I. Country Context

1. The complex challenges facing Yemen today must be understood in the context of Yemen’s broader economic and social context and the effects of the recent crisis on social and economic conditions. A contraction of economic activity, due to the crisis, affected all sectors of the economy and continues to do so. Since 2011, the economy has contracted by almost 11 percent, and the number of people living below the poverty line increased by an estimated 12 percentage points in two years.\(^1\) Even prior to this latest crisis, Yemen was already one of the poorest countries in the world. The country has a GDP per capita of US$1,160 (2010) compared with an average US$2,321 for lower middle-income countries and US$3,597 for the Middle East and North Africa (MENA) region. The population living below the national poverty line was 35 percent in 2005/2006, increasing to 54.5 percent by the end of 2011 with poverty more widespread and persistent in rural areas.\(^2\) On the United National Development Programme Human Development Index, Yemen ranked 154th out of 187 countries in 2011.\(^3\) On the other hand, indicators have improved over the past few decades. The report shows that average life expectancy is up from 41.6 years in 1970 to 62.7 in 2010. Enrollment rates in basic education have increased

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\(^2\) Ibid.

\(^3\) Human Development Report, UNDP, 2011.
significantly (up from 68 percent to 76 percent from 1999-2011), and enrollment in technical education and vocational training (TEVT) has increased 15 times from 2000-2009. While there have been gains over the years, women’s inclusion in development gains is an acute challenge in Yemen. Female literacy rates stood at only 44 percent in 2006, but that was almost double the level of ten years earlier. Maternal mortality stood at 210 per 100,000 births in 2009, the highest in the region, but that is down 38 percent since 2000. Women’s economic participation has not progressed as well; at 21 percent female labor force participation is among the lowest in the world, and women’s participation in business is even more limited.4

2. Despite the serious and complex challenges facing Yemen today, the Government of National Reconciliation (GNR) has an opportunity to start addressing the underlying factors of instability and social strife to rebuild Yemen’s social and economic base and restore macroeconomic stability. Regional and international partners have pledged their support to help Yemen to overcome the short term social and economic impact of the crisis and sustain development. At the donor conference in Riyadh in September, 2012, the international community committed to support Yemen in its recovery. Donor countries and agencies pledged US$6.372 billion towards the priorities of the Transitional Plan for Security and Development (TPSD). The subsequent Mutual Accountability Framework (MAF) committed both the GNR and donors to a set of specific actions towards recovery and growth.

3. In October, 2012, Yemen joined the Deauville Partnership with Arab Countries in Transition, in which G-8 countries, regional partners, and international financial institutions committed to working in partnership with countries undergoing historic political and social transitions in MENA. At the October 2012 meeting in Tokyo, the Partnership launched a new Transition Fund to provide Partnership countries with technical assistance to undertake policy reforms to build more inclusive and transparent economies, boost trade and integration of the region, and enhance the environment for private sector growth.5

4. Key among the objectives, actions, and commitments made in Riyadh, the subsequent MAF, and the Deauville Partnership Transition Fund are those related to private sector development and job creation, particularly for youth and through Small and Medium Enterprises (SME). This pilot project proposes to create such a program for SME revitalization and employment that can inform public policies for job creation and SME development.

II. Sectoral and Institutional Context

5. The recently released Transitional Program for Stability and Development (TPSD) lays out two main national priorities addressing the political and economic transition for the next two years: 1) political and security stability and state building, and 2) socio-economic recovery.


5 The United States, United Kingdom, Saudi Arabia, Canada, Japan, France, Kuwait, Russia, and Qatar all announced their proposed contributions, totaling about $165 million towards a goal of $250 million over several years.
Under the latter priority, one of the focus areas is economic recovery which comprises an agenda for private sector recovery and growth including jobs, revival of the productive sectors, public-private partnership, and enhancement of the investment environment.

