, have yielded often not successful results for MSMEs. Furthermore, BDS providers lack the knowledge and sometimes the capacity to assess the actual needs of MSMEs, and end up not catering fully to their needs, but delivering a standard 'one size fits all' solution to these. Institutions/BDS providers, in fact, often provide basic information on topics such as financial management and business planning, but do not provide SMEs with technical specialized training or post training support that yields evidenced success. Usually, in-depth needs assessments are mostly foregone because of budgetary restrictions.

Additionally, as BDS providers sometimes are only specialised in just some of the fields or topics within the Entrepreneurship training framework, the training delivered is limited in scope, and often they are not able to recommend to entrepreneurs/MSMEs what other types of support they should seek. Consultations with both stakeholders and entrepreneurs found that while training programmes equipped MSME owners with some of the necessary tools to succeed as entrepreneurs, the support received needed to be continuous (many programmes are intensive short term courses), and needed to adapt to the changing needs of new enterprises as they journeyed through the enterprise life cycle (from starting up to becoming an established MSME) such that they could deal with the new difficulties they continuously encounter as the businesses grow and change. The view was that many entrepreneurs of MSMEs that did receive capacity building did not achieve the targets envisioned because of their inability to address other needs (such as access to finance, markets, and reliable BDS services) as their businesses grew. It was of particular note that SME training is not a guarantee to effective application to the business and thus to ensuring business success. Coaching and mentoring around softskills was noted to be important, but lacking in many of the programmes consulted in this mission. One important finding is that many entrepreneurship development interventions present in Malawi often focus on direct delivery rather than facilitating long term systemic change and are too targeted and not aimed at improving the overall competitiveness of the MSMEs ecosystem.

In terms of government support, a conversation with SMEDI, the Small and Medium Enterprises Development Institute, has indicated that many entrepreneurs still fail after training because of SMEDI's inability to embark in long timeframes for entrepreneurs' support, due to budget and personnel constraints. Entrepreneurs receive very short-term intensive training, and often do not apply gained skills as there are no frameworks to ensure that these are translated into action. Furthermore, echoing Graca Machal's issues, some of SMEDI's entrepreneurs that accessed funding through the AfDB, through a matching grants programme, found difficulties in growing because training received only addressed their needs at the point in time in which they received it, and new needs in entrepreneurship skills development arose that heavily affected the success of their businesses. SMEDI works directly with donors and development partners, and a particular point raised was that DPs and Donors that support them have historically focused overwhelmingly on Entrepreneurship training and foregone other needs such as access to markets and finance (although as expounded in the introduction section some like GIZ and DfiD are addressing some of these issues in their cooperation programmes).

3.2.2.1 Challenges to the sector

As early as 2009, the World Bank Enterprise Survey (2009) revealed that an overwhelming 45.6% of MSMEs recounted limited access to finance as the main obstacle to their business growth. Other obstacles included poor transportation, unreliable power supply, exorbitant tax rates, inadequately educated workforce, crime, complicated business licensing procedures, corruption and limited access

to land. This evidently shows how counterproductive financing challenges have become in defining the survival and growth of most MSMEs in Malawi. Similarly, the Finscope survey found that MSMEs lacked credit facilities in general, and export credit in particular (although recently the government of Malawi has tried to address this issue). Additionally, technology access, information asymmetries, market access, and most importantly access to networks were found to be major challenges to the growth of MSMEs. MSME associations that provide opportunities for networking are lacking in Malawi. Those present are often dependant on financial donations to be active, without which they become dormant, and usually are not fully accessible to the majority of MSMEs as their reach is geographically limited.

Concurrently, the consultant found that the issues to the growth of MSMEs in Malawi that were identified through qualitative consultations are in line with those identified by other major stakeholders. These include: lack of access to capital; lack of business skills among small-scale entrepreneurs and an absence of varied vehicles for skills development and capacity building; lack of information, training, markets, technology and business infrastructure; a weak culture of entrepreneurship; weak private sector support institutions; outdated policy, legal and regulatory framework; and unreliable and costly infrastructure services.

To add to this, the present consultations revealed some of the challenges that apply to MSMEs in Malawi to include cultural and societal problems, the psychological impact of cultural norms, fragmented approaches to identifying issues and developing strategy to influence policy affecting business and government interventions, and a mis-coordination of permanent market actors and stakeholders within the ecosystem.

Policy Environment

Government initiatives to develop and support the MSME sector have been put in place since the 1980's, through for example the establishment of support institutions like the Malawian Entrepreneurs Development Institute, the Development of Malawi Enterprises Trust, Small Enterprise Development Organisation of Malawi, and the Malawi Industrial Research and Technology Development Centre. However, specific policies and strategies for MSME development were not put in place until the first ever Small and Medium Enterprise Policy developed by the Ministry of Industry and Trade was approved by Government in 1998.

The current policy is outdated. There is a new policy for MSMEs in draft form that is waiting for approval from government. The policy recognises the particular importance of the sector for the growth of the Malawian Economy, and is taking measure to build various support strategies through better and more coordinated BDS provision, better engagement with the financial sector, market strategies etc. Unfortunately, the policy has been in draft form for a while (drafted in 2012) and may not be approved and implemented in the near future. It is, however, very important that its approval and implementation goes forward to enable the MSME sector to grow, and the EU delegation should, as part of its work around enabling business environment, push for its approval after the upcoming elections.

3.2.2.2 Financing MSMEs

According to various consultations of this mission, and in line with Finscope's survey, a swooping majority of MSME owners are financially excluded (59%), i.e. they do not use any financial products / services to manage their business finances. Savings are kept at home, and coping mechanisms are overwhelmingly reliant on the family networks around them. According to the Finscope survey while 33% have/use product/services offered by another formal (non-bank) financial institution or use informal mechanisms for managing business finances, only 22% of MSMEs have/use products/services offered by a commercial bank.

The low levels of access and usage of financial products/services indicate that the current product set does not adequately address the needs of MSME owners. Businesses that are individually owned are most likely to be financially excluded (66%) followed by micro enterprises (50%). Medium sized businesses and, to a limited extent, small businesses have higher levels of financial inclusion and increasingly sophisticated methods to run their businesses.

In terms of borrowing, the large majority of small business owners do not borrow largely due to the concern that they would be unable to repay the debt. Those who borrow are most likely to do so from family and friends. Cost of capital is one of the major reasons why MSMEs will not ask for a loan, as these do not come with concessional terms (either lower rate, or long grace periods). In fact, for the most part, Malawian commercial banks do not cater with dedicated credit lines and adequate products to MSMEs.

However, there is a tendency to be biased in the assessment that financial inclusion is an issue to be solved by ensuring better cost of capital, and that banks themselves are the hurdle to access to finance. However, the macro-economic environment in Malawi has not been particularly conducive: policy interest rates set by the Reserve Bank of Malawi for the last 15 years have been really high and volatile. Commercial bank lending rates have therefore followed this pattern, and this has been a discouragement to small businesses to obtain lines of credits from commercial banks. The unpredictability and volatility have posed a huge challenge to both business planning and profitability, as a whole to the country, but specifically to SMEs.[22] Furthermore, the disparities in the management system of foreign exchange rate have posed another big challenge to small and medium-sized enterprises. Exchange rate fluctuations hurt SMEs considerably in procurement of raw materials and by constraining the availability of trade credit. Institutional weakness of the legal framework also creates a difficult environment when commercial banks want enforcement in recovering bad loans. As a result, stiffer conditions for financing SMEs are imposed by banks creating an unconducive environment for small enterprise. Therefore, macroeconomic conditions and policy objectives of Government have hindered the attainment of the expectation of lower market cost of capital. Nonetheless, it is also a fact that better products/services are in effect needed.

The consultant was able to speak to the Reserve Bank, 1 SACCO, 1 MFI, 5 Banks, 2 alternative financing firms, and the representative bodies of these financial actors (SACCOs umbrella body, MFI network, Banks representative body). The institutions capable of supporting and seeing to the growth of start-ups and MSMEs are unwilling to invest in the sector. On surface it seems that these institutions are not investing simply because of perceived and real default risks of MSMEs. In reality, the situation is a bit more complex as explained previously, where macro-economic conditions influence commercial banks' decisions. Additionally, inherent issues and the nature of MSMEs, such as poor organisational capacities or the personalised nature of MSMEs, are in effect some of the hurdles that are found to impede financial inclusion.

From conversations with key informants, those who were unable to access credit despite trying had issues such as inadequate collateral, poor repayment history, low cash flows, and over indebtedness. For those who have been successful they have registered title deeds, have a good repayment history, use group guarantees, and have good cash flows that reflect ability to repay and good character.

Commercial Banks

[22] Zidana, R., 2015, "*Exploring alternative sources of financing small and medium enterprises (smes) in malawi: lessons from elsewhere"*, Afro Asian Journal of Social Sciences Volume VI, No 4. Quarter IV

Banks have an obligation to their deposit customers and therefore, though extremely liquid, lending using depositor money is seen as too risky and not worth it in the SME sector. In the banks' perspective, SME owners lack skills to run businesses properly and they often also lack the passion and the hunger for entrepreneurship needed for long-term engagement with their enterprises. Instead, most entrepreneurs open businesses to meet immediate financial needs. All the banks consulted concur in their perspective of SMEs as follows:

- SMEs do not grow even when money is poured into them as they tend to divert the credit received to meet an immediate need or to invest in another business.
- SMEs are often without collateral and the banks cannot/are wary to invest without. Collateral requirements are high because of the mis-use of funds by SMEs
- It is difficult to provide a loan to an SME even in the event that they do have collateral as there is lack of data recording at the SME and micro space as such on credit scores. In fact, SMEs tend to provide the same collateral to multiple banks and MFIs when repayment is due tend to relocate their businesses easily making it difficult and costly to track and make a claim upon disbursed loans.
- When credit received is not mis-used, it is invested in the wrong parts of the SME business. There is no knowledge amongst SMEs on debt servicing and efficient use of credit received. Investing the loan received into a wrong component that does not yield growth defeats the purpose of taking the loan itself.
- SME training received by other donor-funded programmes or imparted by the banks themselves is never a guarantee of effective application of acquired knowledge to the business to ensure its success and growth. Most of the time, knowledge is not applied correctly nor there is follow-up to ensure that this happens.

Upon self-evaluation however, the banks admit to the following:

- A lack of capacity to understand SMEs. Banks underline that they use for SMEs the same inflexible systems in place to do credit assessment and processing that they use for bigger companies. Therefore, products, assessments, processes, and loan monitoring and disbursements are not catered and designed with SMEs in mind. Where this is done, it still lacks the granular design needed to make them successful.
- Banks generally provide very high minimum loan amounts that are most often beyond the needs of micro, and/or cannot be accessed by most micro and small businesses are often with too high interest rates, which can be beyond the range of an SME to access.
- Banks do not provide initial grace periods for loan repayments, and when they do these are not long enough to permit the SME to fully invest in growing the business. Instead SMEs have to pay back too soon, which stifles their businesses and halts the growth.
- They do not cater to start-ups at all, and often do not give loans to SMEs that have not been operating less than 3 years. This obviously limits the chances of new businesses growing or surviving even if they are performing well.
- The collateral requirements they request cannot be met by the majority of SMEs and most often are 100% to 200% of the loan request.

While the banks may be reluctant to lend to the sector, they recognise a key fact within the financial industry space: corporate clients are overbanked, and banks are increasingly competing for the same clients. The corporate client base is very small, and while government is a key client, banks recognise that they are incurring continuous hurdles to client acquisition. Therefore, banks understand and are very keen to enter in the SME sector to expand their operations. The single biggest hurdle perceived is that the risk-reward of entering the space is not well covered by their ability to cater to the unique client base. As discussed above as well, management of the loan portfolios is extremely costly and difficult because of the lack of measures and processes that help banks seamlessly and successfully disburse, trace, manage, collect and target the SME sector. These hurdles, more so than high default risks per se, put off the banks in engaging in the space.

However, there is, amongst banks, a perceived course of action that could be taken to create processes that both protect them and allow them to support and benefit the SME sector, and steps that could be taken to ascertain the SME owner's ability to run the business and secure their support. This, in their opinion, is a coordinated and concerted effort by various stakeholders, including donors, to ensure that the necessary skills are acquired by entrepreneurs. In truth, it is the opinion of the consultant that the banks are looking for technical assistance to address their own bottlenecks in assessment of the sector, in creating innovative products, in adopting successful models from other countries, and most importantly in ensuring efficiency in SME loan portfolio management. Adding to this, they are looking to de-risk their investments through various instruments – on-lending liquidity injections that are guaranteed, guarantees to their portfolio with affordable terms, injections of capital to on-lend to SMEs

Banks on their parts have been trying to cater to SMEs through various solutions in a bid to try and cater to the market:

- Needs assessment of the SME and then a training to build the capacity of the SME.
- SME clinics where the SME owner is trained in areas such as financial management.
- Encouraging grouping of complementary services among entrepreneurs to access loans/funds which lessens the loan risk for the bank.
- Providing mobile vans to provide banking services to the under banked in the case of NBS.
- FDH created an innovative tool to disburse loans through MFIs and has accessed
- Creating a dedicated SME department in the case of National and NBS bank.
- NBS asks a cash cover of 20% of all SME loans.
- Some are considering specific mobile banking products for loan repayments that could potentially lower the interest as asking and collecting repayments costs would be greatly reduced.

The banks' attempt to participate in the SME sector is for the most part unsuccessful. When providing trainings, the banks are using BDS services to do a needs assessment of some SMEs and then they propose the type of training the SME needs. However, the assessment is shallow which leads to trainings that are limited in time (lasting a day), limited in scope (the topics are generically chosen, e.g. financial management) and limited in follow up as no one returns to measure absorption and implementation. Furthermore, the BDS providers are used sporadically. Without a complete understanding of the SME owner's goals or skill, it happens, even when faced with a successful SME, that banks do not tailor the support package, which in most cases requires support to develop particular types of skills needed for the growth phase in which the SME is. Inherently, the funds are then mis-used and the banks have created an environment of mistrust, as they point to failure of the SME not because of inadequate training, but because of the SME owners not being good entrepreneurs.

Micro Finance Institutions

The MFI sector is less discriminatory when lending out money in comparison to banks. Although their concerns are similar to those of the banks in areas of loan repayments, collateral and identification of the borrower, they easily provide individual loans and group lending in rural areas.
MFIs however, contribute to the lack of growth of the SME sector as SME owners prefer to lend each other money to avoid turning to the MFIs due to their exorbitant interest rates and non-deferment loan policies.

The Micro finance sector is composed of deposit and non-deposit taking MFIs. Main products are individual loans and group lending in the rural areas. The sector is significant in size, with total assets representing about 4% of the banks total assets, and growing, as per the RBM statistics; however, recent

growth was related to increased investment in government securities rather than increased gross loans to private clients.
The sector is also benefiting from the expansion of mobile payments which facilitate the management of loans and repayments fund flows. Interest rate charged to clients is reported by the Malawi Microfinance Network to be very high, in excess of 100% per annum, except for MFIs benefiting from donors' grant support. It is reported that unregulated money lenders in the rural areas may charge up to 10% per month or more.
The high cost of MFI finance is the result of:

- MFIs' high refinancing costs at interest rates of about 25 to 30% p.a. from banks, including inflation;
- High operating expenses compared to the small size of the loans;
- High Non-Performing Loans (the recent introduction of a national identity card system shall facilitate the proper identification of the borrowers and cross-reference with other financial institutions).

