Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 09-25-2018| Report No: PIDXXX

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Tunisia	P167380		Innovative Start-Ups and SMEs
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Financing Instrument**
MIDDLE EAST AND NORTH AFRICA	17-Dec-2018	28-Feb-2019	Investment Project Financing
Borrower(s)	**Implementing Agency**		
Government of Tunisia	TBD		

Proposed Development Objective(s)

The project development objective is to increase growth of, and innovation in, select startups and small, and medium enterprises.

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	100.00
Total Financing	100.00
of which IBRD/IDA	100.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Counterpart Funding	0.00
Borrowing Country's Fin. Intermediary/ies	0.00
Trust Funds	0.00
Montreal Protocol Investment Fund	0.00

Environmental and Social Risk Classification	Concept Review Decision
Moderate	

Other Decision (as needed)

B. Introduction and Context

Country Context

Tunisia's post-revolution transition has been characterized by sluggish economic growth, low productivity, and a fragile macroeconomic environment. Economic growth stood at 1.9 per cent in 2017, averaging 1.7 per cent per annum from 2011-2017 compared to 4.5 per cent per annum in the five years before the revolution. While economic growth has recovered modestly in recent years–driven mainly by services, agriculture, and export-oriented manufacturing–overall industrial output remains low, and the contribution of exports and investment to growth has been limited. The fiscal and current accounts deteriorated to 6.1 per cent and 10 per cent of GDP, respectively, in 2017; and gross international reserves declined to 3.1 months of import by end-2017 and 70 days (US$ 3.9 billion) in August 2018. Consequently, the dinar depreciated significantly which, in combination with increases in public wages, some administered prices and VAT, pushed inflation to over 7 per cent in July 2018. Recent efforts by the Government have, however, begun to address these macroeconomic vulnerabilities, including efforts to stabilize public debt, raise investment and social spending, and limit interventions in the foreign exchange market.[1]

Extremely high unemployment has remained a pressing challenge, especially for young educated graduates, women, and populations in the lagging regions. Long-standing structural distortions, combined with recent macroeconomic vulnerabilities, has resulted in a private sector in which firms have remained stuck in low-value added activities, generating few high-quality jobs. According to World Bank (2014), 77 percent of the workforce was employed in low-productivity sectors, such as agriculture and textiles; while high-productivity service sectors–such as banking, transport, and telecommunications–absorbed only 7.7 percent of total employment.[2] As a result, unemployment has remained persistently high, at 15.5 per cent in 2017. The unemployment is even higher among young graduates (31 per cent), women (22.6 per cent), and in the lagging regions (over 25 percent in the South-West and South East, compared to 10 percent in the Center-East and North-East). In this context, startups and SMEs have become a crucial source of employment, although several bottlenecks continue to limit their ability to grow, harness innovation, and expand into new markets.

In recognition of the importance of entrepreneurship and innovation for economic growth and job creation, the Government of Tunisia has initiated a series of reforms aimed at addressing the challenges facing startups and SMEs. A wide set of legal and regulatory reforms are currently underway to address constraints in the business environment, as well as to enhance access finance and access to markets, including export markets. Most notably, the Government approved the Start-Up Act in April 2018, which provides several incentives to promote the creation and growth of

[1] These efforts are supported by the IMF EFF program, as well as the Investment, Competitiveness, and Innovation DPL (2018).
[2] World Bank (2014). The Unfinished Revolution Bringing Opportunity, Good Jobs and Greater Wealth to all Tunisians

innovative startups. In parallel, the Government is taking steps to establish an early stage equity fund aimed at catalyzing risk capital for investments in innovative startups and high-growth SMEs. Similarly, ongoing reforms to the credit infrastructure and regulatory framework, as well as to key public SME finance institutions, are expected to enhance access to debt financing for SMEs. the Government has requested the assistance of the World Bank Group to support innovative startups and technology-based SMEs, by mobilizing private sector financing, enhancing firm-level capabilities and technology adoption, and strengthening the entrepreneurship and innovation ecosystem.

Sectoral and Institutional Context

With a young well-educated population and increasing rates of technology adoption, Tunisia has the potential to become an attractive market for entrepreneurship and innovation. According to the 2018 Bloomberg Innovation Index, Tunisia is ranked first in new science and engineering graduates per 1,000 people in the labor force; and is considered one of several top innovative countries in Africa and the Arab World. Internet and mobile penetration rates have increased rapidly to 55.5 per cent and 124.3 per cent, respectively, in 2017; and several public initiatives have been launched to encourage firm adoption of technology and research and development (R&D). Nevertheless, startups and SMEs, particularly those led by women and youth, continue to face considerable obstacles to creating, managing and growing productive businesses.

