PROJECT INFORMATION DOCUMENT (PID)
ADDITIONAL FINANCING

Report No.: PIDA21812

Project Name	JO-MSME Development for Inclusive Growth (P153987)
Parent Project Name	MSME Development Project for Inclusive Growth (P132314)
Region	MIDDLE EAST AND NORTH AFRICA
Country	Jordan
Sector(s)	SME Finance (50%), Microfinance (50%)
Theme(s)	Micro, Small and Medium Enterprise support (100%)
Lending Instrument	Investment Project Financing
Project ID	P153987
Parent Project ID	P132314
Borrower(s)	Government of Jordan
Implementing Agency	Central Bank of Jordan
Environmental Category	F-Financial Intermediary Assessment
Date PID Prepared/Updated	11-Feb-2015
Date PID Approved/Disclosed	11-Feb-2015
Estimated Date of Appraisal Completion	19-Feb-2015
Estimated Date of Board Approval	04-May-2015
Decision	

I. Project Context

Country Context

1. The Arab region’s uprisings and the global financial and economic slowdown have had implications on Jordan, taking the form of economic shocks, as well as demands for a more level playing field, equal access, and increased opportunities. The regional turmoil has significantly reduced short term growth prospects for Jordan through sharp declines in foreign direct investment (FDI), and, to some extent, remittances, while the import bill increased as a result of higher commodity prices, adversely affecting the economic environment. Overall, the Jordanian economy has been operating below its potential and has not been generating enough jobs to absorb the more than 60,000 young citizens who enter the labor market annually.

2. Regional and international external shocks have weighed negatively on Jordan’s economic performance. GDP growth has decelerated to reach an average of 2.7 percent in the period from 2010 to 2014, despite a period of high rapid growth that reached an average of 6.5 in the period from 2000 to 2009. This slowdown is mainly due to the effects of the financial crisis, the Arab spring, the Syrian conflict, the disruption of Egyptian gas supply to Jordan, and to some extent the deteriorating political situation in Iraq (the largest export market for Jordanian products), and. Moreover, the influx of more than 620,000 Syrian refugees has exacerbated a number of challenges

for the Jordanian economy.

3. Despite fiscal consolidation efforts, modest economic growth has contributed to widen the fiscal deficit excluding grants, projected to have reached 14.7 percent of GDP in 2014 from 14.1 percent in 2013. The fiscal deficit including grants is however expected to have narrowed to reach an estimated 9.6 percent in 2014 from 11.5 percent in 2013. Fiscal pressures have resulted in worsening public debt, expected to have reached almost 91 percent of GDP by end-2014. Public debt as a share of GDP has been on an increasing trend for the past seven years but should fiscal adjustment efforts continue as part of the IMF's outstanding SBA, the debt to GDP ratio is expected to reverse this trend as of 2016.

4. High unemployment and poverty persist. Unemployment remains high at 11.9 percent in 2014. The unemployment rate among females is typically at least double that amongst males, reaching 20.8 percent in 2014 compared to 10.1 percent for males. The unemployment problem is more aggravated among youth where unemployment rates reached 36.1 percent and 31.8 percent for age groups 15 to 19 years old and 20 to 24 years old, respectively for 2014. The poverty rate stands at 14.4 percent in 2010 based on the most recent official estimates. Despite the progress in poverty alleviation, deteriorating global and regional economic conditions might have a negative impact on poverty in Jordan, especially with the limited fiscal space available to the government to extend social protection networks.

5. Developing MSMEs is one of the top priorities of the Jordanian government stemming from their significant role in job creation, economic inclusion and poverty alleviation. Promoting MSMEs in Jordan shall reduce unemployment especially among youth and women, in addition to positively contributing to financial inclusion through reaching out to marginalized groups in different geographical regions. The government is keen on developing private sector led growth through enabling the environment for fast growing innovative small enterprises. These developments call upon leveling the playing field for MSMEs and ameliorating the business environment, particularly their access to finance.

Sectoral and institutional Context

1. Micro, small and medium enterprises (MSMEs) today are positioned as the backbone and vanguard of the modern enterprise sector in Jordan. The 2011 General Economic Establishments Census revealed that MSMEs represent 95 percent of Jordanian enterprises, 66 percent of which have less than 19 employees; employ 70 percent of the total labor force employed by the private sector; produce outputs that contribute 40 percent towards national GDP, and account for 45 percent of total exports. Around 40 percent of the operating enterprises are located outside Amman.

