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IMPLEMENTATION COMPLETION REPORT
(TF-23631)

ON A

GRANT

IN THE AMOUNT OF US$ 4.85 MILLION

TO THE

DEMOCRATIC REPUBLIC OF TIMOR-LESTE

FOR THE

SMALL ENTERPRISES PROJECT

June 26, 2003

Private Sector Development Unit
East Asia and Pacific Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective - Not Applicable)

Currency Unit = US$

FISCAL YEAR

July 1 June 30

ABBREVIATIONS AND ACRONYMS

ADB	-	Asian Development Bank
ANZ	-	Australia and New Zealand Banking Group Limited
AusAID	-	Australian Agency for International Development
Bank	-	World Bank
BAS	-	Beneficiary Assessment Survey
BDC	-	Business Development Center
BPA	-	Banking and Payments Authority
BNU	-	Banco Nacional Ultramarino
CEP	-	Community Empowerment and Local Governance Project
CGD	-	Caixa Geral de Depósitos
ICR	-	Implementation Completion Report
CFET	-	Consolidated Fund for East Timor
DEA	-	Department of Economic Affairs
DLP	-	Directorate of Land and Property
DPA	-	Department of Political Affairs
DPKO	-	Department of Peacekeeping Operations
ERR	-	Economic Rate of Return
IDA	-	International Development Association
IFI	-	Intermediary Financial Institution
ILO	-	International Labour Organization
JAM	-	Joint Assessment Mission
LPU	-	Land and Property Unit
MEA	-	Ministry of Economic Affairs
MDE	-	Ministry of Development and Environment
M&E	-	Monitoring and Evaluation
MTR	-	Mid-Term Review
NGO	-	Non-Government Organization
NPV	-	Net Present Value
OP	-	(World Bank) Operational Policy
PAD	-	Project Appraisal Document
PAR	-	Portfolio at Risk
PDO	-	Project Development Objective
PIU	-	Project Implementation Unit
PMU	-	Project Management Unit
PSD	-	Private Sector Development
QAG	-	Quality Assurance Group (of the Wold Bank)
SEP I	-	Small Enterprises Project
SEP II	-	Second Small Enterprises Project
STEI	-	Secretariat of Tourism, Environment and Investment
SME	-	Small- and Medium-sized Enterprises
TFET	-	Trust Fund for East Timor
TSS	-	Transitional Support Strategy
UN	-	United Nations
UNCHS	-	United Nations Center for Human Settlements
UNMISET	-	United Nations Missions of Support in East Timor
UNTAET	-	United Nations Transitional Administration in East Timor
USAID	-	United States Agency for International Development

Vice President:	Jemal-ud-din Kassum
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Sector Manager:	Khalid Mirza
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DEMOCRATIC REPUBLIC OF TIMOR-LESTE
Small Enterprises Project

CONTENTS

Project ID: P070283	*Project Name:* Small Enterprises Project
Team Leader: Desiree Green	*TL Unit:* EASPS
ICR Type: Intensive Learning Model (ILM) of ICR	*Report Date: June 26, 2003*

1. Project Data

Name:	Small Enterprises Project	*L/C/TF Number:*	TF-23631
Country/Department:	TIMOR-LESTE	*Region:*	East Asia and Pacific Region

Sector/subsector: FE - Micro- and SME-finance (83%); YW - Other Industry (12%); BC - Central Government (5%)

Theme: Small and medium enterprise support (P); Land management (S); Personal and property rights (S); Other urban development (S)

KEY DATES

			Original	*Revised/Actual*
PCD: 11/01/2003		*Effective:*	05/05/2000	05/05/2000
Appraisal: 03/07/2000		*MTR:*		12/14/2001
Approval: 04/10/2000		*Closing:*	06/30/2002	12/31/2002

Borrower/Implementing Agency: Recipient: Democratic Republic of Timor-Leste/Caixa Geral de Depósitos

Other Partners:

STAFF	Current	At Appraisal
Vice President:	Jemal-ud-din Kassum	Jemal-ud-din Kassum
Country Director:	Xian Zhu	Klaus Rohland
Sector Manager:	Khalid Mirza	Javed Hamid
Team Leader at ICR:	Desiree Green	Frida Johansen
ICR Primary Author:	Dely P. Gapasin; John Conroy; Craig Wilson	

2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

Outcome: S

Sustainability: L

Institutional Development Impact: N

Bank Performance: S

Borrower Performance: U

	QAG (if available)	ICR
Quality at Entry:		S
Project at Risk at Any Time:		

3. Assessment of Development Objective and Design, and of Quality at Entry

3.1 Original Objective:

SEP I was designed as an emergency project immediately after the violence in Timor-Leste in September 1999. Its objectives were to help restart viable economic activities in the private sector through lending on commercial terms; to promote sustainable employment in urban areas; to prepare complementary follow on programs; and to restore essential elements of a land and property administration system. The objectives were devised in a post-conflict environment in which circumstances and capacity for implementation were especially difficult.

3.2 Revised Objective:

The original objectives of the project remained unchanged throughout the life of the project.

3.3 Original Components:

The project included the following components:

Component 1. Small Loans for Private Businesses (US$4,000,000). The activities under this component included:

· A credit line of US$4,000,000 to provide loans of US$500 up to US$50,000 to Timor-Leste business men and women through an intermediating financial institution, Banco Nacional Ultramarino *(*BNU), now renamed Caixa Geral do Depósitos (CGD);

· Information dissemination by CGD staff and facilitators to potential borrowers, providing assistance to borrowers, screening and approving loan applications, and monitoring the utilization of loans and repayments; and

· Intermediation by CGD and ongoing loan portfolio administration.

Component 2. Strengthening Land and Property Administration (US$265,750). The activities under this component included:

· United Nations Center for Human Settlements (UNCHS or Habitat) to provide and manage technical assistance to strengthen service delivery of UNTAET's Land and Property Unit (LPU) in land registration, cadastral survey and mapping, and land law by carrying out land and property rights studies;

· Support to LPU, now the Directorate of Land and Property (DLP), to review policies related to land rights adjudication and allocation of public and abandoned property; and

· Assistance for the development of Timor-Leste institutional capacity in land administration.

Component 3. Technical Assistance (US$390,000). The activities under this component included:

· Support for a Project Management Unit (PMU) to interface with CGD to manage contracts for consultants' services, submit related payment requests to CGD, have overall reporting responsibility, and oversee the three project components (US$70,000);

· Provision of start-up costs of CGD to set up facilities, acquire transportation means, and allowances for staff to start the loan component of the project (US$100,000);

· Preparing and carrying out training programs on business skills including training needs assessment (US$110,000); and

Preparation of a program for grants to urban communities in support of businesses to provide public works, amenities or services with public benefits (US$110,000).

3.4 Revised Components:

The three main components of the project remained unchanged during the life of the project except that one of the activities under Component 3 (to provide grants to urban communities) was redesigned to become

Component 4 of the project. On May 15, 2001, the SEP I Grant Agreement was amended to include a new Part D (Component 4) in the Schedule for the rehabilitation of four buildings to serve as Business Development Centers (BDCs) in Dili, Baucau, Maliana, and Oecussi districts to deliver business development services. For this purpose, the Grant was amended to include US$200,000 for Civil Works and US$15,000 for Consultants' Services.

3.5 Quality at Entry:

The quality at entry of SEP I has been rated by the ICR mission as **satisfactory**. The World Bank's Quality Assurance Group (QAG) did not review the quality at entry for this project. The project was designed in three months, rather than the average of nine months, following approval to use OP 8.50 which allowed, in emergency circumstances, for project appraisal and preparation to be conducted simultaneously. The project design drew heavily on the findings and recommendations of the Joint Assessment Mission (JAM) which was conducted jointly by the World Bank, other donors, and the Timor-Leste leadership. The project design responded appropriately both to the prevailing conditions of the time and to foreseeable future conditions and circumstances.

Like other TFET-funded IDA projects in Timor-Leste where the UN was the Recipient, there was insufficient understanding of the conflict that would be caused by differing operating systems between IDA and the UN, especially procurement systems. SEP I also was designed to complement the ADB's Microfinance Development Project, but the start of implementation of the latter project was significantly delayed. SEP I project implementation relied heavily on the capacity of the intermediating bank (CGD) to perform well, thus reducing demands on the Government. Initial assumptions regarding the capacity of the transitional administration to implement and supervise the project were overly positive. The difficulty in achieving post-independence Government ownership of the project was underestimated. Key project development objectives and performance indicators were well cast. The project's design was fully consistent with and supportive of the Transitional Support Strategy (in particular objective 1, TSS page 12).

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective:

Strictly in terms of its overarching Project Development Objective (PDO), SEP I has achieved an overall **satisfactory** rating. When judged against its various component objectives, SEP I has helped to restart viable economic activities through a lending program on commercial terms; promoted sustainable employment in urban areas; and prepared complementary follow-on programs. SEP I was less effective in helping to restore essential elements of a land and property administration system.

