## Project Information Document (PID)
### Concept Stage

<table>
<thead>
<tr>
<th><strong>Project Name</strong></th>
<th>Micro and Small Enterprise Development for Inclusive Growth (P146244)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Region</strong></td>
<td>MIDDLE EAST AND NORTH AFRICA</td>
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<tr>
<td><strong>Country</strong></td>
<td>Egypt, Arab Republic of</td>
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<td><strong>Sector(s)</strong></td>
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<td><strong>Theme(s)</strong></td>
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<td><strong>Lending Instrument</strong></td>
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<td><strong>Project ID</strong></td>
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<td><strong>Borrower(s)</strong></td>
<td>Government of Egypt, Ministry of International Cooperation</td>
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<td><strong>Implementing Agency</strong></td>
<td>The Social Fund for Development</td>
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<td><strong>Environmental Category</strong></td>
<td>F-Financial Intermediary Assessment</td>
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<td><strong>Date PID Prepared/Updated</strong></td>
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<td><strong>Date PID Approved/Disclosed</strong></td>
<td>12-Nov-2013</td>
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<tr>
<td><strong>Estimated Date of Appraisal Completion</strong></td>
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<td><strong>Estimated Date of Board Approval</strong></td>
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<td><strong>Concept Review Decision</strong></td>
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Other Decision (as needed)

The review authorized project preparation, and agreed to process the project following Track 2. To ensure a quality operation, the team will move forward with a Quality Enhancement Review (QER) meeting shortly (August), prior to the Decision Meeting.

The country and sectoral context will be updated in the PAD, reflecting latest developments.

The design of the project will benefit from the experience of other operations, and IFC’s expertise and knowledge in the sector.

The link between this operation and the Governance for Jobs Project will be put more explicit.

The PAD will document in more details how improving access to finance for MSEs will help in playing a more pivotal role in employment generation, documenting the impact of the on-going project in creating jobs, mainstreaming gender, and reaching out to the poor villages and underserved Governorates.

The PDO will be made more simple and linear. The team will coordinate with MNAOS on this matter.

The design will be finetuned during preparation to reduce and streamline the number of actual funding mechanisms, based on consultations and assessment of market needs and priorities.

Financing mechanisms would be more clearly defined, differentiating between the outreach venues from the cross cutting tools, and the actual lines of credit.

Innovative aspects of the proposed operation would be documented to distinguish it from the previous one.

Rational for selecting SFD as the implementing entity will be provided in the PAD, and throughout the preparation phase, the team will continue to capitalize on the on-going capacity building and modernization of SFD to ensure effective and efficient implementation.

MNA Readiness Checklist will be a key tool used to ensure timely and smooth implementation.

Project design will include stakeholders feedback mechanism.

The review discussed the risk ratings of the project, and agreed to revisit the ratings during preparation, and appraisal.

Results Framework will include the core indicators used by the MNA Region to measure results.

The review confirmed the project category as FI, according to OP 4.01.

All safeguards assessments will be updated and finalized before appraisal; and the updated ISDS and safeguards documents, including, the Environmental and Social Impact Assessment Framework, would be disclosed in-country and in Infoshop during preparation mission, and before appraisal begins, and this would be reflected in the updated Operational Manual.

The team will begin preparing the PAD along with the ISDS, ESIA, and ESMF, as well as finalize the Operational Manual with SFD prior to the QER, and will take into account the comments and guidance provided at the Review Meeting, and the MNA readiness checklist.
I. Introduction and Context  
Country Context
The Egyptian economy has been in a deteriorating tailspin since the 25th of January 2011 revolution. Economic growth reached 2.2 percent in FY12, and is expected to remain at almost the same level in FY13. The fiscal deficit has soared to reach 10.7 percent of Gross Domestic Product (GDP) in FY12, and is projected to reach 12 percent in FY13. Inflation is picking up (8.8 percent in April 2013) mainly due to currency devaluation, compared to 4.1 percent in November 2012. The sluggish growth and fiscal deficit have had a negative effect on the creation of economic opportunities.

The overall economic and political instability has adversely affected investments, and the growth of the private sector. Domestic investment fell to 16.7 percent of GDP in FY12, and is expected to decrease further in FY13. Foreign direct investments (FDI) have fallen to 0.8 percent of GDP in FY12. The business environment and the security situation have also discouraged the establishment of new enterprises. Micro and small enterprises (MSEs) were disproportionally affected by the deteriorating business climate and the security situation.