Tunisia's location close to key export markets, particularly in Europe, provides significant opportunities for startups and SMEs to innovate and grow beyond the relatively small domestic market. Tunisia's strategic location presents an opportunity for startups and MSMEs to enter into high-values sectors, including agribusiness, manufacturing (electromechanical, leather and footwear, petrochemicals, pharmaceuticals) and services (ICT, niche tourism, health). Even traditionally low-value added sectors, such as agriculture, have potential for export growth, especially where technology is leveraged to improve production processes, enhance product quality, or provide key services within the value chain–e.g. high-tech logistics.

The entrepreneurship and innovation ecosystem is relatively nascent, despite strong growth potential and increasing dynamism. While several business incubators, accelerators and PE/VC funds exist, few have a presence beyond the coastal regions, and many are unable to meet the rapidly growing demand for comprehensive business development support. The Tunisian entrepreneurship ecosystem is dominated by public actors which have been ineffective in supporting startups and SMEs, mainly due to the outsized role of the Government in the management of these programs. Private sector players have also struggled to meet the high demand for incubation, acceleration and other business development services, as well as to sustainably expand their programs to meet this demand. As a result, a large proportion of start-ups struggle to reach the investment-readiness stage, or to build linkages with potential clients, and gain access to new technologies, markets and value chains.

Although a number of public initiatives have been introduced to promote digital entrepreneurship, research commercialisation and technology adoption, Tunisian startups and MSMEs continue to operate below their innovation potential. Public initiatives have not been sufficient in boosting innovation, largely due to fragmented public policy formulation and governance, poorly defined technology transfer models at the firm level, and limited private funding directed at R&D. Additional limitations include: unclear Intellectual Property (IP) policies on ownership of research; poor knowledge and managerial capacities to undertake R&D; and few incentives to encourage academics and researchers to get involved in research commercialisation. In this context, the ability of existing and disruptive technologies (such as IoT, blockchain, data analytics etc) to drive process innovation, new business models and increased productivity, remains limited.

The lack of access to the right mix of equity and debt finance remains a critical constraint for startups and established MSMEs alike. The Tunisian equity market is relatively vibrant, although the PE/VC market remains underdeveloped. As a result of the limited PE/VC investment reaching Tunisia, entrepreneurs and start-ups are starved of much needed early stage equity capital and technical assistance crucial for product development, market entry and growth. Few business angels and angel investor networks exist, further limiting access to finance and related networking support for startups in the very early stages of business development. Equally, access traditional working capital and investment lending remains challenging for SMEs in Tunisia. Several institutional weaknesses, including rapidly declining liquidity, poor asset quality and low levels of capitalization, have constrained bank lending to MSMEs. In this context, the banking sector has seen a rapid "flight to quality," with bank lending increasingly channeled away from SMEs perceived as high risk towards Government and large corporate borrowers.

Relationship to CPF

The proposed project is aligned with the Tunisia Country Partnership Framework FY16-20, the IFC Strategy for Tunisia, as well as the Government's Five-Year Development Plan 2016-2018 and Economic and Social Program 2018-2020. The project contributes to the CPF objectives under Pillar 1: Restoring an Environment Conducive to Sustainable Economic Growth and Private Sector-Led Job creation–specifically, Objective 1.3, which seeks to foster sound financial sector development. The project also supports IFC's strategy in Tunisia, which aims to facilitate private investments to drive job creation, particularly for youth, and to promote inclusive and competitive economic growth. The project complements Axis 1 of the Government's Five-Year Development Plan 2016-2018 which aims at enhancing financial inclusion and access to finance for SMEs; as well as the Economic and Social Program 2018-2020, which includes the 'Smart Tunisia' program, which seeks to accelerate reforms to boost private sector investment, entrepreneurship, and innovation, thus transforming Tunisia into a productive and competitive "hub economy".