The largest component was the line of credit (US$4.0 million), which was about 82 percent of the project. This component successfully supported the broader project objective of financing start-up of small businesses. In turn, the line of credit generated employment, sustainable to a greater or lesser degree, and helped with the restoration of the supply of goods and services in the economy. Other positive outcomes of the line of credit were to engage a commercial bank with the sector and to contribute to an early and improved understanding of lending operations in Timor-Leste.

Although SEP I was a key contributor to the start-up of viable economic activities as well as the creation of jobs, other independent private interventions (supply of capital, systems, and personnel) also supported these same objectives through independent profit-seeking activity. The degree to which SEP I was responsible for overall achievement of these broad objectives would be difficult to isolate. Importantly, the timing of the SEP I intervention is relevant; although SEP I became quickly effective (in April 2000), it was one year later before the majority of the line of credit was disbursed. In turn, this occurred one full year ahead of the commencement of the ADB Microfinance Project, which was designed to start with SEP I and as a direct complement to it. This time lag is crucial in any assessment of SEP I impact. By the end of 2000, when UN and donor efforts were shifting from humanitarian or emergency relief to reconstruction and development, the impact of SEP I's individual contribution to achieving the objective of restoration of economic activity and supply of goods and services was shared with other public and private activities with economic consequences. The impact of SEP I's individual contribution to achievement of the objective of restoration of economic activity and supply of goods and services was augmented by other public and private activities which carried economic consequences and brought about restored private sector economic activity.

4.2 Outputs by components:

Component 1. Small Loans for Private Businesses (US$3.99 million of the original allocation of US$4.0 million).

Outputs expected of Component 1 were loans, new or revived small businesses, the development of banking and other services, and provision of sustainable jobs. These are financial sector, business development, and employment generation outputs. The component is judged on balance to have been **satisfactory**.

SEP I financed 341 enterprises and created about 1,300 jobs directly as reported by CGD at the close of the project. Surveys conducted in February 2003 provided estimates of additional 1,040 to 1,200 jobs created, or about four jobs per enterprise. Some reduction in the quality of jobs occurred, represented by a shift away from waged employment. It contributed to capacity in road transport, retailing and agricultural processing. Lending also financed investment in areas such as restaurants and personal services, which proved more vulnerable to the economic decline following the UN withdrawal in 2002. Borrowers complained of competition from privately-financed businesses as private capital has returned, and of competition from enterprises funded with grant assistance from NGOs or under the Community Empowerment and Local Governance Project (CEP). Original loans totaled US$4.0 million, and the originally projected second phase lending of US$2.0 million from recycled capital did not occur due to lengthy delays in the first phase of loan processing. Failure to follow through with loan recycling deprived borrowers of a crucial incentive for repayment and reduced the financing available for other component outputs.

Commencing immediately after the 1999 destruction, the project faced a difficult environment. Modest targets were set for loan repayment. Repayment performance was lower than targeted, with progressive deterioration over the project. Three-quarters of loans were in default (more than one month late in repayment) in February 28, 2003. This does not mean a similar proportion of the enterprises were in difficulty. CGD recorded 294 loans as active at the close of the project. Repayment rates were rapidly trending downwards by the time of the ICR, with the prospect of eventual write-off of 40 percent of initial capital. It is striking that the 50 fully-paid loan accounts have a mean value of US$4,900, as against a mean loan size of US$11,500 for the component as a whole and US$12,870 for the other 291 borrowers (of whom 258 were in technical default in February 2003). This suggests that greater emphasis on smaller, fast-disbursing loans in the early stages of the project might have led to more successful enterprises and ensured higher rates of loan repayment.

Slow approval of loans impeded the early resumption of small private business activity. The time between receipt of applications and approval was substantially longer than projected because of the difficulty in processing loan applications and capacity constraints of the implementing bank. Initially, about 2,100 applications were received for amounts totaling more than US$30.0 million. In total, 2,947 applications were received over the life of the project. This indicated a high demand in the small business sector for loans at a nominal 10 percent interest rate, but posed unforeseen problems for the implementing bank in assessing applications. The arrangement between IDA and the Government was designed to secure good lending performance. However, in a situation of limited information, CGD had difficulty in applying normal commercial lending principles because of poor knowledge of borrowers and guarantors, weak capacity to assess collateral, and imperfect understanding of market conditions facing the small business sector.

SEP I's lending experience has had a positive impact on the development of banking services. As one of only two commercial banks operating in Timor-Leste, the intermediary financial institution (CGD) has gained insight into the operations and credit needs of the small business sector. Thus, SEP I has contributed to the capacity for delivery of sustainable financial services to the sector. In addition, 50 businesses have had the learning experience of successfully servicing a commercial loan and are ready for the next credit opportunity. On the other hand, there is little evidence of increased use of banking services among the borrower group. CGD reported minimal balances in the deposit accounts established for borrowers and it has not picked up any of the "graduates" of the project as independent commercial borrowers. This is attributable largely to risk-aversion on the part of CGD and the fact that it has been achieving profits from fees for services rather than lending.

The experience of substantial rate of default in the project may have positive outcomes. It has stimulated the formation of a Loan Performance Committee comprising representatives from CGD and the Government. Although the LPC has had a limited role of enforcement, it has developed an action plan to recover loan arrears and is determined to test the legal enforceability of loan contracts (which is uncertain at present). Exemplary penalties secured against some defaulters could positively affect credit discipline, providing that political will exists to support financial institutions in this process. The committee has initiated discussion with the Banking and Payments Authority (BPA) concerning the establishment of a credit registry. The second commercial bank has displayed interest in the outcomes of SEP I and is prepared to consider modest initiatives in small business lending.

Component 2. Strengthening Land and Property Administration (US$0.26 M of the original allocation of US$0.27 M).
The main recipient and beneficiary of the SEP I land and property studies is the Directorate of Land and Property (DLP) of the Ministry of Justice, then known as the Land and Property Unit (LPU) under UNTAET. The output from this component has been rated as **satisfactory** despite the flaws in design and implementation. The reports, with the benefit of hindsight, added little value to the relevant policy- and decision-makers within UNTAET, particularly those from the local leadership. There was insufficient political buy-in from the transitional administration, especially the Timor-Leste leadership, and may have inadequately taken stock of political imperatives and constraints. However, the more technically focused reports, such as cadastre and mapping, have been utilized to some degree. In addition, subsequent donors working on issues related to land and property found many of the UNCHS reports to be very useful as baseline documents which assisted them with their project work.

The UNCHS (Habitat) managed teams of consultants that worked in Timor-Leste on land, housing, and property issues in May-August 2000. The outputs were seven reports on: (1) land registration, (2) cadastral survey and mapping, (3) housing, property and land rights, (4) housing property and land rights (improved proposals), (5) housing and human settlement development, (6) land law, and (7) land and property planning and administration. A less technical summary of the seven reports was prepared in March 2001. The delivery of large and complex reports at one time was not productive and was beyond the absorptive capacity of the local and UNTAET leadership. Producing smaller reports, annexing technical information separately, and focusing initially on the simplest and least controversial actions would have been a better strategy.

The importance of resolution of land and property uncertainty was highlighted in the Joint Assessment Mission (JAM) report of November 1999. It called for expeditious production of baseline land and property studies. UNCHS's proposal to UNTAET to conduct these studies was then built into SEP I project design. The ICR mission noted that the supply-push of these studies ultimately diluted their value. No evaluation of, or feedback on, the benefit of these reports was prepared by UNTAET or the Government. A greater inclusion of the local leadership in the design of the studies would have created better local ownership.

Component 3. Technical Assistance (US$0.33 M of the original allocation of US$0.39 M).
The output of the technical assistance for project management to support CGD in the implementation of the credit line, and to provide training for borrowers has been rated, overall, as **unsatisfactory**. The PMU remained weak throughout the life of the project due to (i) low capacity of staff for project management, especially in procurement, financial management, monitoring, and evaluation, (ii) delay in contracting Timor-Leste consultants during the transition period, (iii) discontinuity and ineffective management because of high turn over, and (iv) inability to set up project management systems for planning, monitoring and evaluation, reporting, financial management, and procurement. A Project Manual detailing procedures for project management, financial management, and procurement was not prepared. However, CGD had prepared a Project Manual for the line of credit implementation. In addition, there were delays and poor targeting of the training program resulting in few borrowers trained (only 7 percent of 94 respondents in the beneficiary survey said that they participated in business skills training).