The widening deficit led to the crowding out of private sector credit, further diminishing the already low financing available. Banks opted for purchasing less risky, high-yield Government bonds and Treasury bills that reached 58 percent of GDP, leaving very little loanable funds available. Credit allocated from the banking sector to the government-to-total credit has been rising to reach 62 percent of total credit, while that to the private sector credit dropped to 28 percent as of April 2013. At the same time, Egypt’s credit rating has been downgraded several times by international financial institutions (Moody’s and Standards & Poor’s). Accordingly, the cost of financing for MSEs has increased, further hindering their access to finance.

All this has contributed to the rise in unemployment and poverty rates. Unemployment is on the rise, reaching 13.2 percent in Q1 2013 up from 8.9 percent in Q4 2010. This is especially striking among women at 25 percent, and youth at 42 percent. Poverty rate also increased to reach 25 percent in FY11 up from 21.6 percent in FY09. Overall, economic growth has been well below its potential, and, more importantly it has failed to create sufficient job opportunities, and has not been inclusive, creating more unrest among many segments of society.

Besides the anemic macroeconomic environment, governance and transparency remain pressing issues. Egypt rank is low, and deteriorating in almost all governance indicators. According to the World Bank Worldwide, Governance Indicators, government effectiveness, regulatory quality, and rule of law rankings have all declined in the past two years, and have remained below the 50th percentile compared to other countries. Weak governance, privileged lending, lack of a level playing field and unequal access to markets contributed to limited economic opportunities, an underdeveloped private sector, and have ultimately hindered job creation. Strengthening governance will be crucial to support the transition, enhancing credibility in public institutions, and giving equal access to markets, and opportunities is essential for restoring citizens confidence. It is critical to move towards a fairer and more competitive economy that utilizes market mechanisms to generate equal opportunities and create jobs.

Sectoral and Institutional Context
Empirical evidence shows that small and young firms are the main creators of new job opportunities in Egypt. MSEs account for more than 98 percent of enterprises. They generate more than 85
percent of employment in non-agriculture private sectors, and 40 percent of total employment. Despite the crucial role MSEs play, they encounter numerous challenges.

Entrepreneurship and new business formation is a linchpin to the process of innovation and creative destruction. Young firms are five times more likely to be “gazelles” which are estimated to be 3.5 times more likely to grow (measured by employment) than other firms. Yet, Egypt has a very low business entry rate.

Limited access to finance is one of the main obstacles facing entrepreneurs. Egypt’s rank in the 2013 Doing Business Report for ‘Getting Credit’ has deteriorated from 80th in 2012 to 83rd in 2013. In a recent Investment Climate Rapid Assessment Survey (2012), only 23 percent of MSEs have received a bank loan, while only 2.5 percent tap on non-bank financial institutions (NBFIs). More than 70 percent of the surveyed firms raised concerns regarding the surge in the cost of finance post revolution. Most MSEs resort to alternative sources of finance, relying on personal savings (79 percent) or inheritance (14.6 percent) to raise capital, and only four percent from the formal market.

MSEs suffer disproportionately from low financial intermediation. Only 11.1 percent of micro firms and 17.4 percent of small firms have bank loans, as opposed to 38 percent for large firms. Banks are reluctant to lend MSEs, especially young and new firms. These firms also face problems obtaining finance from other capital market vehicles. Venture capital and angel investors are almost completely absent from the Egyptian market. It is essential to empower NBFIs and widen their network to provide alternative sources of finance to MSEs, as bank loans remain the main source of debt financing to MSEs (50 percent).

Disparities in access to finance exist both between and within regions. Upper Egypt is the lowest region in terms of firms’ access to credit. Within Upper Egypt, there are large disparities among governorates. Giza has the highest share of firms with access to credit (11.8 percent), while the rest of the governorates’ shares do not exceed 3 percent. In the Metropolitan area, the share of firms with access to loans in Cairo is almost double that of Alexandria, the second runner in the region, while the percentage in the governorates does not exceed 1.5 percent. There is an urgent need to reach out to these underserved districts.

