PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA720

Project Name	MSME Development Project for Inclusive Growth (P132314)
Region	MIDDLE EAST AND NORTH AFRICA
Country	Jordan
Sector(s)	SME Finance (60%), Microfinance (40%)
Lending Instrument	Financial Intermediary Loan
Project ID	P132314
Borrower(s)	Government of Jordan
Implementing Agency	Central Bank of Jordan
Environmental Category	F-Financial Intermediary Assessment
Date PID Prepared	19-Dec-2012
Estimated Date of Appraisal Completion	20-Dec-2012
Estimated Date of Board Approval	21-Mar-2013
Decision	

I. Project Context

Country Context

The Arab region uprisings, and the global financial and economic slowdown have had implications on Jordan, taking the form of economic shocks, as well as demands for a more level playing field, equal access, and increased opportunities. The regional turmoil has significantly reduced short term growth prospects for Jordan through sharp declines in foreign direct investment (FDI), and, to some extent, remittances, while the import bill increased as a result of higher commodity prices, adversely affecting the economic environment. Overall, the Jordanian economy has been operating below its potential and has not been generating enough jobs to absorb the more than 60,000 young citizens who enter the labor market annually.

As a result of this slowdown in economic activity, unemployment worsened in 2012, rising to 13 percent from 12.5 percent in 2010. Youth and women were mostly affected, with unemployment, reaching high levels of 22.8 percent and 22.3 percent respectively. Moreover, regional disparities across the various governorates persisted. Limited private sector jobs are available in the Governorates, where people have no option but to rely largely on government and public sector jobs. High unemployment rates could be attributed to major constraints arising from the structure of economic activity, the lack of flexible labor markets, and the large presence of the public sector with market-distorting effects on wages and young people’s expectations. At the same time, the private sector fell short of creating sufficient jobs for young entrants into the market due to the non-conducive business environment and inadequate access to finance.

Hence, it is essential that Jordan promotes sustainable and inclusive growth to reduce unemployment, especially among youth and women, as well as geographically and economically marginalized areas. Job creation and economic inclusion are key priorities for Jordan today—these goals will be advanced by improving access to finance, enhancing competitiveness, and fostering sustainable, private-sector led growth. To face the central challenge of unemployment, conditions are needed that promote private sector investment and encourage fast-growing MSMEs, which empirical evidence has shown to be the most significant employment generators. These types of high-growth MSMEs generate the majority of new jobs and can contribute vitally to productivity growth.

The government of Jordan is very much aware of the importance of MSMEs and is committed to the creation of sustainable private sector jobs through MSMEs development. The recent Government’s Executive Development Program (EDP) for 2011–13 that was prepared in a participatory approach underscores the importance of private sector development for job creation, and overall economic inclusion through MSMEs development, and specifically through improving their access to finance. Most recently in the Deauville Partnership Meeting in Rome in July 2012, the Jordanian authorities stressed the need to ensure that the dividends of economic reforms are shared across the country. In that regard, the primary goal is job creation through MSMEs development with a focus on high growth, innovative enterprises. In an effort to minimize the burden on the budget while at the same time facilitating growth-enhancing investments, the government is working on leveraging private sector investment though promoting smaller enterprises.

II. Sectoral and Institutional Context

MSMEs are major contributors to the Jordanian economy, and to its competitiveness, and employment potential. There are around 150,000 registered enterprises in Jordan, of which MSMEs account for more than 99 percent. The majority of jobs are generated through MSMEs, they employ around 71 percent of private sector employees, where SMEs employ 32.7 percent, and microenterprises 38.7 percent. This sector is also a leading source of exports, and incomes in Jordan. It is playing a key role in the shift to high-value growth sectors, initially through enterprise creation and subsequently through providing services and inputs, and increasing productivity through adopting and applying innovations.

Although smaller firms in Jordan grow at faster rates in comparison with their large counterparts, and create more new job opportunities, they are confronted with numerous hurdles. Inadequate access to finance is frequently cited as one of the main constrains confronting their development. Financial intermediation in general is very low in Jordan compared to other developing economies.