The PMU was successively led by several Project Directors, the first one from UNTAET and then three Timor-Leste officials from the Ministry of Economic Affairs (MEA), now the Ministry of Development and Environment (MDE). It was staffed initially by two UNTAET personnel with limited project management skills. In 2001 and 2002, four Timor-Leste consultants were contracted for specialists jobs (i.e., financial management, procurement, business development) but with very limited experience. Even at the start, the composition of the PMU was not clearly identified, hence, the PMU was not properly staffed. Government civil servants in MDE did not benefit from capacity building in project management and business skills. An International Procurement and Project Management Advisor was contracted in April 2002 but there was no significant improvement in project management. The PMU was unable to take action on numerous recommendations of IDA missions on financial management, monitoring and evaluation of project activities, and sporadic submission of project progress reports. Only individual activity reports were prepared. Collaboration with CGD and other institutions involved in SEP 1 remained weak. The PMU would have benefited from early and longer-term inputs from an experienced and well qualified Project Management Advisor.

The output of the training program was rated as **unsatisfactory**. The main target for training was the CGD borrowers to help them manage their debt and businesses. However, training delivery was severely delayed. The 341 borrowers have received loans in 2000 and 2001 before the business skills training was started in January 2002. This delay worsened the performance of individual businesses and, as a result, negatively affected the overall SEP I lending portfolio. The program adopted a two phased training strategy, first to train 24 master trainers (in February 2002), who in turn trained 214 business entrepreneurs (58 women) in nine districts (in April 2002). Lack of advance planning and preparation by the PMU and poor targeting and selection of participants led to training of only 7 percent of borrowers (25) in 13 districts. The mismatch of borrowers and trained people and training delays contributed to many of the problems met by the borrowers. The master trainers were from central and district government, CGD, and NGO staff. Their capacity as master trainers needs to be improved by additional training under SEP

II. No evaluation of trainers and trainees was done as recommended by IDA missions. Management of the SEP II training program has to be improved.

Component 4. Business Development Centers (US$0.21 M of the reallocated amount of US$0.21 M). After community consultations, the small grants component of the project directed to business communities was changed to rehabilitation of buildings for four Business Development Centers (BDC) in Dili, Baucau, Maliana, and Oecussi districts. Funds were reallocated for civil works in May 2001 and rehabilitation of the buildings was completed for all BDCs at closing date. The output of this component has been rated as **satisfactory**. The BDCs will be an important part of SEP II, serving as vehicle for distribution of considerable technical inputs. Aside from the construction jobs created during building rehabilitation, the implementation of this grant component has not yet fully taken effect and the Business Development Services component of SEP II has not yet commenced.

4.3 Net Present Value/Economic rate of return:
No Net Present Value (NPV) or Economic Rate of Return (ERR) was calculated ex-ante and neither will be calculated ex-post.

4.4 Financial rate of return:
Not Applicable.

4.5 Institutional development impact:
The institutional development impact on the government was rated as **negligible**. The PMU, which was always staffed by personnel from UNTAET, transitional administration, or contracted consultants, had little connectedness with the formal Government civil service. It is assessed that there was limited transfer of skills and know-how between the PIU and the staff of the Ministry of Development and Environment, and the Secretariat of Trade and Industry. There was limited exchange of information between the PIU and other parts of Government, including those parts with interest in private sector development. For example, the PIU did little to promote the land and property studies with the Land and Property Unit. The PIU had little formal contact with the Banking and Payments Authority (BPA), for example, on loan repayments, or establishment of credit and collateral registries. Except for two UNTAET staff at the beginning of the project, and the Project Director, no other government staff were involved in the PMU until toward the close of the project. Timor-Leste consultants in the PMU underwent only limited formal training on project management or for skills development in their areas of responsibility (financial management, procurement, credit development, business development, and training management). A positive outcome of the line of credit has been to engage a commercial bank with the sector, building the capacity of its facilitators, and increasing the banking sector's understanding of lending operations in Timor-Leste.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency:
The project was designed and commenced in an emergency situation following the violence in September 1999. Until May 2002, the United Nations Transitional Administration in East Timor (UNTAET) administered the country, in conjunction with a parallel local administration. UNTAET established interim departments to run government services staffed by UN international staff with limited inputs from local civil servants. This situation, and given the destruction of about 70 percent of Timor-Leste's physical infrastructure, 80 percent of its social infrastructure, including its private sector businesses, and displacement of over 75 percent of its population, made project implementation more difficult than under most post-conflict conditions. In addition, because Timor-Leste's citizens were mostly allocated unskilled or junior positions in the previous Indonesian civil service structure, the local human resource base on which project management could be drawn was relatively inexperienced. Similarly, the UNTAET mission

personnel were hastily assembled and they too often lacked the prerequisite skills. The differences in procurement and management systems between the UN and the World Bank also caused numerous systemic problems in implementation. The anticipated economic slowdown following the UN downsizing following independence also affected project implementation, the line of credit in particular.

5.2 Factors generally subject to government control:

The UN, albeit different departments (first Department of Political Affairs and then Department of Peacekeeping Operations), were involved in the JAM and the earliest conceptual efforts to design SEP I. This included design of the components, and support for project management. The "government" for all intents and purposes was the UN. This was the first time that IDA worked with the UN acting as Recipient. Although foreseeable, many aspects of the UN's internal operating systems did not support the implementation of the project, especially in the early stages. Initially the Department of Economic Affairs, now the Ministry of Development and Environment (MDE), was appointed as the project's implementing agency. The initial UNTAET staff was relatively inexperienced in project management, and with the nature of the component parts. It took much longer for SEP I, compared with other TFET-funded projects, to contract Timor-Leste staff, a delay which reduced the transfer of knowledge about the project and its objectives. The appointment of a sufficiently senior Project Director late in the project (September 2002) and the contracting of four local consultants in 2001 improved the PMU's capacity to function more effectively.

5.3 Factors generally subject to implementing agency control:

UNTAET provided the initial management of SEP I until May 2002 through a Project Management Unit (PMU). After independence, the Ministry of Development and Environment (MDE) assumed formal responsibility for the project and appointed a new Project Director in September 2002 to head the PMU. MDE could have taken a stronger lead in managing SEP I's non-performing loans. Lack of capacity and resources dedicated to this task reduced loan portfolio performance. Up to December 2002, the MDE did not designate regular government staff to the project, hence the PMU (later renamed Project Management Unit or PIU) was staffed mainly by local consultants who had limited project management capacity. An International Project Adviser was contracted in 2002 to strengthen the PIU but he failed to improve significantly project implementation. The MDE could also have, in response to regular guidance offered during supervision missions, encouraged improved reporting and analysis from CGD. CGD had reporting and record-keeping systems fully capable of supplying the necessary portfolio data and analysis, if it was required to do so. The PIU's failure to carry out any monitoring and evaluation of the project as it was implemented, also adversely affected final outcomes. A Loan Performance Committee was formed, chaired by Government, and attended by CGD which helped to identify issues and courses of action in relation to delinquent loans, but which was not fully effective in putting agreed plans to tackle the problem into effect.

5.4 Costs and financing:

Grant Disbursements:

Total disbursements as of June 06, 2003 amounted to US$4.79 million. Actual project expenditures on the various components (Annex 2a) were slightly different from those estimated at appraisal. At mid-term, the Government and IDA agreed to reallocate the Grant funds between the various project components and Grant categories, but the credit line remained at US$4.0 million. The Grant amendment reallocated funds amounting to US$0.21 million in May 2001 for the construction of the four BDCs.

Financial Audit and Follow-up Actions on Audit Findings:

IDA has received the Project Account Audit Reports for the periods to December 31, 2000 and June 30, 2001. The June 30, 2002 audit has been delayed due to an ongoing problem with the preparation of the financial statements by CGD. The financial audit report for FY 2002/03 was submitted to IDA in March

2003. For the two previous audits conducted, the auditors have expressed qualified opinions on both audit reports. Qualified audit opinions have been issued on a number of breaches of the Grant and Project Agreements; the adequacy of the provision of doubtful debts; and the inadequacies in internal control. Many of the problems were due to: (i) the lack of a suitable international Financial Management Advisor, and (ii) inability to effectively communicate and monitor CGD activities on credit line issues. In February 2003, a part time Financial Management Advisor was contracted to closely work with the Financial Officer. They will put in place the controls needed to assess the internal control weaknesses as identified in the audit reports and set up an effective system of dialogue with the CGD through regular meetings.

Internal Audit Findings and Internal Controls:
The Government's Internal Audit team undertook an internal audit of the project during the second half of 2002. The internal audit report detailed a number of minor improprieties and misuse of project funds. These improprieties, however, highlight the weaknesses within the project's internal control structure and the need for a tighter structure to be immediately implemented. Subsequent corrective actions were instituted to recover the misused funds but this has not been completed by the Government and needs to be followed up. The new Financial Management Advisor will review the current internal structure and implement the necessary internal controls to ensure no further impropriety will occur in the follow-on project (SEP II).