Therefore, while Microfinance should be an answer to financial inclusiveness in Malawi, it on the contrary excludes a large percentage of MSMEs. Until the sector can finance itself at acceptable rates to be able to on-lend to MSMEs at lower rates, a majority of micro and small enterprises will remain financially excluded and continue using informal mechanisms to manage enterprise finances.

Guarantees and other financing arrangements by DFIs for MSMEs in Malawi.

There are a number of guarantee schemes and loan facilities already present in the country. The EIB under its Kulima project is funding the agricultural sector; OPIC has given a guarantee through a risk sharing facility to Eco-Bank for SMEs; FDH just signed a programme with the Africa guarantee fund for Ag SMEs in particular; Historically, Dutch FMO had signed with the National Bank for credit to SMEs which failed for various bottlenecks both in terms of SME defaults and inadequacy of National bank in creating the necessary processes and products to efficiently cater to the segment. USAID is providing guarantees and financing to Ag SMEs through DAC (no additional detail found).

There may be other guarantee schemes and soft loan arrangements, but as the Reserve Bank of Malawi does not force FIs to register agreements, it was difficult to collect conclusive data on what arrangements there are within the country between local FIs and DFIs. The information collected is from interviews conducted and is not comprehensive (based on narrative and incomplete discussions with bank management that was not comfortable to divulge full information on some of the arrangements). Notwithstanding, though banks are entering into some level of agreements, there is a reluctance by local FIs to enter into risk sharing facility arrangements with international counterparts. In particular two reasons stand out: firstly, the cumbersome reporting and processing requirements of these arrangements make it so that the operation and administration of the facilities requires additional capacity development of internal FI staff that is often not undertaken and creates bottlenecks and mismanagement; Secondly, risk sharing facilities require the banks to put up their own capital, which is then directly guaranteed through a 1st loss arrangement. The very lengthy and complex processes required to access the guarantee funds after defaults in the loan portfolio that is covered by the guarantees (generally a year or two after defaults have been declared), leave the FIs' books open and constrain their liquidity[23] when losses have to be covered. The very reason for signing the guarantee arrangements for the banks is to be able to access quickly the funds and not leave their books open, so that depositor's money is not utilised to cover the losses. Therefore, like any commercial bank in the world, the banks are reluctant to accept risk sharing facilities that constrain their operation in case of losses. Specifically, guarantees usually cover 60% and downwards of the loan portfolio of an FI, which

[23] Liquidity ratios of Malawian banks are amongst the highest in the region, and therefore their loan portfolio should be higher. However, Malawian banks are extremely risk averse and tend to not want to "unnecessarily" burden their balance sheets by constraining their liquidity by dealing with issues as non-performing loans.

sees the risk of entering into spaces they do not operate in as too high and therefore not worth the 40% upwards of non-guaranteed portion of their own capital that they need to put up for loans and will be completely lost in case of defaults.

FIs have indicated that they prefer fresh injection of liquidity via soft loan facilities to be able to operate in sectors that they are unlikely to tackle. However, the lack of project appraisal capacity and expertise, and the volatility of the currency make it so that they are more likely to be very conservative in disbursing credit facilities to target companies, and therefore the loan facilities are not fully utilised.

In general, there is the need of a comprehensive TA element in terms of banking support to ensure the FIs have all the basic building blocks in place to operate effectively in target segments, both in understanding the segment and for operational capacity in administering guarantee related bureaucracy and processes.

There is considerable space for DFIs under the EFSD guarantees scheme to enter in the MSME sector. It is the consultant's belief that the biggest hurdle for lending institutions in lending to SMEs is in fact administrative in nature, more so than risk aversity (which is nonetheless very high). If the MSME ecosystem[24] were to be developed in such a way that there are structures (incubators, accelerators, other types of support) that would help MSMEs through the journey post financing, both banks and Micro-Finance institutions pointed out that they would feel more at ease to lend to SMEs, and possibly price down the cost of capital. However, considerable support also needs to be given to the financing institutions (banks and MFIs) to smooth their operations vis-a-vis DFIs, as there is a perception that procedures are too bureaucratic and draconian and therefore hindering a productive relationship with the DFIs. A TA component is also necessary in helping these institutions create appropriate products to the MSME sector.

Other sources of financing

Unlike its neighbours, the market for venture capital, PE firms, and other investment funds or sources of finance is quasi non-existent. Financial-service providers in Malawi that support the capital needs of start-ups and growing enterprises are far and few in between. Access to impact capital is also severely limited. Impact capital/investment organizations are mainly based in South Africa and while they include Malawi within their geographic catchment, few have operations in-country or staff on the ground. Unfortunately, one of the biggest issues is that the definition of investable MSMEs for these firms is not in line with the definition of MSMEs in Malawi. Malawian enterprises are still mostly micro and small, the large percentage being in the agricultural space. The smallest firms require investments by the thousands of dollars, and bigger firms by the tens of thousands only. A very small percentage of firms is looking for investments beyond that. Therefore, in international investment standards these firms are too small and require major technical assistance to be viable and produce acceptable returns.

This mission was able to identify two SME alternative financial-service providers in Malawi: Business Partners (from South Africa) and Kweza Partners (a purely Ag-SME venture capital firm formed in Malawi). Neither of these firms are, as indicated above, looking at the lower tiers of MSME investments. Furthermore, as their capacity to deliver BDS services to MSMEs is limited, they tend to look at firms that are already performing well, that only marginally need support, and that are bigger than the average MSME in Malawi. Business Partners in particular, has had a number of issues with its own portfolio because of their inability to address the key company shortcomings that hinder their growth after investment. Kweza Partners on the other hand has looked to build partnerships with organisations that do in effect provide BDS to SMEs, or programmes that develop the capacities of SMEs. One such partnership has been with the Malawi Innovation Challenge fund (MICF), which is aimed at developing the capacity of a select few SMEs, provide a matching grant, and then these will

[24] By entrepreneurial ecosystem it is meant a we

possibly receive equity funding from a European Venture capital firm. Kweza, on their part will be looking at enterprises that go through the challenge and ascertain if they can also fund through equity the most promising, effectively solving the access to finance challenge that these SMEs have.

A note has to be made on the cultural specificities of equity as a viable alternative financing mechanism. The pecking order theory[25] postulates that firms first look for internal finances, then debty, and eventually look for external financing in the form of equity. As the majority of firms are in fact Micro and small enterprises, owned by either households or individual entrepreneurs, it is not a tall order to postulate that equity investments may be viable for the medium category and not for the MSEs, because of cultural barriers to accepting to relinquish parts of the business, but also because of the limited size of the businesses.

Grant Mechanisms

Grant mechanisms are the only other type of investment avenue that is available to MSMEs. Grants have been provided to MSMEs through various programmes through the years. As discussed in the introduction section, DFID and GIZ provide such opportunities through their cooperation programmes (Business innovation facility, Ag-Devco, MICF), and the mission is aware of other development partners providing financing in limited manner (although a mapping of these has not been done because beyond the scope of this mission). Grant mechanisms, while useful in environments where small businesses are unable to access finance, are not sustainable nor a solution to tackling the issue of financial inclusiveness.

A particular programme to note , and some of its major shortcomings, is the support the Malawian Government received in 2015 by the African Development Bank. In an effort to prop up small and medium enterprises (SMEs), the Ministry of Industry and Trade unveiled a $3 million-dollar matching fund called “business linkages matching fund” to help small businesses acquire equipment to boost their businesses. The programme however has not been entirely successful according to various discussions with recipients themselves that this mission conducted. According to various MSMEs interviewed, firstly the entry point for receiving the grant was the capacity to match 50% of the requested capital which a lot of MSMEs in Malawi are not in fact able to do, and therefore effectively excluded those in the margins or those that could have benefited from smaller grants. Additionally, according to consultations, many that did receive the grant were not supported through capacity development and found that the purchase of equipment did not translate in growth, because of lack of skills to run the business properly, often resulting in failure.

Capital market

The Malawi Stock Exchange has a dedicated SME platform, when the stock exchange introduced and alternative counter for SMEs. However, to the knowledge of this mission (to be validated as information was informal), no single SME has transacted on the platform so far, and there was no conclusive information as to whether the platform is still functional.

It does not come as a surprise since even the primary tier of the stock exchange has not seen listings in years, and its infrastructure is particularly lacking. There are only 13 listed enterprises, half of which financial institutions and only 4 bonds outstanding (3 from Government, 1 from the NFB bank). The stock market only largely trades in equities with no corporate bond issuances. While government has issued bonds and subsequently listed on the stock exchange, there is little or no secondary trading.

[25] Myers, S., “The Capital Structure Puzzle”, Journal of Finance, (34) 3, 1984, pp. 575-592.

Institutional investors do not engage in secondary markets and are very small in numbers. There is a lack in effect of issuers, investors and intermediaries. The capital market is very slow to develop.

Ideally, the SME platform, as second tier of the stock exchange should provide alternative solutions to the long-term financing issues that SMEs have. This mission was not able to speak to any representatives of the Stock Exchange. Speculatively, there may be a host of complex legal, regulatory and transactional cost requirements that SMEs may have to fulfil that it makes it difficult, if not impossible, for most SMEs to engage in the stock exchange, thereby leaving the issuing of debt or equity to the much larger firms. Flexible listing requirements are paramount to be beneficial to SMEs. Furthermore, there have not been targeted campaigns to publicise the SME platform and its benefits.

3.2.2.3 Agricultural Businesses

Various factors have made the financing of agriculture value chain investments challenging for both credit applicants and providers. Agribusinesses face the same issues as described above, and in addition are faced with issues unique to the agriculture space, such as: uncertainties within very volatile markets, weather fluctuations that impact harvest, lack of rural infrastructure, information asymmetries.

The agriculture sector in Malawi is still hampered by low productivity, low diversification (maize is the dominant crop) and low sustainability of production. With a large majority of MSMEs in Malawi being located in rural area, and tied to the agriculture sector, it is paramount they receive adequate attention to ensure growth. Rural infrastructure is lacking, as are access to support services like extension and provision of quality seeds/fertilisers

The majority of entrepreneurs/MSMEs in rural areas, according to the USAID study conducted in 2014[26], have no access to finance: ownership of land is difficult to demonstrate and therefore cannot be collateralised; there is no credit history; and access to long-term finance is not available. According to the same study, a vast majority borrows from friends to avoid the costs imposed by banks, indicating that the willingness and behaviour of borrowing is present. Furthermore, a vast majority in rural areas are small-scale subsistence farmers who have very limited access to finance in order to adequately invest in their farms to potentially become Micro-entrepreneurs in farm related agri-businesses. Adoption of good agricultural practices requires public and private investments and lack thereof keeps land and labour productivity low.

Sufficiently organised groups or cooperatives to pool resources and address some of the challenges is lacking. Therefore, farmers are unable to collectively bargain for services or access to inputs. Additionally, there is a pervasive lack of market skills among smallholders – seeking market information and aggregating demand information is not usual, leading to major information asymmetries, and risk of not responding to market changes and volatilities in time. In terms of BDS service provision there is really low relevance of BDS services to AgMSMEs, and the coordination between providers is lacking, resulting in the supply of non agricultural related services, which results in low uptake by AgMSMEs.

Lessons learned from a previous EU funded programme in Malawi, STABEX, show that significant technical assistance is needed to allow Agro-processing facilities operated by smallholder farmers to become sustainable. Most programmes, therefore, turned away from facilities run by smallholders and instead linked them to processing facilities run by bigger private sector entities (e.g. the tea and coffee sectors). The evaluation furthermore revealed that programmes driven by the private sector, when it is incentivised, generally have more impact and are more sustainable. This is in line with this mission's

[26] This report remains one of the most comprehensive assessments of Agricultural MSMEs and their behaviours and bottlenecks they face. There may be better assessments of the Agricultural landscape as a whole, however, because the guarantee tools are directed to Agribusinesses, the mission limited itself to assessing AgMSMEs.

assessment of some of the impact of the MICF UNDP[27] programme, which is innovating the involvement of private sector companies in select value chains, by asking companies it supports to introduce innovative models of supply chain management and smallholder engagement.

3.2.2.4 Relevant EFSD Guarantee tools in MSME and Agri-Businesses investment window

Relevant Guarantee tools

EDFI AfDB Joint SME Guarantees for Inclusive Growth and Job Creation:

AfDB SME guarantee programme: This guarantee tool is extremely important for Malawi. The AfDB's Africa SME programme was started in 2014 to provide debt financing and comprehensive TA to Tier III and IV financial institutions across the continent providing financial services to SMEs. The AfDB understands the bottlenecks to MSME financing very well, and this guarantee tool is built to address all the needs and peculiarities of both the financial institutions and the MSME borrowers. The tool foresees a three-pronged approach: 1) Supplying liquidity in local currency to local FIs at favourable terms through various liquidity products or 2) Providing a range of guarantee products to local FIs; both come with 3) TA/capacity building support to FIs and their SME clientele under the SME Programme. As discussed in the previous section Malawian banks prefer liquidity injections that could be either guaranteed or supplied with favourable terms, so that the banks are able to on-lend and do not use own capital for lending to risky sectors, effectively lowering their risk exposure. The liquidity products the tool foresees vary from direct local currency deposits into FIs for back-to-back on-lending, to direct lending to local Tier 1 institutions that would on-lend to smaller FIs for on-lending, to subordinated debt or subscribing to local currency bonds. The AfDB is therefore at a particularly advantageous position to request the banks to adjust their lending rates to MSMEs, which is a driving factor behind the low rate of borrowing by MSMEs in Malawi, beyond their inability to provide collateral. Additionally, the TA component is really comprehensive and covers both the financial institutions (adapted SME products, better risk assessment to build stronger and larger SME portfolios, better operational management and reporting), and the SMEs (strong support in skills development). This guarantee tool can be really beneficial to Malawi. The EU has to push the AfDB to enter into discussions with local Malawian finance institutions and find the most beneficial products under these schemes to spur the Malawian banks to invest in the target segments. While doing so, it is extremely important that the TA component is packaged ad hoc for the Malawian context, such that the banks can be confident of their engagement in the target segment and can create targeted innovative processes and products for MSMEs, and therefore will agree to on-lend at acceptable terms to MSMEs, if they feel the necessary support they lack at the moment is provided. It would be a great opportunity missed if the AfDB does not engage Malawian banks, as their approach is holistic and especially necessary in the context. In fact, none of the arrangements that banks have entered into with DFIs at the moment is structured in such a comprehensive way, and this would pave the way for other DFIs, and Donors, to align their approach in the same comprehensive manner.
Agri-Businesses: This tool is holistic and applies also to rural areas and Agri-Businesses. It is in fact up to the AfDB to decide if the liquidity products or guarantee products it supplies to the institutions should be specific to the agricultural sector. The TA component that the AfDB will supply to the local financial institutions can moreover draw on best practices and lessons learnt from the AfDB's own experiences across the continent and help the institutions in designing the on-lending products and TA to agri-businesses to be impactful.

