REPORT NO.: RES40320

DOCUMENT OF THE WORLD BANK

RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF
SUPPORTING INNOVATION IN SMALL AND MEDIUM ENTERPRISES PROJECT
APPROVED ON OCTOBER 31, 2012
TO
LEBANESE REPUBLIC

FINANCE, COMPETITIVENESS AND INNOVATION
MIDDLE EAST AND NORTH AFRICA

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The World Bank
Supporting Innovation in Small and Medium Enterprises Project (P127306)

I. BASIC DATA

Product Information

<table>
<thead>
<tr>
<th>Project ID</th>
<th>Financing Instrument</th>
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<tbody>
<tr>
<td>P127306</td>
<td>Investment Project Financing</td>
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</table>

<table>
<thead>
<tr>
<th>Original EA Category</th>
<th>Current EA Category</th>
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<tr>
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<table>
<thead>
<tr>
<th>Approval Date</th>
<th>Current Closing Date</th>
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<td>31-Oct-2012</td>
<td>30-Jun-2020</td>
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Organizations

<table>
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<tr>
<th>Borrower</th>
<th>Responsible Agency</th>
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<tbody>
<tr>
<td>Lebanese Republic</td>
<td>Kafalat</td>
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Project Development Objective (PDO)

Original PDO

The project’s 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.

Summary Status of Financing

<table>
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<tr>
<th>Ln/Cr/Tf</th>
<th>Approval</th>
<th>Signing</th>
<th>Effectiveness</th>
<th>Closing</th>
<th>Net Commitment</th>
<th>Disbursed</th>
<th>Undisbursed</th>
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</table>

Policy Waiver(s)

Does this restructuring trigger the need for any policy waiver(s)?

No

I. SUMMARY OF PROJECT STATUS AND PROPOSED CHANGES
The restructuring proposes to extend the closing date of the Supporting Innovation in Small and Medium Enterprises (iSME) Project (Loan no. 8202-LB) by two years, from June 30, 2020 to June 30, 2022.

Background:

The iSME Project has been a successful project in the Mashreq Department portfolio. Despite the different setbacks it has faced since its effectiveness in 2013; mainly delay in loan ratification and delays in deployment of funds, the project currently stands at a 63% disbursement. To ensure a fully implemented project achieving results on all measurable outcomes, the Project Management Unit requested a two-year extension of the project to end on June 30, 2022 which has been approved by both the implementing agency (Kafalat S.A.L) and the borrower (Ministry of Finance). This extension would allow to (i) compensate for the interruptions in the deployment of funds due to delays in processing Withdrawal Applications from the account of Ministry of Finance to the Project account (average 6 to 12-month delays) and (ii) due to nature of activity, ensure a successful and healthy investment portfolio by securing the necessary follow-on financing to the existing underlying portfolio of companies.

Impact of the Lebanese crisis:

The innovation ecosystem and venture capital (VC) industry in general and iSME’s investment portfolio and pipeline in particular are negatively impacted by ongoing crisis in Lebanon since October 2019. This makes this restructuring even more relevant, timely and critical to consolidate project results.

The financial and economic crisis is leading to a severe financing crunch for early-stage companies. Lebanese VC funds are (a) prioritizing follow-on financing (i.e. investing in their existing portfolio companies) over new opportunities, (b) lowering their investment ticket sizes to preserve parts of their limited resources, and (c) not raising new funds due to the loss in Circular 331 scheme’s credibility. The third point will have far reaching impact for the Lebanese VC industry because fund managers model relies on raising new funds periodically. While it is not perceivable yet, the rate of companies’ failure is likely to increase in the absence of new financing rounds.

In addition to the financing crunch, jobs destruction, talent drain, and non-repatriation of earnings are three other noticeable trends since October 2019.

Against this background, iSME revised its investment strategy in the last quarter of 2019 to focus on export-oriented startups with the capacity to generate revenues outside of Lebanon. Kafalat S.A.L also decided to strengthen iSME by establishing a ‘middle office’ with the hiring of a full time Portfolio Manager (in charge of post-investment). Despite the situation, Lebanese VC funds are still active, and the market just welcomed a new fund manager early 2020 (Founders Capital) and existing fund managers are launching new funds (IM Capital and Speed). There are enough co-investors to partner with iSME for the duration of the extension period.

Project status:

The project has been rated as Satisfactory in the last two Implementation Status and Results Reports (ISRs), respectively in February 2020 and August 2019, an upgrade from Moderately Satisfactory rating for three consecutive ISRs (since November 2017). As of March 2020, the project has disbursed 63% of total loan amount.

Upward trends were achieved on the PDO and intermediate indicators as follows (as of February 2020):
i. Increase in access to finance for SMEs:
   a. Total number of firms receiving equity financing leveraging investors and the iSME funding program: 85 firms, 77 percent of the target. Of which 10 firms (achieving 100 percent of the target) are owned by women.
   b. Total amount of equity financing received (leveraged) through the project, leveraging investors and the iSME funding program: $38.8 million, 77.6 percent of the target.
   c. Total number of firms receiving equity financing leveraging investors only (as a result of a Grant activity): 63 (i.e. $13.1 million co-financing mobilized); target exceeded by 110 percent.

ii. Level of Innovation:
   a. Number of new/improved products/processes offered: 100 new/improved products/processes, 60 percent of the target.
   b. Number of new start-ups created under the project: 65 new start-ups, 93 percent of the target.

iii. Jobs Creation:
Number of new jobs created in beneficiary SMEs: 265 full-time equivalent (FTE) positions, target exceeded by 47 percent. Of which 47.38 percent of new jobs created are filled by women (target exceeded by 374 percent). These survey results are part of a jobs assessment study finalized in February 2020. Results also show that the net job creation increased 108% from the time beneficiaries received iSME funding.

The performance of Kafalat S.A.L and its Project Management Unit continues to be satisfactory throughout implementation. The fund has received excellent feedback from industry participants for the rigor of its investment committee and the quality of young firms supported through both equity and concept development grant activities.

It is confirmed that requirements of Bank Policy and Bank Directive for Investment Project Financing have been met, namely: (a) the PDO remains achievable; (b) the performance of the Borrower remains satisfactory; (c) the World Bank and the Borrower agree on actions that will be undertaken to complete the project on time; (d) the project is not subject to suspension of disbursements; and (e) there are no outstanding audit reports and the audit reports are satisfactory to the World Bank. The extension will allow the project to complete remaining activities and fully achieve the PDO.

Relevant project indicator target end dates and disbursement estimates will be adjusted to reflect the proposed closing date of June 30, 2022.

II. DETAILED CHANGES

| LOAN CLOSING DATE(S) |
|----------------------|------------------|-----------------|-------------------|-------------------|
| Ln/Cr/Tf             | Status           | Original Closing | Revised Closing(s) | Proposed Closing |