Gender disparities are also prevalent, with women entrepreneurs facing more challenges in accessing finance than men. Traditions, in some cases, give women little control over their own assets and they are unable to use them as collateral, being under the guardianship of a male member of the family. In addition, banks impose high collateral requirements for women, being perceived as more risky due to their need to balance their family responsibility and work. Moreover, cultural barriers and norms, limit women’s mobility. Funds should be allocated to their most productive uses with no discrimination by gender. Enhancing women’s access to finance and providing them with an equal opportunity will lead to shared economic prosperity.

Another challenge that prevents entrepreneurs from tapping on financial markets is the limited access to Shari’a-compliant financial products. Over the past year, there has been a growing demand for Islamic financial products. Data from the enterprise survey shows that 28 percent of those who did not apply for a loan, despite their need, did not want to deal with interest rate. Expanding access to Islamic financial services will unleash opportunities for a significant segment of young, poor and unprivileged Egyptian entrepreneurs, especially those in rural areas.
The weak financial intermediation of MSEs is attributed to various factors. One of the challenges encountering MSEs is lack of transparency, and their inability to hold regular bookkeeping records and issue audited financial statements. This is partially due to their inadequate capacity. Banks and other financial institutions are unwilling to lend to firms that do not have audited financial statements or concrete business plans. Moreover, smaller firms often do not have sufficient collateral, which is required by banks. There are also limited financial products offered to MSEs. In poor villages, there is often lack of physical access, as it is not cost-effective for financial institutions to establish branches in areas where the client base is small.

The dire political and economic situation in Egypt calls upon innovative approaches to incentivize economic growth and job creation. One important solution is unleashing the potential of MSEs especially fast-growing ones, which empirical evidence has shown to be the most significant employment generators.

In that context, the Government of Egypt has set MSE development as a priority in the reform agenda. The Prime Minister issued Decree No. 318 of 2013 on April 1, 2013 mandating the SFD—the apex institution to be in charge of coordinating the national effort of preparing a National Strategy for MSE Development, with the objective of addressing the key challenges confronting the sector, and putting forward an action plan for immediate implementation whereby MSEs play a more pivotal role in providing employment opportunities.

This operation aims at scaling up efforts on expanding access to financial services in Egypt. It will foster financial innovation to generate employment opportunities and promote more sustainable and inclusive growth. The proposed operation will be tailored to fill the financing gaps in the Egyptian market and enhance inclusiveness in access to finance, reaching out to underserved governorates and marginalized groups such as women and youth.

**Relationship to CAS**

The proposed operation is closely aligned with the 2012 Interim Strategy Note (ISN) for Egypt (2012-2014), discussed by the Bank’s Board of Executive Directors on June 28, 2012—a partnership with a newly elected Government, which will involve a different way of doing business. The ISN envisions attaining a level playing field and supporting MSE development, by setting as a priority improving access to finance for MSEs, which the proposed operation aims to achieve through interventions in poor villages and marginalized governorates, and also focusing on women and youth.

The Project addresses the three pillars of the ISN, namely:

(i) Improving economic management through strengthening governance, enhancing transparency, and accountability of public entities, private sector companies, and the financial system by requiring SFD to disclose its financial statements, improving its governance structure, and setting eligibility criteria for financial intermediaries that enhances their transparency through publishing information more regularly and comprehensively. Moreover, MSEs will be required to keep regular accounting books and issue audited financial statements, which will ameliorate transparency and accountability.

(ii) Creating jobs by improving the business environment, and enhancing access to finance so that the private sector can function efficiently, fostering economic opportunity, competition, innovation
and entrepreneurship with the objective of achieving sustainable private sector-led growth. The importance of MSEs to job creation cannot be overemphasized. MSEs generate the vast majority of jobs in the non-agriculture private sector; and supporting start-ups is critical to employment generation.

(iii) Fostering inclusion and ensuring broader access for disadvantaged segments of the population—women, and youth, as well as, lagging geographical regions. The project will promote economic inclusion through designing special products for women, addressing the high youth unemployment, and expanding the network of beneficiaries through reaching out to marginalized regions via innovative mechanisms and tools (financial leasing, Islamic finance, post office, venture capital, etc.).