EDFI SME guarantee programme is a guarantee agreement between the EU and a consortium, the 15 European DFIs in the EDFI Association. The proposed programme by the joint institutions targets incremental direct and intermediated financing for SMEs in countries that do not currently have strong coverage in the geographic distribution of the current EDFI combined portfolio or in high-additionality

[27] Refer to http://www.micf.mw

institutions and instruments in countries that already have good coverage. Malawi, in this case, would be targeted through intermediated financing for SMEs as coverage within EDFIs' portfolios is poor. The EDFI SME finance guarantee is expected to cover senior loans, and subordinated loans (Tier 2 equity); it targets LFIs, non-banking LFIs and funds that support SMEs. Transactions targeted by the guarantee programme shall be additional to the type of projects European DFIs are already supporting as well as seek complementarity with other EU-funded programmes. Common processes with peer review by other DFIs will ensure additionality and avoid market distortion (i.e. project proposal need to demonstrate clear additionality to receive guarantee support from the EFSD guarantee pool allocated to this tool). There will be no allocation of amounts per DFI, as deals will be approved on a first-come, first-served basis. This tool is relevant for Malawi, as it is structured such that various EDFIs can venture into geographies they do not operate in, and be complementary to programmes on the ground, maybe investing in Malawi under different targets, therefore maximising impact. However, it is unclear from the PIP how the various DFIs decide on the geographic scope or on target countries. It is also not clear if all DFIs have to keep to a limited number of instruments (in this case risk sharing facilities) to be able to access the EFSD guarantee. It is indicated to have a discussion with the EDFI consortium representative to understand the mechanisms by which DFIs may be guided by the EU towards high-risk countries like Malawi. Otherwise, the same issues that prompted DFIs not to enter the Malawian space to begin with will still stand true and the EFSD guarantee will not benefit the local financial sector. A note must be made of the absence of a TA component to help MSMEs capacity development needs, and to help the banks in appraisal techniques of the sector. Additionally, as expounded in the section above, Malawian banks are highly averse to risk sharing facilities, which may result in there being no uptake of the instruments available through this tool.

The **FISEA EFSD SME investment Guarantee tool** works by allowing the AFD to de-risk its investments in junior tranches of investment funds active in Africa through its FISEA programme. The FISEA programme was a pioneer vehicle launched in 2009 aiming at supporting equity investment in African SMEs through minority indirect investments in PE funds active in the region. AFD will therefore invest, indirectly through PE Funds and opportunistically directly, equity or quasi-equity stakes in SMEs. The EFSD guarantee is to cover the new and improved FISEA 'plus' initiative which aims at investing into more high impact SMEs and sectors. The new vehicle is looking to invest in the following: selected high Impact SME funds (approximately 10-15% of EFSD guaranteed junior tranches) and social Business funds (approx. 20-30%). It will also consider investment funds that are looking into two new high-risk/high-impact strategy segments: innovative, digital and early stage investments, and Riskier geographic zones (fragile and-or post-conflict countries specifically). This tool also foresees a pre-investment TA envelope that will be dedicated to support promising SMEs in going the last mile before being ready for investment, and a post-investment TA service that will be offered to companies in which the SME Funds have invested, based on needs identified either during the due diligence process, or during the investment phase. This tool is extremely important for Malawi. SMEs find it almost impossible to access finance through commercial lending. As discussed above, there are only a couple of alternative-finance players that are now considering capital injections into Malawian firms through equity or other arrangements. However, they neither have the staffing nor the willingness to go the extra mile to enter the space productively. The AFD, through FISEA, notoriously invested in well-established investment funds that understand the region. Without a conversation with these funds it is difficult to ascertain whether they came and assessed the market during FISEA, and if they in fact would do so with FISEA 'plus'. It may be unlikely that these funds would invest in the middle and lower categories of SMEs because of their sizes and the ticket size needed, however, as some of these funds may particularly look to invest in high risk low return SMEs (for impact), the EU, through the AFD, should prompt some of the relevant funds to scope Malawi and ensure that significant TA services are given to those that are found to be promising.

Agribusinesses: Some of the funds in which FISEA invested in the past are active specifically in the agricultural sector. Agribusinesses in which PE firms can invest are not many but do exist. Investment funds in the FISEA 'plus' portfolio that are agri-business oriented should therefore be coaxed to do a business opportunities and market assessment scoping exercise in Malawi. Should viable firms be

identified, the AFD should then ensure that TA is supplied to address the bottlenecks to investment in these firms. Some firms, like those that UNDP is working with through the MICF challenge, are big enough to receive funding for their growth plans. Because of this programme in fact in the agriculture sector close to 6 million Euros were committed by the private sector, to match the circa 4 Million that the MICF input in the programme through donor contributions. These companies have the opportunity of growing and involving a large number of smallholders because of contract farming and other innovative models of supply chain management that the companies are creating and introducing, which will have a major impact in rural areas in Malawi. Their biggest hurdle to growth is access to affordable capital, which alternative financing through investment funds could provide them.
There may also be synergy with DfID's AgDevco Programme, as discussions with DfiD Malawi indicated. A more in depth and detailed conversation of how this particular tool can complement their work in investing in Agro-enterprises and catalyse growth in various agri-value chains in Malawi is needed. These firms could create significant job opportunities and growth for the country.

AGREENFI: This tool is extremely relevant to the Malawian context. At the beginning of 2018 the AFD Group launched AGREENFI consisting of an integrated approach to agricultural and rural finance whereby AFD Group provides a combination of financial and technical support to both LFIs and end-beneficiaries to contribute to remove the technical and financial barriers that hinder the local financial institutions (LFI) to finance agriculture and economic activities in rural areas. The instrument is designed to address the major bottlenecks that MSMEs in rural areas deal with, but also to increase access to finance to smallholder farmers, producers' associations, cooperatives, and MSMEs active within agricultural value chains or in any socio-economic sector in rural areas.
The tool is designed with a 4-pronged approach that target local financial institutions (banks and micro-finance institutions)

- Credit facilities to LFIs with appropriate financial incentives and eligibility criteria tailored to foster adapted and affordable credits in agriculture and rural area.
- Dedicated technical assistance (TA) programmes will most of the time be associated to the credit facility
- Risk-sharing mechanisms (with LFIs if required)
- Investment grants can be provided when there is a clear need for incentives to invest or when sub-projects have a long and unsustainable payback period

The tool is comprehensive in nature and is designed to support and catalyse the growth of actors within agricultural value chains at every level, from micro- to middle, as well as involving sectors that are not necessarily directly related to agriculture but are found within rural areas. In this manner it brings a holistic approach to rural economic growth and supports rural ecosystems by allowing the creation of enterprises that can feed into, and thrive from, the agricultural sector.
The provision of credit lines to microfinance institutions and other possible relevant specialised financial institutions, in a country where they face high cost of capital themselves, would benefit the agriculture sector and Agri-entrepreneurs who may be able to access finance at lower rates. Because microfinance institutions have a particular understanding of the segment, to the difference of local banks, potentially supplying them with credit lines would enhance the reach to smallholders and micro-entrepreneurs. The TA component is also comprehensive in nature, addressing both end-beneficiaries as well as the financial institutions, ensuring that perceived and real risks are managed. Close coordination and phasing between TA and credit lines' disbursements is envisaged, something most tools don't have within their structures.

Complementarity with EIB's Kulima Blending Facility for Malawi: The EIB's Kulima Access to finance programme, which is being implemented presently in Malawi, is to provide access to finance for actors in the agriculture value chain in the country. The aim is to provide targeted financial and technical support to a range of anchor and off-take entities, farmer groups/cooperatives and individual agri-food entrepreneurs in Malawi to overcome obstacles within value chains. It aims to enable

smallholder vertical upgrades into value added products and focuses on SMEs. The tool is designed with similar instruments to AGREENFI:

- EIB Loan for Value Chains: The EIB would provide medium to long-term funding to Financial Intermediaries, which would then on-lend such funds to eligible borrowers along selected value chains;
- Risk Sharing Facility: provide Financial Intermediaries, when required in a package together with the EIB loans, with capped portfolio guarantees to enable them to take more risk and reach out to SMEs that integrate smallholders into value chains.
- Expert Support Facility: an advisory component aimed at providing consultancy and other advisory services to beneficiaries and Financial Intermediaries inter alia to develop bankable investments and suitable financial products, respectively.

However, the EIB Blending Facility targets value chain upgrading, and SMEs involved in agri-value chains that can include a large number of smallholders in their operations (as suppliers or receivers of products/services) and are functioning as an aggregator/anchor firm. This is more in line with the type of agri-businesses that the MCIF is supporting at the moment. AGREENFI, to the difference, is designed to directly benefit smallholders and highly underserved key populations in rural areas, and therefore it complements the EIB tool. EIB might foresee a credit facility to MicroFinance institutions, but not in the short term. Furthermore, the comprehensive TA that AFD foresees through AGREENFI is additional and complementary to that of EIB and could be called upon in tandem.

Partly relevant guarantee tools

"Archipelagos - One Platform for Africa" ("ONE4A") is a tool designed to build on the lead financial institutions' experience in developing capital markets in Africa and the lessons learnt through their SME financing programmes. The main objective is to accelerate the accessibility of domestic capital markets financing for high growth SMEs in SSA. The ONE4A programme proposes the establishment of a systemic and holistic approach, combining technical assistance and funding to improve access to alternative financing. The AfDB and CDP have already chosen the capital markets they will work in, which does not include Malawi. The choice of these markets is perfectly logical: these are considered to be African capital markets 'success stories' and are liquid and deep enough to actively promote SME capital markets participation (Nigeria, South Africa, Kenya, Morocco, Egypt, Ivory Coast, Cameroun). The EFSD guarantees are used to enhance capital markets (bonds) issuances, securitizations and private capital market debt placements. A TA component is foreseen to help regulators, central structures and policy makers, specifically capital markets regulators and stock exchanges, in identifying and addressing infrastructure, regulatory and policy impediments limiting SMEs' access to finance and access to capital markets. While it could be beneficial to Malawi, the tool better serves these other capital markets, because the Malawian stock exchange is generally weak, shallow and illiquid. The stock market only largely trades in equities with no corporate bond issuances. While government has issued bonds and subsequently listed on the stock exchange, there is little or no secondary trading. Institutional investors do not engage in secondary markets and are very small in numbers. However, the most important component of the tool/programme proposed by the AfDB is the "hub" structure that it builds around the seven chosen markets. The latter in fact will be called "hubs" and are expected to mentor and share capital markets development knowledge and experience with the other neighbouring nascent capital markets, transferring such experiences to the other countries, and thus ensuring the development of the less functioning capital markets on a regional division programme basis. A TA component will support this programme through AfDB's and CDPs experience of working with the Association of African Stock Exchanges. The EU should, therefore, discuss with AfDB and CDP the ways in which they will include Malawi as part of their TA component, and within the programme for "mentorship" by the hubs.

The Small Loans and Guarantee Program (SLGP) by the IFC is relevant for Malawi, but difficult to implement. The tool aims to support financial institutions in emerging markets to originate new SME lending, in particular to unbanked segments of the SME population, including women- owned SMEs,

and invest in high impact sectors such as health, education and agriculture. This is done through 50:50 risk sharing facilities for SME loan portfolios originated by local Financial institutions in various African countries, that will then be aggregated and pooled for a first loss mechanism. Guarantees will be provided for riskier loan portfolios that will be offset by loan portfolios of banks in less riskier environments/countries. The pooled mechanism enables the IFC to make efficient use of resources and have maximum impact as opposed to managing each risk sharing facility on its own. The IFC also foresees a TA component to banks, giving them operational and technical support to manage the reporting requirements and to develop and enhance products, services and underwriting standards for the riskier SME sector. While the latter is a very much needed and excellent solution to bank's capabilities around SME appraisal, however, as per conversations with all of the Malawian banks that this mission was able to conduct, these have expressly said that a 50:50 risk sharing facility is not something they would accept, even with considerable TA. Banks may be willing to discuss a risk sharing facility with a lower ratio of exposure if the IFC would take higher risks. Regardless, it is highly unlikely that they would lower lending interest rates to SMEs as a result of the risk sharing facility, which is one of the main factors for exclusion of SMEs from accessing financing from banks. The TA component does include technical support to enhance and create products for the target segment, and this should be underlined if engagement is foreseen. Furthermore, there is a need for a concurrent business development services support to SMEs themselves, without which, as discussed in this document, SMEs will not productively make use of loans received.

Non - Relevant Guarantee tools

Guarantee Facility 'NASIRA' – for the Underserved Population is designed to support financing operations that address the pressure and root causes of irregular migration. Its targets are young entrepreneurs, female entrepreneurs, Irregular Migrant Entrepreneurs. It is structured to be a second loss position that covers either new lending portfolios or existing portfolios. On surface this tool may be relevant. However, considering the difficulties Malawian banks have encountered with these kinds of agreements in the past, it is highly unlikely that they would accept the potential terms. Furthermore, FMO, the lead financial institution, had provided to the National bank in the past a very similar arrangement which failed because of issues in procedures. The TA component is foreseen to build capacity of Financial institutions in reporting and risk management procedures required for portfolio guarantees. While useful, as discussed above, banks also require considerable TA in addressing their capacity of appraisal of SMEs. This tool at the moment is not practical for Malawi.

InclusiFI - Financial inclusion driven by diaspora is a tool that is designed with targets in mind to be the individual migrant workers and diaspora organizations in Europe from a select number of target countries, and entrepreneurs running MSMEs in countries of origin, including returnees, with a particular attention to youth and women. The guarantee tool is very thorough and foresees an assessment of regulatory environment, bottlenecks to investments and financial sector peculiarities, as well as specific tools to benefit micro and small enterprises grow and create jobs thus curbing the migration issue. However, this tool is focused on enabling better connection of diasporas and diaspora associations in the EU with investment opportunities in origin countries, while supporting the enabling environment and catalysing more private sector investment, as well as helping local financial institutions build innovative products that cater to diaspora and/or make better use of remittance flows. Guarantees will be provided to selected financial institutions and investors to help expand lending to MSMEs that would otherwise be considered too risky. While this mission did not gather data on migration flows from Malawi, nor whether there is a vibrant Malawian diaspora in the EU, it is noted that this tool is better used for countries where migration flows are larger, and their strong diaspora communities may be found in EU countries. Notoriously, for Malawi, the majority of flows are to South Africa and are of unskilled and semi-skilled workers.

African Local Currency Bond Guarantee Program (ALCBGP) is not relevant to Malawi at this moment. There are a number of structural problems of the capital markets, as well as the non-sovereign

institutions that are supposed to issue bonds. The primary activity of the ALCB fund is to make investments in local currency bonds issued by non-sovereign entities in African countries. The objective of such investments is to promote capital market development in Africa. In this respect the Fund acts as an anchor investor. As explained for the ONE4A, there is very little corporate bond issuance in the Malawi stock exchange. Institutional investors are not willing to disinvest what they've already subscribed in the primary market. There is a lack in effect of issuers, investors and intermediaries. The capital market is slow to develop, and even a TA component to assist bond issuers will not be beneficial in an environment where the players are not prone to issue them. Furthermore, the inherent reasoning behind this tool is that local financial institutions especially, which are thought to be primary bond issuers, will provide financial services to MSMEs in target sectors once they've been able to raise capital. However, Malawian banks are highly liquid, and shortage of capital is not an issue. The capital market itself needs to be developed further, and its infrastructure updated before bond issuance by non-sovereign entities is tackled.