6. The national priority of economic revival and growth through the private sector will need to focus to a large extent on small and micro enterprises, particularly in the short term. The Yemeni economy is comprised primarily of micro and small enterprises. Medium and large enterprises are few, with a heavy presence of state-owned enterprises (so not part of the private sector per se, although many are operating in the commercial sphere) and a few family owned enterprises and conglomerates. Although more recent figures are not available, a micro and small enterprise study conducted in 2000 showed a strong skew towards micro and very small enterprises in Yemen – 96% of enterprises had less than four employees, and 72% were self-employed individuals. Indeed the Mutual Accountability Framework (MAF) prioritizes financial and technical support to SMEs for their job creation potential.

7. The business environment within which MSEs are operating is increasingly challenging. Even prior to the 2011 crisis, Yemen faced a difficult and mounting challenge in moving toward diversified, private sector led economic growth. Yemeni enterprises have consistently identified corruption as a leading constraint to private enterprise activity and growth, and increasingly reported electricity, access to land, political instability, and regulatory policy uncertainty as other key constraints. Corruption has been reported as the leading constraint across firm size, ownership, and sector.

8. These challenges continued through the 2011 crisis, as reported in a rapid assessment of the effects of the crisis on private enterprises. The assessment, which was undertaken in June 2012 of 200 enterprises in six urban centers, showed that the negative effects were widespread and felt more acutely among smaller enterprises. Sales, exports, employment and access to input and markets were all affected. On employment, the developmental bottom line, over 40% of small enterprises reported having decreased employment by 40% between December 2010 and June 2012. The latest Doing Business indicators also provide evidence of the deterioration in the business climate. Yemen’s overall DB rank fell from 101 to 118 last year, with the most severe deterioration in the rankings on getting electricity, starting a business, and dealing with construction permits.

9. And yet there are rich opportunities for gains in MSE performance that would lead to job growth and improved competitiveness. For example, value chain analysis and programs offered to the coffee industry showed that farmers and traders lack information on lucrative final market opportunities and requirements. It was also found that consistent systems for quality grading, certification, and traceability are lacking; as is origin-based branding. In the fish sector, there is a need for a regulatory framework to safeguard the fish population, and to build awareness of consumer expectations and support product differentiation. In the honey sub-sector of agro-business, surveys show that consumers lack confidence in honey quality and reflect the need to build quality systems, as well as improve packaging, export certificate

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7 Yemen Investment Climate Assessment Update, World Bank 2011
facilitation and wholesaler marketing and promotion. Tradeable services, including health and education, are perceived as having enormous growth potential in the domestic market and possibly beyond.

Institutions

10. Institutionally, those concerned with the competitiveness and growth of MSEs include the Ministry of Planning and International cooperation, the Ministry of Industry and Trade and the affiliated Small Enterprise Development Fund (SEDF), the Social Fund for Development (SFD), and its subsidiary the Small and Micro Enterprise Promotion Service (SMEPS). The Ministry of Agriculture and the Ministry of Fisheries are also concerned with MSEs within their respective sectors.

11. The Small and Micro Enterprise Promotion Service (SMEPS), plays the primary role in the Yemeni institutional context for supporting MSE access to business development services, including consulting, technical expertise, and training through a market approach. SMEPS has been operating since 2006 and has been facilitating business training services to businesses and entrepreneurs, including services tailored to youth and women, reaching so far over 34,200 MSEs. They have also conducted value chain studies and activities that have supported innovation in key sectors, including fisheries, coffee, and horticulture. For example, in the coffee sector, SMEPS has been working to introduce international standards to local coffee growers and organized the Arabica Naturals International Conference in Sana’a with participants from the global coffee market from 27 different countries.

12. Donors active in financial and private sector development are in various stages of re-examining their strategies and planned projects. Several donors currently provide assistance for financial and private sector development, with a number of donors funding SFD activities, including SFD’s micro and small finance, services, training activities, and some targeted value chain work. However, a large number of these activities have come to a close, have been discontinued, or are under re-examination at this time with new initiatives emerging. Throughout 2012, the World Bank has conducted a series of consultations with donors active in private sector development to coordinate efforts and better identify the Bank’s value added in this sector. Key initiatives with synergies and complementarities with this project include the Economic Opportunities Fund (EOF), the European Union’s pending small finance project, the GIZ private sector development program, the UNDP youth employment project, IFC’s technical assistance work with microfinance banks, among others.

