BDL's Circular 331: "The State of Play" in Putting Lebanon on the IT Map

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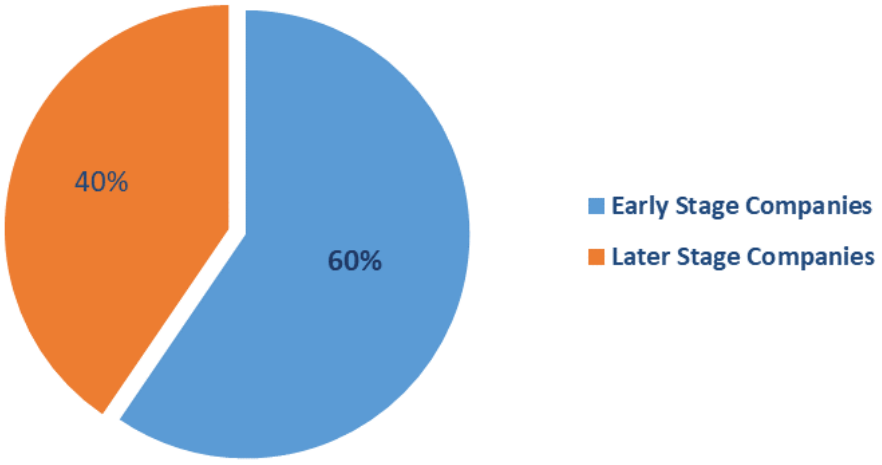
Lebanon witnessed the birth of startup industry by the time the Central Bank issued Circular 331 on August 22nd 2013. The Circular had as the main purpose the improvement of the Lebanese eco-system along with stimulation of investments in start-up companies, and the promotion of entrepreneurs.

For the past eight years, Central Bank's circular 331 paved the way for several companies to convert their innovative ideas into reality not only through the financial support of the Circular 331, but also by uplifting the eco-system in Lebanon, and moving the country to one of the top five places regionally in the tech investments. So, in this note we will address the extent of the Central Bank circular in the Lebanese market, the funds created to secure its function, in addition to the challenges and positive aspects added to the Lebanese eco-market.

At first, the Central Bank was concerned about improving the tech industry and entrepreneurial spirit. In addition, it aimed to reverse the trend of university graduates leaving Lebanon and helped creating new jobs as well as emphasis on the work environment. The 331's goal was to provide cash to startups through Lebanese commercial banks or venture capital funds. In turn, it stipulates that those kinds of investments made by a bank will get a funding and a loss guarantee up to 75% of the investments. At the same time, profits are split between the participating banks and the Central Bank by 50-50%.

Further, adjustments have been added to the circular in order to ensure that the Funds comply with the main objective of the Governor's intention. For instance, the amount of investments made by any single bank should not exceed 3% of its shareholders' equity but later on it has been modified to 4%. Also, the bank cannot invest more than 10% of the aforesaid 4% in a single company. In addition, the participation of banks through the provisions of this Circular can't also surpass, at any time, 80% of the capital of a single company.

As Circular 331 aims to help develop entrepreneurial ideas into real time platforms, the Circular also facilitates the funding process by having banks investing in several funds, and in turn funds diversifying their portfolios and promoting all stages of Lebanese start-ups.



Source: BLOMINVEST

As an overview on the funds, we start by emphasizing ''Seed Stage" whereby funds cover up the initial expenses of turning an idea into action. This stage is considered the riskiest with a need of 200K to 2Mln of investment fund and mainly focuses on the target market and purpose of the product.

Second, in the series A funding stage, businesses are considered to have generated some profit and in turn have set their business model and its expectations in the market. At this stage, investors include Venture Capital (VCs) and Angel investors with a cap of 2Mln – 15Mln.

Third, in the series B Financing stage, established investments start to nurture and expand their market reach. As a result, funding is then associated with gaining market share and an increase in investment size to 7Mln - 10Mln. Moreover, series C Financing is related to market acquisitions and diversifications in products; mainly targeting the successful businesses in hopes for banks and shareholders to double their return from initial investment. At this stage, businesses continue to gauge fast and wide. It mostly includes large investors such as VCs, Hedge funds and Private equity firms and Investment banks.

