REPORT NO.: RES41143

DOCUMENT OF THE WORLD BANK

RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF
INNOVATIVE STARTUPS FUND PROJECT
APPROVED ON JUNE 23, 2017
TO
GOVERNMENT OF JORDAN

FINANCE, COMPETITIVENESS AND INNOVATION
MIDDLE EAST AND NORTH AFRICA

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I. BASIC DATA

Product Information

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Organizations

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Project Development Objective (PDO)

Original PDO
The project’s development objective is to increase private early stage equity finance for innovative small and medium enterprises ("SMEs").

Summary Status of Financing

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Policy Waiver(s)

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

No
A. PROJECT STATUS

1. The Innovative Startups Fund (ISSF) Project is a satisfactory project in the World Bank’s Mashreq Department portfolio and serves as a critical entrepreneurship ecosystem builder in Jordan. The project’s development objective (PDO) is to increase private early stage equity finance for innovative small and medium enterprises ("SMEs"). Despite a slow start after its signing (August 21, 2017), the ISSF has since then been able to address early challenges regarding its staffing, strategy and governance in a satisfactory manner, and has made significant progress particularly in FY20. The project currently stands at a 60.25% disbursement of the total loan amount and a 33% FY20 disbursement ratio. It has been rated as Moderately Satisfactory since the first Implementation Status and Results Report (ISR; September 28, 2017) and 7 project ratings have improved with satisfaction in the last ISR (January 15, 2020 vs. June 16, 2019) due to overall project progress. Based on ISSF capital increase which triggered the last $10M disbursement (April 17, 2020), the project rating will be increased to Satisfactory in the next ISR.

2. There has been a solid momentum under the Equity and Quasi Equity Financing Program (component 1: $53.5M, o/w $44.75 IBRD Loan), which drives 90 percent of the project success. It has shown very encouraging results, committing $7.4M investments in 1 fund ($5M) and 11 startups ($2.4M) with leverage ratio ranging from 1 to 8.2. The project has crowd-in an additional $10.34M private capital from co-investors.

3. Similarly, the ISSF has made notable progress across all four activities under the Deal-flow Creation Support (component 2: $6.25M o/w $3.125M IBRD Loan). The implementation of the Entrepreneurship Enablement & Development Program (EEDP) has started in February 2020 (in collaboration with iPark) with already 38 early-stage companies trained with Business Development Services (BDS). Jordan’s first Angel Investor Network (AIN) was launched in December 2019 (collaboration with Beyond Capital). ISSF is currently finalizing the selection of the Incubation & Acceleration Development Program (IADP) and Deal-flow Marketplace Platform (DMP).

4. As for Project Management, Coordination, and Monitoring and Evaluation (component 3: $4M, o/w $2 IBRD Loan), major improvements have been made, addressing all of World Bank’s FY19 recommendations.

5. 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 (f) the project has been submitting the quarterly Interim-Unaudited Financial statements (IFRs) to the World Bank in acceptable format and content. The restructuring will allow the project to complete remaining activities and fully achieve the PDO while including a COVID-19 operational response. The Financial Management and disbursement arrangements will remain the same without any changes. Next audit report will cover the period from inception until December 31, 2019, due for submission by not later than June 30, 2020. There will no change to the procurement arrangements as well as the environmental and social safeguards.

B. COUNTRY CONTEXT

1. Private-sector firms and workers are feeling the economic brunt of the COVID-19 pandemic. The first case of COVID-19 was reported in Jordan on March 2, 2020 and as of April 27, 2020, there have been 449 confirmed cases and 7 associated deaths. The outbreak has quickly evolved from a health emergency into a full-blown economic crisis, spreading rapidly throughout the financial sector and the real economy. COVID-19 is damaging otherwise healthy firms through four channels: (i) falling demand, (ii) reduced input supply, (iii) tightening of credit conditions and
liquidity crunch, and (iv) rising uncertainty. Without timely support, there may be persistent harm as otherwise-healthy firms are shuttered and the related jobs are permanently lost.

