FINANCE FOR JOBS
استثمار وفرص عمل

وزارة المالية والتخطيط

Finance for Jobs Innovative Financial Tools in Palestine

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Background

Finance for Jobs (F4J) is a four-year project implemented by DAI Global, LLC (DAI) on behalf of the Palestinian Ministry of Finance (MoF) with funding from the World Bank. The project has an overarching objective of "mobilizing private investment in high potential sectors and generating job opportunities across the West Bank and Gaza."

F4J primarily implements its activities through three innovative financial instruments: an Entrepreneurship Ecosystem Matching Grant (EE-MG), a Development Impact Bond (DIB), and the Investment Co-Financing Facility (ICF). Each of these instruments are new in the Palestinian development sphere. They are being purposefully tested in their effectiveness of specifically-designed public support channeled - through a market-based, commercially-oriented modus operandi - through private sector players, to open opportunities for and crowd-in private sector investment that targets job-creation outcomes.

Unemployment rates across the West Bank and Gaza Strip (WB&G) continued to be high in 2018. For example, in 2018 there was 52% unemployment in the Gaza Strip compared to 44% in 2017; while unemployment in the West Bank it was 18% in 2018 down slightly from 19% in 2017 (Palestinian Central Bureau of Statistics on Feb 13, 2019).

Jobs constitute a high priority in the Palestinian development agenda. Given their contribution to household earnings, productivity and economic growth, positive feedback loops on social cohesion and reducing the risk of violence, jobs can play a very important role stabilizing life in Palestine. Job stability and job certainty is particularly challenging in Fragile Conflict Violent (FCV) contexts such as Palestine, where high political, economic and social risks, together with weak institutional capacity and limited financial resources can seriously impede recovery and reconstruction.

Further details on F4J's three innovative financial tools are presented below.

Entrepreneurship Ecosystem Matching Grant (EE-MG)

The Entrepreneurship Ecosystem Matching Grant (EE-MG) is a cost-sharing mechanism that targets early stage investment funds seeking to build a portfolio of startup and early stage enterprises. It is designed to improve the number and quality of investment-ready entrepreneurship initiatives by enhancing the capacity of enterprises to absorb funding from preexisting investment vehicles already in place. The matching grant funds are used to finance eligible business development services (BDS) for these entrepreneurs.

The matching grant amounts cover up to 70 percent of the total value of BDS provided with a cap of USD $100,000 per startup. As a result of this support, the EE-MG has helped participating startups free up their allocated seed funding from investors, reapply these funds towards their business operations and attract investors to get equity shares.

In 2018 the F4J team undertook a rapid assessment of the early startup value chain in Palestine to assess gaps, constraints and opportunities in the startup sector, and the following key highlights represent the primary takeaways:

- Most Palestinian entrepreneurs are recent university graduates, lacking the necessary experience to run and manage a business. They often have limited exposure to the outside world and most of their ideas are related to local contexts, increasing challenges to marketing and exporting their

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products outside Palestine (scalability issues).

- Despite capacity building efforts from broad stakeholder groups (universities, support organizations, and associations) in the existing ecosystem, entrepreneurs still have limited skills to launch a business, assess feasibility and to define financial needs to attract investors.
- On average only two out of 200 entrepreneurial ideas are considered for seed funding; a success rate of merely 1% per round (~200 ideas per round), and an overwhelming majority are rejected as they fail in the verification of product acceptance stage.
- Early stage investment funds (IFs) tend to invest in IT / internet startups. This drastically limits the opportunity for many other promising entrepreneurs with good ideas to get the necessary funding to take them to the next stage, such as green tech startups.
- The decrease in the number of active IFs in the past few years can be attributed to both the limited and poor-quality investment pipelines generated by incubators and accelerators (supply side).

As of June 30, 2019, the cumulative private capital mobilized through 13 EE-MG supported startups reached about US$3,000,000 and 80 new jobs were created as a result. Private capital mobilized through EE-G supported firms is anticipated to reach up to US$6,000,000 by end of the F4J project in October 20121.