Furthermore, exit stage takes place after when start-ups develop and look forward to divest and gain back high returns. At this stage, exit opportunities are approved by Investment committees of each fund. As such, if we compare investing in a fund in contrast to direct investments we find out that investing in a fund holds less risk as it is divided on a pool of investments. Moreover, the fund as a whole needs one approval from Central Bank of Lebanon unlike separate approvals for each deal. We add that investing in a reputational set-up, Venture Capital avoids the hassle of recruiting a managing team as well as assessing the market and product viability from zero. Also, we cannot deny the fact that commercial banks find it hard to compete with specialized fund firms.

Moreover, as per BDL circular, funds play a portfolio management function that helps in providing strategic reviews and build strong relations with start-ups key management. Funds also are required to develop market strategies with telecom and media companies in order to keep businesses on track. Most importantly funds play an important role in the growth of the company, from acquiring human resources to building regional and global exit pipelines.

It is worth mentioning the characteristics of major funds such as:

1. Impact Fund: - Mainly invests in early growth stage of companies
   - Committed Capital of USD 70 Mln
   - Invested USD 50.1 Mln in 29 start-ups

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2. Leap Fund – managed by Leap Ventures:
   - Invests in late growth stage of companies
   - Committed capital down from USD 79.11 to USD 59Mln
   - Invested 44.2 Mln in 10 start-ups

LEAP VENTURES

3. Berytech Fund II:

- Invests in early, growth stage
- Committed capital of USD 51.50 Mln
- Invested USD 37.3 Mln in 19 startups

4. Division 1 Fund – managed by B&Y Venture Partners:

- Invests in early stages
- Committed capital of USD 46 Mln
- Invested USD 25.6 Mln in 41 startups

5. Azure fund – managed by TLF Ventures:

- Invests in early and growth stage
- Committed capital of USD 22.88 Mln
- Invested USD 12.86 Mln in

6. Cedar Mundi Fund – managed by Cedar Mundi Capital:

- Invests in growth stage
- Committed capital of USD 44.44 million
- Invested USD 17.9 Mln in 13 start-ups

7. Phoenician Fund – managed by Phoenix partners:

- Invests in early stage
- Committed capital of USD 26.33 Mln
- Invested USD 14.56 Mln in 17 startups

8. Lebanon Seed Fund – managed by Flat6Labs Beirut:

- Invests in early stage
- Committed Capital of USD 13.50 Mln
- Invested USD 3.44 Mln in 18 startups

Moving to the total capital committed by Lebanese banks to the 8 funds listed above, they have totalled USD 310.18 Mln at end 2020, excluding funds invested in businesses directly. More details are found in the tale below:

Breakdown of Committed Capital as of December 31st, 2020

Rank	Figures in millions of USD	IMPACT	BERYTECH	LEAP	MUNDI	PHOENICIAN	DIVISION 1	AZURE	Lebanon Seed Fund	Total Committed Capital
1	BLOM Bank sal	10.00	10.00	9.81	5.00	2.00	4.00	6.00	4.00	**50.81**
2	Bank Audi sal	10.00	5.00	7.93	4.44	2.58	7.50	4.58	3.00	**45.03**
3	SGBL		5.00	7.55	10.50	7.00				**30.05**
4	BankMed sal	10.00	2.00	4.53			7.50	7.00		**31.03**
5	BLF sal	8.00	8.00	7.55	1.00		1.00	2.00		**27.55**
6	Byblos Bank sal	10.00	5.00	7.55						**22.55**
7	BOB sal	2.00	3.00	3.78	3.00	5.00	5.00			**21.78**
8	Fransabank sal	5.50	3.00	5.29	4.00		2.30		1.00	**21.09**
9	IBL Bank sal	7.00			2.00	2.00	0.50		1.00	**12.50**
10	FNB sal	1.00	1.00	1.13	1.00	0.75			2.00	**6.88**
11	BLC Bank sal		1.50				1.50	2.00		**5.00**
12	Credit Libanais sal	1.50	0.50	1.51					0.50	**4.01**
13	BBAC sal	2.00	2.00						0.50	**4.50**
14	LGB sal	1.00	1.00	1.51						**3.51**
15	Fenicia Bank sal				2.00	2.00				**4.00**
16	Banque Misr Liban sal	1.00				1.00	0.50	0.50	0.50	**3.50**
17	Al-Mawarid Bank sal	1.00	1.00				0.50	0.80		**3.30**
18	CSC Bank sal		1.00	0.84			1.00			**2.84**
19	Jammal Trust Bank sal*		1.00		1.00	1.00				**3.00**
20	Saradar Bank sal		0.50	0.76		0.50	1.00			**2.76**
21	Lebanese Swiss Bank sal					1.50			1.00	**2.50**
22	MEAB sal		1.00			1.00				**2.00**
	Total Committed Capital by Banks under 331	**70.00**	**51.50**	**59.73**	**33.94**	**26.33**	**32.30**	**22.88**	**13.50**	**310.18**
	Other Investors				10.50		13.70			**24.20**
	Total (331 + Other Investors)	**70.00**	**51.50**	**59.73**	**44.44**	**26.33**	**46.00**	**22.88**	**13.50**	**334.38**