2. GOJ has taken several measures to protect businesses and jobs since mid-March and new initiatives are announced on a weekly basis, such as:

(a) Lower mandatory bank reserves. The Central Bank of Jordan (CBJ) reduce compulsory reserves requirement for commercial banks to 5% (down from 7%) in an effort to inject JOD550M of extra liquidity (first reduction since 2009).

(b) Deferral of loan repayment without penalty. CBJ asked commercial banks to facilitate the deferral of loan repayments for companies with rescheduling without penalties.

(c) Lower interest rates and increased loan ceiling. The CBJ lowered the interest rates under its liquidity facility (from 1.75% to 1% in Amman, and from 1 % to 0.5% outside of Amman) and requested participating banks to reduce interests of existing loans. Additionally, CBJ increased lending maturity limits for select sectors to 10 years, including a 2-year grace period. It also increased the lending ceiling for all sectors.

(d) Soft loans and guarantees. The CBJ is in the process of establishing a new concessional financing facility with interest rates not exceeding 2% and JLGC guarantees at 85% for companies in all sectors.

(e) Lower guarantee fees, increased guarantee coverage. JLGC reduced its credit guarantee commission to 0.75% (down from 1.5%) for industrial and services programs, and to 0.75% (down from 1%) for early stage companies while also increasing the guarantee coverage to 90% (up from 80%).

(f) Cashless payments. The Jordan Payments & Clearing Company (JoPACC) has enhanced its existing digital finance services (DFS), including products and services for the unbanked in Jordan. The Unified Agent Interface (UAI) has facilitated the access to mobile wallet information and services remotely. The platform enhancements resulted in the opening of approximately 190,000 new mobile wallets during the crisis, at a total transaction value of JOD36.5 million.

(g) COVID-19 Challenge Fund for digital financial services. The CBJ in partnership with JoPACC launched the COVID-19 Challenge Fund, to promote mobile Payment Service Providers to enable contact less payment technologies and acquire merchants to increase usage opportunities. JoPACC is also in the process of enabling interoperability of eCommerce platforms with mobile wallets and QR acceptance.

(h) Workers compensations. The Social Security Corporation (SCS) started to provide unemployment compensations to workers for temporarily suspended businesses. Workers temporarily out of work will receive 50% of monthly salary for April and May 2020 (at a min of JOD165 and a max of JOD500). The employer will contribute 50% of payments at a ceiling of JOD250. Over 5,000 small firms have registered in 24-hour period.

(i) Salaries exempt from interest costs. The PM announced that SMEs borrowing from banks to cover workers’ salaries will not bear the costs of interests. This cost will be covered by the GOJ.

3. Despite these efforts, a gap remains for businesses that cannot access bank financing. This has been an acute problem for startups across the world and particularly in Jordan. Startups have experienced significant difficulties since the start of the COVID-19 outbreak, because they are structurally ill-suited to borrow from commercial banks, and thus cannot benefit from the aforementioned measures. Many startups risk closing down due to lack of funding,
while others might be able to move forward, but at a much slower pace, missing opportunities to scale up and enter new markets. Startups contribute to the economy but are often operating at a loss because they are constantly reinvesting revenue into human resources, technology, and bringing innovative products and services to market. Therefore, they need a longer runway than traditional SMEs before achieving profitability, and commercial banks are ill-equipped to handle this uncertainty along the way. At the same time, venture financing, which is supposed to cater for startups’ need, has significantly shrunk since the start of the COVID-19 outbreak. Investors have re-focused on their existing portfolio and are unlikely to invest in new companies as long as the current uncertainty continues. Therefore, Jordanian startups which boast high potential for much-needed innovation (some of it unlocked by the current crisis) but remain unprofitable, need urgent targeted support, as they approach the end of their funding runways. In this context, the ISSF can play a key role as it has been the key catalyst of venture financing in the Jordanian ecosystem since its establishment in 2018.

4. As a result, ISSF is receiving an increased number of unsolicited requests for funding from entrepreneurs, startups, and innovative SMEs. Based on these requests, two immediate actions could be deployed to cater for the new normal these companies are facing: (a) quasi equity funding for COVID eligible companies in the form of convertible notes, and (b) digitizing part of ISSF deal-flow offering both in the selection process (automated and online) and in the delivery method (virtual).