2. MSMEs are major contributors to the Jordanian economy and to its competitiveness, and employment potential. There are around 150,000 registered enterprises in Jordan, of which MSMEs account for more than 99 percent. The majority of jobs are generated through MSMEs, employing around 71 percent of private sector employees, where SMEs employ 32.7 percent and microenterprises 38.7 percent. This sector is also a leading source of exports and incomes in Jordan.

3. Financial depth is not fully reflected in an improvement in financial access. Loans-to-deposits ratio is 65 percent as of May 2014, reflecting the banks' conservative lending practices. Private sector credit-to-GDP is relatively low at 43 percent, which is largely allocated to the large corporate (87 percent), often 'name lending'. Bank financing is relatively common for SMEs in Jordan, where banks are the principal source of external finance for SMEs. However, according to the ICA, only 11 percent of bank lending goes to SMEs, compared to 25 percent in emerging markets. SMEs are undercapitalized and predominantly financed through internal funds, as well as, informal sources. The 2013 IFC Enterprise Finance Gap database shows the large disparities in

terms of access to credit by size of firms. Only 12 percent of the micro firms have a loan versus 44 percent of small firms and 70 percent of medium sized firms (Figure 1).

4. Around 18 out of 25 banks have established dedicated SME departments, or have the capability to lend to SMEs. Several banks rely primarily on collateral-based lending rather than creditworthiness, leaving creditworthy SMEs unfinanced. Most loans require collateral, equal to about 23 percent more than the loan value, where small firms report having provided higher collateral than large ones. Moreover, the enforcement of basic contractual rights is cumbersome, time consuming and costly, representing a significant disincentive when lending to SMEs. To address this, several Jordanian banks use internal ratings systems for SME lending, which are based on a financial and qualitative analysis of SMEs. Furthermore, the first private credit information company was established in December 2014.

5. At the Governorates level SMEs face bigger challenges. Few banks and government authorities have branches and offices in the different Governorates, reducing SMEs access to services. The licensing procedures and requirements by municipalities can be quite burdensome and expensive for SMEs. According to a recent World Bank survey (2011), SMEs identify tax rates and macroeconomic uncertainty as key constraints.

6. On the demand side, the MSMEs skills and capacity holds back their access to finance. Enterprises often lack transparency, and do not have audited financial statements. SMEs are perceived as less stable, and lack competent management, and hence considered more risky. These enterprises do not have sufficient collaterals, and when they do, they are not registered, making foreclosure difficult if not impossible. SMEs often refrain from applying for bank loans due to their disbelief in interest-based borrowing. Small firms placed considered business licensing and regulatory policy uncertainty are factors that are hindering their growth. Municipal inspections are common challenges; however, they have not been associated with informal payments.

7. MSMEs growth is constrained by various factors. On the supply side, MSME lending is hampered by an inadequate legal and institutional framework for secured transactions and insolvency, lack of credit reporting and information, and weak regulatory and supervision of financial services. A guarantee or risk-sharing mechanism can help compensate for the financial infrastructure deficiencies in the interim, as Jordan improves its credit information, secured transactions and insolvency. The Jordan Loan Guarantee Corporate (JLGC) contribution to SME lending is currently low at 3575 guarantees in 2014. The JLGC's product offering needs to be improved, and its systems to be modernized in order to enhance its effectiveness.

8. Startups lack access to finance and to debt financing. The government of Jordan is very active in catalyzing a growing entrepreneurial ecosystem, startups and the Venture Capital industry in Jordan. Entrepreneurship development initiatives backed by the Jordanian government include for instance the Jordan Enterprise Development Corporation, King Abdullah II Fund for Development, Queen Rania Center for Entrepreneurship and iPARK as well as partially government-funded incubator Oasis500. Jordan is considered as one of the main startups hub in the MENA region, but even with the existence of these g overnment initiatives and a wide range of private sector-driven Venture Capital companies and angel networks there is still a lack of financing for startups. Even though these government initiatives exist, Jordanian startups are challenged to receive especially follow-up funding after incubation and loans for startups (venture debt), which are not provided widely through banks in Jordan. The main challenges faced by Jordanian startups are the lack of follow-up funding between $200,000 and $500,000 and the need for additional business development services exceeding the supply currently offered (infoDev, 2012).

9. Therefore strengthening the ecosystem requirements through creating innovative financing mechanisms between banks and private Venture Capital stakeholders would boost the Jordanian entrepreneurial ecosystem. The promotion of venture debt financing via banks utilizing the current

and upcoming product offerings of JLGC (such as the JLGC Entrepreneurs Loan Guarantee Program), would support the sustainable growth of the Jordanian entrepreneurial ecosystem.

II. Proposed Development Objectives

A. Current Project Development Objectives – Parent

The objective of the Project is to contribute to the improvement of access to finance for micro, small and medium enterprises in the Hashemite Kingdom of Jordan.

