



RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF
SUPPORTING INNOVATION IN SMALL AND MEDIUM ENTERPRISES PROJECT
APPROVED ON OCTOBER 31, 2012
TO
THE LEBANESE REPUBLIC
FINANCE, COMPETITIVENESS AND INNOVATION
MIDDLE EAST AND NORTH AFRICA

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ABBREVIATIONS AND ACRONYMS

BDL	Banque du Liban – Central Bank of Lebanon
COVID-19	Coronavirus Disease
CDG	Concept Development Grant
DA	Designated Account
ESMF	Environmental and Social Management Framework
FM	Financial Management
FS	Financial Statements
GOL	Government of Lebanon
IA	Implementing Agency
IC	Investment Committee
ICT	Information and Communications Technology
iSME	Innovation in SMEs
IFR	Interim Financial Report
IBRD	International Bank for Reconstruction and Development
LA	Loan Agreement
LBP	Lebanese Pound
M&E	Monitoring and Evaluation
SME	Small and Medium Enterprises
MOF	Ministry of Finance
PA	Project Agreement
PDO	Project Development Objective
PMU	Project Management Unit
POM	Project Operational Manual
PPSD	Project Procurement Strategy for Development
RF	Results Framework
SME	Small and Medium Enterprise
STEP	Systematic Tracking for Exchanges in Procurement
TTL	Task Team Leader
VC	Venture Capital
WB	World Bank



BASIC DATA

Product Information

Project ID P127306	Financing Instrument Investment Project Financing
Original EA Category Not Required (C)	Current EA Category Financial Intermediary Assessment (F)
Approval Date 31-Oct-2012	Current Closing Date 30-Jun-2022

Organizations

Borrower Lebanese Republic	Responsible Agency
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Project Development Objective (PDO)

Original PDO

The project’s development objective is to encourage the equity investment market to increase the supply of early stage investment finance for financially viable, new, and existing innovative firms.

Current PDO

The new project’s development objective is to increase the supply of early stage finance for financially viable, new, and existing innovative firms, and support the capability of firms to respond to the COVID -19 crisis.

Summary Status of Financing (US\$, Millions)

Ln/Cr/Tf	Approval	Signing	Effectiveness	Closing	Net Commitment	Disbursed	Undisbursed
IBRD-82020	31-Oct-2012	13-Feb-2013	03-Feb-2015	30-Jun-2022	30.00	23.01	6.99

Policy Waiver(s)

Does this restructuring trigger the need for any policy waiver(s)?

No



I. PROJECT STATUS AND RATIONALE FOR RESTRUCTURING

A. Project Status

1. The Supporting Innovation in Small and Medium Enterprises (iSME) Project is a successful project in the Lebanon portfolio and has been able to achieve important results over the past years. The project has faced several setbacks since its signing in February 13, 2013, which include: (i) 23-months delay in loan ratification which finally took place on January 14, 2015; interruptions in the replenishment of the Project account by the Ministry of Finance during 2018 and 2019; (iii) 12-months delay in Parliament ratification of the COVID-19 related restructuring, from April 2020 to April 2021; and (iv) challenges related to multiple crises context. Despite all these challenges, the iSME project has significantly contributed to the development of the entrepreneurship sector in Lebanon, has created a high-quality deal flow of investible Lebanese start-ups, and has encouraged the equity investment market to increase early-stage financing to Lebanese SMEs. To date, the iSME project has co-generated a portfolio worth about US\$218 million at market value, spread over 22 active entities, demonstrating the fund's ability to crowd in private sector financing in line with private capital mobilization principles. It has generated proceeds from 2 full exits through acquisitions by global industry leaders at 1.8 multiplier of the initial investments. Most recently, in June 2022, an iSME portfolio company was able to raise US\$18 million in a Series B round, led by the International Finance Corporation (IFC), along with a group of investors to support its expansion in the region. The project stands at 77 percent disbursement of the total loan amount, as of June 2022. The fund has received excellent feedback from industry participants for the rigor of its investment committee and the quality of firms supported. It has been rated as Satisfactory in the last two Implementation Status and Results Reports (ISRs), respectively in November and May 2021. All but one PDO level indicators are either on track, achieved or already exceeded. Only the indicator related to the iSME-COVID facility has not made any progress, given the year long delay of the authorities in approving the loan restructuring. There are no outstanding audits for the project. The latest audit report for the year ended December 31, 2020 has been received and is satisfactory to the Bank.