6. Sustainability

6.1 Rationale for sustainability rating:
Implementation of the SEP I line of credit has produced sustainable impacts in varying degrees. Its sustainability has been rated as **likely**. As a result of implementing the line of credit, CGD has gained a large and sustainable information dividend about the nature of the current and probable future credit market in Timor-Leste. CGD's facilitators have acquired experience and training as a basis for further activity. CGD itself has developed its internal lending, monitoring and reporting systems, and identified successful borrower profiles and viable business sectors. However, this capacity building within CGD has not changed the bank's attitude towards SMEs and CGD has not continued to lend to businesses. One reason cited by CGD is that the environment (legal and regulatory) for commercial lending remains poor.

The imperative to ensure repayment of SEP I loans has precipitated action within the Government and the banking sector to initiate systems and procedures that underpin a lending market. Examples are foreclosure on default loans, procedures for resorting to legal action, and identification of crucial gaps such as credit and collateral registries, and other necessary regulatory instruments like leasing, contract, and bankruptcy laws. The line of credit was offered using TFET funds as capital, and at a rate of 10 percent, which is probably lower than market levels. It is evident from SEP II, in which CGD is willing to put at risk just 10 percent of its own capital, that SEP I itself did not give sufficient confidence to lenders to encourage them to begin lending to small enterprises unilaterally. However, CGD's acceptance of a degree of exposure represents progress as does the commencement of lending by CGD to its staff and Portuguese pensioners, mainly for loans for house improvements. However, the evidence shows that CGD, along with ANZ, is still reluctant to lend to SMEs, thus the value of this information gain may not yet be considered too useful.

Many of the businesses and jobs created by the line of credit are expected to be sustainable. As occurs in business environments everywhere, many of the start-up businesses will fail or have failed. But even in these cases, experience gained by entrepreneurs will inform their subsequent endeavors in small business. The same applies to employees of failed enterprises. In numerous cases though, SEP I businesses were started by entrepreneurs with clearly insufficient know-how. For the individuals concerned, this resulted in high levels of stress, loss of wealth and income generating potential, and the opportunity cost of the time and energy committed to the failed business. Importantly, but to an indeterminate extent, SEP I's contribution to the restoration of the supply of goods and services has also produced a sustainable impact as supply chains and production processes were reactivated. The sustainability of the impact of business skills training is assessed as low. Master trainers who received initial training under the project will require further training to keep their skills at a reasonable level, and all SEP I loan recipients will require further basic business skills training. The translated manuals and training guides delivered by the project will retain long-term value as business skills training aides.

The PMU was staffed mainly by UNTAET personnel and local consultants with limited participation of regular government civil servants. It is **unlikely** to be sustainable. Although the PMU staff has gained some knowledge of project management, their capacity for financial management, small enterprise lending, general project management, business development, and procurement remains weak. Project management systems were not put in place to enable the staff to carry out their responsibilities. The discontinuity in project leadership and delayed staffing affected the effectiveness of the PMU as a management mechanism for project implementation. The contracting of specialists in financial management and procurement in SEP II is expected to improve the PIU. However, the designation of regular government staff to work in the PIU would have made it more sustainable.

6.2 Transition arrangement to regular operations:
Some of the key activities under SEP I are being continued in the follow-on project (SEP II) which was signed October 29, 2001 and became effective March 27, 2002. The line of credit, with additional US$4.5 million for loans, continues to be implemented by CGD, with lending on commercial terms. Business skills training of borrowers will be intensified with improved selection process and monitoring. Training will also be expanded to cover civil servants, dealing with business development concepts and practices. The BDCs, whose offices facilities were rehabilitated, will be operated under SEP II. The designation of regular Government staff to the PIU, as counterparts to local and foreign consultants, has been taken to improve SEP II implementation. The Transition Arrangement Plan is currently being prepared by the Government but was not yet available for discussion with the ICR team.

7. Bank and Borrower Performance

Bank
7.1 Lending:
The ICR mission rated IDA's performance in Grant management as **satisfactory**. In a difficult post-conflict situation, the IDA assisted UNTAET and its Timor-Leste counterparts to identify a strategy to provide a credit line (82 percent of the project allocation) to restart economic activities. Support activities were also proposed such as training of borrowers and land and property studies to provide baseline information for policy-making. The project was a response to the recommendation of the Joint Assessment Mission of November 1999 that identified key short-term economic issues and priorities. The project objectives were in agreement with the interim government's and donors' priorities for rehabilitating the private sector, restarting viable economic activities quickly, and promoting sustainable employment.

7.2 Supervision:
IDA's supervision of the project has been rated as **satisfactory**. The IDA Task Team supervised the project eight times between June 2000 to October 2002. It has also carried out a more thorough mid-term review of project activities in November 2001. The missions consisted of a good mix of private sector development and investment specialists (technical aspects) and the World Bank's financial management and procurement specialists (fiduciary aspects). At the initial stage of supervision, the Task Team did not benefit from the advice of Procurement and Financial Management Specialists. Hence, the team was not able to provide proper advice and guidance to the Government. IDA staff were methodical in identifying

priority issues and problems, and systematically sought agreements with the government on appropriate actions to rectify problems (through detailed Operational Action Plans). At times, seeking to overcome significant implementation delays, IDA missions may have planned project staff more work than they could adequately handle. IDA's Resident Mission also provided support to the PMU staff on financial and procurement matters, especially to comply with IDA procedures and requirements. The ICR mission also assisted project implementers and PIU staff to evaluate the project's achievement of outputs, outcomes and initial impacts in a participatory manner. This exercise helped the Government and project staff in their own final evaluation of the project and to draw lessons for improving SEP II implementation.

7.3 Overall Bank performance:

The overall IDA performance during project implementation has been rated as **satisfactory**. IDA provided support to the Government and the project's various implementing agencies starting with UNTAET to MDE, and CGD, and responded in a timely and efficient manner to solve implementation issues and problems. IDA staff complied with the IDA's policies and procedures.

Borrower

7.4 Preparation:

The performance of the transitional government (UNTAET) in the preparation and design of the project has been rated as **unsatisfactory**. The project was prepared with significant IDA assistance in the post-conflict period following the September 1999 violence. SEP I was an emergency project under OP 8.50 and urgent implementation was required to achieve UNTAET's priorities to restart private sector economic activity and restore the flow of goods and services. There was a high degree of disjointedness in the project preparation such that there was not an optimal level of ownership among key UNTAET staff, or a dedicated section of UNTAET that initiated project implementation.

7.5 Government implementation performance:

The implementation performance of the Government has been rated as **unsatisfactory**. However, the Government faced many constraints and implementation was done within the limitations of available staff and resources. The project was implemented initially under UNTAET in the post-conflict period. Subsequently, changes in the government administration were introduced with the formation of the Department of Economic Affairs (DEA), and finally of MDE. During the transitional period, although support was given to the implementation of the project, there was discontinuity because of the turnover of Project Directors. UNTAET staff and Timor-Leste consultants managed the project. To improve SEP II implementation, the Government has agreed to designate regular Government civil servants to the PIU of SEP II.

7.6 Implementing Agency:

The project had two implementing agencies. CGD was the implementing agency for the line of credit, the main component of the project, under a separate Project Agreement with IDA. The other implementing agency was MDE.

The performance of the CGD has been rated as **satisfactory**, especially given that the role allotted to it was outside the scope of orthodox commercial banking operations in many respects. It provided a Credit Manager, CGD staff, and full time facilitators who implemented the lending program in circumstances of very limited information.

The performance of the series of implementing agencies starting with UNTAET through to MDE has been rated as **unsatisfactory**. The implementing agency was so severely under-staffed that it resorted to contracting Timor-Leste consultants to operate its PMU. The staff was tasked to coordinate with CGD in the implementation of the credit line, to manage contracts of consultants, and to carry out the business skills training. The isolation and discontinuity in the PMU could have been remedied partly through designation of regular government staff to work in the PMU. The assignment of regular civil servants in the PIU has now been agreed by the MDE. Furthermore, inputs from an experienced international Project Management Advisor to backstop the Project Director for day-to-day management activities, to set up project management systems, and to train the PMU staff could improve implementation of SEP II.

7.7 Overall Borrower performance:

The overall Grantee's performance has been rated as **unsatisfactory** for the reasons cited in Section 7 of the ICR.

8. Lessons Learned

On Post-Conflict Situation:

· Immediately following conflict, and the concomitant destruction of property, the prices of assets often rise to an inflated level. Where a line of credit is offered while these conditions persist, this can result in excessive borrowing and expose borrowers to unmanageable levels of debt as asset prices deflate post-boom.

· In a post-conflict environment, both borrowers and lenders face massive information deficiencies and so the misreading of market conditions and opportunities is more likely than not, thus leading to loan losses, unsuccessful businesses and worsening of poverty and livelihood levels.

· A significant proportion of small, short-term loans in the early post-conflict portfolio will support the objectives of injecting liquidity rapidly and restoring retail trade quickly. Such loans are also likely to have superior repayment performance.