The Project’s objective is also aligned with the Bank and IFC’s Regional Framework and Strategy for the MENA Region, which has evolved to respond to the events of the Arab Spring and focuses engagement on inclusion, job creation, and sustainable private sector-led growth. Through contributing to improved access to finance for MSEs, this operation will ultimately expand employment opportunities through the development of the private sector. In doing so, the operation will demonstrate how improved financial intermediation for MSEs can create more private sector jobs, develop entrepreneurship and spur overall economic growth.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The project development objective (PDO) would be to contribute to the improvement and expansion of access to finance for MSEs in Egypt, as well as reaching out to start-ups, using innovative approaches, with a special focus on youth and women.

Key Results (From PCN)

Progress towards achieving the project’s objectives will be measured by a series of quantitative and qualitative indicators at the PDO and at the intermediate level.

Key results and indicators at the PDO level, are: (i) number of MSE beneficiaries financed under the line of credit; (ii) overall MSE portfolio of participating financial institutions; (iii) number of innovative financial products offered to MSEs; (iv) number of jobs created by MSE beneficiaries of the project; and (v) percentage of underserved groups (women and youth) financed.

Intermediate indicators would also be tracked, including: (i) youth-owned businesses as a percent of total businesses served by the line of credit; (ii) women-owned businesses as a percent of total businesses served by the line of credit; (iii) volume of small financing from the line of credit to participating financial institutions; (iv) number of small enterprise clients; (v) overall microfinance portfolio of participating lenders; (vi) number of microfinance enterprise clients; (vii) portfolio at risk for participating lenders, 30 days; (viii) number of participating financial leasing companies; (ix) number of venture capital companies and angel investors engaged; and (x) number of women served through the line of credit.

Monitoring and Evaluation. A robust system to monitor and evaluate progress is crucial to the project success, and will be implemented based on the agreed results framework, monitoring arrangements and indicators. A strong monitoring and evaluation (M&E) framework to track inputs,
outputs, and outcomes in a systematic and timely fashion is being discussed, and will be agreed on with SFD during the preparation phase. The data will be generated as an integral part of the day-to-day business of the participating financial institutions and NGOs-MFIs, as well as, from an impact evaluation with a tailor-made baseline and follow-up surveys to precisely assess impact on the ground and delivery (job creation, poverty reduction, gender mainstreaming). M&E will be based on clearly identified benchmarks and output indicators that feed into the project indicators. In addition, a beneficiary feedback mechanism will be integrated in the project.

SFD will monitor and analyze financial statements, audited reports, expenses, and other material information. The reports produced will also serve to evaluate the effectiveness of the loan. Participating financial intermediaries are required, under the terms of the on-lending financial agreement, to submit Monthly Operations Reports. SFD already complies with this, the following data is collected on a monthly basis from its borrowers: disbursement of the SFD’s line of credit to the borrower, borrower outreach (number of loans/accounts), female participation, portfolio quality, and profitability (a sustainability reporting indicator is being added in the case of NGOs). This is consistent with the World Bank core indicators required for reporting on MSE finance projects.

SFD requires the following reporting from participating banks: (i) borrower information, including name, amount, loan terms, purpose of loan, disbursed loan amount, any rejected loan applications, jobs created, gender, whether existing or start-up; and (ii) portfolio information, including, quarterly reports on non-performing loans (NPLs), disbursement and repayment amounts. SFD will receive more detailed quarterly reports, containing both quantitative and qualitative information from the project implementation consultant. SFD will provide Project Implementation Reports to the Bank on a semi-annual basis for the duration of the project. It also carries the final responsibility for collecting the data from the participating NGO-MFIs and banks and producing the regular monitoring reports.

III. Preliminary Description

Concept Description

The project is a Financial Intermediary Loan (FIL), line of credit to the Government of Egypt, amounting to US$ 300 million that will be channeled through the SFD—the apex institution, which is mandated to lead and coordinate the MSE development sector in Egypt. SFD would then on-lend to financial intermediaries that would ultimately reach the end beneficiaries, namely MSEs, as well as start-ups. The foreign exchange risk will be carried by the Government. Numerous innovative mechanisms will be tapped on to enhance access to finance through offering financial products for MSEs (financial leasing, venture capital); designing products that would mitigate the hurdles faced by some enterprises (special products for women); expanding outreach in underserved villages (through post offices); and addressing unmet demands (Islamic finance). All this will contribute to improving financial intermediation, enhancing access to finance for different segments of the society, which will ultimately contribute to the creation of sustainable private sector jobs.