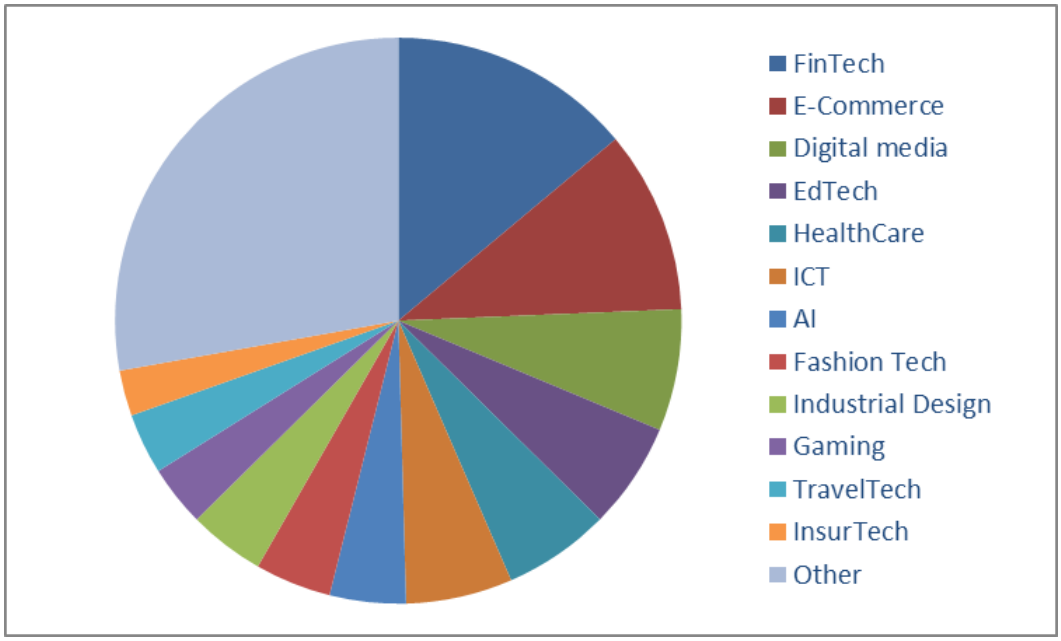
Source: BLOMINVEST

Moreover, it is interesting to note that 3 exit prospects were approved by the Investment Committee. *Impact Fund* had exited from Fuel Powered – in April 2017; Pin Pay – in May 2019; and Treasury Express – in July 2020; and through which the fund gained exit proceeds and as such paid earnings to the shareholders.

As the Circular was initially issued to spread the awareness on the importance of contributing equity capital to startups in a way to develop the eco-system, retain top human assets and making steps to a knowledge based and tech-oriented economy. It aimed also to attract foreign companies to invest in Lebanon. In addition, it has generated over $1B to the Lebanese GDP and created over than 1,400 new jobs, founded more than 180 start-ups.