· The explicit objectives of SEP I could mostly, and probably at lower social and economic cost, have been achieved by issuing grants, approved on commercial principles, to entrepreneurs with viable business proposals, instead of through a credit program. It is difficult to operate a line of credit in an environment where grant-giving is occurring on a large scale.

· In an immediate post-conflict environment, and depending on precise operational conditions, support for the creation of a new formal lending sector is immensely difficult, and should probably not be undertaken until the reconstruction and development process (2-3 years) is more advanced. This implies a managed transition from intermediated grant-giving to intermediated loan-giving. Government-sponsored loans also create a "culture of entitlements" that would undermine the development of sustainable credit programs.

· External studies on land and property issues, in the context of a transitional political environment, require very high levels of local political ownership and should be introduced in a phased manner, gradually building up a baseline of data and a range of policy options for the new/incoming administration.

On Small Enterprise Lending:

· The credible promise of timely approval of subsequent credit lines, with the possibility of progressive increases in loan size, is a potent incentive for repayment.

· Many of the implicit objectives of SEP I related to financial sector development, although the headline SEP I PDO related to broader and more explicit post-conflict PSD goals. The competing objectives and forms of input brought about a degree of internal inconsistency during project implementation.

· Even in an emergency situation, small credit projects need to calculate appropriate measures of portfolio performance to permit the monitoring and analysis of trends in repayment performance. These include data on the aging of arrears and loan collections at the margin as well as cumulatively.

· In an immediate post-conflict environment, donors should coordinate their activities such that there is only one form/approach of donor-provided small enterprise intermediated credit. Where there is more than one, for example, CEP and SEP credit giving systems, chances of problems increase markedly. This is due to

(i) a lack of coordination on interest rates, (ii) significant variation in the quality of portfolio management, and (iii) different tolerance (i.e. concern) for portfolio at risk (PAR) levels.
· Not linking the delivery of business skills training concretely to approval of a loan to borrowers has a materially negative effect on borrowers' ability to manage their businesses and repay loans.

On Project Management:
· The sequencing of post-conflict PSD interventions is crucial and adequate allowances should be made for relatively weak implementation capacity on the part of the transitional administration and the emerging government structure.
· Procurement of services in a post-conflict transitional environment can be expected to take longer than normal. Project design needs to accommodate this accordingly.
· Strong linkages of the PMU to various groups of stakeholders, especially CGD staff and beneficiary groups (borrowers), are critical in monitoring project progress and in responding to emerging issues/problems so these could be addressed/solved quickly.
· Designation, as early as possible, of regular government staff to the PMU as counterparts for the local and foreign consultants, and contracting of an experienced project management advisor would help ensure sustainability of the project initiatives and build capacity in project management within the government.

9. Partner Comments

(a) Borrower/implementing agency:
REPÚBLICA DEMOCRÁTICA DE TIMOR-LESTE
SECRETARIO DE ESTADO DO TURISMO, AMBIENTE E INVESTIMENTO
PROJECT IMPLEMENTATION UNIT-SMALL ENTERPRISES PROJECT

Attached as Annex 10 is a copy of the Government's Implementation Closing Report (ICR) for the Small Enterprises Project. A summary of the contents of the Government's ICR is as follow:

The Trust Agreement for the Small Enterprises Project (SEP I) was signed on April 11, 2000. The project's main objectives were to:
· Restart viable economic activities in the private sector through lending on commercial terms,
· Ensure sustainable employment in urban areas,
· Prepare complementary follow on programs, and
· Restore essential elements of a land and property administration system.

The project's components consisted of: (1) Line of Credit, US$4.00 million, (2) Land and Property Study, US$0.266 million, (3) PMU Technical Assistance including training programs, US$0.25 million, and (4) equipment and rehabilitation of the Business Development Centres, US$0.215 million.

Component 1: US$3.99 million was loaned out under the Line of Credit to 341 recipients at an average of US$11,500. As at December 31, 2002, there were 294 businesses still functioning with 43 loans were liquidated. Despite some problems with repayments, repayments had achieved 70.5% of the amount due resulting in a credit of US$1.96 million. This is held by implementing bank, Caixa Geral de Depositos (CGD) as a deposit for a revolving fund. The outcome of this component is **sustainable** and the performance of the implementing agency CGD is rated **satisfactory**.

Component 2: US$0.264 million was spent on the production of a series of seven reports including a single summary report on land and property issues in Timor Leste. The outcome of this component is the incorporation of some of the recommendations into recent land and property legislation is indicative that the information supplied has met a need and, therefore, can be considered **sustainable**. However, the haste with which UNTAET and UNCHS (Habitat) approached this task, the need to have an extra study to distill the recommendations and then the delay in implementation because of the unpreparedness of the Land and Property Unit (LPU) led to an **unsatisfactory** implementation rating.

Component 3: US$0.329 million was spent on Technical Assistance. This included: (1) Training of Master Trainers and Business Skills training, and (2) Technical Assistance to the PMU. The training sub-component was designed to provide a pool of 24 master trainers who trained 214 business entrepreneurs in a full range of small to medium business skills, loan management and repayment responsibilities. The recruitment of the training consultants was delayed and the training of master trainers and subsequent Business Skills Training (BST) did not take place until early 2002 after all loans had been disbursed. As a result only 7% of borrowers attended BST. This sub-component is not sustainable without follow-up training and so has been rated **unsustainable.** The training was delivered in a professional manner and produced useful training manuals and materials. The delays in recruitment and mobilization were due to the PIU's ineptitude and affected the ability to reach the target group. The implementation is rated **marginally satisfactory**.

Under the PMU Technical Assistance sub-component, there were no full time government staff assigned to the PMU/PIU. UNTAET junior staff, lacking in private sector development skills and experience, were initially assigned and continued for 18 months. When East Timorese where appointed in a full time capacity they were contracted as consultants and not Government civil servants. Consequently there were no development of capacity within Government. In general, the PIU did little to coordinate the various aspects of the project. The staff did not foster a relationship with BNU facilitators and procurement was constantly delayed. These aspects reflected a lack of project leadership. In the form which existed over the larger part of the project, the PIU was **unsustainable** and the implementation performance was **unsatisfactory**.

Component 4: US$0.208 million was spent for the rehabilitation of four BDCs. Although there were initial delays with the tendering process, the outcome were generally satisfactory. The output from the civil works is rated **sustainable**. While the design and supervision was satisfactory, the tendering process is rated **marginally satisfactory**.

Overall, the final evaluation of the Small Enterprises Project was considered **satisfactory**.

(b) Cofinanciers:
The project was funded by a consortium of donors through the Trust Fund for East Timor (TFET) that was managed by the International Development Association (IDA).

(c) Other partners (NGOs/private sector):
Caixa Geral de Depositos
The SEP I Line of Credit (Component 1) was implemented by Caixa Geral de Depositos (CGD), formerly Banco Nacional Ultramarino (BNU), under a separate Project Agreement signed on April 11, 2000. The final amount loaned was US$3.99 million of the original allocation of US$4.00 million. CGD provided small loans to 341 private businesses in 13 districts from 2000 to 2002. A total of 2,947 loan applications were received, indicating a high loan demand during the early post-conflict period in Timor-Leste.

The impact of the loans to small businesses was to increase the circulation of money in all districts, help restart economic activities in the private sector in the urban areas, create employment, and improve the capacity of CGD to provide loans under a difficult post-conflict situation. CGD benefited by gaining some knowledge of the commercial market: by the end of May 2003 (after the close of SEP I), CGD's own capital provided several credit lines totaling US$8.4 million for (i) housing rehabilitation (63.5%), (ii) personal loans for CGD staff (2.0%), and (iii) business support (34.5%). The level of defaults on this portfolio is about 0.80%. This indicated that the people of Timor-Leste must be given the opportunity to show their capacity, and to develop economic activities in the private sector to rebuild their country.

Several important problems encountered by both borrowers and CGD adversely affected smooth implementation of the line of credit. Many borrowers were inexperienced in operating a business and did not receive needed business training. Some borrowers made poor choices of enterprise, which resulted in business failure and inability of borrowers to make payments. CGD encountered difficulties in processing the high volume of loan applications due to limited time and pressure to disburse funds quickly. Some borrowers were unable to maintain their payments on rigid monthly schedule. Hence, the repayment rate of the project (76% in May 2003) was lower than the expected rate of 80% at the end of the project. Overall, the absence of land and property laws and regulations adversely affected the implementation of the line of credit, especially in the ability to collect on overdue payments.

Some lessons learned from the implementation of the line of credit are: (i) borrowers should be provided with business training to assist them to successfully manage their business enterprises; (ii) a credit registry of all financial institutions and NGOs providing funds should be created; and (iii) government should develop the enabling environment (such as approving land and property laws and regulations) to ensure the success of commercial lending.