C. RATIONALE FOR RESTRUCTURING

1. The purpose of the proposed restructuring is to support the GOJ to mitigate the impact of the COVID-19 outbreak on the Jordanian entrepreneurial and startup ecosystem. Startups are responsible for a large proportion of job growth, contribute to deploying innovative solutions during the crisis, to paving the way for a shift to the post-crisis paradigm, and therefore cannot be overlooked. Governments throughout the world have instituted measures to support their startup ecosystems in order to protect the future of their economies and to help lessen the economic impact of COVID-19. GOJ has invested a lot in its innovation ecosystem, and the investor and startup community in Jordan has pressingly requested for equity-based liquidity package measures from the ISSF to save at-risk startups.

2. Innovative Jordanian entrepreneurs have voluntarily supported Jordan during the outbreak. GOJ has partnered with the private sector to offer necessary services during COVID-19 outbreak, including online learning for public school G1-11, through the Darsak.gov.jo platform; delivering household supplies via online ordering, through mouneh.jo; providing health awareness, through corona.moh.gov.jo; and providing e-payment channel for donations, through eFAWATEERCOM. It is important to maintain such innovative capabilities in the ecosystem and support the resilience of Jordanian innovative entrepreneurs during this crisis.

3. The GOJ made an official request to the World Bank dated April 14, 2020 to urgently mobilize COVID-19 funding to startups and innovative SMEs to be housed at the ISSF. This will contribute in sustaining a steady flow of financing to the startup ecosystem in the form of equity instruments, and non-financial instruments including virtual incubation, acceleration, and online technical assistance to ecosystem beneficiaries.

4. It is too soon to assess the magnitude of the impact of COVID-19 and the ensuing paradigm shift, and to identify whether major adjustments should be made to the ISSF’s design beyond short-term emergency measures. A mid-term review (MTR) of the project will be conducted by December 31, 2020, with the objective of examining all aspects of the project, at the strategic, operational, and administrative levels. This will serve as an opportunity to further assess the project’s performance and identify potential areas of improvements. More specifically, the MTR will focus on: (i) the project’s development objectives, the quality in the implementation and progress of the project’s performance
indicators, the justification of any discrepancies between the expected and achieved results, and whether they can be achieved or revised for the remaining implementation period; (ii) the overall performance of the project based on consultations with project stakeholders such as intermediaries and beneficiaries, challenges, and areas for improvement for each component, as well as fiduciary, disbursement, environmental and social safeguards, and monitoring and evaluation aspects; and (iii) modifications or new activities that could be implemented with the support of the project. As part of the MTR, a survey of beneficiaries will be conducted which will include COVID-19 related questions.

D. SUMMARY OF PROPOSED CHANGES

1. The closing date will be extended from November 30, 2023 to June 27, 2024 i.e. about 7 months to account for the COVID-19 outbreak and recovery phases of at least 6 months;

2. The disbursement categories (1) and (2) will be revised to reflect proper eligible expenses, amounts and percent of IBRD co-financing moving forward;

3. A series of operational improvements (section E below) will be included in the Project Operations Manual (POM). The revised POM will be submitted for World Bank approval. These operational improvements aim at providing direct, flexible, streamlined and concessional quasi-equity solutions and online offerings to startups and innovative SMEs affected by the COVID-19 outbreak. The proposed operational changes are further explained below (section E) and can be summarized as follow:

   (a) Reallocating funding within Component 1.1 (or Part A(1) of the Loan Agreement) from indirect to direct investments ($3M, up to a maximum of $7.5M): the first $3M will be divided into two categories: (i) companies negatively impacted by COVID-19 requiring immediate liquidity to cover 3 to 6-month working capital needs ($2M), and (ii) companies for which COVID-19 is an opportunity to innovate and grow ($1M) particularly in front line sectors such as health, education, e-commerce and fin-tech.

   (b) Mobilizing up to $1M within Component 2 (Part B of the Loan Agreement) to digitize deal-flow activities.