In parallel, the Circular itself targeted the knowledge technology which included the IT sector as well as medical, engineering, fashion design and cinematography, as the chart below shows:

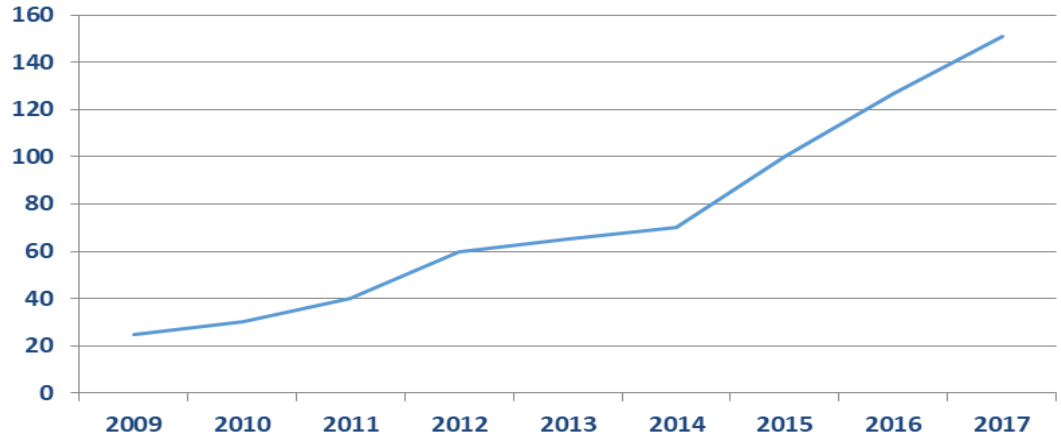
Knowledge technology covers all sectors



Source: BLOMINVEST

On the whole, growth has been steady over the years with a compounded annual growth rate of 24%. As of September 2018, Lebanese entrepreneurs have enhanced the knowledge economy and the circular led to the creation of incubators, co-working spaces, venture capital funds, and provided all the tools needed for start-ups to innovate and thrive in a growing economy

Number of start-ups companies in Lebanon 2009-2017



Source: BLOMINVEST

Note: Numbers provided by the World Bank up until 2015, BLOMInvest sources provided the numbers for the remaining years to date

On the other hand, Circular 331 faced many challenges that limited its success and made it difficult for entrepreneurs to receive funding through the Circular. Firstly, banks imposed investments 'conditions that seemed to be unacceptable by entrepreneurs. Secondly, banks 'conservative positions and natural dislike for risks forced the entrepreneurs to adopt strategies that are not always faithful to their companies and highlighted the opposing interest of the company and the lending bank. Thirdly, the legal framework has tightened just after BDL modified the circular to require quarterly, instead of annually, investor reports. Considerably, this modification in declarations slowed down venture fund's activity.

Fourthly, investors saw difficulties in finding promising startups with strong team, idea and potential market to invest in. In this context, the Central Bank encouraged banks to finance incubators and accelerators for newly born businesses which led to a bubble risk by funding new ideas in an eco-system that is not mature enough yet.

As a final point, the biggest challenge for a startup was the exist scenario. With a maximum duration of seven years on investments, it was hard for the startup businesses to find a way for their exit strategies, as the resale of venture capital units take place either through a buy-out by a large private equity fund or through an initial public offer (IPO). Not to mention the risks of investing in a defaulted

country today will discourage large companies and foreign funds from betting on a Lebanese company. In addition, most promising startups now prefer to settle abroad because of several complications, especially in the UAE, even if it means giving up on funds from the 331 Circular.

Important to note that the Lebanese tech industry has been negatively revised since 2019. For instance, a study released recently by Fitch solutions claimed that IT spending in Lebanon will contract by 12.4% by the end of 2021 before trending positive in late 2022. This contraction is a result of the extreme challenging economic conditions facing the country which are likely to remain in the next one to two years.

To conclude, Circular 331 significantly minimized the capital barrier that Lebanese startups faced in the past. In turn, the Circular has improved the landscape of technology and entrepreneurship in Lebanon and it opened up new opportunities that were not available before as it developed an ecosystem at its very early stage. Unfortunately, no matter how ambitious the Circular is, it could not recompense for the absence of a State and an economic ground favorable to innovation and creativity, both in terms of regulation and infrastructure. Meanwhile, last year has been challenging in abnormal ways for any company across the country. As a result, though the BDL's initiative was the first of its kind; it has not been able to put Lebanon on the track of a startup economy.

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