Access to finance is substantially more of a problem for MSMEs compared to large corporates. The financial system is dominated by the banking sector, which is less competitive and plays a limited role in financial intermediation, compared to other regions.   Enterprises often resort to the informal sector, family and friends for access to finance. Private sector credit-to-GDP is relatively low at 80 percent, which is largely allocated to the large corporate.

Although banks are the principal source of external finance for SMEs, only 11 percent of bank lending goes to SMEs, compared to 25 percent in emerging markets. The 2012 Jordan Investment Climate Assessment (ICA) shows the large disparities in terms of access to credit by size of firms. Only 27 percent of the small firms have a loan versus 38 percent of medium-sized firms and 53 percent of large corporates . Moreover, bank financing is mostly working capital, rather than longer term finance, though in overall terms, both remain a constraint. In terms of physical outreach, overall branches are distributed in line with population, although Governorates such as Irbid and Zarqa, both of which have active SME populations, are relatively less well served by bank branches compared to Amman.

More recently, financial intermediation has been affected by the less favorable macroeconomic conditions, slower deposit growth, and the strain on banks' balance sheets from a potential rise in non-performing loans (NPLs). The situation for MSMEs has become worse after the Arab Spring, for two main reasons: First, the budget deficit (due to the higher oil bill that surged by 30 percent in 2011 because of the interruption of the Egyptian gas supply) meant that government borrowing from the banks has expanded, breaching the constitutional debt ceiling (debt to Gross Domestic Product (GDP) ratio rose to around 65 percent by end of first quarter of 2012), and crowding out the private sector borrowing in general, but especially SME.

Second, the higher oil bill, has not only meant higher deficit and higher debt, but also a balance of payments problem, as the current account went deeper in the red, putting pressure on international reserves, which declined by 14 percent in 2011, and continued to decline in the first half of 2012. Hence, interest rates have been going up to help prop the exchange rates and stop reserves from flowing out. Higher interest rates hurt SMEs disproportionately. All these adverse developments coupled with a slowing GDP growth (expected at less than three percent in 2012); and increasing NPLs, have adversely affected the expansion and growth of MSMEs and has contributed to the dampening of private sector credit growth.

Under these circumstances these banks tend to move away from MSME lending to other sectors. There has been some evidence of crowding out of the private sector by the government with the widening fiscal deficit, which will inevitably have implications on the liquidity of the banking system. The problem is made worse by the uneven distribution of liquidity among the banks. In particular, apart from the three largest banks, in Jordan the other small and medium-sized banks are facing considerable stresses on their liquidity position. So although on aggregate the banking system seems to have excess liquidity, this liquidity is unevenly distributed, whereby the medium-size banks that usually lend to SMEs are the ones suffering from lack of liquidity, while the three biggest banks have ample liquidity.

Microcredit is growing in outreach in Jordan. In fact, Jordan has one of the highest microfinance coverage in the Arab region. The microfinance market consisted of 203,579 active borrowers and an outstanding portfolio of over JD 111.6 million, with an average annual growth rate in outreach of 28 percent between 2006 and 2011. There are seven active microfinance institutions (MFIs) that are leading the sector, and are playing a key role at the Governorate level, reaching out to marginalized groups. Growth of this sector, however, is still constrained by the lack of enabling microfinance regulatory and legal frameworks, and by the organization of most of MFIs as not-for-profit companies rather than as investible corporations. Microfinance regulation is important for consumer protection, and the overall strengthening of the sector. Enhancing access to finance for micro enterprises could be one of the effective tools for poverty eradication, consumption smoothening and improving the standard of living.

Apart from the macro-economic factors discussed earlier that are inhibiting supply of finance to MSMEs, their low access to finance can be attributed to numerous factors. In addition to regulatory hurdles, on the supply side, few banks have established dedicated SME departments, and have the capability to lend to SMEs. Several banks rely primarily on collateral-based lending rather than creditworthiness, leaving creditworthy SMEs unfinanced. Most loans require collateral, equal to about 23 percent more than the loan value, where small firms report having provided higher collateral than large ones. Moreover, the enforcement of basic contractual rights is cumbersome, time consuming and costly, representing a significant disincentive when lending to SMEs. To address this, several Jordanian banks use internal ratings systems for SME lending, which are based on a financial and qualitative analysis of SMEs. However, banks often use outdated techniques that do not effectively help in risk management or in lowering cost.

