PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: AB5071

Project Name	Egypt Enhancing Access to Finance for Micro and Small Enterprises
Region	MIDDLE EAST AND NORTH AFRICA
Sector	Micro- and SME finance (100%)
Project ID	P116011
Borrower(s)	ARAB REPUBLIC OF EGYPT
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1. Key development issues and rationale for Bank involvement

The global economic slowdown that began in 2008 has had an adverse effect on Egypt's growth performance. The benign international environment, together with domestic economic reforms and prudent macro management, helped Egypt's economy grow at a yearly average of seven percent during FY06–FY08. In FY09 growth is expected to be four percent, and to remain around that level in FY10. As a result, employment growth is expected to fall to 2.3 percent, and the unemployment rate is expected to increase to about 10 percent before the end of the year.

Micro and small firms have been disproportionately affected by the slowdown in economic activity as evident in a recent survey of 200 firms recently conducted by the Bank. The adverse impact of the slowdown on micro and small firms, conservatively estimated at 5 million, is worrisome, as they account for over 99 percent of enterprises, 85 percent of non-agricultural private-sector employment, and almost 40 percent of total employment. Lack of access to finance is one of the major factors that have constrained the growth of these micro and small firms—only an estimated five percent currently receive credit, and the Central Bank of Egypt (CBE) reports that bank loans to these enterprises remains limited to less than one percent of total loans.

The lack of access to finance reflects at least three sets of factors, namely; the reforms of the financial sector undertaken since 2004; the recent financial crisis; and the factors specific to micro and small enterprises. The first two sets of factors affected the overall provision of credit

in the Egyptian economy, as indicated by the sharp decline in private credit relative to GDP, from 65 percent in 2003 to 40 percent in 2008, as well as a decline in the loan-to-deposit ratio from 70 percent to 50 percent in the same period. The financial reforms have entailed large scale restructuring and tighter regulation and supervision, leading both public and private banks to provision for their losses and adopt more cautious lending policies. The crisis has reduced the pace of credit further, by causing a retrenchment of foreign capital, slowing down deposit growth, and increasing further the degree of risk aversion by banks, leaving less credit available for the private sector.

In addition to the overall constrained macro-financial environment, there are demand and supply factors affecting the access of micro and small enterprises to credit. These include lack of capacity to prepare a business plan and loan application, opaque financial statements, and insufficient collateral, as well as inadequate banking skills, high administrative costs of small scale lending, and remaining deficiencies in financial infrastructure. In this regard, it should be noted that a new credit bureau is still expanding and cleaning its database and is not yet providing credit scoring of micro and small enterprises, while a functional system of moveable collateral that would facilitate lending to small firms has not been introduced yet.

Enhancing access of micro and small enterprises to finance has always been an important component of the government's agenda. The policy efforts in recent years have included the implementation of the Financial Sector Reform Program (2004-2008); the issuance of the Small Enterprise Law 141 of 2004; the creation of the Small Enterprise Development Organization (SEDO) under the Social Fund for Development (SFD); the endorsement of the National Microfinance Strategy in 2005; the issuance by CBE of Decree 2408 of 2008, reducing reserve requirements for lending to small firms; the establishment of the Small Enterprises Unit at the Egyptian Banking Institute (EBI) providing capacity building to banks; and the launching of the small exchange NILEX in 2008, facilitating small firms access to equity capital.

Strengthening the legal and institutional framework for micro and small enterprise finance has recently become a priority in the government's reform agenda. While the first stage of the Financial Sector Reform Program focused on financial stability, the second stage for the coming five-year period (2009–2013) focuses on financial intermediation and access. Key components of this program include, the establishment of the first Egyptian Financial Supervisory Authority (FSA) under Law 10 of 2009; the issuance of a new law on secured lending; further improvements in the services offered by the credit bureau including developing a scoring and rating systems; and tax exemption for micro and small firms for the first five years under the new tax law. In addition, SFD has developed in 2009 the Micro and Small Enterprise Development Strategy (2009–2013), aiming at attaining an enabling environment.

SFD leads the national program for micro and small enterprises, and currently provides finance to 208,220 microenterprises and 98,564 small enterprises. This represents an important clientele, but the numbers are still modest by comparison with the potential universe of borrowers (2.3 million formally registered micro and small enterprises), and the estimated universe of enterprises amounting to 5 million. Moreover, small enterprises served by SFD have on average a very small number of employees (about 8 on average), revealing the existence of a "missing middle" and missed opportunities for growth. SFD works through 435 non-government organization (NGOs) that are mostly small. Banks provide some financing to small firms but the

volumes are very minimal (amounting to less than one percent of total loans), and primarily through SFD funding and the associated generous guarantee. Banks are still reluctant to engage their own resources to small enterprises finance because of the factors mentioned above.

In that context, the government requested Bank's financial and technical assistance on June 1, 2009 to support SFD in developing the micro and small enterprises sector. SFD is the responsible entity, as mandated by Law 141 of 2004. Presided by the Prime Minister, SFD has strong commitment and ownership, ensuring effective implementation of the operation. The political commitment to enhancing financial intermediation, evidenced by the Presidential Pledges, indicate that the proposed project is timely, aligned with the objectives and efforts of the government and SFD in improving financial intermediation in Egypt.

The proposed operation would contribute to the government's objective of promoting sustained access to finance to micro and small enterprises. It would address the severe shortage of funding to NGOs that provide financing for microenterprises, and also address the shortage of bank financing to small enterprises, aggravated by increased risk aversion in the current economic context. The operation would also ensure the achievement of the strategic objectives of the 2006–09 Country Assistance Strategy (CAS), and the 2008 CAS Progress Report. This project addresses two key strategic objectives of the CAS, namely; facilitating private sector development through improving financial sector competitiveness and efficiency; and promoting inclusive growth and equity.