Relevance of guarantee tools to National Bank's *SME Development Bank of Malawi* and the Malawi Agricultural and Industrial Investment Corporation

The National Bank of Malawi established in December a new arm: the **NB SME Development Bank**, which will give medium to long term loans to small and medium scale businesses at concessional terms from its commercial Bank arm. While these plans had been mentioned during the consultation with National Bank's CEO, more details about the new institution could not be gathered and are still not available. It is unclear if concessionality is achieved either through interest rates below those available on the market or by grace periods, or a combination of these. The institution has been created to specifically cater to the SME segment, as National bank recognises the catalytic effect these can have both for the growth of the country, and the bank's balance sheet.
The government also launched in November the **Malawi Agricultural and Industrial Investment Corporation (Maiic)**. Maicc is a development finance institution (DFI) which combines the concept of development bank and proposed agriculture bank. The institution is a collaboration with CDH investment bank, who is the head of the steering committee, and the government. The new institution has been established with seed capital of $25 million (circa 20 million Euro), and is a government initiated but private sector led development finance entity that will be a vehicle for spearheading private sector development in Malawi. From conversations with CDH Investment bank, the institution is thought to fill the missing gap that exists in financing the agriculture sector, as well as increase reach to SMEs through various financial tools that CDH had created to fund MFIs, which may be used for the DFI as well. In consultations with CDH the firm indicated that it was looking for project development capabilities and resources through TA support by donors.

The details of the terms these institutions would give to MSMEs and AgMSMEs are unclear and yet to be released publicly (if at all they will be). However, this is an excellent opportunity for the EU and other stakeholders to capitalise on the will of the financial sector to target specifically the MSME segment with dedicated establishments and practice. Three tools discussed in the sub-section above (the AfDB and EDFI joint tool, as well as AGREENFI) are very relevant to these institutions. It is a perfect opportunity to build the capacity of these targeted non-commercial lenders and come to arrangements that are in line with the needs of MSMEs and Agri-businesses. As these institutions are nascent, considerable capacity development is required, but it is also an excellent opportunity to mould the products and services to reflect the idiosyncrasies of the segment. It is unclear what restrictions there may be placed by the Reserve bank of Malawi in their dealings with hard currency borrowing or setting up credit risk facilities. The EU delegation, together with EIB, a representative from EDFI and possibly AfDB should engage in detailed and exhaustive discussions with these two institutions as soon as possible. These two institutions may be able to take on the full capacity of the MSME window guarantee tools. Concentrating the tools in these two institutions, though it may be partly detrimental to the larger financial sector for the very short term, may instead result in efficient capacity development and creation of a successful MSME financing portfolio and programme in Malawi, which could eventually function

as a demonstration effect and in the long-run spur the creation of dedicated institutions capable of addressing the needs of the segment.

3.2.3 Sustainable cities

INVESTMENT WINDOW 3 – SUSTAINABLE CITIES

NONE OF THE PIPS ARE RELEVANT PRESENTLY

It was not possible to ascertain what projects and what space would allow for the use of EFSD guarantee schemes under this investment window. The mission consulted with two construction companies and the Ministry of Lands, Housing and Urban Development. The private sector consulted was very sceptical of engaging with government for the development of urban infrastructure, and expressly said that they would not engage with local government under any incentive structure, partnership or contract, as they believe local government to be too politically involved and heavily indebted (and unable to pay for works conducted). Therefore, uncertainty crowds any level of collaboration. Unfortunately, at the time of writing this report meetings scheduled with two other major construction companies and the mayor of Lilongwe had been repeatedly cancelled and the consultant was not able to collect additional data to be able to analyse the guarantee tools in a useful manner. Due to time restrictions, other stakeholders were not sought out.

The three guarantee tools under this investment window targeting the African continent are: the **European Guarantee to Increase Local Governments' Access to Financing**, the **Resilient City Development (RECIDE)** and the **Sustainable Cities Investment Fund Platform.**

3.2.4 Digitalisation

INVESTMENT WINDOW 4 – DIGITALISATION

Guarantee tool	Lead Financial Institution	PRIORITY AND RELEVANCE
The Digital European Health Guarantee Platform,	EIB (in collaboration with Bill and Melinda Gates Foundation)	**VERY LOW** It is an off-take guarantee (for payment of services) to allow private lab service providers to enter into PPP arrangements with the government contracting for a basic set of tests (HIV, TB, Malaria), so that the former provide timely and cost-effective diagnostic services. While the opportunity is very high, private labs already present in the country are not interested in expanding their facilities as they may face issues around availability of technicians, and already have quite a lot of volumes of tests they conduct, whose costs are covered by international INGOs (not govt. of Malawi). The set-up of a diagnostic lab by a private investor is capital intensive and the margins not worth the investment. Since the guarantee is only for payment of services (guaranteeing off-take arrangements) and does not include any other type of commercial loan or investment vehicle to invest in a new lab, it's unlikely that new entrants would invest in labs.

At the time of this mission only one guarantee tool under this investment window had been allocated: The **Digital European Health Guarantee Platform**, a close collaboration between the Bill and Melinda Gates foundation and the EIB that was developed to strengthen diagnostic services for low-income populations in Sub-Saharan Africa. Therefore, this mission limited itself in meeting stakeholders in the health sector and analysing the state of diagnostics in HIV, TB and Malaria in Malawi, and assessing the relevance of the tool for the Malawian context.

In the second round, three other guarantees were allocated, of which only two are targeted to Sub-Saharan Africa: The **FMO Ventures programme** and the **Social impact fund for Africa**. Both of these tools look to enable investment in digital innovation projects and MSMEs offering tech-enabled solutions to development hurdles in a multitude of sectors, from fintech and financial inclusiveness to traditional sectors such as agriculture and health. While the mission has not looked at the maturity of the tech space in Malawi, informal conversations indicated that there are young enterprises that are developing such solutions, which could potentially be disruptive. A closer investigation is indicated. While the digital innovation and tech ecosystem may be far more advanced in other countries on the continent, it is worth searching for those few innovations that may be present in Malawi and could seriously have a wide socio-economic impact. A point of departure could be the new UNDP supported growth accelerator entrepreneurship challenge and a review of the applications it received.

3.2.4.1 The state of diagnostics in HIV, TB and Malaria

HIV

Malawi's HIV prevalence is one of the highest in the world, with 9.2% of the adult population (aged 15-49) living with HIV. [28] An estimated one million Malawians were living with HIV in 2016 and 24,000 Malawians died from AIDS-related illnesses in the same year.[29] The Malawian HIV epidemic plays a critical role in the country's low life expectancy of just 57 years for men and 60 for women.
The Malawian HIV epidemic varies greatly across the country. HIV prevalence and density is high in the urban districts of Lilongwe, Blantyre and Zomba and in the southern region of the country.

HIV testing services are provided in two ways: through client-initiated HIV Testing (also known as 'voluntary testing'), and provider-initiated HIV testing. Provider-initiated testing, which is when a health worker offers an HIV test to a patient, occurs in a wide variety of settings including healthcare facilities; mobile testing units; people's homes and at national health event.

HIV testing services are delivered through 3 tiers of testing institutions and through self-testing kits

1. Central hospitals with bigger labs – These have big and modern molecular diagnostic equipment. The National reference lab is being improved presently, although in the past it didn't have equipment that the central hospitals had.
   There are district hospitals in 28 districts – These have much less sophisticated equipment than the central hospitals, but still conduct testing with molecular testing machines. Multi-disease testing for HIV and TB is done using the GeneXpert platform/machines. These equipment are mostly used for Early infant diagnosis and viral load testing of confirmed or presumptive cases.

2. There are 10 district level facilities that are engaged in near point of care diagnostics and have molecular labs that do viral load and Early Infant diagnostic testing- Particular technical skills in the form of lab technicians for PCR technology are required, and therefore these facilities are small in number. Some of these are privately owned by not-for-profits: Christian health association has two laboratories (Dream Laboratories) and Partners in Hope have two laboratories as well. The Government uses their facilities on a regular basis and the majority of expenses and testing are covered by the Global Fund. These "private" actors have been leading in introducing new equipment for testing. They were the first to do viral load testing in the country, as well as drug resistance testing.

[28] UNAIDS (2017) Data Book
[29] UNAIDS (2017) Data Book

3. There are a variety of settings for rapid testing: health facilities (there are 732 health facilities across the country, private and public) at various community and district level, mobile testing units, at people's homes, and at national health events. Some have Point of care diagnostic equipment. Most do basic testing, including Malaria and TB screening, with presumptive cases going to digital xray and GeneXpert TB testing.

Primarily, the coordinated donor HIV engagement in the country utilises available point of care diagnostic technology, and near point of care diagnostic facilities for early infant diagnosis and Viral load testing. The Global Fund is the major funder for this together with PEPFAR and UNITAID.

UNITAID was expanding Point of Care EID platforms in 2018 through CHAI (Clinton Health Access Initiative) and UNICEF with input from PEPFAR. CHAI and the Ministry of Health procured 25 POC platforms, at the cost of 25,000 $ each, but the additional need is around 84 units.

According to consultations with CHAI, circa 54,000 expected HIV exposed infants are supposed to be tested annually but only 34 to 36 thousand for both Point of Care and conventional diagnostic platforms are tested. In terms of viral load needs, the annual testing needs are around 1 million (estimated People living with HIV), while the tests conducted are close to 300,000 a year only.

There is very limited private sector engagement in Malawi so most engagement occurs with foundations and non-governmental organizations (NGOs) at the global level. Most private sector engagement is of the machinery distributor companies: those that represent for example Abbot or GenExpert include placement of equipment and maintenance, as well as other services, as part of the delivery and use of the machines. These companies use the model of pay per test, and sometimes are charging an added surcharge on cartridges.

TB

TB and HIV services are provided in a 'one-stop shop' by environmental health officers (CHW), who supervise health surveillance assistants (HSA). These are provided either in mobile van testing units or at health facilities. Of the 732 healthcare facilities, TB testing is provided in 342 facilities, mostly of public sector. Only presumptive cases go to digital X-ray and GeneXpert TB testing.

In 2016, TB incidence was 29,000 people, of whom 15,000 occurred among people living with HIV. This is a sharp decline from a decade before, when 78% of TB patients were living with HIV in 2006, which declined to 49% in 2016 (newer numbers were not found). This number is still declining.

Diagnostic labs and GeneXpert machines for TB testing are therefore used in concurrence with HIV viral load testing. TB/HIV coinfection may be declining, but as TB is often a concurrent issue with HIV positive individuals, all individuals living with HIV whose viral load is tested are also concurrently tested for TB. Only an additional limited number of TB presumptive cases is tested with these machines. HIV testing among TB presumptive cases is at 99% according to the Ministry of Health. Therefore, testing needs and numbers of TB are similar to those of HIV.

Malaria

Diagnostic largely funded by USAID as well as the drugs associated with treatment. USAID funded drugstores in each and every hospital in the country to receive drugs, and create space for their storage/exhibit, as space had been a huge issue. Cost of diagnostic kits is very minimal, and therefore private sector does not really enter the market. Kits are brought in mostly by the ministry or donor organisations.

Relevant Guarantee tool

The European Health Guarantee platform for Africa looks to mobilise investments from private providers in international-standard laboratory facilities that can provide timely and cost-effective diagnostic services for diseases such as Tuberculosis, HIV and Malaria. It is a partnership between the Bill and Melinda Gates foundation and the EIB. The intention would be that private lab services providers would enter into PPP arrangements with the government contracting for a basic set of tests, to be defined and agreed between the government and the companies concerned as part of the design of each PPP. The menu of potential tests includes tests for infectious diseases (e.g. HIV) and routine diagnostics. Additional payers may be sought to co-finance the PPP alongside the government (e.g. PEPFAR, GFATM, World Bank). The guarantee is an off-take guarantee (payment for services), covering the risk that the government may not pay.

There is a major opportunity in pay per test facilities for private entrants, which would make the testing model more efficient than it is at the moment. The need as described briefly above is high, since testing is not reaching the targets set by various stakeholders nationally. Additionally, as the antiretroviral drug regimen is being revised by the ministry of health, there will be need of immediate Viral load testing once the new regimen is adopted. Therefore, all HIV positive individuals will need to get re-tested before going on the new regimen: the facilities and hospitals that have molecular testing equipment won't be able to handle efficiently such volumes. This would call for new entrants or the expansion of capacity of those already present (like the two non-profits). However, from consultations with stakeholders, it seemed unlikely that private sector would enter the space for two reasons: the set-up of a diagnostic lab is capital intensive and private sector players are not willing to enter a space where the margins are limited and may even be low; and the availability of technicians and educated/skilled personnel to manage these facilities is limited and an additional investment in human resource development is required. The only two private players have enough work that they don't need to expand their capacities, and other private sector players would prefer to use liquidity for other investments. Since the guarantee is only for payment of services (guaranteeing off-take arrangements) and does not include any other type of commercial loan or investment vehicle to invest in a new lab, it's unlikely that new entrants would invest in labs. However, since the opportunity is major, if this guarantee is coupled with investment from one of the Social Impact Funds, a private actor may very well agree to mobilise resources for a lab. Discussions with the Ministry of Health and other stakeholders in identifying possible candidates is warranted.

4 ADVANCING THE EUROPEAN ECONOMIC DIPLOMACY AGENDA IN MALAWI

In addition to assessing viable modalities of operationalising the EIP via the EFSD's guarantee tools, this mission also analysed viable modalities of furthering the European Economic Diplomacy agenda in Malawi.

After initial discussions with the EU delegation in-country, a choice was made to focus on analysing the presence of European businesses in the country and on analysing the viability and impact of a potential series of measures designed to support them. The choice made to critically focus on the latter is an attempt to limit what otherwise would have been too wide a scope for the mission, as the tools used to further European Economic Diplomacy are a multitude and vary in nature, from trade policy to aid and development support. Therefore, in a purposely targeted manner, it was discussed and determined to analyse how EU businesses present in-country could potentially play a catalytic role for furthering investments by firms from Europe and could potentially help unlock regulatory and investment reforms if given the right support and the platform for dialogue with relevant authorities, notwithstanding other tools and avenues that the EU and the delegation have at their disposal for advancing EED agenda.

A short reflection is warranted as to why Malawian businesses that have commercial relationships with European countries (in terms of trade, representations of firms, dealership deals, etc) have not been considered in this mission as deserving support despite their potential to be catalytic for investments or increased commercial engagement by firms from Europe. Malawi is a very small country, with a small private sector. While the EUD could easily give good grounds and justifications for supporting exclusively EU businesses (as is expounded further in the next subsections), it would be very problematic to justify support of local firms without directly supporting their representing institutions such as the local national chamber of commerce. These institutions would, in this mission's opinion, see the action of supporting Malawian businesses as contesting their own mandates and jurisdictions.