In terms of financial institutional infrastructure, Jordan's rank in Doing Business' "Getting Credit" indicator dropped 20 ranks in 2012 compared to 2011, from the 130th to the 150th, and in 2013 it witnessed a further drop by 17 ranks to reach the 167th among 175 countries. The depth of credit information index's score for Jordan is far lower than that of the average of Middle East and North Africa (MENA) and Organization for Economic Co-operation and Development (OECD) countries. This is attributed to the lack of historical credit information distributed beyond two years, non-availability of credit information from retailers, trade creditors, utility companies, or financial institutions, non-availability of data on loans below one percent of income per capita; and the fact that borrowers cannot inspect their data in the largest credit registry. Jordan also compares poorly against MENA and OECD on public registry coverage and private credit bureau coverage.

Another challenge revealed by the World Bank's recent enterprise survey (2012) is that SMEs often refrain from applying for bank loans due to their religious discomfort with interest-based borrowing. There has been a growing demand for Shari'ah compliant financial products in Jordan, which are offered only by a limited number of banks. On the demand side, MSMEs also lack a number of necessary business skills—they often do not have sufficient knowledge of the products offered in the market and when they do, they do not always have the capacity to fill out loan application forms. These enterprises usually do not have sufficient funds to have audited financial statements or adequate collaterals to apply for a loan.

Nevertheless, there is good potential for growth of the MSME sector in Jordan. The recent estimates for IFC-led G20 Experts Group on SME Finance, reveal a potential financing gap in Jordan to be relatively wide at around US$ 547 million, compared to US$ 1.05 billion in Egypt, US$ 497 million in Morocco, and US$ 247 million in Tunisia.   This is consistent with the findings of the recent banks' survey conducted by the Central Bank of Jordan (CBJ) in June 2012, which showed the large demand by the banking sector for funding, especially the medium-size banks, ranging from JD 200 million to JD 440 million over the coming three years.

The Jordanian authorities are committed to MSME development, and have undertaken significant reform measures to improve the enabling environment, and encourage its expansion with the objective of creating jobs. Efforts have been exerted to address the various challenges confronting MSMEs development, as main creators of new jobs and employment opportunities. Improving their access to finance as well as their access to business development services have been a key priority on the government's agenda. Given the overwhelming preponderance of MSMEs in the Jordanian economy, it is important to support the sector as means to boost employment. Since these enterprises grow at faster rates once provided with sufficient funding, and a conducive environment, it is critical to support their growth. Moreover, high importance was given to Governorates outside Amman to promote growth in these districts, addressing any regional disparities. The Jordanian authorities are keen on improving peoples' standard of living, and maintain social stability in the previously marginalized areas.

III. Project Development Objectives

The proposed operation's main development objective is to contribute to an improvement in access to finance for MSMEs in Jordan. The project will be designed such that it strengthens the link between the financing and performance in achieving sustainable, more inclusive access to finance and it supports new approaches to extend MSME finance on a larger scale. In particular, the design will incentivize lending to MSMEs that are underserved, women headed MSMEs, and MSMEs that are clustered around the Business Development Units being established in less served Governorates by the Government, thereby fostering a close link with a complementary demand side intervention initiative being undertaken by the Government. Lastly, it will seek to focus funding microfinance institutions, especially those that have an outreach in less served areas. Through such support, the project will increase access to finance, including to particularly under-served segments, support banks' liquidity such that the constraints to MSME lending for them are reduced and promote good and responsible practices in lending, including through the use of a systematic safeguards framework.

