I. Project Context

Country Context

Lebanon is a high-middle-income country with a population of around 4.3 million and a per capita (2010) GDP of US$ 8,645. Despite recent political turmoil in the region and in the wake of a significant global financial crisis, the country has managed to show positive economic growth and a measure of stability mostly due to a strong banking system, continued foreign capital flows, and domestic private investment. Despite a second financial crisis in Europe and conflict in neighboring countries, the economy is expected to weather the turbulence. Unemployment, which stands at 11% 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.

Small firms dominate the private sector. Over 99 percent of all private enterprises have fewer than 50 employees of which 93 percent have fewer than 5. According to the National Economics Accounts Report for 2010, market services, transportation and communications account for 39 percent of GDP, Industry follows at 7.2 percent then agriculture at 4.7 percent. After banking, transportation, communications and tourism in the services sector, Lebanon’s main industries are food processing, wine, jewelry, cement, textiles, mineral and chemical products, wood and furniture products, oil refining, and metal fabrication. Lebanon has also established itself as a creative hub for the MENA region. According to studies conducted by the Lebanese Creative Cluster association, more than 70% of regional investment goes to Lebanon’s creative industries such as media and entertainment, digital media, advertising, film, fashion and architectural design. Lebanon also boasts several excellent universities and hospital centers.

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 needs measures to boost commercial investment by its Diaspora and others, and to promote opportunities for entrepreneurial innovative Lebanese to start businesses in their own country.

II. Sectoral and Institutional Context

In terms of competitiveness, Lebanon ranked 89 out of 142 economies in the World Economic Forum’s Global Competitiveness Report 2011-2012. Among MENA countries, it ranked 12th out of 14 countries. This reflects Lebanon’s weak institutional set-up, and barriers faced by the private sector as highlighted in the Doing Business Indicators and the Country Investment Climate assessment (2010). However, it ranks highly in educational indicators and is recognized for having a dynamic entrepreneurial economy.

In an effort to focus the attention and efforts of all stakeholders on selected issues affecting the development of entrepreneurship and small and medium companies, the government has commissioned the preparation of an “Improving the Doing Business Action Plan” that would facilitate the creation of new businesses, encourage local employment and contribute to economic growth and competitiveness. The Plan, which is in its final stages of completion, involves all stakeholders in Lebanon working through public-private groups focusing on specific issues. The nine primary areas of focus for the Action Plan were selected to improve key steps that entrepreneurs and local companies have to undertake to formalize their project, operate a limited liability company (SARL) or a joint stock corporation (SAL), and close it down or restructure in case of insolvency. These nine reform areas include: (i) incorporating a company; (ii) obtaining a construction permit; (iii) transferring real property; (iv) getting access to credit; (v) protecting equity investors; (vi) paying taxes; (vii) trading goods across borders; (viii) enforcing contracts before courts or through mediation; and (ix) closing down a business.

III. Project Development Objectives

The project’s main development objective is to encourage the equity investment market to increase the supply of early stage investment finance for financially viable, new, and existing innovative firms.

IV. Project Description
VI. Implementation

Institutional and Implementation Arrangements

The Ministry of Finance (MOF) will sign the Loan Agreement and receive the WB loan on behalf of the Lebanese Republic as the Borrower. Execution and implementation of all project activities will be done by Kafalat s.a.l. (a joint stock company established pursuant to the Lebanese Code of Commerce, incorporated and operating as a Financial Institution under Lebanese law).

The Banque de Liban (BDL) under the Law for Money and Credit Section 6 Articles 85 and 97 which specify the BDL’s role and responsibilities towards public funds, will monitor the Designated Account (DA) where the projects funds will be placed in accordance with the financial management monitoring and reporting guidelines specified in the PAD and the Project Operations Manual (POM).

Oversight

The MOF will have broad oversight of the project and will receive full reporting from Kafalat regarding project activities on a quarterly basis. Once a year, Kafalat will provide a comprehensive annual review. The BDL will monitor all the financial transactions related to the Grants and the Equity investments that will go through the Designated Account (DA) to ensure that all the terms and conditions of the project loan are being met prior to any disbursements. In terms of financial reporting, Kafalat will report to the WB as indicated in the financial management section of the project appraisal document (PAD) and as reflected in the POM.