E. OTHER KEY OPERATIONAL IMPROVEMENTS

1. Indirect to direct ($3M, up to a maximum of $7.5M based on World Bank non-objection): A strategic reallocation of funding from the ISSF’s existing indirect investment (funds) to its direct investment (companies) will be necessary. This funding will provide liquidity to startups which have been affected by the COVID-19 crisis and are in need of working capital ($2M), and/or companies which seek to increase capital to modify their business models or their value propositions to address COVID-19 impacts and/or opportunities ($1M). In particular, startups providing technology/services which fall into one of the following fields are expected to represent priorities for such funding: education, health, food security, data analysis, delivery service, and e-commerce. Follow-on funding is also considered under this operational changes, i.e. to the existing portfolio of companies (direct and indirect) within the limit of ISSF strategy.

2. Convertible notes will be the primary instrument used by the ISSF, to make new direct investments in startups experiencing difficulties raising funding due to COVID-19. A convertible note is a quasi-equity instrument that takes the form of short-term debt that converts into equity, typically in conjunction with a future financing round. In effect, ISSF will make money available to startups and after a duration of one year (with a possible extension of another one year),
and will have the option of either receiving a return in the form of principal plus interest (ca. 5%), or taking equity in the companies (with a discount rate of up to 25%). The advantages of issuing convertible notes in the current context are twofold: First, for startups it avoids the problem of dilution (i.e. the decrease in ownership for existing shareholders that occurs when a company issues new shares) at a time when their potential and valuation have yet to be determined, due to their early-stage of development and the uncertainty of the macro/ COVID-19 environment. Second, convertible notes require a more basic and faster due diligence process than traditional equity, because no legal due diligence is required (since convertible notes are prepared in advance by the lawyer). The provision of convertible notes will be rapid, broad-based, transparent, and time bound. It should be noted that the ISSF has already used convertible notes in several direct investment transactions. Convertible notes are a common tool for venture financing globally.

3. Compliance: To receive ISSF funding, companies will have to submit annual audited financial statements for their past one to three year(s) of operations, conducted by an auditor licensed from the Jordanian Association for CPA (JACPA), and not have adverse or disclaimer audit opinions for the last three years. It will be made clear to the companies that the funding cannot be used to restructure existing debt in any form, settle facilities, etc., to pay dividends, or to settle any outstanding dues to founders / shareholders.

4. The following additional changes will only apply specifically for an amount of $2M direct investments for startups which have been affected by the COVID-19 crisis and are in need of working capital:

(a) Ticket size will be in the range of $50,000 to 150,000, which corresponds to the working capital needed by Jordanian seed stage startups for a three to six-month period, factoring in average monthly cash burn rate of $30,000. It is expected that most of this funding will pay staff salaries, which are the primary asset of such companies.

(b) Eligibility. Companies will need to be legally registered, have no more than 5 years of existence, be Jordanian centric, already have a minimum viable product (MVP) and generate revenues (pre-COVID-19), and have a path to sustainability for the future. Companies which have already benefited from the JLGC’s guarantee facility since the COVID-19 outbreak or have participation or ownership by any other public entity, will be ineligible.

(c) Relaxing institutional/ co-investor requirements. Contrary to traditional direct investment parameters thus far, the ISSF will now consider startups with no co-investor(s) at the time the convertible note is issued; however startups with co-investors will be prioritized. Due to the current context discussed above since many private investors have temporarily halted new investments. This will also hasten the investment process, since the identification and due diligence of the co-investors usually delay many of ISSF’s direct investments, and the current crisis highlights urgent support to avoid startups’ bankruptcy. However, to be eligible, startups will need to have already received funding from an institutional investor, which was previously not a requirement for ISSF’s traditional direct investments.

(d) Due diligence will be carried out by the ISSF internally, led by its senior and associate investment officers. They will check the tax and social security certificates (pending or disputes), the business value proposition, the roll-out plan for the next 12 months, the financials for the last 3 years, the schedule of major customer and suppliers, and the key employment terms for staff and contracts.