IV. Project Description

Component Name

Line of Credit

V. Financing *(in USD Million)*

For Loans/Credits/Others	Amount
Borrower	0.00
International Bank for Reconstruction and Development	70.00
Total	70.00

VI. Implementation

The Ministry of Planning and International Cooperation, in agreement with the Ministry of Finance have designated CBJ as the implementing agency for the project, which will be responsible for coordinating and managing the overall project. CBJ was selected as the implementing agency, being the entity responsible for regulating and supervising the banking system in Jordan (which constitutes the vast majority of the financial system), composes 22 commercial banks, and four Islamic banks. There are no development banks in Jordan (unlike in Turkey or India), there are no SME-focused development banks and there are no state-owned banks. Hence the most effective way to reach MSMEs is through banks. Since there is no viable or sound apex institution, the best way to channel funds through banks is through the central bank. Such a project structure is much more efficient than a structure involving individual participation agreements with each participating bank, as it helps assign clear accountability and reporting duties to one institution, ensures better coordination during implementation, and facilitates project monitoring and supervision.

Public Disclosure Copy

A project Operational Manual (OM) acceptable to the Bank has been prepared by CBJ. The OM includes, among other things, the agreed financial management (FM) and disbursement arrangements; procurement arrangements; guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits; and a detailed framework for the continuous measurement and monitoring of outcomes, a key element in ensuring effective implementation.

For implementation, CBJ established a Project Implementation Unit (PIU) headed by the Assistant Executive Manager of the Banking Supervision Department, and comprising representatives from the Data Analysis Division, the Licensing Division, the Legal Department and Investment, and the Foreign Operations Department. The PIU is mandated to oversee and implement the project in line with the implementation arrangements detailed in the OM. CBJ will be responsible for ensuring compliance of project activities to the fiduciary and safeguards arrangements for the project. Given its financial capacity and track record based on the OP 8.30 review, CBJ is well placed and has the capacity to implement the project and ensure compliance during implementation. Under the Regional MSME TA Facility, the Bank will help in building the capacity of CBJ staff on a sustainable basis.

IBRD funds will flow to CBJ with a guarantee from the Government of Jordan and CBJ will channel them to banks in accordance with the eligibility criteria and procedures outlined in the OM. Funds would be received in CBJ's main account and disbursements will be made on a reimbursement basis using interim unaudited financial reports (IFRs)—evidencing actual expenditures—prepared by CBJ. IFRs will be submitted on a quarterly basis, but CBJ would have the flexibility to seek reimbursement earlier than the quarterly intervals by submitting reports for shorter periods. All the above will be coordinated by the PIU, and reported to CBJ management.

All assessments of CBJ have shown that it has adequate financial management systems and procedures to generate the quarterly IFRs in the agreed upon formats, detailed in the OM. Procurement under the Project is limited to the TA component.

An Environmental and Social Management Framework (ESMF) has been developed to identify, minimize, avoid, screen out, mitigate and monitor potential social and environmental impacts in compliance with both World Bank policies and Jordan's applicable laws and regulations. The ESMF will be applied by the banks in the selection and supervision of MSME sub-projects to be financed. The ESMF was disclosed prior to appraisal, and was adopted by the CBJ. CBJ's capacity to monitor, evaluate and report on the ESMF is modest although CBJ has dealt previously with social and environmental safeguards issues. CBJ does not have a specialized team in this field in house and thus would require refresher training and would welcome the Bank's TA component support and training to ensure that their capacity needs are further strengthened. Continuous monitoring may be provided by the Jordanian Ministry of Environment with audits being carried out by the Bank environmental and safeguards consultants.

Arrangements will be put in place to ensure adequate project supervision, covering fiduciary and safeguards aspects, with semi-annual supervision missions. The supervision team will draw on expertise from the Bank as well as external experts, where necessary. Meetings with other concerned stakeholders engaged in MSME finance and microfinance, including donor agencies, will be undertaken during supervision missions.

Banks will be required to distinguish between lending to MSME and to MFIs, notably in their reporting requirements in terms of number of beneficiaries reached. The number of microfinance clients served through banks on-lending to MFIs should be reported separately.

VII. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	x	
Natural Habitats OP/BP 4.04		x
Forests OP/BP 4.36		x
Pest Management OP 4.09		x
Physical Cultural Resources OP/BP 4.11		x
Indigenous Peoples OP/BP 4.10		x
Involuntary Resettlement OP/BP 4.12		x
Safety of Dams OP/BP 4.37		x
Projects on International Waterways OP/BP 7.50		x
Projects in Disputed Areas OP/BP 7.60		x

VIII. Contact point

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