Based on the experience and lessons from SEP I, CGD suggests that the follow-on project SEP II be implemented with consideration to the following issues: (i) loan maturities must match the needs of the borrower's project; (ii) variable interest rates should be introduced; (iii) borrowers must be trained before loan funds are disbursed; (iv) as criteria for selection of borrowers, priority sectors and businesses should be based on the National Development Plan of Timor-Leste; (v) CGD must wholly assume responsibility for the implementation process of analysis and decision of lending operations; (vi) According with the rules of bank secrecy CGD will report to government and World Bank the performance and quality of the portfolio.

10. Additional Information

Not applicable.

Annex 1. Key Performance Indicators/Log Frame Matrix

Outcome / Impact Indicators:

Indicator/Matrix	Projected in last PSR[1]	Actual/Latest Estimate
No. of small businesses started	300	341 small businesses were established by 341 borrowers in 13 districts
Percent of loan amounts approved	15	12 percent of 2,947 applications were approved
Percent businesses still operating	>80	82 percent of 341 businesses were still operating at the end of the project
Benefits by type of activity		
(a) Transport		64 percent of borrowers perceived that transport was developed (from Beneficiary Survey)
(b) Commerce	Survey	63 percent of borrowers perceived that commerce was also developed (from Beneficiary survey)
(c) Quality of Life		71 percent of beneficiaries reported some improvement in their quality of life (from Beneficiary Survey)

Output Indicators:

Indicator/Matrix	Projected in last PSR[1]	Actual/Latest Estimate
Component 1. Small Loans for Private Businesses		
No. of loans applied for	1,100	2,947 applications were received by CGD
No. of loans approved	300	341 loans were approved of 2,947 applications received
No. of loans to women	>40	57 women received loans (17 percent)
Average loan size	US$20,000	US$11,696
Repayment of capital	US$2,300,000	US$2,506,458 /1
Repayment of interest		/1
Repayment as percentage of due amount	>80 percent	76 percent
No. of workers employed	2,000	1,321 were estimated to have been employed in 341 businesses; an estimated additional 1,040 to 1,200 other jobs were indirectly created by these businesses; 90 percent of workers were recruited in the same place as the entrepreneurs (from Beneficiary Survey)
No. of women employees	200	341 women were employed (26 percent) in 341 businesses
Component 2. Strengthening Land and Property Administration		
Improved Land and Property Administration		(This cannot be assessed at end of project because no formal attempt was made to integrate relevant recommendations into land and property management regulations.)
No. of land and property studies carried out		7 studies were carried out in May-August 2000
Component 3. Technical Assistance Delivery of training program:		
No. of master trainers completed training		24 master trainers were trained in February 2002
No. of trainees completed business skills training		218 trainees were trained in business skills in April 2002
Utilization of grant funds		(Fund was reallocated to rehabilitate

		buildings for 4 BDCs in May 2001)
Component 4. Business Development Centers		
No. of BDCs provided with rehabilitated facilities	4 BDCs	Rehabilitation of buildings for 4 BDCs in Baucau, Bobonaro, Dili, and Oecussi Districts have been completed

[1] End of project

/1 This is the amount received in interest and principal payments on the amount of US$3,752,062 which fell due to end-May 2003. CGD monthly reports do not permit capital and interest repayments to be distinguished separately.

Annex 2. Project Costs and Financing

Project Cost by Component (in US$ million equivalent)

Component	Appraisal Estimate US$ million	Actual/Latest Estimate US$ million	Percentage of Appraisal
Small Loans for Private Businesses	4.00	3.99	100
Strengthening Land and Property Administration	0.27	0.26	96
Technical Assistance	0.39	0.33	85
Business Development Centers		0.21	105
Unallocated	0.19		
Total Baseline Cost	4.85	4.79	
Total Project Costs	4.85	4.79	
Total Financing Required	4.85	4.79	

Project Costs by Procurement Arrangements (Appraisal Estimate) (US$ million equivalent)

Expenditure Category	Procurement Method[1] ICB	NCB	Other[2]	N.B.F.	Total Cost
1. Loans	0.00 (0.00)	0.00 (0.00)	**4.00** (0.00)	0.00 (0.00)	**4.00** (0.00)
2. Consultants' Services	0.00 (0.00)	0.00 (0.00)	**0.52** (0.00)	0.00 (0.00)	**0.52** (0.00)
(a) Part B of the Project	0.00 (0.00)	0.00 (0.00)	**0.25** (0.00)	0.00 (0.00)	**0.25** (0.00)
(b) Part C of the Project	0.00 (0.00)	0.00 (0.00)	**0.25** (0.00)	0.00 (0.00)	**0.25** (0.00)
(c) Part D of the Project	0.00 (0.00)	0.00 (0.00)	**0.02** (0.00)	0.00 (0.00)	**0.02** (0.00)
3. UNCHS Fee	0.00 (0.00)	0.00 (0.00)	**0.01** (0.00)	0.00 (0.00)	**0.01** (0.00)
4. Goods	0.00 (0.00)	0.00 (0.00)	**0.10** (0.00)	0.00 (0.00)	**0.10** (0.00)
(a) Part C.1 of the Project	0.00 (0.00)	0.00 (0.00)	**0.01** (0.00)	0.00 (0.00)	**0.01** (0.00)
(b) Part C.3 of the Project	0.00 (0.00)	0.00 (0.00)	**0.09** (0.00)	0.00 (0.00)	**0.09** (0.00)
5. Works under Part D of the Project	0.00 (0.00)	**0.20** (0.00)	0.00 (0.00)	0.00 (0.00)	**0.20** (0.00)
6. Incremental Operating Costs:	0.00 (0.00)	0.00 (0.00)	**0.01** (0.00)	0.00 (0.00)	**0.01** (0.00)
(a) Project Auditing	0.00 (0.00)	0.00 (0.00)	**0.01** (0.00)	0.00 (0.00)	**0.01** (0.00)
(b) Other	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
7. Unallocated (except Categories 2(a) and 3)	0.00 (0.00)	0.00 (0.00)	**0.01** (0.00)	0.00 (0.00)	**0.01** (0.00)
Total	0.00 (0.00)	**0.20** (0.00)	**4.65** (0.00)	0.00 (0.00)	**4.85** (0.00)

Project Costs by Procurement Arrangements (Actual/Latest Estimate)(US$ million equivalent)

Expenditure Category	Procurement Method[1] ICB	NCB	Other[2]	N.B.F.	Total Cost
1. Loans	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(3.99)**	(0.00)	**(3.99)**
2. Consultants' Services	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.50)**	(0.00)	**(0.49)**
(a) Part B of the Project	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.23)**	(0.00)	**(0.23)**
(b) Part C of the Project	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.25)**	(0.00)	**(0.25)**
(c) Part D of the Project	0.00	0.00	**0.01**	0.00	**0.01**
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
3. UNCHS Fee	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.01)**	(0.00)	**(0.01)**
4. Goods	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.08)**	(0.00)	**(0.08)**
(a) Part C.1 of the Project	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.01)**	(0.00)	**(0.01)**
(b) Part C.3 of the Project	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.07)**	(0.00)	**(0.07)**
5. Works under Part D of the Project	0.00	0.00	0.00	0.00	0.00
	(0.00)	**(0.21)**	(0.00)	(0.00)	**(0.21)**
6. Incremental Operating Costs:	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.01)**	(0.00)	**(0.01)**
(a) Project Auditing	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	**(0.01)**	(0.00)	**(0.01)**
(b) Other	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
7. Unallocated (except Categories 2(a) and 3)	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
TOTAL	0.00	0.00	0.00	0.00	0.00
	(0.00)	**(0.21)**	**(4.58)**	(0.00)	**(4.79)**

1/ Figures in parenthesis are the amounts to be financed by the Bank Loan. All costs include contingencies.

2/ Includes civil works and goods to be procured through national shopping, consulting services, services of contracted staff of the project management office, training, technical assistance services, and incremental operating costs related to (i) managing the project, and (ii) re-lending project funds to local government units.

Project Financing by Component (in US$ million equivalent)

Component	Appraisal Estimate			Actual/Latest Estimate			Percentage of Appraisal		
	IDA	Govt.	CoF.	IDA	Govt.	CoF.	IDA	Govt.	CoF.
Small Loans for Private Businesses	4.00			3.99			99.8		
Strengthening Land and Property Administration	0.27			0.26			96.3		
Technical Assistance	0.39			0.33			84.6		
Business Development Centers	0.00			0.21			0.0		
Unallocated	0.19						0.0		
TOTAL	4.85			4.79			98.8		

Annex 3. Economic Costs and Benefits

Summary

The methodology used in this economic analysis was drawn as much as possible on World Bank guidelines for the economic analysis of World Bank projects. Financial measurements such as Net Present Value (NPV) and Economic Rate of Return (ERR) were not calculable when the project was designed in 1999/2000 and there is no data available upon which NPV or ERR can be calculated ex-post. However, an attempt at measuring net benefit was made, reliant on considerable assumptions, ignoring opportunity costs and immeasurable shadow prices, and avoiding adjustments for inflation and estimations of the annual cost of capital. Apart from data on the performance of the loan portfolio as supplied by the intermediating bank, CGD of Portugal, very limited monitoring and evaluation occurred during the life of the project, capturing negligible usable economic and financial data. More broadly, only the most basic macroeconomic data is available at this time.

