I. Introduction and Context

Country Context

1. Lebanon is a high-middle-income country with a population of around 4.5 million and a per capita (2010) GDP of US$ 9,262 (Current US$). Despite recent political turmoil in the region and in the wake of a significant global financial crisis the country managed to show positive economic growth mostly due to a strong banking system, continued foreign capital flows and domestic private investment. With a looming second financial crisis in Europe and turmoil in neighboring countries the economy is expected to continue its growth much more modestly for the period 2011-2012 at around 2-3%. Unemployment estimated at 9 percent in 2007 (ILO laborsta) and high migration of young educated Lebanese are significant challenges for the government. Private sector led growth is thus a crucial factor for the country and constitutes a core pillar of the national development agenda. The Lebanese economy depends significantly on high levels of remittances sent back home by its Diaspora but little of it is channeled into local investments, hence the government is in need of measures to boost commercial investment by its Diaspora and others, and provide encouragement and opportunities for entrepreneurial innovative Lebanese to start businesses in their own country.

The five year project proposed in this concept note is based on a request by the Ministry of Finance to build the institutions and create the processes that will invigorate innovation, facilitate start-ups and support high growth of SMEs. It will allow the government to invest in mechanisms that build the capacity of the private sector from ideas stage to high growth, and expand their ability to tap into global knowledge and international markets, to be competitive and create jobs.

The proposed project conforms with the Country Partnership Strategy and builds on the Arab World Initiative (AWI) MSME development pillar. It will combine access to early stage financing for pre-start-up, start-ups, and early stage growth. Drawing on successful regional experiences in India, Singapore and China, where tapping into global knowledge helped foster innovation and growth, bridges will be built to the extensive Lebanese diaspora and the broader business ecosystem within Lebanon. The goal of accelerating Lebanon’s conversion into an innovation driven economy, as the source of sustainable development and job creation, will be achieved by investing in promising entrepreneurs, and stimulating the creation of new products and services through the transference of global knowledge.

Sectoral and Institutional Context

Lebanon’s emergence as a dynamic entrepreneurial hub is primarily the result of organic and slow evolutionary developments (Beirut as expected seems to enjoy more in terms of centers and resources but some early developments can be seen in some of the larger cities like Tripoli in the North). Policy makers did not craft a deliberate policy to make Lebanon an innovation center. But once the private sector took the lead and began guiding the process, the government adopted a supportive posture. For example, key government officials at the Central Bank, Ministry of Economy, Ministry of Finance, Council of Ministers, and Kafalat (a national loan guarantee program), are all very supportive and exceptionally competent. They encouraged and supported the growth of newly emerging institutions and trends. They worked with the market, rather than attempting to unduly regulate these evolutionary developments or crowd out spontaneous private sector initiatives with well-intentioned but ill- designed government support programs.

Despite these impressive, recent developments, there are two substantial gaps in Lebanon’s innovation ecosystem: the first is funding at the early start-up stage where entrepreneurs need to develop their ideas into a viable business concept; and the second gap is the absence of early stage venture finance. Money is not the only ingredient for success but it is especially difficult to sustain a start-up business for very long without adequate financing. Once a company has demonstrated that it is a viable, going
concern, it can also arrange expansion capital in chunks of $2 million and above. But many firms found in the so-called “valley of death,” the gap between what family and friends can provide and the $2 million and above amount that typical venture capitalists provide to finance expansion.

To fill these gaps the government of Lebanon under this Project seeks to establish and finance a funding program to stimulate innovation by entrepreneurs to initiate more start-ups and increase the availability of funding for equity investments for young, growing firms until they reach the stage where they can be attractive to later stage Growth Capital VC Funds (US$2 million plus).

Relationship to CAS
Lebanon has a dynamic business environment that is not achieving its full potential in terms of higher employment growth. According to the Lebanon 2010 CPS more support for SMEs is needed as a way to reduce the migration of skills due to the lack of opportunities. The CPS recognizes that SMEs can play an increasing role in catalyzing economic growth, as sources of job creation. Yet the key factor that has restrained the potential growth of SMEs in Lebanon has been the tendency for investments to be concentrated in activities such as real estate, which has little effect on employment, or industries with a low demand for skilled labor like construction. Another potential source of growth, female entrepreneurship, has been restricted by the greater challenges women owned SMEs face in accessing finance, and circumventing the many regulatory processes. This has produced a relatively low level of female entrepreneurship in Lebanon.