(e) Lower internal rate of return (IRR). Due to the exceptional situation resulting in significant uncertainties and risks, the expected IRR of the investments made under this facility are expected to be on average 5%, rather than the projected 15% stipulated in ISSF’s direct investments guidelines.
(f) Streamlined process. While ISSF’s direct investment process usually lasts a minimum of 10 weeks (without taking into account the potential delays caused by securing co-investors), the investment process for convertible notes is expected to be reduced to 5 weeks maximum, from application submission to the approval and sign off, see figure below. To ensure startups’ re-activeness, the ISSF will publish its Information Request List (“IRL”) and the details of its due diligence process on its website.

5. Digitization of deal-flow support activities (up to $1M). In light of the COVID-19 lock-down measures implemented by the GOJ, ecosystem intermediaries contracted by the ISSF will have to provide virtual incubation, acceleration, and technical assistance in lieu of in-person activities, see table 1. They are expected to leverage international best practices and lessons to optimize virtual service delivery. Below are proposed examples in digitizing the delivery of Deal-Flow Support Activities:

(a) Incubation & Acceleration Development Program: (i) Launching online curriculum (e-learning) & resources, such as video tutorials; (ii) Virtual meetings with technical advisers, business coaches, & mentors

(b) Entrepreneurship Enablement & Development Program: (i) Virtual delivery of investment-readiness training; (ii) Virtual meetings with technical advisers, business coaches, & mentors.

(c) Angel Investor Network: (i) Startup pitches to investors conducted virtually, followed by Q&A; (ii) Investors utilize virtual conferencing platforms to review DD and finalize investment decisions; (iii) Electronic communications and use of virtual data rooms utilized throughout the process, including signing final agreements electronically.

(d) Deal-flow Marketplace Platform: (i) Platform always envisaged to be a virtual marketplace to strengthen interactions, matches, and linkages among entrepreneurs, business development services providers, and early-stage investors; (ii) Platform will incorporate international best practices and utilize digital communication channels & social media to build entrepreneurial community.

F. RISKS ASSOCIATED WITH OPERATIONAL CHANGES AND MITIGATION MEASURES

1. There are higher risks inherent to the proposed operational changes:

(a) First, a direct investment mobilizes more human and financial resources (high operating costs) than an indirect one.

(b) Second, the proposed smaller ticket size ($50-150k) can translate into a riskier investment due to earlier stage of maturity of eligible companies.

(c) Third, companies negatively impacted by COVID-19 have a higher risk profile (i.e. survival rate) due to the uncertainty of commercial viability post-COVID-19.

(d) Fourth, private equity capital mobilization may be lower with the use of convertible notes and the absence of co-investor(s) requirement at the time of closing.

(e) Fifth, if not converted into equity the proposed convertible debt has lower financial returns and could lead to losses.

2. However, ISSF is well equipped to address the five above mentioned risks with the following mitigation measures:
(a) First, ISSF has gained more experience in direct than indirect investment to date. Thus ISSF was able to streamline its direct investment processes by cutting in half the time and cost it takes to close a convertible note.

(b) Second, out of the 11 direct investments approved by ISSF Investment Committee (IC), the average ticket size is $218k (of which 30 percent at $150k or below) and 45 percent are through convertible notes. ISSF is well equipped to handle such investments.

(c) Third, ISSF will invest in companies that already received funding from an institutional investor (i.e. referral) and which financials were robust prior to the COVID-19 outbreak (i.e. track record). As such, the focus on 6-month working capital is a deliberate choice to prioritize firm survival and extend their runaways until the next financing round.

(d) Fourth, the average ticket size of ISSF convertible notes is $210k to date (in 5 companies: Abwaab, POS Rocket, Whyise, Nestrom, Progressive Generation) with a leverage ratio of 3.9. This is 140 percent higher than the other 6 direct investments and 2.6 times the intended project’s leverage ratio of 1.5 for direct investment. It is expected that most companies will convert into equity, and this would be sufficient to exceed project’s target on private equity capital mobilized.

(e) Fifth, while the return on the convertible debt is three times lower than expected equity returns, it does cover all ISSF direct and indirect costs associated to the instrument in addition to a risk premium. If repaid, the money can be re-invested. However, ISSF does expect most companies to convert the note into equity, typically taking place with a future funding round for which ISSF will have a 25 percent discount.

II. DETAILED CHANGES

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