The Small Enterprises Project (SEP I) had a moderately positive impact on the economy in immediate post-conflict through to post-independence Timor-Leste. SEP I had a mixed impact on poverty reduction. To an indeterminate extent the project did significantly hasten and support the restoration of the supply of goods and services. The project, through payment of border taxes on imported capital equipment purchased by borrowers, did improve the fiscal position of Government, especially in 2000-2001, although worsened the current account around that same time as imports for start-up businesses were demanded. However, few SEP I borrowers now fall within the formal direct tax net. The project has, again to an indeterminate extent, also provided some underpinnings for an understanding within the banking sector of the characteristics, risks and opportunities of the lending environment in Timor-Leste.

Direct job creation was achieved as a result of the project. At the outset staff were employed at an approximate rate of four per loan (an estimated total of around 1,321 employees), although this has declined to perhaps 3.5 employees per loan over the life of the project (estimated 1,190 employees). Given ongoing structural changes to the economy, and normal small business churn, perhaps half of these jobs are, to a reasonable extent, sustainable. The Business Development Centers (BDCs) rehabilitation work is estimated to have created about 500 person months (or about 41 jobs for one year) of construction worker jobs. First-round indirect employment is more difficult to calculate, but an average coefficient of 0.2 indirect jobs for each direct job would not be unreasonable, assuming a high level of underemployment. Accepting that in the immediate post-conflict situation unemployment was especially high in urban areas, and that most borrowers were non-farmers, the shadow price of labor is assessed to have been near zero at the outset of the project but rising through to 2002 and then declining marginally during the post-independence economic slowdown.

There was a degree of private sector crowding out as a result of the various donor and non-government organization (NGO) initiatives. Many SEP I borrowers whose businesses were debt financed have experienced difficulties in competing with those businesses which were assisted with grants (of goods and equipment, as well as cash) from donors. This was especially the case in the agriculture and fisheries sectors where numerous donors and NGOs supplied goods and capital equipment to individuals and communities on an ex gratis basis. This gave rise to a situation where two equivalent businesses (one funded by an SEP I loan, and one funded through a non-repayable grant) offering the same services, or producing the same products, were operating (after starting at a similar point) based on different cost structures. Thus, those businesses with debt overhang became uncompetitive.

When the SEP I line of credit became available in the immediate post-conflict environment in 2000, and capital goods and equipment were purchased with SEP I financing, the prices of assets were at an inflated level. This meant that borrowing levels became necessarily higher, passing (at least initially) higher costs on to consumers. Also, the value of assets fell rapidly over time as asset prices normalized and as other sources of goods and capital equipment became available. This situation had a deleterious effect on poverty reduction among SEP I borrowers and reduced the consumer surplus available to their customers. In addition, many borrowers are now using income from other sources, for example, civil service salaries, to keep up repayments on their loans. These loans have in many instances financed the purchase of over-valued, under-productive and quickly-depreciating capital goods. And failing service sector businesses have also suffered as a result of the general economic slowdown. In all of these cases borrower income levels are in overall decline.

The delay in the disbursement of the line of credit had a notable effect on the impact of the project. In general, the life cycle of businesses and loans was pushed out from the period of the boom reconstruction period into the period of economic slowdown following independence and the United Nations (UN) downsizing. This lag in disbursement was perhaps a year long and the negative impact of this is only now becoming apparent.

It is likely that $2.4 million of the $4.0 million line of credit will be repaid. Government has indicated its view that these repaid funds should be quarantined for reuse in a future SME lending program via a different and more sustainable mechanism. This expected level of SEP I loan repayment suggests that total project cost has only been around $2.1 million.

In a very crude attempt to estimate net benefits of the project, a very approximate two-period analysis of net benefits accruing from the line of credit component was undertaken. It comprises three referent groups, namely Government, SEP I borrowers, and workers. It does not allow for the effects of inflation or shadow prices, and makes considerable assumptions about asset values, tax revenue flows attributable to Government, and wages and salaries payable to workers and owners of capital, and ignores the complexity involved in measuring possible opportunity costs incurred as a result of implementing this project over any other feasible alternatives. Total two-period net benefit to Government, SEP I borrowers and workers filling new jobs is put at $3.66 million, $2.33 million and $4.80 million, respectively. In total, therefore, the above analysis suggests that the $4.00 million line of credit component has produced net benefits, subject to the foregoing caveats, of $10.79 million.

Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle Month/Year	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.) Count	 Specialty	Performance Rating Implementation Progress	 Development Objective
Identification/Preparation				
03/07/2000*	*6*	Task Team Leader (1); PSD Specialist (2); Social Development Specialist (1); Disbursement Officer (1); Urban Specialist (1)		
Appraisal/Negotiation				
03/07/2000*	*6*	Task Team Leader (1); PSD Specialist (2); Social Development Specialist (1); Disbursement Officer (1); Urban Specialist (1)		
Supervision				
06/20/2000	*2*	TTL (1); Economist (1)	S	S
10/11/2000	*4*	TTL (1); PSD SPECIALIST (1); ECONOMIST (1); AGRIBUS. SPECIALIST (1)	S	S
01/29/2001	*6*	TASK TEAM LEADER (1); SR. PSD SPECIALIST (1); FIN. MGMT. SPECIALIST (1); PROCUREMENT SPECIALIST (1); ECONOMIST (1); OPERATIONS ASSISTANT (1)	S	S
06/07/2001	*3*	TASK TEAM LEADER (1); ECONOMIST (1); PROCUREMENT SPECIALIST (1)	S	S
11/28/2001	*6*	TASK TEAM LEADER (1); PROCUREMENT SPEC. (1); ECONOMIST/SME SPEC. (1); FINANCIAL MGMT. SPEC. (1); MICRO/SME FINANCE SPEC. (2)	S	S
05/26/2002	*6*	TASK TEAM LEADER (1); ECONOMIST (1); PROCUREMENT SPEC. (1); FINANCIAL MANAGEMENT SPEC. (1); PSD SPEC. (1); OPERATIONS ASSISTANT (1)	S	S
08/2002	*1*	ECONOMIST (1)	S	S
10/14/2002	*6*	TASK TEAM LEADER (1); ECONOMIST (1); FOREIGN INVESTMENT SPEC. (2); PROCUREMENT SPEC. (1); OPERATIONS ASST. (1)	S	S

ICR 03/01/2003		*4*	MISSION LEADER/RURAL DEV. SPEC. (1); SME FINANCE SPEC. (1); ECONOMIST (1); OPERATIONS ASST. (HALF TIME)(1)	S	S

* Combined mission Preparation/Appraisal/Negotiations.

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US$ ('000)
Identification/Preparation	15.4*	169,169.78*
Appraisal/Negotiation		*
Supervision	67.7	310,054.28**
ICR	8.6	**
Total	91.7	479,224.06

* Total amount includes project identification mission to negotiation which was done in one mission.
** Total amount includes supervision missions and the implementation completion report mission.

Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	H	SU	M	N	NA
	Rating				
☐ *Macro policies*	○	○	○	○	○
☒ *Sector Policies*	○	○	●	○	○
☒ *Physical*	○	○	○	○	●
☒ *Financial*	○	○	●	○	○
☒ *Institutional Development*	○	○	○	●	○
☒ *Environmental*	○	○	○	○	●
Social					
☒ *Poverty Reduction*	○	○	●	○	○
☒ *Gender*	○	●	○	○	○
☒ *Other (Please specify)* *Restoration of Goods and Services*	○	○	●	○	○
☒ *Private sector development*	○	○	●	○	○
☒ *Public sector management*	○	○	○	●	○
☐ *Other (Please specify)*	○	○	○	○	○

Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

6.1 Bank performance	*Rating*			
☒ *Lending*	○ *HS*	● *S*	○ *U*	○ *HU*
☒ *Supervision*	○ *HS*	● *S*	○ *U*	○ *HU*
☒ *Overall*	○ *HS*	● *S*	○ *U*	○ *HU*

6.2 Borrower performance	*Rating*			
☒ *Preparation*	○ *HS*	○ *S*	● *U*	○ *HU*
☒ *Government implementation performance*	○ *HS*	○ *S*	● *U*	○ *HU*
☒ *Implementation agency performance*	○ *HS*	● *S*	○ *U*	○ *HU*
☒ *Overall*	○ *HS*	○ *S*	● *U*	○ *HU*