Given the limited number of IFs in Palestine targeting startups at post acceleration, the F4J team found that it could be useful to go backward in the value chain and look for other ways to support the development of a quality pipeline for viable investments through synergies with existing entrepreneurship development programs. This approach was determined to have a high likelihood of addressing existing market gaps and providing BDS support at different levels of the entrepreneurial value chain in multiple stages; such as: incubation, acceleration, and post-acceleration.

Investment Co-Financing Facility (ICF)

This is a risk-sharing grant mechanism that provides commercially sound, job-creating, private sector investments that may otherwise not be considered viable due to market and institutional failures, and other FCV risk considerations. ICF is focused on Building a Pipeline of Job-Focused Private Investments Requiring Financial Enhancements via public grant support of up to 20% of total capital expenditures, and at $5,000 cost per job.

A key proposition of the F4J project is that the creation of jobs through private sector investment generates benefits above the market returns to the factors of production (capital, labor and land). Moreover, in instances where the market returns would not be sufficient for the investment to take place, because of elevated FCV risks, market and/or institutional failures, these benefits constitute additional social returns that can justify and merit public financing support to enable the investment to proceed, and the benefits to be generated. On this basis, F4J is testing feasibility of ICF as a financial product to leverage private investment with the objective of creating sustainable new jobs - providing the marginal financing needed for a fundamentally sound commercial private investment (that falls short of financial viability due to the FCV risks and/or other market/institutional failures) can proceed. The allocation of ICF funding is then made conditional on firm eligibility and performance criteria.

The challenge in Palestine, from the private sector perspective, is that the highly risky business environment and market and government failures increase costs, reduce demand, and compromise return of investment. Even where it is a fundamentally sound commercial venture, high risk, high cost, and low and uncertain demand depress returns and lead to low overall investments and job creation. The market and institutional failures facing the private sector in WB&G are myriad, and primarily include:

- *Factor market failures:* limited financing available in the financial sector, shortfalls in public infrastructure, and labor market weaknesses.
- *Institutional failures*: lack of control over trade borders, and non-honoring of government obligations.
- *Greater probability of force majeure events*: security actions that can result in border closures and destruction of assets, such as the Government of Israel's Dual Use policy.

Each of the above represent policy areas in which the Palestinian Authority (PA) has limited\no control, and for which, the private sector nor other actors currently have means to mitigate. As a result, investments that would have been proceeded in most other economic settings are stalled in Palestine and the economic and social returns that these investments would have made are lost. In this context, it is important to distinguish between financial, economic and social returns, as this provides the basis on which the eligibility and performance criteria for the ICF are designed to establish the rationale for public financing to private investments.

Financial analysis examines the financial flows generated by the project itself, and the direct costs of the project measured at market prices. The principal financial indicator is the internal rate of return (IRR). Private investors will elect to proceed with an investment based on the achievement of a targeted risk-adjusted hurdle IRR. In highly risky environments this hurdle rate will tend to be higher. In addition to the return to the private investor, there will be wider returns to the economy from a given investment. Taking these into account require assessment beyond the net costs and benefits to the investor and likely returns to his\her investment risk (financial analysis, indicator: IRR). This entails a wider economic appraisal that adjusts the IRR to take account of costs and benefits to the economy at large. Put differently, whereas the financial rate of return is IRR calculated when all the inputs and outputs are reckoned at market prices; the economic rate of return (ERR) is the IRR based on economic opportunity costs.

Current assessments indicate that a number of sound private investments in sectors such as tourism, ITC, agribusiness, renewable energy, and light manufacturing in the WB&G are unable to move forward due to exceptional FCV risks and related market failures, including limited financing options (e.g. lack of long-term debt financing). These are nevertheless fundamentally commercially sound investments that are likely to generate significant social and economic benefits through the creation of formal jobs. Currently, four investment proposals have been assessed to receive ICF grant support and those projects are expected to create approximately 2,200 jobs, and total private capita mobilization of about US$ 55,000,000.