B. Country Context

2. ¹For almost 3 years, Lebanon has been facing a confluence of severe crises that impacted every vital sector in the country and led to alarming levels of poverty: an economic and financial crisis; the COVID-19 pandemic; the aftermath of the Port of Beirut (POB) explosion; and more recently food security crisis. The multiple crises are imposing a serious impact on the private sector and have changed dramatically the already difficult conditions under which it operates. According to a rapid firm-level survey conducted by the World Bank in October 2021, 22 percent of formal firms were confirmed or assumed permanently closed since October 2019. Firms are operating at very low capacity, with average capacity utilization at 45 percent only. 60 percent of firms continue experiencing sales' decreases by more than 50 percent. 64 percent of formal firms surveyed have seen a net job reduction of 27 percent.

¹ The Lebanon Economic Monitor entitled "The Great Denial". The World Bank. Fall 2021.



3. Access to finance remains the biggest challenge for the private sector, more acutely so for startups and SMEs. The interruption of financial services including lending, equity investments and access to deposits, crippled firms that are often unable to finance their working capital, import raw material, maintain their workforce, remain solvent or scale up their operations. Moreover, firms have to deal with multiple exchange rates for different types of financial and daily transactions while the official peg has not been formally abandoned, severely impacting their operations. In fact, 51 percent of firms are having liquidity shortages; 13 percent of firms were unable to meet their financial dues (delayed payments more than a week, or/and overdue on its obligations to financial institutions).
4. The Venture Capital (VC) industry is facing a large liquidity shortage and is unable to raise capital, due to suspension of BDL 331, lack of liquidity at commercial banks who invested between US\$300 and US\$400 million in the past years in Lebanese VCs, and lack of appetite from international investors to invest in Lebanon given the current conditions. Innovative startups and SMEs, that require sizable amounts of funding in their initial stages of growth, are facing serious risks of bankruptcies and closures.

C. Rationale for Restructuring

5. On May 5, 2022, the Bank received a request from the MOF to: (i) extend the Closing Date of the iSME Project by an additional 2 years until June 30, 2024; (ii) cancel Component 3: Emergency Financing Facility Funding Program (iSME-COVID), which was introduced through the restructuring approved in April 2020, (iii) reallocate the Loan proceeds back to Component 1(b): Equity Investment Facility; and (iv) relatedly, modify the PDO to align it with its original description (ie without a reference to COVID-19).
6. The current closing date of the iSME project is June 30, 2022, and the project still has US\$7 million to disburse and around US\$5.53 million in the Designated Account (DA). Given the ongoing financial crisis and the severe shortage in the first line equity funds, demand from the start-ups for iSME's equity investments is increasing, and the active start-ups in the iSME portfolio are continuously looking for follow-on investment rounds, amounting to US\$14.5 million. Keeping the access to the iSME funds available for two more years would be extremely important to help innovative startups and SMEs meet their financing needs, grow and contribute eventually to the recovery the Lebanese economy.
7. In the past few years, the project had implementation and disbursement delays for a number of factors: (i) it took nearly 2 years to conclude the previous project restructuring and the implementation was stalled during that time; (ii) COVID-19 related restrictions; (iii) economic and financial crisis related shortage in the first line equity funds; and (iv) unofficial capital control and unclarity on the nature of the funds available at iSME Designated Account (DA) at BDL, "fresh" dollars versus "lollars" or local dollars². The iSME Fund is designed as co-investment which requires startups to secure funding first from another partner Venture Capital fund before approaching iSME, and given the liquidity shortages in the market, start-ups were not able to secure a co-investor. Moreover, given that a large share of the startups' expenses are not local expenses and as such require fresh dollar investments, attracting start-ups has been very slow, despite the huge financing needs. A number of startups are considering exiting Lebanon and looking to establish abroad to raise fresh funds from international VCs and other external sources. To address this issue, the MOF, based on a World Bank request, had asked BDL to facilitate disbursements in Fresh USD, and this was approved by BDL's Central Council and

