Project Information Document (PID)
# BASIC INFORMATION

## A. Basic Project Data

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<tr>
<th>Country</th>
<th>Project ID</th>
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<tbody>
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<td>Tunisia</td>
<td>P167380</td>
<td>Tunisia Innovative Startups and SMEs Project</td>
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<tr>
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<th>Practice Area (Lead)</th>
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<td>MIDDLE EAST AND NORTH AFRICA</td>
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<td>13-Jun-2019</td>
<td>Finance, Competitiveness and Innovation</td>
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<th>Financing Instrument</th>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
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<tr>
<td>Investment Project Financing</td>
<td>Republic of Tunisia</td>
<td>Caisse de Depots et de Consignations</td>
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### Proposed Development Objective(s)

The Project Development Objective is to increase access to finance and support the growth of innovative start-ups and small and medium enterprises.

### Components

- Equity and Quasi-Equity Financing for Innovative Start-ups and SMEs
- Ecosystem and Firm-Level Support for Innovative Start-ups and SMEs
- Project Management and Capacity Building

## PROJECT FINANCING DATA (US$, Millions)

### SUMMARY

<p>| | |</p>
<table>
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<tr>
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<tr>
<td>Total Project Cost</td>
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<tr>
<td>Total Financing</td>
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<td>of which IBRD/IDA</td>
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<td>Financing Gap</td>
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### DETAILS

#### World Bank Group Financing

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<table>
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<tbody>
<tr>
<td>International Bank for Reconstruction and Development (IBRD)</td>
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Environmental and Social Risk Classification
B. Introduction and Context

Country Context

A sustained transition to democracy and an ambitious reform agenda have marked Tunisia’s path since the 2011 revolution. Tunisia is a lower middle-income country, with a population of 11.6 million and a GDP of US$40.3 billion (2018). Often hailed as the only success story of the Arab Spring, the country has made great strides towards establishing the fundamentals of democracy, including the establishment of the National Dialogue Quartet in 2013, and the introduction of a new constitution in 2014. The Government of Tunisia (GoT) has also embarked on an ambitious reform agenda, aimed at boosting civil society and democratic freedoms as well as stimulating private-sector driven growth and job creation. In 2016, the GoT adopted the Five-Year Development Plan 2016-2020 (FYDP), followed by the Economic and Social Roadmap 2018-2020, aimed at accelerating the implementation of reforms focused on macroeconomic and fiscal stabilization, the modernization of social safety nets (SSN), and the enhancement of private investment, competitiveness, and productivity. In May 2018, the first free and fair municipal elections were held, further anchoring the democratic culture and laying the groundwork for decentralization.

However, structural challenges, a growing fiscal deficit and socio-political tensions pose an ongoing threat to economic and social development. The increased instability in the aftermath of the revolution, due to political unrest and terrorist attacks, weakened the investment climate and severely affected economic sectors, such as tourism, that were traditionally engines of growth and sources of foreign exchange. To counter social tensions, the GoT embraced expansionary fiscal policies, including public sector hiring and wage increase which have impaired public finances. The fiscal deficit and public debt respectively reached 6.1 percent and 71 percent of GDP in 2017. In addition, the current account deficit widened to 10.1 percent in 2017; and by August 2018, gross international reserves had declined to 70 days import cover (US$3.9 billion). Despite these macroeconomic vulnerabilities, GDP growth recovered in 2017, reaching 2.5 percent in the first quarter of 2018, largely due to stronger performance of the agriculture, services and export-oriented manufacturing sectors. Progress in terms of poverty reduction and shared prosperity has, however, been slow. In particular, the poverty headcount ratio stood at 15 percent in 2015, and disparities among regions and age groups have persisted or widened.

Unemployment has remained persistently high, especially for young educated graduates, women, and populations in the interior regions. Long-standing structural distortions, combined with recent macroeconomic vulnerabilities, have resulted in a private sector that has generated few high-quality jobs. Total unemployment stood at 15.4 percent in 2017, and has been higher among young graduates (30.2 percent), women (23.1
percent), and populations in the interior regions (over 25 percent in the South-West and South East, compared to 10 percent in the Center-East and North-East). According to World Bank (2018), 42.7 percent of the workforce is employed in industry, 43.8 percent in services, and 13.5 percent in agriculture; while close to 21 percent of the workforce is estimated to be vulnerably employed – i.e. self-employed without employees or working as unpaid family workers.

To address these challenges, the Government has launched an ambitious agenda to boost entrepreneurship, innovation, and inclusive economic growth. Most notably, the GoT approved the Start-Up Act in April 2018, which aims to provide tax and other incentives to support the creation and growth of innovative startups and SMEs, and to turn Tunisia into a vibrant, entrepreneurship hub. In addition, a new ‘horizontal law,’ which aims to ease restrictions to private investment and remove obstacles in the business environment including those related to private equity, was approved by the Government and has been submitted to the Parliament for adoption. An ambitious Digital Economy program is also under development, and includes numerous digital government projects, the upgrading of ICT and payment infrastructure, and the opening of the market to digital financial service providers and financial technology (FinTech) companies. The success of this policy agenda will, however, depend on ensuring ‘private-sector friendly’ implementation, broad outreach of activities to lagging and underserved regions, and stronger coordination among various Government agencies, development partners, civil society, and other stakeholders.