The exercise above, therefore, was then complemented with an analysis of the avenues that the EUD in Malawi has for advancing the agenda through the EIP's Pillar 3 (and the SB4A platform). In doing so, the focus on EU businesses was juxtaposed to the framework of the SB4A which is designed to provide a structure for dialogue for all businesses, and through such a framework enable the reform of investment climate of the country.

The two approaches are not mutually exclusive, and both advance concurrently the EED agenda, while serving two different purposes. The former enables EU businesses, and the EUD through them, to have a stronger foothold in the conversation and dialogue with local government authorities, while separating their issues from the larger private sector and allowing them to be aimed with precision in their demands for intervention and reform (although often these will be the same as for local firms). If the requests are addressed it will benefit specifically EU businesses but will have a wider effect on the private sector at large. The latter, on the other hand, allows the EU to support the set-up of more targeted, sector based, all-stakeholder inclusive dialogues with the government in which it can make use of various policy instruments for negotiation, including its cooperation agreements, in order to press for policy reforms and support the private sector in Malawi at large. Consequently, it would promote its EED agenda and strengthen its position.

The following sections expound on the points made in the paragraphs above and are structured as follow: firstly we define briefly our understanding of EU economic diplomacy, then a consideration on the interlinks between EED and SB4A are expounded. Furthermore, a reflection on EU business organisations is made in relation to EED. A regional consideration of EED processes in Zambia and

Tanzania is subsequently undertaken. Following this, an analysis of the key stakeholders is made, from local private sector representing institutions to EU owned businesses that the mission interviewed.

Finally, a framework for engagement and operationalisation of the EED agenda is proposed. In this framework the two-pronged approach discussed in the paragraphs above is further expounded. A strong case is made for operationalising the SB4A through setting up targeted sectoral public private dialogue platforms that can bring together various players and may enable reforms in investment climate (at least at sectoral level), because there are major bottlenecks to investment that are generally sector-specific. These structures are thought to be complementary to the national public private dialogue platform already existing and will bring both EU and non-EU businesses together with government entities.

On the other hand, the set-up of an EU business organisation through a phased approach to support EU businesses is suggested as an additional approach for advancing EED, especially in regard to addressing investment climate constraints from a more national perspective. While the need of establishing this organisation is not necessarily immediate, the mission notes that EU businesses present in-country feel misrepresented and require/request dedicated support. The EU business organisation is thought to become the bridge between EU Delegation, EU businesses in-country, Malawian private sector (both those involved with EU firms and non), and other major stakeholders. With too little a presence of EU businesses in the country, this initiative is suggested to be driven by the EUD itself.

4.1 European Economic Diplomacy

The general definition of economic diplomacy is one that is disparate and can span from the facilitation of access to foreign markets for national businesses, to influencing international rules in order to serve national interest. The term more commonly implies the use, by a state, of a spectrum of economic tools to secure its national interests by involving itself in an array of issues (ex. natural resources, security, energy, trade, investment, migration etc.). Understood in a narrower sense, it is an instrument to promote enterprises, particularly Small and Medium Enterprises (SMEs) where the potential for job creation is greater than for multinationals, on foreign markets.

In the context of the European Union, while there is no one exact definition of European Economic Diplomacy as well as no single clearly defined framework under which the various instruments of the union should be used to further its global strategy, economic diplomacy is largely understood as a strategy by which the EU makes optimal use of all levers to promote EU economic interests and prosperity in a global context, making the EU better able to reach both its economic and political objectives. It is a more coherent approach that targets strong economic and political outcomes to foster growth and jobs in Europe, while at the same time advancing EU economic interests abroad that are coherent with European values and wider objectives and tools of foreign policy. The main elements of an economic diplomacy strategy therefore include: access to external markets for trade and investment; cooperation on economic governance and regulatory convergence; support for the internationalisation of EU businesses; and improving the coherence and effectiveness of the EU's external action in the economic sphere, underlining the link with the jobs, growth and investment agenda.

As such it is the convergence, coherence, articulation and more focused use of existing policies: (Industrial policy, Trade policy, Investment plan, Foreign policy, Innovation policy, Development policy) with **the core element being in a narrow sense the Internationalisation of European businesses**.

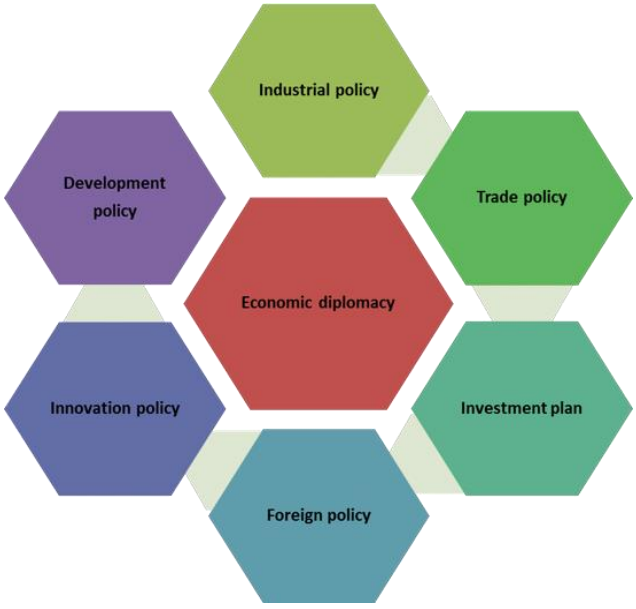

Figure 2 Economic Diplomacy and its convergence with other strategies

However, while the internationalisation of European businesses, and specifically SMEs, is recognised to be a driving element of EU economic diplomacy, IT IS NOT AS SUCH THE ONLY ELEMENT and instrument of ensuring European interests in third countries. It is interesting to note that, within the EU institutions, there are different views about what should be the primary objective of economic diplomacy. For some, it is seen as a vehicle for exporting EU values through regulatory convergence and political dialogue, and for reaching a common understanding with third countries. For others, it is more a tool for ensuring policy coherence and enabling the EU to operate as a global player. All recognise, though, that building an economic diplomacy strategy is a complex process.

4.1.1 Pillar 3 of the EIP and the SB4A (sustainable business for Africa platform) in the context of European Economic Diplomacy (EED)

Pillar 3 on promoting a conducive investment climate, is the enabler for attracting foreign (and catalysing local) impactful investment towards sustainable and inclusive growth. This requires increasing coherence and complementarity of EU actions with local actors and dynamics, and among EU entities, with a key role of EU Delegations (EUDs).

In regard to its third pillar, the EIP will provide a multi-level approach in partner countries through the following elements, in which EU Delegations play a key role:

- structured dialogue with businesses at country, sector and strategic levels, including through the Sustainable Business for Africa platform (SB4A) and promotion of European and national business fora;
- policy and political dialogue with partner governments to address key constraints to investments and promote good governance;
- support to regulatory, policy and governance reforms, building upon market, sectoral and value-chain intelligence at country level; and
- ensuring coherence with other European Union policies, aid modalities

In the multi-level approach described previously, structured dialogue with business happens at different levels: local level (EU Delegations); sector level (agriculture, energy, digitalisation...), and strategic level (headquarters level), so that African and EU business perspectives and investment climate constraints can be addressed. Country analysis regarding priority sectors and value chains by providing market intelligence and investment opportunities is another major part that can enable increased and better private sector engagement and informs policy dialogue. Policy and political dialogue with partner countries builds on existing EU development cooperation, political dialogue and emerging economic diplomacy (regarding governance, policy reforms, value chain upgrading, technical assistance and budget support).

For this purpose, the **Sustainable Business for Africa (SB4A)** platform has been set-up to be the overarching structure under which existing and new structured dialogues are managed. It is an essential building block of pillar 3 of the EIP. Structured dialogue will ensure the right level of private sector

perspective, ownership and engagement in EIP implementation. It should also help establish a bridge between investment support under pillar 1 of the EIP and necessary investment climate reform agenda under pillar 3. The SB4A's ultimate objective is to contribute to decent job creation –in particular for youth and women– in African partner countries. Engagement at the country level involves EU and African private sector and non-profit actors and is facilitated by EU delegations and EU business groups where they exist (although it is not necessary) and is centered as mentioned previously around country specific investment climate issues.

Integrating in a coordinated manner the SB4A to the overall European Economic Diplomacy agenda is challenging. Traditionally, the EU tends to engage in a policy dialogue along the priority sectors identified in its programming with its partner countries. Often, sectors not identified in its programming are de-prioritised and policy dialogue around wider issues may not be undertaken. However, as mentioned above, without identifying and prioritising the necessary investment climate reforms in a country, the internationalisations of EU firms is unlikely to happen. Similarly, the growth of local and EU businesses already existing in country will not happen if said key constraints affecting the investment climate are not addressed. Therefore, only a sustained dialogue with key players and stakeholders nationally, and not only those along the sectors in its programming, can identify the most important barriers to private investment and find ways to address them, and therefore advance the EED agenda. As such, the SB4A and EED agenda are interlinked. The platform that the SB4A provides can help in materialising EED agenda objectives, and at the same time further the EIP's intentions under Pillar 3.

4.1.1.1 EU business support organisations in the context of SB4A and EED

In the context laid out above, EU business support organisations on the ground have played a key role in representing EU businesses in various public-private sector dialogue platforms in the countries where they exist, as well as in catalysing an increased dialogue in general with private sector actors in-country.

Currently, in fact, support structures beyond member state missions and EU delegations, which are the primary structures for businesses looking to explore investments outside of EU boundaries, are found in the form of European business organisations that exist in 5 continents and 35 countries. Most of these European chambers and organisations have a clear objective to defend and promote common European economic interests towards local authorities, and to create EU visibility. They are grouped together in the European Business Organisation Worldwide Network (EBO-WWN). Of these, Ethiopia, Ghana, Tanzania, and Ivory Coast from Africa have already attained EBO-WWN accreditation and membership.[30] They are also sometimes linked to other EU Networks such as the Enterprise Europe Network (EEN). These European Chambers/organisations that are present in third countries generally epitomise the interests of EU companies which are already active in that market. They are quintessential for the European business community on the ground to speak with one voice in favour of the reduction of trade barriers. By doing so, many have been instrumental in identifying and formulating policy change recommendations on behalf of their memberships. As such they've also participated in structured dialogue fora with other counterparts and government. In this sense they operate under the SB4A framework.

However, many of these European chambers/organisations are generally not specialised in the internationalisation of SMEs as new entrants to the markets in which they operate, focusing mostly on the ones that are already active within the dedicated markets. To achieve such goals several EU Business Centres/Networks have been launched in Asia (case in point the Gateway projects), which is a lacking feature in the African context. As mentioned previously, the core element of the EED agenda is in a very narrow sense the Internationalisation of European businesses.

[30] A number of other European business fora/groups/chambers have emerged and been facilitated by EU Delegations in Africa (e.g. Uganda, Zambia, Senegal, Benin) but are not part of the EBO-WNN as of yet

Concurrently, in some countries, EU business organisations have laid the foundations for the creation of sector working groups or have represented EU businesses in specific fora, liaising with EU delegations to further engagement in addressing business environment bottlenecks. These kinds of engagements are directly in line with the aim of the SB4A framework. This becomes therefore an important element to consider in the EED process launched by the EU delegation in the Malawian context, as we will see in below sections.

4.1.2 The EED Agenda in Malawi

In the context of a more coherent and coordinate global strategy by the EU and following its external action, the EU Delegation in Malawi, after consultations held in December 2017, proposed a number of action points for EED operationalisation in Malawi:

i. Set up a structured dialogue (three to four times a year) with European commercial and trade attachés and honorary consuls accredited to Malawi on the business;
ii. **Hold a flexible platform for liaising with EU businesses and Malawian business associations** in order to identify key barriers to trade and investment to EU business operators (i.e. European Businesses present on ground);
iii. **Set up a structured dialogue with the Malawi Government** where the EU Delegation takes an advocacy role in terms of addressing policy and regulatory issues with relevant authorities (regulatory barriers, fiscal policy, corruption and maladministration, unfair treatment and uncompetitive practices, etc.);
iv. Establish, in line with experiences around the globe, a possible European business organisation/platform in Malawi based on consensus of the European actors involved in the EED in Malawi. This would be the main platform for network and dialogue with the European private sector and the Government.

The aim of the EED agenda in Malawi is to promote an efficient use of existing resources, both private and public, both of the EU and Member States, but not duplicate what exists, and not supersede Member states' responsibilities towards own firms. Therefore, the EED agenda, specifically where it looks to establish the platform for network and dialogue, looks to operate with the principles of subsidiarity and complementarity.

4.1.3 Regional EED Initiatives and lessons learned

4.1.3.1 The case of Zambia

The European Union Zambia Business Club (EUZBC) was formed in June 2016 and still operates within the EU Zambia Delegation, which was instrumental in kickstarting the club. There was interest among both private companies on the one hand, and particularly the EU delegation and member states on the other, to set up a business association to support EU businesses already established or looking to enter the Zambian market. The delegation took the lead in hosting a meeting to present the idea of forming business association, after which a volunteer-based steering committee was formed within the delegation. EU-linked business organizations were positive towards EUZBC, but the Zambian chamber of commerce saw it as competition to their fee-based organisation. All in all, the delegation has been devoting considerable resources to EUZBC: 20,000 € over 1,5 years and even more in human resources. At the moment, EUZBC has 110 members from 15 Member states.

The EUZBC is endorsed by member states, who are also its honorary members. In addition to European businesses, actual members include Zambian businesses that usually have a more or less loose connection to EU businesses, such as distribution partnerships. Criteria for membership are set by a members' committee. There is an outspoken interest among EUZBC members to include more Zambian businesses. Broadly speaking, EUZBC aims to focus on common bilateral interests, not bilateral conflicts. Though the EUZBC is endorsed by the delegation and members states, they do not dictate EUZBC actions. That being said, the 100+ companies in EUZBC carry some political weight, and the EUZBC often endorses the EU delegation in its positions in dialogue with government.

To be sustainable, EUZBC will require contributions from members which it is not receiving at the moment. Thus, an important focus is proving EUZBC's usefulness to its members before asking for contributions. This goes hand in hand with another current priority, which is attracting new members. More members and thus more resources would allow EUZBC to launch a number of services, amongst which more comprehensive study on the impact of Euro private investment in Zambia, which, in turn, would help further engage the Zambia private sector. This study is at the moment being conducted thanks to technical assistance from the delegation.

EUZBC activities are focused on networking between members, advocacy, and keeping members informed about legislation and market developments that may affect them. For example, EUZBC organizes networking events four times a year and disseminates information on Zambia's business environment, business opportunities / info (eg. national and regional trade fairs). Services are not particularly tailored to specific businesses, nor can EUZBC offer in-depth market analysis due to limited resources and because services are provided free of charge.