² Lollars or Local Dollars are USD dollars stuck in the Lebanese banking system. These are subject to multiple withdrawal rules and exchange rates set by the Central Bank of Lebanon depending on the date of their reconstitution.



signed by the Governor of BDL on June 21, 2022, and will be applied to all funds transferred or will be transferred to iSME after November 2019. As such, all funds currently available at the iSME DA at BDL are considered Fresh USD.

8. Due to the significant delays (nearly 2 years) in getting Parliament's approval for the COVID-19 related restructuring and in signing the amended subsidiary agreement between Kafalat and the Ministry of Finance, the project implementing agency, and the Ministry of Finance, consider that the demand from the companies for grants and soft loans to produce COVID-related supplies is no longer applicable, as this demand has already been met. Moreover, a clause in the Law #217, "Amendment of law number 6 dated 3/11/2014 related to the loan agreement provided by the WBG to support innovative SMEs", which was ratified by the Parliament in March 2021, signed by the President and published in the Official Gazette on April 15, 2021, included a clause stating that in case there is no demand for COVID-related supplies and the iSME-Covid facility does not become effective within a year (by April 15, 2022), then the reallocated funds will go back for use to their original purposes, i.e. to the Equity Investment Facility. As such, and given that the approval of the previous restructuring envisioned this possibility, it is permissible to reallocate the funds from the component introduced during the restructuring "Component 3: the Emergency Financing Facility Funding Program (iSME-COVID)" back to the Equity Investment Facility where the funds are very much needed and the demand is increasing. In fact, in the past 6 months, Kafalat, the project implementing agency, had received 4 co-equity investment requests. Kafalat has shared with the task team a list of 43 start-ups from the multiple entrepreneurship ecosystem players on the market, who are actively seeking financing with total investment needs at around US\$30 million. While this list has not yet been screened by iSME's Investment Committee to confirm investment readiness and feasibility, it gives some indication on the potential investment opportunities in the market and the significant financing needs.

II. DESCRIPTION OF PROPOSED CHANGES

A. Summary of proposed changes

1. Below is an overview of the main proposed changes:
 - (a) The closing date will be extended by 2 years, from June 30, 2022 until June 30, 2024;
 - (b) Funds allocated to "Component 3: Emergency Financing Facility (iSME-COVID) Funding Program" will be reallocated to Component 1 (b): Equity Investment Facility; and
 - (c) The Results Framework (RF) will be amended to adjust indicators and targets for Component 1 and 3.
2. Given the unpredictable and fluid situation regarding COVID-19, it was agreed not to cancel Component 3 and keep the PDO as is, to allow for flexibility should financing for domestically produced medical supplies, equipment and services be needed ahead of the revised closing date for the project.
3. Proposed changes in components and cost will be as follows:



	Original Budget Allocation (Million US\$)	Budget Allocation after the Previous Restructuring (Million US\$)	Proposed Budget Allocation after the Restructuring (Million US\$)	Original Key Indicators	Revised Key Indicators after Previous Restructuring (% of the original)	Proposed Revised Key Indicators after Restructuring (% of the previous)	Rationale for Revision			
Component 1: Innovation in SMEs (iSME) Funding Program	27.5	22	27.5	- Total number of firms receiving equity financing leveraging investors and the iSME funding program: 95	- Total number of firms receiving equity financing leveraging investors and the iSME funding program: 95 (100%)	- Total number of firms receiving equity financing leveraging investors and the iSME funding program: 101 (106%)	- Number of firms is revised with the expectation that 16 new firms will receive co-investment funds additional to the existing actual 199 supported firms (average investment ticket \$600k).			
<i>Concept Development Grants</i>	2.5	3	3							
<i>Equity Co-Investment</i>	25	19	24.5							
Component 2: Project Management	2.425	2.425	2.425							
Component 3: Emergency Financing Facility (iSME-COVID) Funding Program	0	5.5	0					-Amount of private capital leveraged: \$50 Million	-Amount of private capital leveraged: \$57 Million (143% of previous)	- Private capital already achieved and exceeded the previous target, the additional financing should include the estimated investment in 16 firms of the remaining 9.5 Million at an estimate 80% contribution from iSME.
Front-end Fee	0.075	0.075	0.075							
Total	30	30	30		- Percent of beneficiary firms reporting sales of new medical goods and services sales: 70%	- Percent of beneficiary firms reporting sales of new medical goods and services sales: 0%	- Given the reallocation of funds from component 3 to component 1, this indicator will be dropped to 0%.			