13. The World Bank has undertaken significant analytical and technical assistance work in the financial and private sector in Yemen, including the World Bank’s investment climate assessments, the World Bank’s 2012 Rapid Assessment of the impacts of the 2011 crisis on private enterprises, the Doing Business reports and studies of the micro and small finance

8 “Analysis of 5 Value Chains in Yemen” by the Yemen Small Micro Enterprise Promotion Service (SMEPS) and Royal Tropical Institute (KIT) of the Netherlands, July 2009.
market, and technical assistance on the financial sector and business climate. These products have diagnosed the limitations of the business environment and the factors contributing to the low competitiveness of the Yemeni private sector. Work undertaken by the Yemeni institutions SMEPS and SFD, as well as recent interventions by IFAD, IFC, and GIZ have begun to respond to micro-enterprise and SME needs but are far from meeting them. Building on the World Bank’s analytical foundation, partnerships with active stakeholders already on the ground, and the Bank’s successes in market-based approaches in Tunisia and the West Bank & Gaza among others, the World Bank is now well positioned to pilot a market-based mechanism to catalyze new market and product development towards higher competitiveness, productivity, and job growth among private enterprises.

III. Project Development Objectives

14. The project development objectives are to improve individual employability and SME capabilities for graduates and firms participating in a pilot scheme and to inform related policies and programs.

15. Progress towards achieving the project’s development objectives will be measured by a series of quantitative and qualitative indicators at the PDO level and at the component level. The expected key results of the pilot project are:
   - Increased employment of participating youth three and 6 months after the end of the subsidy (percentage female)
   - Participating firms have improved capabilities after completion of services.
   - Policies and programs utilize the outcomes of the pilot project.
   - Direct project beneficiaries (percentage female)

IV. Project Description

16. The project aims to inform private sector development policies and programs in Yemen, with a particular emphasis on SME development and employment. This focus on SMEs and employment stems from the conflict-affected nature of the country context and evidence of the importance of SMEs in private sector development and employment generation.

Project Components

Component 1: SME Internship and Upgrading Program (US$3.72 million)

17. This component will finance two sub-components, a) internships and b) business development plans an estimated 400 graduates and private enterprises on a cost-sharing basis (typically a 50 percent match is required by the firms). The program would facilitate and support the placement of the interns through a matchmaking process, providing basic skills

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9 Prior to 2011, much of the private sector development work in Yemen was informed by donor programs focused on the regulatory environment including microfinance regulation, credit registry, tax law, private public dialogue, and other related regulatory issues. Microfinance regulation is perhaps the greatest success among these, with Yemen having passed laws and regulations to allow the functioning of commercial, deposit taking microfinance banks and the operation of traditional banks in the microfinance space
training to all accepted applicants and basic orientation training to participating interns (work ethics, personal productivity), and a subsidy of 50 percent or more of the internship cost (expected length of 6 months or longer). The program will also provide up to 400 firms, depending on uptake, with a matching grant (typically 50 percent of the cost) for the procurement of business development services (BDS), training and goods (as a minority component) to improve management practices, technology, or products or to reach new markets (domestic or export) as defined in a Business Development Plan submitted by the firm. Firms may apply for an intern, a business development matching grant, or both. These activities would be implemented at firms in two locations, Sana’a and Aden.

18. This component will finance partial grants for youth internships and partial grants for services (including both consulting and non-consulting services) and minor goods (such as office and IT equipment, measurement and test equipment, spare parts) within the scope of the business development plans. It will also finance goods, services, travel (including international travel), and incremental operating costs incurred by SMEPS in the implementation and management of the project.

Component 2: Bank-executed activities: Impact Evaluation, Technical Assistance, and Support (US$0.43 million)

19. This component will include the implementation of an impact evaluation and provision of technical assistance to the GoY to inform policies and programs on SME development and employment based on the outcomes and demonstrated effect of the pilot. The component will finance the costs of the impact evaluation and technical assistance (TA) provided to GoY entities and SMEPS, particularly on monitoring and evaluation.