III. Project Description

Component Name

Comments (optional)

IV. Financing *(in USD Million)*

Total Project Cost:	50.00	Total Bank Financing:	50.00
Financing Gap:	0.00		

For Loans/Credits/Others	Amount
Borrower	0.00
International Bank for Reconstruction and Development	50.00
Total	50.00

V. Implementation

1. The Ministry of Planning and International Cooperation, in agreement with the Ministry of Finance have designated the CBJ as the implementing agency for the Project, which will be responsible for coordinating and managing the overall project. The CBJ was selected as the implementing agency, being the entity responsible for regulating and supervising the banking system in Jordan (which constitutes the vast majority of the financial system), composes 22 commercial banks and four Islamic banks. There are no development banks in Jordan (unlike in Turkey or India), no SME-focused development banks and no state-owned banks. Hence the most effective way to reach MSMEs is through banks. Since there is no viable or sound apex institution, the best way to channel funds through banks is through the central bank. Such a project structure is much more efficient than a structure involving individual participation agreements with each participating bank, as it helps assign clear accountability and reporting duties to one institution, ensures better coordination during implementation, and facilitates project monitoring and supervision.

2. The OM acceptable to the Bank has been prepared by CBJ. The OM includes, among other things, the agreed financial management (FM) and disbursement arrangements; procurement arrangements; Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants, dated October 15, 2006 and revised January 2011; and a detailed framework for the continuous measurement and monitoring of outcomes, a key element in ensuring effective implementation.

3. The CBJ has established a PIU headed by the Acting Executive Manager of the Financial Stability Department, and comprising representatives from the Data Analysis Division, the Studies and Licensing Division, the Legal Department and Investment, and the Foreign Operations Department. The PIU is mandated to oversee and implement the Project in line with the implementation arrangements detailed in the OM. The CBJ will be responsible for ensuring compliance of project activities to the fiduciary and safeguards arrangements for the project. Given its financial capacity and track record based on the OP 8.30 review (see Annex 13), the CBJ is well placed and has the capacity to implement the project and ensure compliance during implementation.

4. The CBJ will channel the funds to the banks in accordance with the eligibility criteria and procedures outlined in the OM. There will be a subsidiary agreement signed between the Borrower and the CBJ whereby the Borrower on-lends the proceeds of the loan to the CBJ for implementation of the Project under terms and conditions acceptable to the Bank. Funds would be received in the CBJ's main account and disbursements will be made on a reimbursement basis using interim unaudited financial reports (IFRs)—evidencing actual expenditures—prepared by the CBJ. IFRs will be submitted on a quarterly basis, but the CBJ would have the flexibility to seek reimbursement earlier than the quarterly intervals by submitting reports for shorter periods. All the above will be coordinated by the PIU, and reported to the CBJ management.

5. All assessments of the CBJ have shown that it has adequate financial management systems and procedures to generate the quarterly IFRs in the agreed upon formats, detailed in the OM. Procurement under the Project is limited to the TA component.

6. An Environmental and Social Management Framework (ESMF) has been developed to identify, minimize, avoid, screen out, mitigate and monitor potential social and environmental impacts in compliance with both World Bank policies and Jordan's applicable laws and regulations. The ESMF will be applied by the banks in the selection and supervision of MSME sub-projects to be financed. The ESMF was disclosed prior to appraisal, and was adopted by the CBJ. The CBJ's capacity to monitor, evaluate and report on the ESMF is modest although the CBJ has dealt previously with social and environmental safeguards issues.

7. Arrangements will be put in place to ensure adequate project supervision, covering fiduciary and safeguards aspects, with semi-annual supervision missions. The supervision team will draw on expertise from the Bank as well as external experts, where necessary. Meetings with other concerned stakeholders engaged in MSME finance and microfinance, including donor agencies, will be undertaken during supervision missions.

8. Banks will be required to distinguish between lending to MSME and to MFIs, notably in their reporting requirements in terms of number of beneficiaries reached. The number of microfinance clients served through banks on-lending to MFIs should be reported separately.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01	×	
Natural Habitats OP/BP 4.04		×
Forests OP/BP 4.36		×
Pest Management OP 4.09		×
Physical Cultural Resources OP/BP 4.11		×
Indigenous Peoples OP/BP 4.10		×
Involuntary Resettlement OP/BP 4.12		×
Safety of Dams OP/BP 4.37		×

Projects on International Waterways OP/BP 7.50		x
Projects in Disputed Areas OP/BP 7.60		x

Comments (optional)

VII. Contact point

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