Sectoral and Institutional Context

Start-ups and small and medium enterprises (SMEs) in Tunisia have become an important source of employment and growth. Recent research on high-growth firms in Tunisia\(^1\) finds that, between 1996 and 2015, small and young firms have been more likely to exhibit High Growth Firm (HGF) status—i.e. achieve outstanding growth in employment or revenue over a three-year period—compared to large, older firms. Furthermore, the share of Tunisian firms that have achieved greater than 20 per cent growth in employment has been found to be on par with peer countries. This suggests that SMEs in Tunisia can be an important source of employment and productivity growth. However, several factors continue to limit the ability of Tunisian startups and SMEs to grow, including: limited access to lucrative export markets; a restrictive business and regulatory environment; lack of access to finance; and limited support for business development, technology adoption, and innovation. These constraints are further compounded for women entrepreneurs, largely due to challenging social norms and cultural barriers, as well as additional obstacles faced in navigating the business environment and accessing suitable financial and non-financial service.

Tunisia is located close to key export markets in Europe and Africa, although exports remain concentrated in a few European markets. Europe has remained Tunisia’s main export market, accounting for 78.5 per cent of Tunisia’s exports in 2017. Although exports to Europe have contributed to productivity gains in some sectors, particularly machinery and equipment, Tunisia’s exports have generally been low-value added products and services, including textiles and clothing, agricultural goods, and tourism. There is therefore scope for innovative startups and SMEs to enter high-value, high-productivity export sectors, such as agribusiness, manufacturing (electromechanical, leather and footwear, petrochemicals, pharmaceuticals) and services (ICT, niche tourism,

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health); as well as to tap new regional and global markets. However, several constraints continue to impede the growth of high-value added exports to new markets, including: inefficient and costly logistics and export procedures; poor linkages with regional and non-European markets; weak positioning of Tunisian firms in global supply chains; and limited ability of some firms to meet higher product or service standards in international markets.

**Despite recent reform efforts, the business environment continues to be a critical bottleneck to private sector investment and competitiveness.** For the first time since 2012, Tunisia has improved its Doing Business (DB) ranking from 88th to 80th, driven mainly by progress in “starting a business” (+37), “protecting minority investors (+35), and “getting credit” (+6). However, the ranking deteriorated most notably for “trading across borders” (-5) and “resolving insolvency” (-4). Additional challenges in the business environment include: burdensome regulatory and authorization requirements; lack of infrastructure and security in the interior regions; a workforce lacking job-readiness skills, despite being relatively well-educated; and a high tax burden on firms, among others. The high costs of doing business, combined with rigid labor laws, and limited contestability of protected sectors, has contributed to an underperforming domestic private sector, driving many innovative Tunisian firms to establish businesses abroad (primarily in Europe).

**Access to finance remains a key constraint for start-ups and SMEs.** Banks dominate the financial system; while private equity and venture capital (PE/VC) remains underdeveloped, despite the presence of 57 risk capital investment companies (SICARs) and 37 venture capital mutual investment funds (FCPR). SICARS and FCPRs are generally risk-averse and channel most funding to late stage startups or established SMEs. Although a number of venture capital funds (such as UGFS CapitalEase Fund, Flat6Labs Seed Fund, etc.) have recently been established to provide financing to startups in the early stages of business development, there remains a critical gap in finance for start-ups in the “loss zone”. Similarly, SMEs continue to face high collateral requirements and borrowing costs, while those operating in technology sectors lack the fixed collateral required to access traditional financing from banks.

**The entrepreneurship ecosystem is nascent and suffers from poor coordination among public and private stakeholders.** The Tunisian entrepreneurship ecosystem is dominated by public sector entities, including the Agency of Industry and Innovation Promotion (APII), the National Agency for Employment and Independent Work (ANETI) and others. APII manages 30 business incubators (‘pépinières’) and nine technology parks (‘technoparks’) which provide business development support to firms across all stages of business creation. Private sector players in the ecosystem include one business angel network (Carthage Business Angels) and 13 incubators and accelerators, and 16 private equity and venture capital (PE/VC) funds and other investors. Despite key elements being in place, the ecosystem has been ineffective in providing sufficient, high-quality support to innovative start-ups and SMEs. This is largely due to the outsized role of the Government in the management of public programs, the limited number and reach of private programs outside coastal regions, and the poor coordination among public and private sector initiatives. As a result, a large proportion of start-ups and SMEs struggle to obtain the right business and technical expertise, build linkages with potential clients, and gain access to new technologies, markets and value chains.