20. The rationale for World Bank execution of this component lies primarily in the need to conduct a robust impact evaluation, and SMEPS has requested that the World Bank take responsibility for the implementation of the impact evaluation to ensure its independence. Furthermore, the second element of this component is the provision of technical assistance to the GoY by the World Bank, bringing the results of the impact evaluation as well as lessons learned from this project and global practices to serve the GoY’s policies and programs, which is most effectively undertaken by direct World Bank execution.

V. Financing

<table>
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<th>Source: Borrower/Recipient</th>
<th>IBRD</th>
<th>IDA</th>
<th>Others (specify) Trust Fund (Grant)</th>
<th>US$ 4.15</th>
</tr>
</thead>
</table>

Total US$ 4.15

VI. Implementation
Institutions

21. According to Law No. 10 of 1997 for the Establishment of the Social Fund for Development (SFD), SFD is the institution mandated with, among other things, “financing manufacturing and service projects, either directly or indirectly, for individuals, households, small enterprises, and other beneficiary groups under legitimate, soft terms”. The SMED department in the SFD has been focused on finance and technical support for both micro and small enterprises and provides SFD oversight over SMEPS. SMEPS is a subsidiary of SFD with a focus on technical assistance, training, and value chain interventions. The project will be implemented by SMEPS, as the recipient and implementing agency.

22. Very few agencies in Yemen have capacity and experience working on overcoming information gaps of small enterprises with respect to international best practices and management techniques such as quality systems, cost accounting, and directed marketing. SMEPS has an appropriate combination of internal business culture within it and a set of operational experiences closely related to the kind of work that the EREP project would support. SMEPS has carried out a survey of BDS providers throughout Yemen (providers of technical, management, training, legal, and other services) and launched a BDS website (www.istishaari.com). They have also conducted some specific interventions in the fisheries and coffee value chains to introduce new technology, market research, and information to the supply chain, and believe there is high demand and potential for further work in this area. SMEPS also facilitates the provision of a range of management and entrepreneurship training courses, including IFC’s Business Edge, through the qualification of trainers and training institutions, including some subsidies to training costs. Moreover, SMEPS has undertaken a youth employment program for internally displaced youth in Aden during the height of the crisis, with good results in providing training, internship programs, and even permanent jobs for some of the youth beneficiaries.

Implementation of Activities

23. SMEPS, will implement Component 1 of the project, including the internship program, business development plan support program, and overall project management. Component 2, for technical assistance and project support, is a Bank-executed component, and will be implemented by the World Bank. Detailed implementation arrangements are available in Annex 3 of the PAD.

24. SMEPS will provide a Work Plan to the World Bank describing activities, timeline, and budgets for activity implementation. SMEPS will also develop an Operations Manual (OM), which will be subject to World Bank no objection and will be completed prior to negotiations or otherwise will constitute a condition of grant effectiveness. The OM will describe the policies to be followed for activities 1A, 1B and 1C under Component 1, including grant making activities for the internships and BDP support activities; EREP Project organization and roles and responsibilities; and the financial, procurement, and operational systems supporting implementation. The OM will be supported by sub-manuals with detailed procedures, instructions, and templates, which will not require World Bank no objection.

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10 World Bank staff unofficial translation of the Arabic text of the Law.
25. **Project Team:** The Project will be implemented by leveraging the SMEPS in-house team with a team of local consultants, managed by a dedicated Project Manager reporting to the SMEPS Executive Director and supported by a Procurement Officer and Accountant hired for the project. The local consultants will act as an extension to the SMEPS team, working directly with firms and graduates to facilitate matching of services and interns with firms. These local consultants will include at least one female consultant in each location to facilitate outreach to and participation of female business owners, managers, and interns. BDP Advisors support firms in developing business plans and assess their viability, while Internship Advisors bring internship applicants and host firms together. Both will be supervised by SMEPS Project Officers (existing SMEPS staff) assigned to work on the EREP project and reporting to the EREP Project Manager for the purposes of the project. SMEPS has followed this model of using local consultants successfully in the past, including most recently in its implementation of an internship program for IDPs in Aden. SMEPS will have assembled the Project team prior to effectiveness. The SMEPS Business Development Director and Finance Manager also make up an important part of the team and are part of the Management Committee that approves the grants and reviews the project portfolio. The project team will be in place prior to negotiations or otherwise will constitute a condition of grant effectiveness.

