I. Introduction and Context

Country Context

Yemen is in the midst of a difficult political transition with uncertain outcomes. After nearly a year of political, economic, and security upheaval, parties to the political conflict signed on to an agreement brokered by the Gulf Cooperation Council (GCC) and overseen by the UN and the international community. In addition to responding to continued popular demands to end corruption, provide equitable development, create an inclusive society and political system, and spur employment and economic development, the newly formed Government of National Reconciliation (GNR) faces long standing socio-economic challenges as well as the Houthi revolt in the north, the separatist movement in the south, and the emergence of Al-Qaeda in the Arabian Peninsula (AQAP) in the southern province of Abyan. Despite these serious and complex challenges, the 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.

Sectoral and Institutional Context

The recently completed Transitional Program for Stability and Development (TPSD) of the GNR 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. 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. The national priority of economic revival and growth through the private sector will need to focus to a large extent on micro and small enterprises (MSEs), particularly in the short term.

The business environment within which MSEs are operating is increasingly challenging. Even prior to the 2011 crisis, Yemen faced difficulties 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. These challenges continued through the 2011 crisis, as reported in interviews with Yemeni business owners in March 2012 but were overshadowed by new concerns over political stability and physical security.

And yet there are rich opportunities for gains in MSE performance that would support 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 business, surveys show that consumers lack confidence in honey quality, reflecting the need to build quality systems, improve packaging, facilitate export certification and support wholesaler marketing and promotion.

Relationship to CAS

The proposed project is consistent with the upcoming Interim Strategy Note (ISN) planned for CY2012 which is expected to focus on short term confidence building measures while laying the groundwork for tackling medium term challenges. One of the four focus areas of the ISN will likely be on private sector led growth and job creation, which the project will support by providing financial assistance, facilitation, and technical assistance for business and financial services and activities that promote recovery and growth.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The MSE Revitalization Project (MSERP) aims to support inclusive revitalization and growth of the Yemeni private sector.

Inclusiveness will be achieved through the focus on micro and small enterprises as well as outreach to women and youth beneficiaries, including the enterprise owners and those hired by those enterprises as a result of the project. Revitalization will be achieved by including assistance to firms seeking to recover from the effects of the 2011 crisis on their businesses, while growth will be achieved through the uptake of skills, best practices, and innovation by enterprises that are expected to improve their performance in terms of both domestic and export markets and employment.

Key Results (From PCN)

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 MSERP are:
• Increased domestic sales of participating firms
• Increased export sales of participating firms
• Increased employment of participating firms (% female and youth)

III. Preliminary Description

Concept Description
Private Sector Development can be a vital tool in conflict-affected environments. In the 2011 World Development Report on Conflict, Fragility and Development (2011 WDR) and elsewhere, it is now recognized that low GDP per capita and unemployment are major drivers of conflict. This is supported by survey data cited in the 2011 WDR: Asked for the reasons why young people join rebel groups or gangs, the biggest share of respondents indicated unemployment as the main reason. The report concludes that the path to longer-term development and peace “is dependent on a healthy private sector”. PSD is therefore crucial, “especially if creating jobs and incomes is to out-last donor-funded, short-term emergency works.” Since in Yemen, as in many other developing countries, the private sector consists predominantly of micro and small enterprises, this places the competitiveness and growth of MSEs at the top of the development agenda in fragile and conflict situations.

Literature on small and medium enterprises (SMEs) suggests that the majority of new jobs in diverse economies are generated by a small percentage of fast-growing SMEs, or “gazelles”. Being a high employment growth SME in MENA tends to be positively correlated with specific initiatives and activities including new/ improved product development, formal training, international quality certification, and a company website. And yet these are precisely the type of practices that smaller firms are particularly challenged to adopt.

In addition to these typical challenges, MSEs in Yemen face a particularly difficult business environment and the need to overcome the impacts of the 2011 crisis on their businesses with limited resources. Overcoming these combined factors will require an intervention that can address both the short-term challenges of revitalizing businesses after the 2011 crisis and the challenge of competitiveness and growth in the longer term. The 2011 WDR on Conflict, Fragility and Development emphasizes the importance of early results and confidence building measures that promote jobs and business confidence, including initiatives for private sector recovery. The WDR notes approaches that have been found effective in fragile and conflict situations, including matching grant facilities for new market development that exploit the private sector’s capacity to innovate and help entrepreneurs develop new product lines while sharing the risk of investment, and value chain approaches that address breakdowns in business and market linkages.

MSEs looking to recover, innovate or grow are also likely to need financing for capital investments or working capital, particularly given the likelihood that their own resources may have been exhausted by coping with the 2011 crisis. Improving access to finance for micro and small businesses is a proposed complementary element to the matching grant facility.

Proposed Micro and Small Enterprise Revitalization Project (MSERP) Components

Component 1: MSE Access to Business Development Services
• Matching Grant Facility
• Strategic Initiatives
Component 1: MSE Access to Business Development Services

The program would provide incentives and support mainly to existing, small firms to prepare and implement well-defined business development plans aimed at developing new markets (particularly new export markets), new products, and new processes or technology or at sustainable recovery. It would aim to support mainly small scale firms - but micro and medium firms would also be eligible. Services such as food retail, transport, car repair, and business service providers themselves; agro-processing such as fishing, honey and coffee; and light manufacturing, such as food processing, stone and marble, garments, and fabricated metals, are expected to be prominent industries as reflected in the composition of the economy. The focus would not only be urban, but be inclusive of rural communities involved in various value chains from across all regions of Yemen. The matching grant facility would aim to provide matching grants (50% or 30% cost sharing basis) to 900 firms over a three year intake period. The project would also support Strategic Market Development Initiatives identifying and diagnosing constraints and seeking to break market development bottlenecks that either commonly constrain individual firms or can benefit from treatment that will broadly benefit a market of firms and business associations. Subject to further investigation, the SMEPS under the supervision of the Social Fund for Development (SFD) should be responsible for the implementation of the matching grant facility.

Component 2 – MSE Access to Credit

The objective of Component 2 is to attain a more inclusive financial services industry, focusing on youth, women and regional disparities for financing MSEs. Subject to further confirmation of the funding needs and gaps, the project proposes to offer a line of credit, likely through the SFD, which would on-lend to financial institutions and intermediaries according to agreed criteria targeting MSEs with the purpose of financing their capital investment and operating capital. This facility will be complimented by a technical assistance program, that would focus on improving micro and small finance institutions’ resilience to political and economic shocks and small enterprise lending.

Component 3 – Management

This component will cover activities and costs for management of the overall project and funds by SFD, the Small and Micro Enterprise Development (SMED) or SFD, SFD’s management of line of credit and technical assistance activities for Component 2, and the sponsoring agency's sponsorship and oversight of the matching grants, strategic initiatives and technical assistance in Component 1. It should be noted that the complexity and cost of this component may be elevated due to the difficult security context in Yemen, particularly as this project intends to be inclusive and have national reach.
IV. Safeguard Policies that might apply

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