The project fits squarely within the WBG Maximizing Finance for Development (MFD) approach, by undertaking activities that seek to crowd in and leverage private sector financing. The proposed project directly contributes to MFD by mobilizing private sector risk capital for startups and SMEs through co-investments and other risk-sharing mechanisms with private sector PE/VC funds, angel investors, accelerators and banks. When combined with the package of reforms being implemented under the Investment, Competitiveness and Inclusion DPL 2018, as well as other ongoing policy dialogue and technical assistance, the proposed project will contribute to encouraging the allocation private capital towards innovative startups and growth-oriented SMEs. As such, the project has been selected as a demonstration project under the WBG's MFD Accelerator program.

C. Proposed Development Objective(s)

The project development objective is to increase the growth of and innovation in select startups, and small and medium enterprises.

Key Results (From PCN)

The PDO will be measured through the following Results Indicators:

(a) Financing to start-ups and SMEs delivered through the project, specified by public financing, private financing, specified gender of main owner(s).

(b) Number of startups and SMEs that received financing and/or business development services through the project, specified by gender of main owner(s).

(c) Number of startups and SMEs that received financing and/or business development services through the project with a developed innovation[3] (specific indicator to be assessed during preparation).

(d) Increase in jobs and/or revenue of beneficiary startups and SMEs (specific indicator to be assessed during preparation).

D. Concept Description

Project Description

The project will be made up of three components: (i) Support for Innovative Startups; (ii) Support for Growth-Oriented SMEs; and (iii) Project Management, Coordination and Monitoring & Evaluation. Project activities will focus on enhancing firm capabilities for innovation and technology adoption and growth; filling the debt and equity financing gap for innovative startups and SMEs; and building capacity within the entrepreneurship and innovation ecosystem to support high-growth innovative startups and SMEs. The project will also provide mechanisms to encourage and sustain increased participation by women, youth, and populations in the lagging regions in entrepreneurial activities.

Component 1: Support for Startups

This component will provide support to: (i) facilitate private risk capital for innovative startups and entrepreneurs in the pre-seed, seed and early growth stages; and (ii) strengthen the entrepreneurship ecosystem and deal-flow.

Component 2: Support for Technology-based SMEs

This component will provide support to: (i) facilitate increased bank lending to SMEs, by supporting the development of effective credit risk sharing mechanisms and facilities to encourage investments in SME technology adoption; (ii) strengthen the innovation ecosystem and increase adoption of technology (including Industry 4.0 technologies) by SMEs.

Component 3: Project Management, Coordination and Monitoring & Evaluation

Funds under this component will go towards management and consulting fees, service provider fees for implementation of select project activities, as well as operating and administrative costs for the management and supervision of the project activities.

Preliminary Implementation Arrangements

The implementation of the project activities will leverage private sector management and expertise as far as possible, across the financing and non-financing activities. Eligible participating financial intermediaries (PFIs) under the relevant sub-components will be required to meet the prudential standards defined by the relevant regulatory authorities, including BCT and CMF, unless otherwise agreed with the World Bank. PFIs will also be required to meet the criteria set out in the World Bank Operational Policy 10 (OP 10) on Financial Intermediary Lending as well as the criteria set out in the Project Operations Manual (POM). Overall responsibility for the implementation of the proposed project will be agreed and determined with the Government of Tunisia.

[3] According to Corporate Results Indicators, a 'developed' innovation can be measured as the number of businesses receiving advisory services and/or technical assistance through the Project that develop new/innovative business models resulting in the development of new products and/or processes or the enhancement of existing products and/or processes in their operations.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Project in Disputed OP 7.60	No

Summary of Screening of Environmental Risks and Impacts

The project is classified as Moderate Risk taking in account the nature and magnitude of the potential environmental and social risks and impacts of subprojects. No adverse impacts such as involuntary land acquisition, impacts on indigenous peoples, on biodiversity and habitats, on cultural heritage, are expected. While the project does not intend to restrict the sectors eligible for financing, potential FI sub-projects for which startups and SMEs would receive financing are generally expected to be in the technology, commercial and services sectors and not entail adverse environmental and social risks. The majority of the FI subprojects are expected to be Low Risk, specifically for investments in startups and SMEs at low ticket sizes and/or at low tenors. 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. This may raise the risk to Moderate Risk. The capacity of the responsible FIs implementing the project to put in place and manage their Environmental and Social Management Systems (ESMS) will be assessed during project preparation.

Environmental and Social Safeguard Specialists on the Team

Mohamed Adnene Bezzaouia, Environmental Specialist; Markus Friedrich Vorpahl, Senior Social Development Specialist.

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

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Borrower/Client/Recipient

Republic of Tunisia

Implementing Agencies

TBD

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