The EUZBC could be considerably more impactful if it had more resources at its disposal and if cooperation between EUZBC and Zambian counterparts was smoother. Some members would like EUZBC to be more actively involved in sectoral matters, but given the complexity and variability of sectoral matters, EUZBC is currently limited to following more general trends. The board of the group is able to provide potential investors and investment missions with presentation on the Zambian business environment, but this is not possible at the club level. The German national business promotion association can provide this kind of service for a fee, and EUZBC occasionally send enquiries to them, and assists entrants through contact networks. With regard to cooperation between EUZBC and Zambian chamber of commerce, cooperation between board members of the two has been more fruitful.

The EU delegation to Zambia will not be able to devote as many human resources to EUZBC indefinitely, and support depends largely on the priorities of the Head of Delegation. EUZBC needs a stable secretariat, and sufficient technical staff, (e.g. to build and maintain a functional website, or conduct on the spot analysis). EUZBC would be nimbler if decisions could be made internally, and thus with less political pressure, instead of at the delegation. While charging membership fees would allow EUZBC to provide more and better services, e.g. sector-specific services, members may be unwilling to pay without prior first or second-hand knowledge of the benefits of membership.

Currently, EUZBC is considering implementing capacity-building trainings for members, on e.g. financial literacy, event management and social media skills. Members may find practical business-oriented interventions as more attractive than mere advocacy, which takes long to have an effect. Such concrete services might also attract more members.

4.1.3.2 The case of Tanzania

The Tanzanian European Union Business Group (TZEUBG) was set up with the intention of supporting and representing European businesses already operating in Tanzania, and to serve as a platform for dialogue between public and private sector actors. Trade promotion is a direct national interest, and the

EU-wide group needed to be complementary and subsidiary to those interests. Also, purely commercial goals had to be balanced with the EU's delegation political and diplomatic objectives in Tanzania, as the initiative was spurred by the EU delegation. Initially, funding for TZEUBG came directly from Brussels, but presently costs are covered by fees paid by members of the group, i.e. EU businesses operating in Tanzania. There are currently over 100 companies from 15 EU member states in TZEUBG.

A comprehensive study of the EU business and investments in Tanzania was conducted, supported by the EU, which was catalytic to the engagement of the Government and Tanzanian private sector with the TZEUBG. The study, in fact, provided concrete figures to substantiate the policy dialogue with Tanzanian authorities and private sector. The study also highlighted the contribution of European companies to the national growth. Initial support by the EU was instrumental in cementing and allowing the group to become operational and grow.

The TZEUBG has been helpful in advancing EED agenda, by improving the flow of information between businesses and embassies. They've been able to harmonise key messages that the Diplomatic Missions should be passing to the Government; In terms of SB4A on the other hand, the TZEUBG has been part of various government task forces and has participated in sector specific workshops (ex. Ministry of Finance Budget Review Taskforce or workshop with the Ministry of Trade and Industry).

At first, TZEUBG was focused on advocacy and lobbying, which is targeted not at the central government level, but at the agency level, (e.g. the tax revenue authority). Sector-specific lobbying proved difficult due to the high number of individual actors, and is usually done when new legislation is in the works. A success of the TZEUBG has been the engagement with the Tanzania Port Authority, Tanzania food and drug authority, and the Tanzania bureau of standards. The TZEUBG engaged these institutions through ad hoc working groups, in which key stakeholders participated and solutions to hurdles were sought and adopted. However, because advocacy and lobbying take time to bear fruit, members of TZEUBG have increasingly been demanding a different approach, and more services. None has left the group yet, but surveys done among members show that information on Tanzania's business climate and business-to-business connection between EU and other companies are seen as more useful than lobbying and advocacy.

Currently, TZEUBG activities are centred around providing information about the Tanzanian market and government policies, setting up experience-sharing between companies and investors, and updating companies on new development. For example, TZEUBG holds seminar around half a dozen times a year, sends out weekly reports to companies, does some market research, and keeps members informed on legislative changes in the pipeline.

Given more resources, TZEUBG could do more. There is a definite demand for trainings, but TZEUBG does not have the resources to do anything aside facilitate trainings given by third parties – which have proved popular among TZEUBG members. Relatedly, there is demand for services for businesses interested in entering the Tanzanian market and to expand coverage beyond Dar es Salaam to Arusha and Zanzibar, but these plans are unfeasible with current resources.

Funding is an issue for TZEUBG, since direct funding from Brussels has to be approved by the Tanzanian government, which is problematic. The initial start-up costs of TZEUBG was 20,000 € which included hiring a consultant for the initial set-up and commissioning small studies, analyses and diagnoses. This eventually was followed by a € 200,000 grant element given to the group for commissioning a comprehensive one-year study on European investments in Tanzania. At the moment, contributions from group members cover costs, but more resources would allow TZEUBG to be much more efficient and cover a wider area outside Dar es Salaam and to provide more tailored services to individual businesses. Ideally, TZEUBG would have an executive director, three administrators, and a couple of people based in different regions. The Tanzanian context makes employing an in-house analyst difficult, but technical assistance for a consultancy-based analyst would be the ideal set-up. It

is clear that the group may need further funding from either Brussels or the EU Tanzania delegation if it is to grow further.

4.1.3.3 Considerations on regional EED initiatives

As it can be seen, success or lack thereof is directly related to the level of external support that these organisations receive from EU or EU delegations.

In Zambia, where members do not yet pay for sustaining the business club, continued support is required to unlock the potential of the club. While businesses appreciate the need for structured dialogue, they are likely to not engage in the long run if short term dividends are not seen. Furthermore, the lack of financial resources to dis-entangle the European Union Zambia Club from the EU delegation's "leadership", has resulted in very slow growth of its capabilities and services offered to its members. Additionally, it is yet to identify investment climate bottlenecks that could inform EU policy dialogues, as well as strengthen its position vis-à-vis the Zambia chamber, or other local associations.

For the Tanzanian counterpart on the other hand, the continued support of the EU in terms of funding and technical assistance, as well as membership fees collected, have allowed it to deliver a more varied and substantial set of services and results for EU businesses. In terms of advancing EED agenda specifically, it has unlocked key barriers for EU businesses, both local and international, for example by tackling some tax and import duty related issues on imports from EU, and by facilitating more dialogue for bottlenecks at the Tanzania port authority. However, the TZEUBG is also highly resource restricted.

Resource abundance is therefore a primary issue in both cases. Without more resources, these organisations cannot collect nor provide the information needed for a fruitful dialogue with government and local counterparts, nor can they continue to build better alliances with other private sector associations. In terms of SB4A, resources allow for studies that can catalyse the creation of dialogue platforms or enhance those that already exist, fundamentally strengthening the SB4A approach.

Up to now, the EED agenda in these places seems to operate in isolation from the tenets of SB4A. The outcomes of the TZEUBG for example in relation to SB4A are only a by-product of the work that the business group did. In terms of the Zambia platform as well, the club was created because of the need to pull together EU businesses, but then it has not evolved to include various dialogue platforms, or it has not become member itself of the Zambia chamber of commerce or other fora (to the knowledge of the consultant and to be validated). While this is normal, as SB4A has only recently been proposed as the framework for structured dialogue, there is a need to push this dialogue to become core activities in these organisations.

4.2 Public-private sector dialogue and EU private sector positioning

4.2.1 Stakeholder analysis of public-private sector engagement in Malawi

4.2.1.1 MCCCI and the PPD

The Malawi confederation of chambers of commerce and industry (MCCCI) is the main organ of private sector representation in Malawi. The chamber conducts its dialogue through the Public Private Dialogue (PPD) forum, held 4 times a year, which was created through a 900k $ TA grant from the World Bank. The PPD Forum is a platform involving select senior representatives, Chief Executives from the private sector, and associations and Government Ministers and Principal Secretaries as policy-makers. The

Forum is led by the sitting Minister of Industry, Trade and Tourism. The objective of the forum is to provide a platform for dialogue on policy issues that require Government action. While the platform is the only avenue we found for businesses to enter into coordinated dialogue with the government, it is seen by many medium and smaller firms as not representative, in a view that there is bias towards larger firms.

The MCCCIs membership comprises some 280 companies, mostly of large size. Various sector associations are also part of the chamber, such as the manufacturer's association, the city trader's association, or association of women in business, effectively allowing the chamber to have a larger reach in the private sector sphere. While we haven't yet been able to see a list of membership, the MCCCI confirmed that the majority of its members are of foreign origin. However, the MCCI shared a list of 21 European companies that are part of its membership, representing 7,8% of the total members. Of these 5 French, 13 British, 1 Netherlands, 1 German, 1 JV Luxembourg/Scotland.

Financial sustainability of the chamber is through membership fees, yearly fair organisation, and renting the premises that house the head-quarters, which the chamber owns. Beyond lobbying and advocacy, they provide some limited training to companies, although human resources are not sufficient for more structured training services. Some information services to businesses on present market conditions are also given.

In 2017 SMEs that were members of the MCCCI formed a different group amid controversy about the MCCCI's non-support of smaller businesses in its private-public sector dialogues. At the time of writing this report, we were not able to find more information about the group (SMEA), which was said to have become a dedicated SME chamber.

Sensitivities were found around the possible creation of a different support system for European companies, as the chamber saw this as possible diversion of aid/support towards private sector development and the MCCCI itself. These sensitivities will need to be handled from the EUD and member state ambassadors by ensuring that any initiative undertaken to support EU firms will be on top of possible support of MCCCI under cooperation agreements. EU firms' support is a political and economic decision that is separate from cooperation and aid. This message will have to be clearly and "diplomatically" stated.

4.2.1.2 Other initiatives

Other structured dialogues in the area of private sector development exist in the form of (i) the Trade, Investment and Private Sector Development Sector Wide Approach (TIPSWAp), (ii) the New Alliance for Food Security and Nutrition (NAFSN). These fora provide a framework for collaboration and engagement among government, development partners and the private sector.

1. The TIPSWAp operates within the framework of Malawi's National Export Strategy 2013-2018 (NES). The NES identified policy, programmatic and resourcing inconsistencies and a lack of coordination as one of the obstacles to growth in Malawi. TIPSWAp provides a public-private collaboration and implementation mechanism to achieve effective levels of communication and coordination among policy holders, resource holders, implementers, economic analysts and a representative forum of private sector players to seek consistency between policies, programmatic interventions and resources. The EU has been providing the TIPSWAp Secretariat with technical assistance, as well as with support towards SWAp and technical working group meetings.

2. Malawi joined the New Alliance for Food Security and Nutrition31 (NA) in 2013 signing up to a number of commitments as documented in the NA's Country's Cooperation Framework. In Malawi the New Alliance has been co-chaired by the EU, with Government, since its inception. The main aim of the framework is to create an enabling environment for investment in agriculture (in line with commitments made under Malawi's Sector Wide Approach for Agriculture). The EU, alongside other Development Partners, has allocated significant financial resources and political capital towards achieving the aims of the NA. Since its inception, and in particular in 2016-2017, the New Alliance has provided a highly valuable platform to engage Government on a small set of key policy reforms needed to improve the enabling environment and attract more investment in Agriculture. Given the multiplicity of dialogue platforms and the slowness of the reform process on the Government side, the Private sector appears to be losing interest. The process may however well be absorbed within the Comprehensive African Agriculture Development Programme (CAADP).

The consultant is not aware of other working groups, fora, or key public-private sector dialogue platforms in the country. However, as the mission was short, there may be some possible existing platforms that have not been analysed.

4.2.2 Consultations with Malawi's EU private sector

At the moment of writing this report, it had been difficult to compile a comprehensive list and map of EU businesses presently operating in Malawi. The extent to which there is considerable presence of EU private sector in Malawi is in fact not information that has been compiled or mapped, and is at the moment unknown. Information was gathered from the Malawi Trade and Investment Centre, but it is outdated and the reliability of the data questionable. Conversations pointed to the fact that businesses owned by EU citizens are small in numbers. Information from the Malawi Trade and Investment Center also pointed towards the interest of EU firms to come and invest into Malawi. A total of 110 companies showed interest in the decade between 2005-2016, pledging close to 300 million Euros. It is unclear how many of these investments have materialised, nor if specific barriers impeded these investments.

EU private sector consulted was varied in nature. These ranged from construction company, beer manufacturing, tea estate, and SMEs such as accounting firms, restaurant, and chocolate producers. In total 13 EU businesses were interviewed directly, and some additional informal conversations were conducted in cafès. Additionally, honorary consuls, themselves business owners, were interviewed as part of the exercise.

Firms were divided into two categories: firms of owners that are Malawian but of European descent, as in the case of Italian or Greek second or third generation families; and firms that are the result of FDI investments from European investors into the country, such as big UK agricultural firms.

The above presents a singular quandary as to the definition of EU firm, which we found to be better left to the private sector itself. In conversations, any affiliation with Europe, either through descent or business dealings, seemed to be the defining feature for a firm to be classified as European, and accepted amongst the various firms spoken to. However, a major issue is drawn around the participation of firms owned by individuals of Indian origin (third or even fourth generation in Malawi) but with UK passports, which are in abundance in the Malawian context.

Firms were interviewed for three objectives: 1. to understand how better the EU can support EU businesses in the country, 2. to collect their opinion on business environment and investment

[31] "New Alliance" is a G8 initiative launched in 2012, aiming to reduce poverty and food and nutrition insecurity by stimulating private sector investment in Agriculture in Sub Saharan Africa.

bottlenecks and how better to address these, and 3. to assess their participation in coordinated dialogue platforms.

In terms of the possibility of having a platform that would support them in a more targeted manner, most found this a good idea. In fact, they all believe that European firms in Malawi are mis-coordinated, and that not enough support is provided, especially in dialogue with government. Furthermore, all firms interviewed said that there was not enough dialogue between their businesses and the EU delegation, missions, or consuls. The perception is that EU firms in loco could access better support structures through TA components, or information on advantageous and specific programmes or products designed for them. As such a support/coordination platform would be ideal. However, conversations around what the structure should look like repeatedly brought forward the idea that the platform should not be driven by the EU delegation, but rather by the private sector itself. That said, none were ready to take on the coordination to bring about a grouping as champions of the idea. There is an inherent need to see some results that would warrant their investment, in their own time especially (mirroring the Zambia experience).

In terms of business environment bottlenecks, priority reform areas have been expounded below. Investment climate issues on the other hand were for the most part dismissed, indicating that the local EU private sector is very much focused towards its own in-country issues that it needs to solve.

Additionally, in relation to their participation in dialogue platforms, many of the firms' owners questioned the utility of advocacy and lobbying. Most of the respondents were adamant that policy dialogue with Malawian authorities is not useful, and therefore efforts should be placed elsewhere.
The two large firms interviewed were part of the MCCCI but found that the institution did not represent them, or that there was an inherent bias towards local more connected firms. The SMEs, on the other hand, had no affiliation, partly because of the perceived prohibitive membership fees, and partly because they believed the institution did not represent them. Two firms also indicated that they belonged to Ag-related platforms and associations, which they found were more useful and targeted.

Most indicated that a primary need for a support framework is around the access to information, and support of market studies and technical assistance in project appraisals for both entrant investors and those firms that want to expand locally. It was often found that information asymmetries and technical capacity gaps left firms not venturing into new investments. Furthermore, many interviewed firms indicated that they receive requests of support by European and foreign SMEs multiple times, which often they cannot provide. Moreover, they saw a possible support framework as a means to increased and better access to Malawian companies and partners, especially through networking.