3. The POM will be updated and adopted by Kafalat upon the approval of the restructuring by the Bank. The update of the POM will reflect approved changes in the restructuring and will allow the iSME fund to increase its investment share in startups from currently up to 50 percent to up to 80 percent investment share, alongside credible institutional and angel investors with pre-existing track records.
4. The team confirms that the project objectives are still relevant and achievable, and recommends the restructuring and extension be approved. With these proposed changes, together with facilitation from the Central Bank of Lebanon (BDL) with regards to the currency and nature of the funds, the project will be able to complete remaining activities and achieve its overall Project Development Objective.

B. Procurement

5. Procurement will continue to be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers, dated July 2014; and "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA credits and Grants by World Bank Borrowers" dated July 2014.
6. The project provides grants to entrepreneurs according to selection criteria of eligible proposals and will fund equity. As such, the POM describes the basic guiding procurement principles, the established acceptable methods, procedures and commercial practices, contract forms, and the main responsibilities of the beneficiary entrepreneurs/enterprises. Procurement activities are restricted to the project management requirements, such as hiring of staff, the external auditor and experts as needed. The project will also procure minor goods.
7. The overall risk rating continues to be Low.

C. Financial Management

9. The Financial Management (FM) arrangements at Kafalat continue to be adequate with a dedicated team handling project implementation. The same FM arrangements will continue to apply. Slight delays have been observed in the submission of the Interim Financial Reports (IFRs) due to the fact that these require to be certified by the external auditor. IFRs are found acceptable. Annual audit reports are submitted and found acceptable. There are no overdue audit reports for the project as of June 2022.

D. Disbursement

10. Disbursement arrangements will remain the same, the Designated Account (DA) will be handled by Kafalat, the DA is opened at the Central Bank of Lebanon (BDL). Disbursements for the project will be based on six months forecast of expenditures. The direct payment is also added as a disbursement method. Kafalat will be responsible for submitting withdrawal applications to claim the funds and to subsequently document all expenditures under the project. A reallocation of funds from category 6 to category 2 will be applied as per the below. Disbursement guidelines will follow the loan agreement and the disbursement letter.

Change in disbursement categories:



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Category	Original Allocation (US\$)	Amount After Reallocation – Previous Restructuring April 2020 (US\$)	Amount After Reallocation – Proposed Restructuring June 2022 (US\$)	Percent of Expenditures to be financed (inclusive of Taxes)
(1) Goods, non-consulting services, and consultants' services for Concept Development Grants (CDGs) under Part 1(a) of the Project	2,500,000	3,000,000	3,000,000	100%
(2) Eligible Investments under Part 1(b) of the Project	25,000,000	19,000,000	24,500,000	100%
(3) Goods, non-consulting services, and consultants' services, audit, Incremental Operation Costs, Training and Incremental Fees for Part 2 of the Project	2,425,000	2,425,000	2,425,000	100%
(4) Front-end Fee	75,000	75,000	75,000	Amount payable pursuant to Section 2.03 of the loan agreement in accordance with Section 2.07(b) of the General Conditions
(5) Interest Rate Cap or Interest Rate Collar premium	0	0	0	Amount due pursuant to Section 2.07(c) of this Agreement
(6) Goods, non-consulting services, works, and consultants' services under Part 3 of the Project	0	5,500,000	0	100%
Total Amount	30,000,000	30,000,000	30,000,000	



E. Safeguards

- 11. This project falls under the World Bank safeguards operational policies and OP 4.01 is triggered. Under this restructuring requested by the Government of Lebanon, there are no changes to the safeguards operational policies and OP. 4.01 remains triggered. The Government of Lebanon is not expected to prepare any safeguards instruments under this restructuring request.