The rationale for advancing this proposed operation is twofold: (i) enhance the long-run efficiency and productivity of the Egyptian economy by contributing to a sustained framework of micro and small enterprise finance; and (ii) reduce the impact of the global crisis on micro and small enterprises that are responsible for a large share of employment. The operation would provide medium-term financing for investment and also ensure that enterprises have access to working capital. Bank financing would complement the government's reforms to the enabling environment, providing a stimulus for the upgrading of NGOs into regulated micro finance institutions (MFIs) and encouraging sound bank lending to small enterprises.

Strong partnership has been established between the Bank and the authorities through policy dialogue, technical assistance, and key operations focusing on financial sector stability and development. The Bank's financial sector work program has included two Development Policy Loans (DPLs) that have supported the restructuring of the banking sector and the development of non-banking financial institutions and markets, as well as seven Financial Sector Reform and Strengthening (FIRST) initiatives that have *inter alia* contributed to improved financial infrastructure.

Analytical underpinning to the design of the operation includes the 2007 *Finance for All: Policies and Pitfalls in Expanding Access*, 2007 *Access to Finance and Economic Growth in Egypt*, 2007 *FSAP Update*, 2009 *ICA*, and 2009 *Egypt Macroeconomic Policy Note*. Moreover, well documented international experiences comparing different approaches to promote access to finance to micro and small enterprises and reducing informality will inform the design of this operation. Finally, during appraisal, the team will conduct a micro and small enterprise finance survey with leading banks that has already been conducted and tested in several countries in Latin American and Central Europe.

The World Bank Group's work in Egypt's financial sector has been considered exemplary by IEG especially in terms of comprising a continuum of instruments, from analytical work, technical assistance, and lending from International Bank for Reconstruction and Development (IBRD), to advisory services from the Consultative Group to Assist the Poor (CGAP), and capacity building by the World Bank Institute (WBI), as well as International Finance Corporation (IFC) investments and advisory services. In addition, the operation is being prepared in close coordination with development partners actively involved in micro and small enterprise development.

2. Proposed objective(s)

The project development objective is to contribute to sustainable access to finance for micro and small enterprises on a commercial basis, thus promoting growth and job creation, minimize the impact of the financial crisis on micro and small enterprises, and attaining an inclusive system. Project beneficiaries will be: (i) microenterprises, defined as enterprises with paid-in capital of less than LE 50,000; and (ii) small enterprises, defined as enterprises with paid-in capital of LE 50,001 till LE 1 million, and up to 50 workers. The project will initiate a successful institutional framework that can enable eventual nationwide rollout and scaling up.

The project's objectives would be achieved through: (i) unblocking the expansion of microfinance by providing additional funds through SFD to eligible NGOs; (ii) improving governance of NGOs through innovative approaches to deliver and recover loans on commercial basis in an efficient and a cost-effective manner, and transforming them into profitable MFIs regulated under the newly established FSA; (iii) helping microenterprises graduate to formal small enterprises; (iv) engaging the banks in sound small enterprise lending, both through the provision of support services and complementary funding to their own deposits; and (v) ensuring gender equality in terms of access to finance. It must be noted that this operation is taking place in a moment when the government is also making an effort to improve the enabling environment to small enterprise finance and reduce the related risks for banks.

3. Preliminary description

This operation provides a credit line through SFD, the apex body for micro and small enterprise finance. SFD would on-lend on commercial terms to eligible NGOs (serving microenterprises) and banks (serving small enterprises). The envisaged allocation of the Bank loan would entail 50 percent to micro enterprises, and 50 percent to small enterprises. This approach is about finding pathways to bring NGOs and potential MFIs into the financial system, helping microenterprises graduate to small modern formal enterprises, and promoting commercial bank lending to small enterprises. Participating NGOs and banks would be selected by the SFD based on institutional capacity, portfolio size and quality, and most importantly, willingness to leverage significantly the volume of credit lines made available by the project.

Financing from SFD would be disbursed in tranches based on regular monitoring of an agreed set of performance indicators covering disbursement, outreach, quality of portfolio, and proportion of women clients.SFD loans would charge an interest rate to cover SFD repayment to the Bank, its operational expenditures, and foreign exchange risk. SFD has a proven track record as an apex financier of banks and MFIs, with excellent disbursement and reported portfolio

quality levels on its microfinance and small enterprise finance portfolio. The design of the credit line will incorporate lessons learned in previous operations in Egypt and elsewhere with respect to pricing, project evaluation, and targeting of end-clients. In order to achieve a significant and sustained development of micro and small enterprises in Egypt, this operation will be complemented by business support services and advisory work on business development. These are offered by the Non-financial Services Unit at SFD, the Small Enterprises Unit at EBI, or through technical assistance and advisory work under other Bank activities and other donors.

4. Safeguard policies that might apply

The Bank's Operational Procedures (O.P) 4.01 states *"A proposed project is classified as Category FI (Financial Intermediary) if it involves investment of Bank funds through a financial intermediary, in subprojects that may result in adverse environmental impacts."* To ensure that any potential environmental impacts are identified through on-lending, this project is classified as Category FI and follows the procedures as set out in O.P 4.01. The Bank will therefore require the Financial Intermediary to screen proposed subprojects and to ensure that sub-borrowers carry out appropriate Environmental Assessment (EA) for each subproject. Before approving a subproject, the FI verifies that the subproject meets the environmental requirements of appropriate national and local authorities and is consistent with this OP and other applicable environmental policies of the Bank. However, no significant adverse environmental impacts are expected under the project. The project will not trigger social safeguards.

5. Tentative financing

Source:		($m.)
Borrower		0
International Bank for Reconstruction and Development		300
	Total	300

6. Contact point

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