There was a unanimous agreement that regulations and legislation changes needed to be compiled and monitored and disseminated to the EU private sector, and the private sector at large, to enable them to better face these very rapid changes.

4.2.2.1 Priority reform areas identified in consultations with Malawi's EU private sector

The World Bank 2016 Malawi Enterprise Survey indicated that the top 3 investment climate constraints as reported by firms were Taxation, Access to finance and Corruption. While these still remain major issues, from consultations with the EU private sector, access to power has now become the single biggest issue to operation and new investment, followed by an uncertain regulatory environment around taxes including the enforcement of their regulations. Hurdles around the access to finance are mostly centred around the high cost of capital for both large firms and SMEs which constricts their growth potential.

- **Access to power:** Access to power remains now the biggest challenge of all firms. While bigger firms have the ability to pay for diesel generation sets, smaller firms are finding it more and

more difficult to face the high costs of maintaining operations. Some firms put forth the idea of accessing loans at preferential rates for small solar systems for the smaller businesses, which would save them considerable costs in energy access

- **Tax regime:** there is a general consensus that the tax burden is borne by the formal sector, and administration and collection systems are unnecessarily coercive in nature. The country's tax structure is characterised by heavy taxation on labour and capital income, relying mainly on 3 taxes, i.e. Corporate Income Tax (CIT), Personal Income Tax (PIT), and Value Added Tax (VAT), which together account for 94% of total domestic taxes
- **Access to finance:** Access to finance is particularly difficult for SMEs which incur the highest cost of capital at rates ranging from 23% to 36% depending on various factors. This has limited their ability to grow, and face also challenges around accessing capital to invest in alternative power sources. Big corporates have access to preferential rates, but that is not certain, as they constantly have to cultivate relationships. As these remain uncertain, risk taking behaviour, and therefore investments, of big firms is limited.

The above are in line with barriers identified by the non-EU local private sector in conversations the consultant had during the EFSD window. There is therefore overlap, and any support of EU businesses in tackling these barriers will have overspill benefits to the larger private sector.

4.3 Proposed framework for a synergistic public-private sector engagement strategy in Malawi – advancing EED while operationalising SB4A

From the sections above two things are clear:
1. Business environment bottlenecks found are affecting everyone and addressing these will benefit both EU and non-EU private sector;
2. The EU private sector feels mis-represented, and not supported enough, therefore requires a more coordinated approach in bringing it together. The decision therefore rests on how to find a synergy between ensuring that EU companies receive the necessary support, as well as support the changes needed in the enabling environment for all firms.

Firstly, if the EU delegation is to enact its EED agenda, the presence of a European business organisation or support structure will be important and beneficial going forward. However, the premise that the exercise should be a bottom-up approach, which is driven by companies themselves and becomes sustainable because of company contributions, is not one that will ensure the strategy of EU interests in the short run, especially given the reticence of Malawian EU firms in putting skin in the game. If the EU's goal is a stronger and more coordinated European Union that enables access to external markets for trade and investment; that ensures cooperation on economic governance; that supports the internationalisation of EU businesses; and that improves the coherence and effectiveness of the EU's external action in the economic sphere, then it has to actively support business networks and avenues for the internationalisation of European businesses in Third countries, and in this case in Malawi. Business strategies have to be married to diplomatic and policy efforts.

While it may be premature to establish in the immediacy a full-fledged EU business organisation, a phased approach with the end goal being that direction, should be taken. Information on the fragmented EU presence in the country, the investment bottlenecks faced by EU firms, potential of growth of these companies, present and future planned activities, sizes/contributions to sectors, and other information would be useful to complement the EU's work and feed into the initiatives already in place. Furthermore, a business organisation would help in aggregating issues, requests, opinions; in information collection and dissemination, participation in multiple fora or working groups, and a myriad of other responsibilities that would otherwise put considerable strain on the EU delegation's resources,

particularly of staff. Effectively, this would create a structured dialogue between the EU delegation and EU businesses and would give EU businesses the sense of having a strong backing. But most importantly, it would give EU delegation and diplomatic missions concrete figures and evidence to substantiate the policy dialogue with Malawian authorities and allow for a more fruitful direct policy engagement on specific topics via technical and high-level meetings, effectively allowing concerns from the European private sector over doing business in Malawi to be discussed directly with the Government.

Secondly, on the other hand, structured dialogue between EU delegation, EU private sector, local government, necessary other stakeholders (including other donors, the financial sector, CSOs and international and regional organisations) and businesses can be set up through the SB4A platform. In effect, in the context of the SB4A, European business organisations remain just one piece of the puzzle towards addressing investment and business climate hurdles, although they are important in terms of EED. However, as the European business organisation aggregates a fragmented base, it also aggregates diverse players from multiple sectors that can help better identify sector specific investment climate barriers that could be tackled to unlock the potential of individual sectors and or institutions (Malawi bureau of standards for example). For that to happen, however, sector/thematic structure dialogue platforms will need to be established, potentially even at an informal level, to help identify relevant information.

The EU business organisation would be a member of the MCCCI and participate in the PPD, by way of representing those members that are not part of the chamber (like EU SMEs). Those already in the chamber may join the EU business organisation and contribute their share of fees to MCCCI through the organisation. The organisation therefore will aggregate fees, and voices. Therefore, additionality is created, and the MCCCI will not be superseded. Furthermore, through SB4A, the EU business organisation and MCCCI will be able to relate with other African actors and share best practice, which will benefit the private sector in Malawi to a greater extent.

Notwithstanding, country and sector specific investment climate barriers identified by EU organisations may, in some cases, not be those that could yield major shifts in the investment climate if addressed, as they are specific to EU businesses. Therefore, a larger engagement with multiple stakeholders through the SB4A is important such that issues are prioritised and addressed by EU assistance modalities in an integrated and coherent way. Most importantly, however, is the understanding that the PPD and other platforms may not be targeted enough, and their scope too wide for the private sector to really benefit from the dialogue component, as results are difficult to materialise.

4.3.1 SB4A operationalisation guidelines in the context of EED

In terms of SB4A, it is important for the EU delegation to assess whether it has the resources, or it can access them (both in terms of finance and human resources), to long-term actively sustain any engagement with existing structured dialogue platforms, and any new ones it may want to propose/create.

The EU business organisation will eventually only bring together EU businesses and one side of the story as discussed previously. Therefore, it is important that the EU delegation continue its work in engaging the Malawian private sector in an effort of aligning its programming to the needs of those on the ground. To this avail, a more targeted approach should be taken, beyond participation in the PPD forum and occasional conversations with the MCCCI, or participation in the other two private-public sector dialogue initiatives described above. The EU business organisation will eventually be part of these processes as representative of one faction of the private sector – as is the SME chamber, or the MCCCI chamber.

The delegation does not have to create cumbersome structures, as long as they serve the purpose: it should assess if working groups can be created in the 4 thematic areas where the EU delegation has

already initiatives in place. It should consult with various stakeholder about the potential benefit of having these platforms in particular thematic areas. These potential structures should capitalise on the EIP Pillars, and make full use of all components: identify barriers in specific sectors and/or policy thematic areas, then gather market intelligence to inform policy dialogue and formulation, after which if barriers are lifted investment is catalysed through EFSD. Ultimately, investment catalysed through EFSD will also mean advancement of EED agenda. For example, the intention could be to establish a working group to support incoming investors.

One such platform for example, which the consultant has not come across but could already be in existence, is a working group around renewable energy investments and the hurdles the private sector encounters in investing in the space. While the delegation and a number of development partners do work around energy access and support the country in reaching its targets, and therefore have their own working groups, there is no dedicated structured dialogue that involves the private sector and CSOs in the matter. This could include large local independent power producers, local financial sector, DFIs, government, donors and development partners, and could help unlock barriers that can catalyse investment in the sector (example could be the adoption of an off-grid regulation/strategy that would spur investment in the space by a multiple of actors that were consulted in this mission). The private sector, in this case, would be represented either by energy related business association, or by the MCCCI and SME chambers.

The above is just an example that may, when closely analysed, not be viable. However, the premise is that the EU delegation has to proceed in the following manner:

1. Assess thoroughly all thematic areas it has initiatives in for the presence of any type of private-public dialogue: Agriculture, Trade policy, Taxation and Public procurement, Entrepreneurship. Determine the gaps and the need for structured dialogue platforms
2. Assess thoroughly the needs for private-public dialogue within the EFSD investment windows and determine the gaps
3. IF gaps have been identified in either, determine if the creation of a possible structured dialogue platform will create conflict with PPD and other existing platforms (in agriculture there are sector association groups for example)
4. Juxtapose these assessments with internal EU cooperation agenda and EED agenda and determine which would be the most aligned platform to the objectives of the EU delegation, and the one that would yield the most effective results. Determine if resources (time, funds, people) are available.
5. Convene chosen stakeholders and propose platform. Seek buy-in. Establish platform.
6. Involve specific EU firms, such that when the EU business organisation is established, easy synergy will be created. The EU business organisation will eventually co-facilitate this process when needed and participate in these platforms to bring the one voice of EU organisations, and to advance EED agenda.

The creation of an EU business organisation will add to the SB4A, and the SB4A will vice-versa enable a better functioning of the organisation, but it is not a necessary requirement for structured dialogue to happen. The EU delegation has at its availability multiple tools under the EIP and other assistance modalities to engage the private sector in Malawi, and it should do so pro-actively, beyond supporting MCCCI and the PPD, through targeted structured dialogue platforms and other avenues. In fact, it is important to note that under the SB4A, the EU delegation can create links with the private sector in multiple modalities: ex. mentoring schemes between companies, support to start-ups, incubators, replicators and networking platforms, or partnerships between African and EU business organisations[32].

[32] 2018, EU, *'Guidance note: the sustainable business for Africa platform (SB4A) - Enhanced structured dialogue with the private sector as a key driver of EIP implementation'.*

These will eventually be an avenue to collect information that informs the policy dialogue component of the EU.

The EED agenda will be advanced in this case also without the EU business organisation. If links are created between EU companies and Malawian companies, or particular barriers to investment are addressed that result in investment from EU companies, then through the SB4A the EED agenda has been advanced, demonstrating the strong interlink.

4.3.2 EU public-private sector engagement platform in Malawi: European Business organisation as a part of EED strategy

In Malawi, the presence of EU businesses is minimal, and therefore as stated above the likelihood that firms would coordinate to form even a fora without a level of engagement by the EU delegation is very minimal. Consultations with EU private sector, Member State missions present in the country, and EU honorary consuls all point unanimously to the need of support of some form.

However, as seen from the Tanzanian and Zambian experiences, and from surveys the EOB-WNN has done worldwide of European chambers and organisations, when EU business organisations focus on advocacy and lobbying, it generally won't be enough to sustain their membership, in a context in which the advocacy and lobbying does not bare any fruit (the probable case in the Malawian context). In fact, from experiences of organisations in Asia, it is clear that structured private-public sector dialogue and policy dialogue remain but one aspect of the internationalisation of SMEs, and support in situ of European businesses.

The proposed final framework therefore is one of a European business network/organisation that is created both as a support unit for businesses in Malawi, taking on policy dialogues and coordination with various actors in situ, but also one of market access facilitation and market intelligence (following both the tenets of pillar 3 of the EIP, and commonly found services of other organisations across the world).



Figure 3 Representation of the Ideal European Business Organisation

The following provides an overview of several tasks in the three focus areas which will need to be taken on by the future organisation, in terms of business support with a view to helping more European businesses to expand in Malawi and contribute to the betterment of the business enabling environment. The situation on the ground in Malawi may be different as time goes forward, however these tasks complement each other, and ensure utility to future members:

Advocacy and Visibility

- Developing contacts and relationships with Malawi country officials for lobbying purposes to improve market conditions and effectively address barriers to foreign trade and investment.
- When summits and high-level conferences are organised by government or other stakeholder, organise business summits back-to-back together with MCCCI (and as part of it) and other private sector representatives to capitalise on added joint influence, as well as holding interventions at other events or conferences.
- Better promotion of the brand 'European Union' as one entity standing for certain core principles like open but fair trade and investment relations which are embedded in a broader cooperation between the EU and Malawi.
- Issuing necessary public sector engagement publications like Position Papers, Open Letters, testimonies, speeches, op-eds, etc.

Market Intelligence

- Doing market research, gathering and disseminating commercial information e.g. marketing data and market analyses for the European business community at large.
- Compiling reports/studies which are identifying trade and non-trade barriers for systematic reporting to EU delegation.
- Engaging in frequent coordination meetings with Market Access Teams of the EU Delegation so that private and public sector representatives can exchange information in the mutual interest.

Market Access Services

- Organising business delegations, match-making (B2Bs), sector-specific events on business opportunities and participation in trade fairs.
- Establish a working group to support incoming investors. This will involve development of a directory of affordable and trusted service providers and advice on how to establish in Malawi.
- Providing information on project and partner opportunities to European SMEs, including the search for partners (research organisations, producers, investors, organisations, distributors, lawyers, etc.)
- Tailored consultancy on business strategies, adaptation/localisation of products and technologies, IPR protection, legal contracts, business practices, cultural values, etc.

The EU Delegation, should not engage in the provision of market access services when this platform is in place. Instead, it should:

- Regularly and systematically invite and meet with representatives of the European business community to receive their inputs for policy purposes.
- Monitor political and policy processes as well as the evolution of the local business environment, foreign access to public procurement and political and regulatory developments affecting EU companies in order to Feed this information pro-actively to the European business community through the European business organisation.

4.3.2.1 Implementation proposal

The above will necessarily have to be reached in phases, as the EU businesses landscape in Malawi is small and is yet to buy in to the utility of a platform, but it is nonetheless the important final direction to ensure European Economic Diplomacy outcomes. If the engagement remains in simply structured-dialogue, when and if there are positive outcomes in the investment climate, the Member state missions in country, honorary consuls, and EU delegation don't have the capacity nor the resources to be the support structure needed by investors to come into the country, or for EU businesses in-country that

want to grow. That said, the creation of such a support unit at the onset will need to be one spurred by the EU delegation with considerable technical assistance help and funding.

We propose a two phased approach:

Phase 1 will be entirely driven by the EU delegation, as is in effect created to address present information asymmetries around the size of the EU presence in country, and to achieve demonstration effects that will create engagement and replication by the private sector. This phase may be the longest in terms of implementation but will yield considerable buy in from the private sector. It is a necessary phase such that it will allow to convene the private sector as a whole, and effectively help in understanding what the market looks like, and what level of investment is warranted by the EU delegation.

Phase 2 on the other hand will be about the creation, formalisation, and operationalisation of the future platform/business organisation/unit. In this phase considerable support from the EU delegation will be needed in terms of access to technical assistance to allow the organisation to create a wealth of services it can provide its future membership. Furthermore, the EU delegation will have to keep funding the organisation until members are willing to take on that burden fully.