One ICF investment example is a PV solar energy roof top project at the Gaza Industrial Estate (GIE). The For example, the PV solar project recently started its project mobilization phase with a US$2,000,000 ICF grant. The private equity investment is about US$ 2,750,000 and a loan of about US$ 7,000,000 from the International Finance Corporation (IFC)has also been secured. Solar-generated electricity produced will power 32 factories and warehouses that comprise the GIE, which—like most of the West Bank and Gaza—relies heavily on Israeli imports to meet electricity needs. Electricity generated is projected to supply 80 percent of the power to the 50-hectare industrial park, enabling expanded production and the creation of approximately 600 new jobs (mostly indirect, as they will result from expansion of production in the GIE) in food, wood, metals, and other business sectors operating in the park.

The rationale for public financing for the GIE solar project stems from the fact that the demand for electricity in Gaza significantly exceeds the supply. The Gaza Electricity Distribution Company – which distributes all electricity in Gaza – faces sustained energy shortages and unreliability, largely due to its

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inability to provide a 24-hour electricity supply, which depends on a link from Israel. Political and security issues impede agreement on this link. As a result, enterprises in the GIE must either shut down their operations during electricity blackouts or generate their own electricity via private generators at a rate that renders any manufacturing process unsustainable. The implications for output and employment are significant when enterprises at the GIE has struggled to operate at more than half capacity.

The largest stated constraint limiting the GIE's expansion is access to affordable and stable electricity. To address this situation and foster the increase in industrial activity and job creation for which there is clear market demand, a private investment project to install solar panels on the rooftops of the factory and warehouse facilities in the GIE has been initiated. This project would allow the GIE to generate enough electricity to extend to new tenants and to meet existing tenants' needs for two to three shifts of operation. This investment would not have proceeded due to market failures attributable to the significant fragility constraints confronting Gaza and where the IRR of th solar facility is below the investors' minimum hurdle rate and the payoff period exceeds the normal time required for such an infrastructure facility in a very risky environment. As such, private investment will not occur without additional financial support. World Bank co-financing (through the ICF component of F4J) has played a role by reducing the payback period, allowing the IRR to increase to a minimally viable rate while ensuring a feasible price for electricity for companies in the GIE. Consequently, the project has proceeded, and installations of solar panels is in process.

Development Impact Bond: skills development

The Development Impact Bond (DIB) is an innovative results-based financing model that leverages private sector investment, whereby investors pay in advance for interventions to achieve agreed upon results and work with service delivery organizations to ensure that the results are achieved. Outcome funders make payments to investors if the interventions succeed. F4J's DIB will initiate not just the first-ever DIB by the World Bank, but also the first in an FCV setting anywhere. This component will pilot a US$5 million DIB.

F4J's DIB will focus on enhancing the skills of the Palestinian workforce in a more market-driven way to foster improved job outcomes. The DIB will target an estimated cohort of approximately 2,000 beneficiaries aged 18–29 years (including at least 30 percent women). It will finance the training, job search, and placement services provided to beneficiaries, depending on private sector demand. Specific outputs and outcomes will include the completion of beneficiaries' training, their placement into an apprenticeship/internship/work-based training scheme, and their ultimate employment.

In 2018, an initial investment commitment of private capital in the amount of US$1,800,000 was mobilized. The mix of investors attracted by the DIB includes "impact first" investors such as foundations, international financial institutions, and some quasi-commercial investors. The output and outcome payments are designed to help balance investor risk/reward, and reduce the DIB's cost of capital, as early output payments can be recycled. Expected IRRs for DIBs designed to date range between 5–15 percent, depending on performance.

Monitoring and evaluation (M&E) of the DIB implementation is a principal objective of the F4J project. Impact evaluation to draw lessons learned for replication both in the West Bank and Gaza and in other FCV settings is an integral part of F4J's DIB design. The evaluation will be performed by a third-party institution and will be designed jointly by the World Bank and the Project Implementation Agency (PIA) in consultation with the Ministry of Finance (MOF).