26. **Ad-hoc Advisory Committee:** An ad-hoc advisory committee comprising representatives from the private sector, public sector, and academia will be formed to advise the project based on ad-hoc briefings provided by SMEPS throughout the lifetime of the project.

27. **The BDP grant-making process:** The grant-making process for partial support of BDPs will follow a transparent process with clear and simple eligibility criteria with appropriate due diligence measures and governance to ensure independence of the selection process from application to approval and preventing capture, all of which will be documented in the OM. Key aspects of this process are the BDP Advisors’ role in guiding and advising on the development of these plans, and the EREP Project Management Committee’s role in the review and approval of the plans. The BDP Advisor also has a key role in guiding the firm in the procurement of services. This is particularly important as SMEs often have no prior experience in procuring BDS, and this provides a learning experience to increase the likelihood of the firm’s repeated use of BDS after the project. Selection of firms will be transparent, planned through a public lottery with results posted on the project website.

28. **Internship process:** The internship process will have clearly defined eligibility criteria for both host firms and graduates. The key element of the internship process is the matchmaking which will require the Internship Advisors to match internship applicants from a sorted pool to firms based on the firm needs. The matchmaking process is expected to be an important determinant of the successful outcome of the internship for both firms and recent graduates. After screening and sorting, selection of intern applicants for interviews with firms is planned through a random selection process.

29. **Bank-executed component:** The bank executed component will be executed by World Bank staff and consultants to provide an independent, robust impact evaluation and technical assistance. Coordination and responsiveness to MOPIC and other agencies mandated with SME development and employment will be central to this activity. Technical assistance will be provided through policy notes, workshops, and direct support on a just-in-time basis as
well as at the end of the project in the form of a policy note based on the results of the impact
evaluation. The Bank will also provide technical assistance to SMEPS for improving
Monitoring and Evaluation (M&E) capacity by providing direct support in developing the
M&E system for the project as well as other learning opportunities.

30. **Coordination Activities:** SMEPS will undertake to coordinate with other private sector
development activities throughout the implementation of the project. Steps will be taken to
identify synergies with other projects and to leverage linkages between them. For example,
outreach will be undertaken through the Economic Opportunities Program in Sanaa and Aden
governorates to inform them of matching grant opportunities available. Similarly, SMEPS
will seek opportunities to link supply-side BDS activities undertaken under the GIZ program
with demand-side matching grants. Linkages with micro and small finance projects will also
be established to better guide project beneficiaries in need of financing for capital goods or
working capital.

VII. **Safeguard Policies (including public consultation)**

<table>
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<th>Safeguard Policies Triggered by the Project</th>
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<th>No</th>
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<tr>
<td>Environmental Assessment (OP/BP 4.01)</td>
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<td>Projects on International Waterways (OP/BP 7.50)</td>
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VIII. **Contact point at World Bank and Borrower**

**World Bank**
Contact: Nabila Assaf
Title: Senior Private Sector Development Specialist
Tel: +1 (202) 473-0531
Email: nassaf@worldbank.org

**Borrower/Client/Recipient**
*Republic of Yemen – Ministry of Planning and International Cooperation (MOPIC)*
Contact: Dr. Mohammed Ahmed Ali Al-Hawri
Title: Deputy Minister for Economic Studies and Forecasts

*By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*
Tel: ++ 967 711 941 100
Email: malhawri@mpic.gov.ye, malhawri@gmail.com

Implementing Agencies
The Small and Micro Enterprise Promotion Service (SMEPS)
Contact: Wesam Qaid
Title: Executive Director
Tel: +967 1 450910/11-205
Email: wqaid@smeps.org

IX. For more information contact:
The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop