

**PROGRAM-FOR-RESULTS INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

Report No.: 113653

Program Name	Strengthening microfinance sector for Promoting Inclusion Program
Region	MIDDLE EAST AND NORTH AFRICA
Country	Arab Republic of Egypt
Sector	Finance and Markets
Lending Instrument	Program-for-Results
Program ID	P162835
Borrower(s)	Arab Republic of Egypt
Implementing Agency	Social Fund for Development (SFD)
Date PID Prepared	January 23, 2017
Estimated Date of Appraisal Completion	April 29, 2017
Estimated Date of Board Approval	July10, 2017
Concept Review Decision	

I. Introduction and Context

A. Country Context

1. Over the past year, Egypt has recovered some political and security stability that hampered economic growth. A newly amended constitution was adopted by popular referendum, the presidential elections were held in End-May 2014, and parliamentary elections were completed at the end of 2015.

2. But the Egyptian economy still faces both urgent and long-standing structural challenges with unemployment and poverty remaining among the biggest challenges. Since 2011, political and regional development have resulted in subdued growth and weak investments levels. This combined with poorly targeted subsidies and a growing public wage bill resulted in a consistently deteriorating budget deficit (11.7% in FY15).¹ Inflation soared to 20% in December 2016. Unemployment is persistently high at 12.5%, with youth and female unemployment at 26.1% and 24.2%, respectively. In 2014/2015, poverty rates, at 27.8%, reaching a 15-year high according to official estimates (See Annex 2 for detail data on poverty).

3. To help the economy recover, the GoE has recently embarked in a series of bold economic reforms. Egyptian authorities have designed a comprehensive package of reforms to reduce public debt from about 98% of GDP to about 88% of GDP between 2016 and 2019, via a review of expenditure and tax policies, including introduction of Value Added Tax, and rationing fuel subsidy. In parallel, the Central Bank of Egypt (CBE) adopted a free floating exchange rate policy (November 2016), which resulted in more than a 100% depreciation in the value of the

¹ The deterioration occurred in the context of quasi-fixed EGP-USD exchange rate maintained at an artificially unsustainable level: before the decision to float the EGP, parallel market rates were more than double official rates.

Egyptian Pound (EGP). Reforms also target structural challenges to low growth and include the streamlining of industrial licensing for businesses, greater access to finance, and updating insolvency and bankruptcy procedures.

4. To alleviate the social impact of these reforms, the authorities are adopting mitigation measures including strengthening the country's social safety nets (SSNs). As poverty and extreme poverty rates are expected to increase the government took some measures to mitigate these impact through SSNs include the following: i) widening the base of ration card beneficiaries and increasing the value of cards, ii) scaling up social programs and pension program (including Takaful & Karama), and iii) investment incentives to formalize informal sectors especially in marginalized regions. The government is also planning to make additional steps through implementing labor-intensive projects and expanding microfinance to low-income populations especially women and youth.

B. Sectoral and Institutional Context

5. Micro and small enterprises (MSEs) is central to the GoE's strategy to promote economic opportunity and growth.² According to the Central Agency for Public Mobilization and Statistics (CAPMAS), at the end of 2015 there were 2.4 million micro and small enterprises employing 6.3 million formal workers. Although sectoral analysis shows that there is no liquidity crunch in the financial sector, MSEs face significant access to finance challenges. Financial intermediation, already low before the revolution, continued decreasing, as demonstrated by the decline of private sector credit-to-GDP from 36.1% in June 2009 to 20% in August 2016. MSMEs in Egypt suffer disproportionately from low financial intermediation and are offered limited financial products as only 5% of small firms have access to finance, compared to an average of 21% in the MENA region³. Concerning financial inclusion, only 14% of Egyptian adults have access to a bank or postal account, below regional and income group averages.⁴ Headline access figures are uniformly lower for women (9%), youth (6%), rural (10%), and lower-income segments (5%).