- 12. In March 2020, the Government of Lebanon sent a restructuring request to the World Bank to add a new component 3 to the iSME project that would focus on COVID19 preparedness and response to allow for immediate support to increase the supply of domestically produced medical goods and equipment. This previous request for restructuring changed the projects EA category (Category C) under the original parent project to a new proposed EA category (Financial Intermediary Assessment), due to the addition of new activities that may be associated with environmental and social risks and impacts. As such the implementing Agency, Kafalat, prepared an ESMF which was cleared by the Bank and disclosed in May 2020 (which can be found through this link [ESMF](#)). In May 2022, the World Bank received another request for restructuring from the Government of Lebanon to extend the closing date of the iSME project until June 30, 2024, and to reallocate the funds back to their original purpose under component 1 of the project. In this regard, the project’s EA category remains unchanged and the Financial Intermediary Assessment still applies. As the ESMF was prepared under the previous restructuring, and given that the restructuring does not have impact on the project components, there is no need for any safeguards instruments to be prepared under this restructuring request.

III. SUMMARY OF CHANGES

	Changed	Not Changed
Results Framework	✓	
Components and Cost	✓	
Loan Closing Date(s)	✓	
Reallocation between Disbursement Categories	✓	
Disbursement Estimates	✓	



Implementation Schedule	✓	
Implementing Agency		✓
DDO Status		✓
Project's Development Objectives		✓
PBCs		✓
Cancellations Proposed		✓
Disbursements Arrangements		✓
Overall Risk Rating		✓
Safeguard Policies Triggered		✓
EA category		✓
Legal Covenants		✓
Institutional Arrangements		✓
Financial Management		✓
Procurement		✓
Other Change(s)		✓
Economic and Financial Analysis		✓
Technical Analysis		✓
Social Analysis		✓
Environmental Analysis		✓

IV. DETAILED CHANGE(S)**COMPONENTS**

Current Component Name	Current Cost (US\$M)	Action	Proposed Component Name	Proposed Cost (US\$M)
Innovation in SMEs (iSMEs) Funding Program	22.00	Revised	Innovation in SMEs (iSMEs) Funding Program	27.50
Project Management	2.50	No Change	Project Management	2.50
Emergency Financing Facility (iSME-COVID) Funding Program	5.50	Revised	Emergency Financing Facility (iSME-COVID) Funding Program	0.00
TOTAL	30.00			30.00



LOAN CLOSING DATE(S)

Ln/Cr/Tf	Status	Original Closing	Revised Closing(s)	Proposed Closing	Proposed Deadline for Withdrawal Applications
IBRD-82020	Effective	30-Jun-2018	30-Jun-2020, 30-Jun-2022	30-Jun-2024	30-Oct-2024

REALLOCATION BETWEEN DISBURSEMENT CATEGORIES

Current Allocation	Actuals + Committed	Proposed Allocation	Financing % (Type Total)	
			Current	Proposed
IBRD-82020-001 Currency: USD				
iLap Category Sequence No: 1	Current Expenditure Category: G NCS CS CDGs P1a			
3,000,000.00	2,875,000.00	3,000,000.00	100.00	100.00
iLap Category Sequence No: 2	Current Expenditure Category: Elig invest under Part 1b			
19,000,000.00	13,516,700.00	24,500,000.00	100.00	100.00
iLap Category Sequence No: 3	Current Expenditure Category: G,Non CS,CS, ADT, IOC, TR,IFEE -P2			
2,425,000.00	1,541,081.06	2,425,000.00	100.00	100.00
iLap Category Sequence No: 5	Current Expenditure Category: PREMIUM FOR CAPS/COLLARS			
0.00	0.00	0.00		
iLap Category Sequence No: 6	Current Expenditure Category: G NCS W CS P3			
5,500,000.00	0.00	0.00	100.00	100.00
iLap Category Sequence No: FEF	Current Expenditure Category: FRONT END FEE			