Hereunder in table form the phased approach, in format of objective, expected results and actions to be taken:

Table 3 Detailed description of Phase 1 of EED approach implementation

PHASE 1	EXPECTED RESULT	ACTIONS	TIMEFRAME
Objective 1: **Address information asymmetry around the size and presence of EU businesses in Malawi, and their needs**	The EU presence in the country is mapped out and its investment size and future potential determined. Policy agenda directions collected and compiled to feed into EED agenda and EUD dialogues.	i. MAP EU companies' presence in Malawi ii. Gather information on most pressing Advocacy and Lobbying needs iii. Gather information on practical services most in need by EU businesses and Investors (Q. What service would you pay for?)	**3/4 Months**
Objective 2: **Convene together all EU private sector and relevant stakeholders and attain buy-in into EED plan forward**	The EU private sector is convened, buy-in is achieved.	iv. The EU private sector is invited to share experiences and information to compile and disseminate; v. Present to the EU private sector an informal plan forward, which includes models of engagement with public sector, as well as coordination among actors (and examples of successes abroad). Incorporate into future plan recommendations received. vi. The three most pressing thematic areas of intervention are identified and policy dialogue by EU delegation around them initiated	**1 month**
	An informal volunteers board is created, to keep abreast of developments towards future platform. An initial informal group/forum established.	vii. Identify private sector champion group to drive initiative viii. Initial coordinator/support person of group's activities designated and/or hired to deal with the day to day needs of the group/forum;	**vii. 1 month** **viii. 1 year**
Objective 3: **Achieve demonstration effects that will create**	Practical studies for in country EU private sector around thematic areas of choice commissioned	ix. Two/three market studies or policy/regulation studies, in specific value chains and/or sectors in which the EU private sector needs most information are commissioned;	**3 to 6 months**

further engagement and replication by the private sector		x. A unified position paper of EU businesses for better lobbying and engagement with Govt produced	
	Practical services rendered to investors and local EU businesses showcasing possible utility of future platform	xi. Networking workshops organised both for local EU businesses and investors connecting with relevant stakeholders and In-country businesses operating in same sector xii. Training sessions / workshops organised around thematic areas of choice xiii. Relevant information is collected and disseminated in the form of policy briefs /.brief market analysis, etc.	**Frequently organised throughout 6 months**

Table 4 Detailed description of Phase 2 of EED approach implementation

PHASE 2	EXPECTED RESULT	ACTIONS	TIMEFRAME
Objective 1: **Formalise initiative into a European businesses organisation / support unit**	The private sector has accepted the utility of the informal group and a more formal structure is created, following successful models not only in the region but worldwide	i. Pre-set up and set-up activities. Legal fees, registration fees, ii. A team of three people is hired to iii. Communication and other related needs are outsourced iv. Membership fee structure created and members recruited v. Services to be given to membership designed, and experts compiled into a data-bank vi. Offices set-up and equipment purchased	**3/4 Months**
Objective 2: **Grow initiative into a solid organisation providing multiple streams of services to its members /EU investors and make it part of the larger network of worldwide EU support organisations.**	The group is strongly advocating and lobbying GoM on issues pertaining its members	vii. Private sector dialogue has now shifted to the group, which will engage directly with agencies and relevant public institutions;	**N/A**
	The group / support unit is self-sustaining through studies, workshops, trainings, etc that is commissions on behalf of clients as per EU private sector needs	viii. The group hires multiple staff on site, and at part time / consulting basis ix. A range of services are provided on fee basis or through technical assistance.	**Within 6 months**
	The group/support unit is better able to serve both EU SMEs wanting to come into the country as well as EU firms that are in -country	x. The group applies and becomes part of the international EOB-WNN and other intermediary networks, xi. B2B Services provided xii. Improve flow of info between Business and Other associations, Missions, Delegation, xiii. Provide reports, market studies, market scoping, research xiv. Provide set-up services xv. Provide Businesses connection with technical experts	**Within a year/two**

4.3.2.2 Budget and Technical support suggested for Malawi EED agenda implementation

The proposed budget and technical support for the implementation of the EED agenda roadmap is summarised in table form here. Estimated budget voices come both from the consultant's own considerations and some from informal quotes received by firms and individuals. Unfortunately, detailed quotes and other budget items are still to be received in official manner. Therefore, the EU delegation should include a 10% to 15% buffer in these estimates. Please note that macro-economic conditions may vary and these numbers become obsolete. *Budget estimates for Phase 2 have not been provided here as these will need to necessarily be revised at the beginning of the period. Phase two*

requires funds for set-up, including communications and website, hiring of staff, office space if not provided by members, legal fees, bi-laws, and other additional expenses.

PHASE 1

Table 5 Detailed budget needs for Phase 1 of EED implementation approach

ACTIONS	TIMEFRAME	TA or Human Resource	Budget Item	Estimated Budget needs
i. MAP EU companies' presence in Malawi ii. Gather information on most pressing Advocacy and Lobbying needs iii. Gather information on practical services most in need by EU businesses and Investors (Q. What service would you pay for?)	**3/4 Months**	**Technical Assistance**	Service Contract of Local Firm - Team of 3 consultants allocated by firm.[33]	**60,000 €**
iv. The EU private sector is invited to share experiences and information to compile and disseminate; v. Present to EU private sector an informal plan forward, which includes models of engagement with public sector, as well as coordination among actors (and examples of successes abroad) vi. Incorporate into future plan recommendations received vii. The three most pressing thematic areas of intervention are identified and policy dialogue by EU delegation around them initiated	**1 month**	**N/A**	Logistics costs – 1 big event to convene private sector. 3 meetings envisioned to discuss recommendations and thematic areas	**3,000 €**
viii. Identify private sector champion group to drive initiative ix. Initial coordinator/support person of group's activities designated and/or hired to deal with the day to day needs of the group/forum;	**vii. 1 month** **viii. 1 year**	**viii. 1 local qualified individual**	Service contract (or EU HR policy based local external contract) for one year for coordinator Office space and/or other equipment as deemed necessary	**21,000 € yearly gross salary** **4,000 € yearly expenses**
x. Two/three market studies or policy/regulation studies, in specific value chains and/or sectors in which the EU private sector needs most information are commissioned; xi. A unified position paper of EU businesses for better lobbying and engagement with Govt produced	**3 to 6 months**	**Technical Assistance**	• Service contract of local consulting firm for 1 policy/regulatory environment study and 1 market access study	**100,000 €**
xii. Networking workshops organised both for local EU businesses and investors connecting with relevant stakeholders and In-country businesses operating in same sector xiii. Training sessions /workshops organised around thematic areas of choice xiv. Relevant information is collected and disseminated in the form of policy briefs/brief market analysis, etc.	**Ongoing over 6 months**	**N/A**	xii. One workshop every month organised – 6 workshops xiii. At least one session workshop organised per month – Service contract to experts and logistics budget for sessions	**50,000 €**
			TOTAL PHASE 1	**248,000 €**

[33] A local firm will be best placed to do the mapping because of the inherent knowledge of the complexities and sensitivities of local EU firms and environment. The consultants strongly advises against getting an international consultant to do the mapping for two reasons: their lack of knowledge of the context, and the cumbersome and lengthy procedures to hire external expertise. A local service contract can be deployed quickly, and will keep the local private sector engaged.

4.3.2.3 Possible risks and mitigation measures

Table 6 Risk and mitigation matrix of EED implementation process

RISK	MITIGATING MEASURE	RATIONALE
FINANCIAL SUSTAINABILITY	• Initial engagement will need to be driven by EU delegation/Member states	• the private sector will want to see the utility before it commits to paying for services. If left to private sector, the platform will not be
	• Membership fees and Pay for Use services need to be structured and built in a business model prior to formalising the group.	
	• Continued engagement through technical assistance for market access studies by the delegation and member states (even after formalisation)	• The provision of market access studies enforces the idea of utility among members
SENSITIVITIES OF EXISTING STRUCTURES (MCCCI and MITC)	EU Delegation and Member states will need to engage MCCCI and MITC in dialogue at the beginning. A coherent MESSAGE will need to be designed that tells that the EU business group is necessary to aggregate the EU businesses in the country, and this is important for dialogue and liasing between EU delegation and EU businesses. Furthermore, it has to be demonstrated that the group will be complementary to the functions of these institutions: explanation given that the group will eventually be a member of MCCCI and therefore strengthen the organisation and will add value by conducting sector specific research or gathering market intelligence that will be shared to MCCCI private sector at large, but is designed to enable better engagement of EU businesses in country. For MICT – the EU organisation will work alongside the institution to strengthen its capacities and effectively support it in servicing EU incoming investors, which it understands better. A partnership/working group with MICT and others involved in investment promotion enabling (maybe under the SB4A) will only strengthen the ecosystem and render the institution successful. This will involve development of a directory of affordable and trusted service providers and advice on how to establish in Malawi.	• Sensitivities lie around perceived loss of technical assistance under cooperation. The initiative is not part of cooperation agreements, and therefore this will be conveyed in the right manner.
COMPLEMENTARITY TO OTHER INITIATIVES	• Design initiative to complement other PPD initiatives from the onset, ensuring that stakeholders understand the nuanced difference of the new initiative with those already present	• Other initiatives are sector specific and have specific objectives. This initiative will help to aggregate information and structure its flow to inform and better serve existing dialogue structures
SUBSIDIARITY TO MEMBER STATES	• The initiative will be designed not to supersede member states' responsibilities towards own firms, and operate under principles of subsidiarity and complementarity.	• Issues facing specific companies, or trade promotion have to remain competence of member states.

5 CONCLUSION

The EIP and EED agenda are two different components that are however very synergistic in nature. Contextually the EIP seeks to lower the risk of investing in key sectors like sustainable energy or lending to small businesses and go beyond 'traditional' development aid based on grants and instead use innovative financial products such as risk sharing guarantees instruments and the blending of grants and loans to ensure that investments have a major development impact. At the same time, it is encouraging and enabling investment climate and business environment changes, including through promotion of structured dialogue with the private sector. The EED on the other hand implies the use of a spectrum of economic tools to promote EU interests, and further its global strategy by capitalising on all instruments at its disposal (including EFSD and EIP). Particularly the promotion of EU enterprises, where the potential for job creation is greater than for multinationals, on foreign markets.

The synergy of the two will enable the EU to better be able to reach both its broader economic and political objectives, as well as its development and cooperation objectives in Malawi to ensure that the Sustainable Development Goals are met.

It is important therefore that for both the EIP and EED agendas, the EU delegation to Malawi take a proactive approach to ensuring their operationalisation. There will be considerable funding needs to drive these agendas forward, and additional budget lines should be requested.

In terms of the EIP and EFSD agenda, as we have seen in this document, the environment in Malawi is complex: the energy sector is marred by policy and regulatory hurdles, as well as the lack of capacity both on private sector and government counterparts; the Financial sector is unable and unwilling to invest in sectors outside of those it perceives there is very little risk in, and cost of capital is prohibitive for any sort of investments by both big and small players; MSMEs lack the necessary capacity to run businesses and are faced with prohibitive costs to access capital; government corruption and perceived volatility of currency keep the local sector from investing and therefore constrain capital formation; Without capital in effect, growth cannot happen.

These major hurdles can be overcome by involvement of the EUD through all the instruments that it has at its availability. In this case, access to capital that is guaranteed by EFSD is an important part of addressing barriers to investment. However, as discussed, administrative complexities, non-presence of DFIs in the geography, small ticket sizes of potential projects, high risks and in general a difficult political, economic and bureaucratic environment that creates a multitude of uncertainties make Malawi an unfavourable target for most DFIs.

Therefore, the EUD and EUHQ have a responsibility of coaxing DFIs to engage in Malawi, which is perceived as a high-risk country. As we have seen, the potential for investment is there, and the idea that the private sector is not ready, nor capable of absorbing the tools is faulty. Moreover, because of considerable access to TA through the EFSD, capacity building of all stakeholders in Malawi is possible. The very premise of the guarantee tools is to veer away from direct aid and cooperation and spur private sector investment to ensure development and growth. **The guarantees are built to ensure that DFIs take the risks and invest in expanding their capabilities to engage with countries, private sector, and local banks that need these investments.** DFIs SHOULD NOT have a predilection for easier environments/countries. A bias towards easier countries will create an environment where Malawi will be negatively affected, and possibly be surpassed by regional counterparts because of the advantages and preferential treatment its neighbours have received, effectively leaving the country “behind”.

Technical assistance is paramount. In case of the financial sector TA needs are for understanding the target segments and creating products that are specific to the segments, as well as capacity development in administering, reporting, and clearly processing all documentation and processes required by DFIs. In terms of investors it’s twofold: it may be needed to have a TA component post-financing to ensure that the investment is successful, but it is also in helping identify, prepare, and package possible investments to apply to products (such as credit lines) afforded by the guarantee schemes. In effect, none of the investors spoken to have any idea of the guarantee schemes being available and would not apply to the schemes unless helped by the EUD or another institution in the process. For MSMEs TA needs are particularly around building business skills. All in all, in Malawi, TA needs are key.

A particular emphasis should be put on the fact that in regard to MSMEs if DFIs enter into negotiations with Malawian banks, TA support will need to have an element of conditionality such that FIs lower their interest rates to beneficiaries in order to access the scheme. As such, engagement with the newly created National Bank SME Development bank of Malawi and the Malawi Agricultural and Industrial Investment Corporation will be a natural choice for engagement, as they are building their portfolio with concessional loan terms in mind.

In terms of the EED agenda, investigation shows that there is need to create a dedicated private sector structured dialogue between EU delegation and EU businesses, to strengthen the connection and information sharing between the two, eventually driving policy discussions by the EUD with high-level

meetings. This structured dialogue is needed to support in a more coordinated manner EU businesses in the country. It will also be created in alignment and in complementarity to the already present platforms (MCCCI's PPD). The platforms that are present at the moment do not cater in particular to the European business community. Furthermore, as the community has indicated, and from what has been learnt from other regional advanced EED processes, structured dialogue is not enough to ensure that business and investment environment hurdles are addressed. A key issue remains information asymmetry and market intelligence, which is at the moment lacking. Therefore, the EUD will need to commission further market studies to identify the three major barriers to entry for investment and ensure that the hurdles identified in this report are representative of all EU businesses on ground.

Concurrently, SB4A processes need to be actively pushed by the EU delegation. While the EED agenda is paramount to further EU interests in the region, the establishment of SB4A processes under the EIP is paramount to unlock the potential for growth of the country. The EU delegation has to drive private sector dialogues, and not limit itself to participating in the PPD. It has to identify the gaps and levers where its intervention with structured dialogue and market intelligence can unlock hurdles and considerably catalyse investments/growth.

A final and important point is the following: while the EU may support the creation of a new support organisation that can cater specifically to EU businesses, an additional better dividend is achieved by technical and financial long-term support of institutions like the Malawi Trade and investment center, which is not efficient for the lack of follow up and long-term support after having been created, or the MCCCI itself (although questions remain as to their integrity and involvement in the political landscape). As expounded in the previous section, the EED agenda will interlink with these institutions through the EU business organisation, which will either work alongside or be member of these institutions. However, as structured dialogue and enabling investment climate are also part of the EIP agenda through SB4A, the MCCCI and MICT could be given strong support through funding under the former tools.

If MICT for example were to function properly, then market intelligence, and advocacy even, could very well be its mandate and it would enable and change the investment and business environment not only for EU companies but for the business community at large.