Aligning incentives of all stakeholders towards achieving employment outcomes for Palestinian youth:

Outcomes Funders

– The Ministry of Finance and Planning (MoFP), with support from the World Bank – commit to paying for pre-defined employment outcomes for young Palestinians (if achieved).

DAI and Social Finance UK are designing the DIB on behalf of MoFP.

Social Investors

provide the upfront capital required by service providers to deliver training and job placement services.

Service Providers

coordinate with employers and other market actors to identify employment opportunities and deliver skills training and job placement services

At the end of the service, Outcomes Funders repay Investors, but only if desired outcomes are achieved.

OUTLINE OF DIB STRUCTURE

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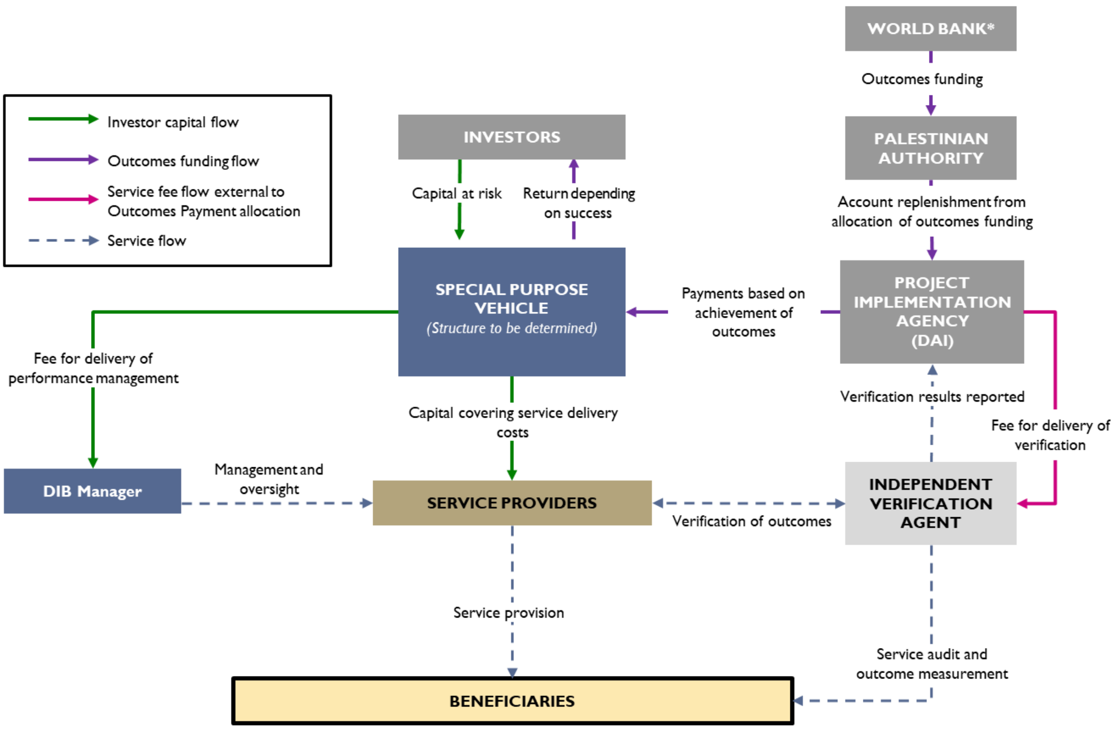

The World Bank is providing outcomes funding for this project as part of their Finance for Jobs (F4J) series of projects in the West Bank and Gaza. This programme falls within the second component of the F4J programme, which also includes pipeline building for job-focused private investments and capacity building to the Palestinian Authority

Note: *the content of this paper is extracted from the World Bank Project Appraisal Document (PAD) and F4J reports.*

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