The first step in promoting innovation and growth in high wage industries is to establish a critical mass of successful SMEs. This requires an initial public investment in key structures and mechanisms that will launch a self-sustaining dynamic ecosystem over the long term. Successful and innovative SMEs will attract others from the private sector, and investment from foreign markets, that will in turn attract more innovation and investment, in a virtuous cycle of growth. In supporting the government make the initial investment, and create an environment that nurtures SMEs with expanded access to global knowledge, resources and finance, this project is fully aligned with the CPS objectives.

The proposed project also supports the wider goal of the AWI MSME of promoting innovative and high growth potential SMEs. It would provide risk capital for high potential growth enterprises and start-ups, and link them up with sources of knowledge and expertise through mentoring, and partnerships with providers of business services.

II. Proposed Development Objective(s)

Proposed Development Objective(s)

The overarching higher level objective this project supports is a stronger, more dynamic and competitive private sector by addressing a market failure in early stage equity funding and a funding gap to support innovation.

Key Results

7. By stimulating an expansion in the availability of funding and equity investments in new and innovative firms, the project seeks to achieve the following key results:

(i) Increased innovation (increased new products or processes);
(ii) Increased number of start-ups;
(iii) Increased growth by SMEs.
(iv) Increased equity financing provided to early stage firms.

Due to the small size of the project job creation is not one of the intended key results but given that the new enterprise creation and expansion that will result from the project will contribute to more jobs being created, the number of new jobs that emanate directly from the project beneficiaries will be measured under the PDO level Results Indicators. the project is expected to create a high number of indirect jobs due to spillover effects to the supply and value chain around the project beneficiary enterprises however measuring this is beyond the monitoring scope of the project.

III. Preliminary Description

Concept Description

A. Concept

The project will fund the key mechanisms for the pre-start-up, start-up and very early growth stages of an enterprise. Currently, the biggest funding gap lies in the initial stages preceding full commercialization. This is a period of high risk, where a significant number of start-ups and new ideas emerge but only a few survive. Lack of innovation is an obvious reason for the failure of new product developments and start-ups as well as the lack of skills by innovators and dormant entrepreneurs to start a business. However, many of these ventures also fail due to lack of resources, technical know-how and training support. These factors are critical in allowing companies to further improve and refine their products to the point where they attract the necessary financing not only to survive, but to prosper. The high risk nature of these early stages, and the level of investment needed for product development and enterprise growth, require government intervention and funding. This intervention will be needed to establish the initial structures, and a critical mass of market agents, investors and successful SMEs. The private sector will then be able to step in, leverage the established structures and sustain the financing and training/mentoring linkages through the long term.
The Government of Lebanon has requested support from the WB to develop a project to enhance the ecosystem infrastructure to promote innovation, competitiveness and growth of private sector firms in Lebanon. The proposed project will consist of a Funding facility which will provide two types of funding. The process will engage private sector investors, including national, regional and international Venture Capital funds, and industry experts and entrepreneurs from among the diaspora. The activities are detailed below:

Development grant (in the amounts of approximately US$15,000 each): Potential entrepreneurs with a new business idea will be invited to apply for a small grant to help them develop their innovative concept. The grant will fund the collection of evidence and the building of a case for external investment in their business, along with an assessment of the key areas of risk. The outcome will be an improvement in the ability of the potential entrepreneur to demonstrate the value of their proposed business idea, and the conversion of the idea into a business ready for investment. The grants will be provided in two phases: a small grant of up to $5000 during the first phase which would allow the entrepreneur to begin working on a proof of concept, and a larger second phase grant of up to $10,000 which would enable the entrepreneur to work closely with VCs to prepare the enterprise for possible early stage VC financing. The outreach to potential entrepreneurs will be conducted via incubators, universities, national and regional chambers of commerce, business and professional associations, municipalities and NGOs. These organizations will be invited to participate by helping their clients in the application process. A program to leverage partnerships and fund targeted assistance to potential entrepreneurs and students who have creative ideas but lack the skills and entrepreneurial knowledge to get them to a proposal stage will be integrated to increase the base of potential concepts and start-ups entering the pipeline needed to achieve a critical mass.