Implementation of the activities

Kafalat’s role will be to administer both the grant and equity investment sub-components of the iSME funding program. The draft POM, satisfactory to the Bank was prepared by project negotiations stipulating the operational structure, financial management, governance, the decision-making process, eligibility, and selection, and eligibility (including negative list) criteria for the grants and the equity investment activities and all other processes related to project implementation. The templates of shareholder agreement, investment agreement and grant agreement will be finalized prior to effectiveness. Adoption by MOF and Kafalat of the final approved POM is a condition of effectiveness. Kafalat will also put in place a list of Evaluators selected from the private sector to judge the grant proposals, and an Equity Investment Committee (IC) composed of business, technical and financial experts also from the private sector, will evaluate and select the equity investments based on their commercial viability. A PMU will be created at Kafalat to manage and implement the project activities. The PMU should be in place and operational at the latest by project effectiveness.

For both the Concept/Ideas Grants and the Equity investments, clear transparent governance structure and accountability measures are specified in the POM, specifically with regards to the eligibility and criteria for the Evaluators and IC, the review, due diligence, and selection process. These measures embody the principles of responsible governance, equity and transparency by assuring the independence of the selection process from the application or review process, eliminating the risk of capture by select groups and thorough filtering, and accountability measures of the grants and investment decision-making bodies. Further details on specific implementation processes of the Grant and the Equity components are included in Annex 3 of the PAD (Detailed Project Implementation).

The ISME grants, project management and outreach and training activities will be administered and disbursed directly by Kafalat through the DA to the beneficiaries. For the purpose of managing the equity investments, Kafalat will establish one or more Holding Company(ies) (HC(ies)) for the implementation of the capital equity investments financed by the ISME program as selected by the IC and monitored by the BDL. As per Decree-Law No.45 of June 24, 1983 (DL 45/83), the HC will be set up in the form of a Joint Stock Company and at least 98 percent of the shares of the HC will be registered in the name of Kafalat as Asset Manager, and the remainder in the names of two Board members of Kafalat. All HC shareholders would be the HC board members. Kafalat s.a.l. will totally control the management of the HC(ies) under a Management Agreement.

As a corporation governed under Lebanese corporate law, Kafalat has the legal mandate to open and own a HC(ies) to manage assets and other financial activities and operations. The HC(ies) for the Project will be established with no other purpose than to hold the equity investments until they are exited and rolled back for additional investment under the ISME program or liquidated and processed in accordance with the agreement between Kafalat and the Borrower. Kafalat shall under the Management Agreement cause the HC(ies) to adopt the POM and stipulate its functions and operations in accordance with the terms and conditions of the Project Agreement. The same project conditions and management processes will be applied to any HC under the project. The original HC will be established by Kafalat s.a.l. prior to project effectiveness contingent upon a legal opinion to confirm it has been set up in accordance with Lebanese law and able to exercise its functions.

A Project Management Unit (PMU) will be created at Kafalat to manage and implement the project activities, its marketing, relevant training and related outreach to the business ecosystem. Kafalat will also exclusively manage and implement the HC investments. The PMU must be in place and operational by project effectiveness. It must include: a) one full-time project manager with the requisite qualification and experience in start-ups and equity investment who will be responsible for the overall management of the project and its reporting requirements, including monitoring of the results indicators, procurement, and financial reporting; b) an operations officer in charge of marketing, the grants program and outreach; and c) an accountant to work along with the current Kafalat Chief Financial Officer (CFO) in the project financial reporting. In addition, Kafalat...
staff already experienced in credit analyses and assessment of start-ups and businesses in IT, Energy, and Innovation, will have 10 - 30 percent of their time allocated to work with the project manager in reviewing proposals, collecting data and preparing monitoring reports. Kafalat will also have its own internal auditor assigned to the project to do its internal audit reports.

VII. Safeguard Policies (including public consultation)

<table>
<thead>
<tr>
<th>Safeguard Policies Triggered by the Project</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental Assessment OP/BP 4.01</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Natural Habitats OP/BP 4.04</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Forests OP/BP 4.36</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Pest Management OP 4.09</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Physical Cultural Resources OP/BP 4.11</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Indigenous Peoples OP/BP 4.10</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Involuntary Resettlement OP/BP 4.12</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Safety of Dams OP/BP 4.37</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Projects on International Waterways OP/BP 7.50</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Projects in Disputed Areas OP/BP 7.60</td>
<td></td>
<td>✗</td>
</tr>
</tbody>
</table>

VIII. Contact point

**World Bank**
Contact: Randa Akeel
Title: Senior Economist
Tel: 473-4152
Email: rakeel@worldbank.org

**Borrower/Client/Recipient**
Name: Ministry of Finance
Contact: Alain Bifani
Title: Director General
Tel: 9613-306935
Email: alainb@finance.gov.lb

**Implementing Agencies**
Name: Kafalat
Contact: Khater Abi Habib
Title: Managing Director
Tel: 9611-346255
Email: khater@kafalat.com.lb

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