**Similarly, the research and innovation ecosystem— a potential pipeline for innovative startups and SMEs— is fragmented and poorly linked to the entrepreneurship ecosystem.** A few public initiatives have been introduced to encourage innovation and technology adoption within Tunisian start-ups and SMEs. Recent programs include the Horizon 2020 program aimed at boosting research commercialization, and the Digital Tunisia 2020 program aimed at facilitating a shift towards a digital economy. However, these and other public
initiatives have not been able to boost large-scale research and development (R&D) and innovation among startups and SMEs. This is due to: fragmented public policy formulation and governance; limited private sector funding directed at R&D; unclear Intellectual Property (IP) policies on ownership of research; limited managerial capacities among start-ups and SMEs to undertake R&D; few incentives to encourage academics and researchers to get involved in research commercialization; and weak linkages between the research, innovation and entrepreneurship ecosystems. In this context, the ability of existing and disruptive technologies (such as IoT, blockchain, data analytics) to drive process innovation, new business models and increased productivity, remains limited.

C. Proposed Development Objective(s)

Project Development Objective

The Project Development Objective is to increase access to finance and support the growth of innovative start-ups and small and medium enterprises.

Innovation will be defined as new or improved products, processes, business models, as well as goods and services that are new or improved to Tunisia or other markets. A particular focus will be made on technology-driven innovation, which has the potential to deliver high-growth and scalability.

Project Beneficiaries

The final project beneficiaries will be innovative startups and SMEs. The investment strategy and eligibility criteria, along with deal-flow activities, will ensure that funding is allocated to early stage startups and high-growth technology-based SMEs (see Component 1). In addition, particular focus will be made on increasing the participation of women-led startups and SMEs and on expanding project activities to lagging areas and the interior regions.

Intermediate beneficiaries will include actors that provide risk capital and business development support to innovative startups and SMEs. These actors will include private financial intermediaries, such as PE/VC funds; entrepreneurship ecosystem intermediaries, such as incubators, accelerators, and other Business Development Service (BDS) providers; and academic and research institutions.

D. Project Description

This is a seven-year Project which will provide a comprehensive package of financing, ecosystem and firm-level support, and project management and capacity building. The project will be made up of three components: (i) equity and quasi-equity financing for innovative startups and SMEs; (ii) ecosystem and firm-level support for innovative startups and SMEs; and (iii) project management and capacity building. Parallel and co-financing arrangements with other DFIs are being considered by the Government however none are confirmed at this stage. Project funds will flow through the Caisse des Dépôts et Consignations (CDC) as the implementing agency that would establish and channel finance to Start-up Capital Fund of Funds and Smart Capital Co-Investment Fund.
Component 1: Equity and Quasi-Equity Financing for Innovative Startups and SMEs (US$62 million). Under this component, the project will provide equity and quasi-equity financing through both Start-up Capital and Smart Capital. This component will finance the provision of the following equity investments: (a) equity and quasi-equity financing through Startup Capital Fund (through “participating financial intermediaries” or PFIs) to eligible innovative startups; and (b) equity and quasi-equity financing through Smart Capital Fund to eligible innovative SMEs.

Component 2: Ecosystem and firm-level Support for Innovative Start-ups and SMEs (US$8 million): This component aims to strengthen the pipeline of innovative start-ups and SMEs, support the entrepreneurship ecosystem, as well as provide support for firm-level adoption of innovation and technology and investment readiness.

Component 3: Project Management and Capacity Building (US$5 million): This component will cover costs incurred by the CDC in its role as the implementing agency. Under this component, CDC will also provide needed support to Start-up Capital and Smart Capital to deliver activities under components 1 and 2 and additional outreach and capacity building activities.

Legal Operational Policies

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<td>Projects in Disputed Areas OP 7.60</td>
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Summary of Assessment of Environmental and Social Risks and Impacts

The majority of the FI subprojects are expected to be Low Risk, specifically for investments in startups and SMEs at low ticket sizes (USD200,000 – USD500,000) and/or at low tenors (1-5 years). However, may be a small number of investments at higher ticket sizes/tenors, as well as a small number FI sub-projects which could potentially have some negative environmental and social impacts, particularly in the SMEs.

Note: To view the Environmental and Social Risks and Impacts, please refer to the Appraisal Stage ESRS Document.

E. Implementation

Institutional and Implementation Arrangements

The institutional and implementation arrangements for the project are based on public-private partnerships, with an emphasis on private sector implementation of key project activities. The CDC will maintain overall responsibility for the fiduciary and administrative aspects of the project (Component 3), and will act as the public investor (equity shareholder on behalf of Government) in the Start-up Capital Fund of Funds and Smart Capital Direct Co-Investment Fund. The CDC will also establish the Startup Capital and Smart Capital fund managers, who will be responsible for implementing the project investments (Component 1) and ecosystem and deal-flow
support activities (Component 2).

**CONTACT POINT**

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**APPROVAL**

Task Team Leader(s): Fadwa Bennani

Approved By

Environmental and Social Standards Advisor:
<table>
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