Equity Investment (in the amounts of up to US$1,500,000): Potential entrepreneurs, both as part of the stages covered by the development grant above and others seeking growth financing, will be encouraged to meet with venture funds to ensure the evidence they have assembled, or their business plan, will address the investors’ information needs, and truly demonstrate that the entrepreneur is investment ready. To qualify for the equity investment financing, the entrepreneur must first have approached a potential investor with the completed business idea, and received from them a commitment to invest in the new venture. Having acquired this commitment, the venture investor or the entrepreneur can then approach the project Funding facility to seek a matching investment that will share the initial venture fund's risk, and add to the capital available to the new business. The scheme relies on the efforts of partner VC funds both to identify and promote new business projects and to provide the active mentoring and professional inputs that characterize truly effective VC participation in successful investments. VCs will therefore be screened to ensure that they enjoy a reputation of active participation, and have a proven track record of mentoring and support.

An Investment Committee (IC) will be appointed to make the decisions for the awarding of the equity investments. The criteria for the IC role and its members will be developed and described in the project operational manual and will ensure that: the IC can make full independent decisions based on the commercial viability of the proposals; it is diverse; does not allow capture of political and sectarian interests; and addresses potential conflict of interest. Members will be acting in their personal capacities and will be constituted of high status individuals (from Lebanon, the MENA region, from the Diaspora around the world as well as international experts) who have direct and relevant business experience and whose participation will reassure VC and investor partners of the serious intent behind these proposals and good governance of the funding facility.

The design and governance features of the proposed Fund will ensure that it complies with the Bank’s OP 8.30 guidelines as well as with the legal requirements governing Kafalat and the government’s mandates and operational structures in Lebanon.

Institutional set up and implementation:

The project government counterpart will be the Ministry of Economy and Trade (MOET) who is in the processing of setting up a Small and Medium Enterprise (SME) Observatory unit to support and monitor all projects and initiatives to assist SMEs in their development and access to financing. The implementation of the grant and equity funding activities will be done by Kafalat a quasi government agency that operates a national credit guarantee scheme.

Project implementation and oversight/ monitoring mechanism:

A Project Steering Committee will be created to oversee the project and provide strategic guidance and monitoring in accordance to the project operations manual and national development objectives. The MOET will Chair the Steering Committee which will include representatives from other key ministries and agencies that have related work as well as some NGOs that support the broader ecosystem. The project SC will:

-Represent the GOL
-Resolve operational issues
-Approves the operations manual,
-Select the IC
-Oversee operations of the project in accordance with the operations manual and development objectives
-Proposes when necessary changes to the operations and seeks no objection from the WB
-Conduct regular stakeholder consultations with civil soc. and the private sector regarding the project impact.
Kafalat as the implementing agency will:
- Be accountable and responsible for project execution
- Report to the SC
- Have the Project implementation Unit (PIU) including dedicated full time project manager and an extra accountant and staff as needed and determined during appraisal.
- Handle the disbursement and financial management arrangements and compiling the data and reporting for monitoring and evaluation
- Call on the SC for changes in conditions, exceptions, etc.
- Collect all project indicators and provide the M & E reporting

The project will include mechanisms for Monitoring and Evaluation (M&E) of development indicators. A preliminary M&E is outlined in Annex IV. of the PCN. The framework will build on the results sought from each component and develop indicators to assess accomplishments against the development objectives. The design of the M&E framework will be in proportion to the relatively modest loan size, and driven by the need for the appropriate M&E capacity. Annex IV details some preliminary indicators being proposed as a starting point for discussions with the counterparts.

IV. Safeguard Policies that might apply

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V. Tentative financing

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VI. Contact point

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