6. Microfinance has emerged as a critical avenue through which to promote economic activity amongst vulnerable communities in Egypt. As of September 2016, microfinance outreach was an estimated 1.9 million active clients (EGP 4.3 billion in loan portfolio). Estimates of potential demand fall between 4 and 10 million clients (individuals and entrepreneurs)⁵, suggesting the market is currently reaching approximately 25% to 50% of demand. Market players estimate that 7 million micro-entrepreneurs could benefit from a micro-loan within the next four years. However, all else being equal, at the current annual progression rate of 5.7%, the 4 million individuals/ micro-entrepreneur's threshold would not be reached before 20 years.

7. Microfinance supply side is in-adapted. The microfinance sector in Egypt is composed of 3 companies and 728 NGO-MFIs. Thirteen NGOs-MFIs fall under Tier A (Gross Loan Portfolio > EGP 50 million) and hold 90% of the market. These Tier A MFIs are amongst the most

² For more, see: World Bank, "Implementation Completion Report" Enhancing Access to Finance for Micro and Small Enterprises, June 2016. ICR number ICR00003851.

³ ICA data 2012.

⁴ Data in this paragraph taken from global finindex survey unless otherwise stated.

⁵ Based on analysis completed by UNCDF current market outreach represents 10% of potential.

sophisticated in the MENA region. The rest of the market is characterized by excessive fragmentation. In addition to their size, most MFIs are associations, a status that actually limits their access bank financing

8. The Social Fund for Development (SFD) plays a key role in promoting access to finance and operational expansion of micro-entrepreneurs. A law passed in 2004 designated the SFD as the agency responsible for MSE development and created the Small Enterprise Development Organization (SEDO), which was mandated to establish, develop, support, and finance small enterprises for job creation purposes. The SFD also led the development of Egypt's microfinance strategy in 2005. As of June 2016, the microfinance portfolio in the SFD, amounted for a total of EGP 5 billion. SFD allocated approximately 31% of the value of disbursed loans to underserved governorates and poor villages, with a focus on Upper Egypt that alone accounted for 52% of total value of disbursed loans. Moreover, women and youth accounted for 47 and 51% of beneficiaries.

9. There is significant room for improvement for SFD to play a more active and sustainable role in building the microfinance market through overcoming particular structural, operational, and strategic challenges. At the operational (market) level, there appears to be a perception that SFD has a conflicted role in the market. Given that SFD also provides direct small business financing to beneficiaries, certain institutions view SFD as a competitor (market player) rather than a wholesaler. Large banks report working with SFD because it offers below market funding as compared to their cost of capital. Smaller financial institutions report inefficiencies working with SFD. Pricing on certain contracts includes interest rate caps.

C. Relationship to Country Partnership Strategy

10. The proposed operation fully embodies the first pillar of the WBG Strategy for MENA⁶, “renewing the social contract,” which aims at enhancing opportunities, quality services and citizen engagement across the region. As mentioned above, the project aims at stimulating private sector led growth to create sustainable jobs through increased access to credit and in particular to mitigating the negative impact of the economic reforms on the vulnerable population through enhancing the financing of youth, women and micro-entrepreneurs in lagging regions. The operation also aims at transforming SFD into a well-governed institution that is able to crowd in private sector funds to scale up MSEs financing. A more efficient, transparent and accountable SFD will improve its operational performance and allow diversification of its funding and the attraction of private funds. SFD transformation also seeks to improve the SFD M&E framework and good governance practices. This will improve the capacity of SFD to assess economic and social impact and formulate related policy measures.

11. Similarly, the project is well aligned with the strategic objectives of the WBG's Country Partnership Framework (CPF) for Egypt for Fiscal Year 2015-2019. The CPF supports the three pillars of Government's development strategy: i) improving governance, ii) supporting private sector job creation and iii) improving social inclusion. The proposed Program is

⁶ Economic and Social Inclusion for Peace and Stability in the Middle East and North Africa: A New Strategy for the World Bank Group, 2015. The WBG MENA Strategy 2015 includes the following four pillars: 1. Renewing the Social Contract; 2. Regional Cooperation; 3. Resilience to IDP/Refugee Shocks; and, (iv) Recovery and Reconstruction.

closely linked to all of these goals. First, it will promote good governance as it will bring international best practices regarding transformation of apex institutions to SFD. Second, it will support private sector in creating jobs and self-employed micro-entrepreneurs especially by improving the mechanisms through which microbusinesses invest productively and expand. Finally, the project directly contributes to the CPF's third focus area of fostering social justice and inclusion through developing financial sector mechanisms to reduce economic vulnerability amongst the poor and promote economic and social participation.