Financing mechanisms covered under this project would be as follows:

Line of credit through banks. Funds from the line of credit will be channeled through SFD to eligible participating banks that either have an active MSE portfolio, large branch network in the different Governorates, or the willingness and capacity to develop one. The banks will then on-lend to MSEs—the ultimate end beneficiaries. The participating banks could be incentivized through
various mechanisms, such as training and capacity building under the MENA MSME Facility. Eligibility criteria and the appraisal of funding proposals from banks will form the basis of selection.

Line of credit for NGOs-MFIs. Funds will be channeled through SFD to eligible participating NGO-MFIs that will then on-lend to micro enterprises. Based on eligibility criteria identified, funding will be focused on high performing, high potential NGO-MFIs. NGOs-MFIs play a crucial role in the development of the marginalized regions through their branch networks in poor villages. Women owned-micro enterprises benefit from such mechanisms, as they account for more than 85 percent of this sector, contributing to women’s economic empowerment, especially in rural areas.

Wholesale microfinance development facility with banks. SFD will set-up financing facilities with banks, to provide wholesale funding to NGOs-MFIs. Banks would be expected to provide matching funds from their own resources. This would stimulate the growth of more market-based funding for NGOs and MFIs and link microfinance to bank resources. The SFD involvement provides banks with valuable market knowledge and also NGO-MFI assessment techniques. Two banks have already pursued this arrangement with SFD for its knowledge of the microfinance market, and clients’ network.

Line of credit through financial leasing companies. The SFD will channel the funds to the financial leasing companies that will cater to MSEs. This would benefit younger and smaller firms, as well as enterprises that do not have a lengthy credit history or a sufficient asset-base to use as collateral. Leasing can play a critical role in bridging the finance gap and bringing smaller businesses into the formal financial sector. As opposed to other financial instruments, leasing, being an asset-based financing option, also has the added advantage of being an inherently Shari’a-compliant product, which makes it an attractive financial option for enterprises in Egypt with an appetite for Islamic finance.

Equity investments—venture capital and angel investors. Venture capital and angel investors are essential financing vehicles to small and young firms that have limited access to banking services. A certain minimal percentage of the proposed operation amount would be channeled through SFD to a financial intermediary (venture capital company or NGO) that would invest in innovative value-adding start-ups, taking the form of matching funds alongside angel investments. This mechanism will cater to young potential entrepreneurs with innovative ideas, yet lack funding to venture into businesses. It will also introduce a new and specialized financing mechanism for start-ups.

Gender-based finance. Designing special financial products and windows for women will enhance their access to finance, contributing to their economic empowerment. This will benefit from the impact evaluation that is being conducted with the support from the Gender and Development Department. In order to achieve inclusive growth, it is important to target women-owned enterprises through developing new gender-based products, developing special windows for women, especially in marginalized governorates where there are more social and cultural barriers. Banks and NGOs-MFIs networks will be capitalized on to provide financing for women entrepreneurs, especially micro enterprises.

Post office network through NGOs-MFIs. SFD will on-lend to NGOs-MFIs that will tap on the huge branch network of the Egypt Post, which is widespread in the poor villages. The designated financial intermediary (NGO-MFI), as well as, MSEs, will open accounts in the post office, and
funds will flow through the post office network from the former to the latter. This mechanism will reduce transaction costs and administrative burdens. More importantly, micro and small borrowers will have enhanced access to finance and better exposure to financial services and markets through dealing with the post office. This mechanism will also encourage saving, in addition to reduction in cash dealing.

Islamic finance. There is demand for Shari’a-compliant products—equity-based financial instruments such as Mudarba and Musharaka—to promote entrepreneurship, share risks, and foster financial intermediation. The project will promote the deepening of MSEs access to Islamic financial products through mainstreaming other risk-sharing non-bank financial services as Ijarah—leasing, as well as micro Takaful—insurance. The provision of Ijarah instruments will reduce business entry costs for startups and strengthen their competitiveness especially during their infancy stage. Moreover, micro Takaful will help with hedging against unanticipated shocks to MSE’s, especially during the startup phase. SFD will on-lend to banks to provide Islamic products to small enterprises, and to SFD-NGOs to reach out to micro enterprises.

IV. Safeguard Policies that might apply

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V. Financing (in USD Million)

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VI. Contact point

World Bank

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**Borrower/Client/Recipient**  
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