	75,000.00	75,000.00	75,000.00
Total	30,000,000.00	18,007,781.06	30,000,000.00

DISBURSEMENT ESTIMATES

Change in Disbursement Estimates

Yes

Year	Current	Proposed
2013	0.00	0.00
2014	0.00	0.00
2015	5,075,000.00	5,075,000.00
2016	48,525.00	48,525.00
2017	2,226,103.90	2,226,103.90
2018	5,553,859.42	5,553,859.40
2019	4,046,472.50	4,046,472.00
2020	3,057,820.24	6,057,820.20
2021	8,869,577.00	0.00
2022	1,122,641.94	0.00
2023	0.00	4,992,000.00
2024	0.00	2,000,029.00



Results framework

COUNTRY: Lebanon

Supporting Innovation in Small and Medium Enterprises Project

Project Development Objectives(s)

The new project’s development objective is to increase the supply of early stage finance for financially viable, new, and existing innovative firms, and support the capability of firms to respond to the COVID -19 crisis.

Project Development Objective Indicators by Objectives/ Outcomes

Indicator Name	PBC	Baseline	End Target
Increase supply of early stage finance for financially viable, new, and existing innovative firms			
Total number of firms receiving equity financing leveraging investors and the iSME funding program (Number)		0.00	101.00
<i>Action: This indicator has been Revised</i>			
No. of beneficiary firms, women owned (Number)		0.00	10.00
<i>Action: This indicator has been Revised</i>			
Total amount of equity financing received (leveraged) leveraging investors and the iSME funding program (Amount(USD))		0.00	57,875,000.00
<i>Action: This indicator has been Revised</i>			
Number of new jobs created in beneficiary firms (Number)		0.00	250.00
<i>Action: This indicator has been Revised</i>			
No. of new jobs created, of which % are filled by women (Number)		0.00	30.00
<i>Action: This indicator has been Revised</i>			
Support the capability of firms to support the response to COVID-19 crisis			



Indicator Name	PBC	Baseline	End Target
Percent of beneficiary firms reporting sales of new medical goods and services sales (Percentage)		0.00	0.00
<i>Action: This indicator has been Revised</i>			

Intermediate Results Indicators by Components

Indicator Name	PBC	Baseline	End Target
Innovation in SMEs (iSMEs) Funding Program			
Intermediate Result Indicator 1: No. of eligible firms applying for proof of concept grants (Number)		0.00	360.00
<i>Action: This indicator has been Revised</i>			
Intermediate Result Indicator 2: No. of firms receiving proof of concept grants (Number)		0.00	200.00
<i>Action: This indicator has been Revised</i>			
Intermediate Result Indicator 3: Vol. of proof of concept grants (Amount(USD))		0.00	3,000,000.00
<i>Action: This indicator has been Revised</i>			
Intermediate Result Indicator 4: Vol. of equity investments mobilized by Grantees (Amount(USD))		0.00	13,500,000.00
<i>Action: This indicator has been Revised</i>			
Intermediate Result Indicator 5: No. of firms successfully receiving equity (Number)		0.00	40.00
<i>Action: This indicator has been Revised</i>			



Indicator Name	PBC	Baseline	End Target
Intermediate Result Indicator 6: Vol. of equity investments mobilized as co-investments in portfolio of companies (Amount(USD))		0.00	35,870,000.00
Action: This indicator has been Revised			
Emergency Financing Facility (iSME-COVID) Funding Program			
Intermediate Result Indicator 7: No. of firms receiving funding from the COVID19 financing facility (Number)		0.00	0.00
Action: This indicator has been Revised			
Project Management			
Intermediate Result Indicator 8: Percent of firms reporting that iSME funding contribute to jobs protection during the economic crisis and COVID-19 outbreak (Percentage)		0.00	0.00
Action: This indicator has been Revised			
Project implementation is satisfactory (Yes/No)		Yes	Yes
Action: This indicator is New	Rationale: To measure the quality of project implementation by PMU		



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