12. The proposed Program is also fully in line with the Egyptian Government top priorities, reflected in its Sustainable Development Strategy: Egypt's Vision for the Year 2030. The strategy focuses on three main areas: economic development, improving governance, and social justice and inclusion. Salient features of the strategy are a focus on the leading role the private sector is expected to play in economic development, with an emphasis on boosting the growth of SMEs, and an emphasis on the need for greater transparency and accountability in the public sector, both closely related with the proposed Program.

II. Program Description

13. The Program Development Objective (PDO). The PDO would be to mitigate the negative impact of the economic reforms on the vulnerable population through i) enhancing the financing of youth, women and micro-entrepreneurs in lagging regions and ii) strengthening of SFD efficiency and sustainability.

14. The proposed project would include two results areas:

- **Results Area 1:** the first results area would focus on increasing the number of new young and women micro-entrepreneurs in the lagging regions having access to financial services.;
- **Results Area 2:** a second results area would focus on the modernization and transformation of SFD, mainly through improvement to its institutional and legal mandate, funding diversification (including from the private sector), operational efficiency (including enhanced targeting to micro-entrepreneurs), product development, and improved monitoring and evaluation systems.

III. Initial Environmental and Social Screening

15. Environmental Assessment. The proposed Program will support the microfinance sector which, by definition, could only be associated with minor environmental issues. Most of micro-entrepreneurs are working in non-polluting small-scale activities that would have negligible environmental impacts. Although, some activities may be within industrial sectors associated with considerable environmental impacts, the small scale of investments makes environmental risks relatively low. The SFD has developed a system for ensuring that the financed projects comply with the national environmental system and the Bank has assisted in improving such system through the Emergency Labor Intensive Investment Project and the Promoting Finance for Inclusive Financial Access Project currently under implementation. During the assessment, the SFD environmental tracking system will be assessed and would be scrutinized, as needed, to capture different environmental issues related to microfinance.

16. Social Assessment. The proposed Program is expected to have social benefits because it will provide opportunities to finance poor youth, women and micro-entrepreneurs in lagging regions. It will also strengthen the efficiency and sustainability of the SFD, which plays an important role in microfinance sector and in providing economic opportunities for the poor. Also, the program will alleviate social impacts by adopting mitigation measures to strengthen country's SSN. The program is not likely to cause any negative social safeguard impacts. However, the following are key social concerns that the program should give special attention to:

- i) Reaching vulnerable people effectively to ensure fair service. In order to reach the poorest people in target areas, the proposed program should identify these areas to be supported, as well as include details for gender sensitive outreach and communication activities. The SFD can play an important role identifying the most needed individuals in targeted areas;
- ii) Enhancing citizen's engagement: limited citizen's engagement has been demonstrated by absence of formal service feedback system, grievance redress mechanism, and lack of participation in monitoring the quality, satisfaction and utilization of the delivery of services. The program may consider the establishment of client friendly system for assessing the level of satisfaction of providing services.

17. An Environmental and Social Systems Assessment (ESSA) will be carried out as part of project preparation. This would include an assessment of: i) potential environmental and social impacts and risks; ii) existing regulations and policies and procedures that govern the environmental and social management system; (iii) institutional capacity and environmental and social management performance; and (iv) environmental and social management action plans. Consultations will be carried out with various stakeholders during the process of the ESSA preparation and the draft ESSA will be publically disclosed before project appraisal.

IV. Tentative financing

Source:	(\$m.)
Borrower/Recipient	0.00
IBRD	200.00
IDA	0.00
Others (specify)	0.00
Total	200.00

V. Contact point

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