Annex 7. List of Supporting Documents

A. IDA Documents:

1. East Timor: Building A Nation, A Framework for Reconstruction and Development, Joint Assessment Mission, Macro-Economics Background Paper, November 1999
2. East Timor Policy Challenges for a New Nation, May 2002
3. Project Agreement for the Trust Fund for East Timor between the United Nations Transitional Administration in East Timor and International Development Association, Small Enterprises Project, April 11, 2000
4. Project Agreement for the Trust Fund for East Timor between the International Development Association and Banco National Ultramarino, Small Enterprises Project, April 11, 2000
5. Amendment to the Project Agreement, Small Enterprises Project, May 15, 2001
6. Amendment to the Project Agreement, Small Enterprises Project, September 20, 2002
7. Project Appraisal Document, Small Enterprises Project, April 17, 2000
8. Supervision Mission Aide Memoire, June 20-July 05, 2000
9. Supervision Mission Aide Memoire, October 2000
10. Supervision Mission Aide Memoire, January 29-February 26, 2001
11. Supervision Mission Aide Memoire, June 07-25, 2001
12. Mid-Term Review Mission Aide Memoire, November 28-December 14, 2001
13. Supervision Mission Aide Memoire, May 26-June 07, 2002
14. Supervision Mission Aide Memoire, August 20-29, 2002
15. Supervision Mission Aide Memoire, October 14-25, 2002

B. Government Documents:

1. Beneficiary Assessment Survey Report, Daniel Simiao, March 2003
2. Banco Nacional Ultramarino (BNU) Monthly Portfolio Reports
3. Land and Property Administration in East Timor, Summary of Consultants' Reports Prepared by the Land and Property Administration Project, Michael Brown, March 14, 2001
4. Master Trainer and Business Skills Training Programme, Mid-Term Report, Solomon Leonard, March 2002
5. Master Trainer and Business Skills Training Programme, Final Report, Solomon Leonard, May 2002
6. PMU Monthly Reports
7. PMU Quarterly Financial Reports

Annex 8. Beneficiary Survey Results

Introduction:
A Beneficiary Assessment Survey (BAS), focused on the credit line beneficiaries of SEP I, was carried out in February 2003 by an Anthropologist contracted by the project. The assessment covered the project impact on borrowers related to personal, cultural, social, and economic aspects, based on the beneficiaries' own perceptions. The BAS was structured to measure the impact of the project on beneficiaries, following guidelines based on the main goals, project objectives, and components of SEP I.

The research was carried out using random stratified samples of 94 borrowers of the 341 total borrowers of SEP I, in a set of six districts. Four of them were defined by being the places where Business Development Centers (BDCs) were already built by the project – in Baucau, Bobonaro, Dili, and Oecussi Districts. Two other districts were added according to the distribution of borrowers by district, in order to give a representative sample of the range in the 13 Districts – Manatuto and Ermera. In each of these six districts, a set of borrowers was selected respecting the general distribution by sex of participants and economic activity.

The 94 beneficiaries answered a 42 questions questionnaire structured in four sessions. In summary, the BAS identified the following main questions according to beneficiaries' perception.

Legal Framework:
SEP I had a considerable impact in reinforcing local governance by giving a positive value to legal instruments. Among majority of the beneficiaries, the development of business skills have had impact on their knowledge of law, rights, and duties. Business experience was, in this case, a way of people learning the new legal framework that is being formulated at the moment in Timor-Leste and they recognized this importance.

On the other hand, the absence of a complete legal framework related to loans, trade, and business, had a negative impact both on the development of small enterprises and the loan repayments. Many borrowers cited problems, although variable, such as non-regulated transport, contraband of products from Indonesia, or NGO donations. This has caused some difficulties in the repayment of loans in the project.

Repayment Problems:
Besides the economic difficulties perceived by some borrowers, the lack of legal instruments – particularly land and property laws – also caused problems to CGD facilitators in charging borrowers who were in default. Despite the acknowledgement of their duties, many borrowers did not want to pay back their loans because until now judicial sanctions are not effective in Timor-Leste.

The absence of enforcement of sanctions, combined with historical and cultural factors, reinforced the perception among some borrowers that the loans were grants that do not need to repay. The Survey showed that this was not something that could be changed by giving information to people. Almost all borrowers said that they understood their duties and received good information about them. The way of changing this situation seemed to include the consolidation of legal instruments of pressure over borrowers in debt; the implementation of strong development projects in order to avoid emergency situations; the creation of mechanisms of rewarding the borrowers who really concentrated in their enterprises, invested adequately in their own capacity building, and repay loans in right time; and the continuous and enlarged training program that should start on the very first day of the loan taking.

Capacity Building:
The Survey revealed that there is still a considerable lack of trading and management skills among the CGD borrowers. Many still did not understand some basic management values and skills. This is strongly related to the lack of a trading culture among majority of borrowers. Some beneficiaries indicated that they used the loan to pay unexpected familial costs, such as the duties in a funeral or a marriage. Of course, this amount could not be recuperated. The lack of business skills among borrowers could be due to their not participating in training sessions. Unfortunately, training coverage among the beneficiaries was almost insignificant, and must be reinforced as soon as possible.

Employment:
Job generation was an important component of SEP I, varying considerably among activity sectors. The Survey revealed that transport – the main sector of borrower's enterprises – had a low employment potential, compensated by hotels, restaurants, commerce, and agriculture. Job generation did not reflect a higher level of monthly benefits. On the contrary, enterprises with the lowest benefit level were those that employed more workers. This may indicate that a big part of job generated (especially in restaurant/hotel sector) may be precarious job, and it would be interesting, in further analysis, to evaluate how salaries are being paid to the employees. It is possible that these jobs may not be sustainable for much longer because of the downturn in the economy. This was reinforced by the fact that job positions measured in the beginning of the project were substantively more numerous than the Survey showed in early 2003. Many of the jobs may be closed because of this problem of lack of sustainability.

Community Ties:
Beneficiaries also perceived many changes in their relation to local communities due to their participation in SEP 1. Respondents have indicated that their position in social structure has changed. On the other hand, some problems emerged due to this change. Some of these problems in community relationship may be related to the fact beneficiaries were taking money outside the local social structure (familial and traditional safety nets). In this sense, some guidelines must be established in future programs to safeguard borrowers from similar problems. Otherwise, the participation of beneficiaries may be discouraged, and the incorporation of a modern relation to credit institutions will be affected.

The same happened when we look at the impact of a modern credit conception to local tradition and community obligations. Certain community ties imply economic prejudices to borrowers, as reported by some entrepreneurs of the transport sector – due to community ties. The owners of transport services may not deny transportation for friends, family or community members, which many times have no condition for paying them.

Local Differences:
Lastly, the Survey revealed that indicators such as job generation, monthly profits, and economic sustainability have a great variation among the districts. Oecussi frequently appeared to be the most contrary relative to the national trends. This may imply, in further programs, to consider having different norms according to different answers in each location. Local economic conditions and community characteristics, if not properly treated, may cause problems to borrowers, as the Oecussi's case showed in relation to social jealousy and low-income level of the population.

Lessons Learned:
As lessons learned, the beneficiary assessment indicated that:

· Providing credit without a legal framework regulation for paying back may result in misunderstanding among borrowers that they do not need to repay.

· In the absence of legal instruments, it is fundamental to build mechanisms and incentives to encourage repayments.
· In post-conflict or emergency situations, giving credit without a strong training component would result in low repayment rates.
· Training coverage must be enlarged among the borrowers and needs to be a continuous process.
· Agriculture has the highest potential for social impact (quality of life and local community changes) of the project, and this can be an opportunity to be tapped under SEP II.
· Special attention must be paid to community ties, in order to develop social punishment for delinquent borrowers.
· Special attention must be paid to particular districts, especially Oecussi, where economic conditions do not allow for the normal development of small enterprises.

Annex 9. Stakeholder Workshop Results

A one-day workshop to get feedback from the stakeholders of the Small Enterprises Project (SEP I) was held on February 24, 2003 at the Business Development Center (BDC) in Dili. The 76 participants included representatives from donors and foreign governments (USAID, AusAID, ADB, Embassy of Portugal, Embassy of Japan, Embassy of Korea), various development and non-government organizations (Caritas Australia, Timor Aid, the Catholic Relief Service, East Timor Study Group), international organizations (UNMISET, ILO), Timor-Leste business entrepreneurs, local media, the implementing bank CGD, the Government (Ministries, District Administrators, and the SEP PIU), and IDA.

The workshop was opened by the Secretary of State for Tourism, Environment and Investment, Mr. José Teixeira, who is also the Director of the SEP Project. Mr. Teixeira gave a brief description of SEP I and its implementation. He was followed by Mr. Daniel Simiao, an Anthropologist consultant, who presented the results of the recently completed Beneficiary Assessment Survey (BAS) for the SEP I. Mr. João Manuel Correia Pinto, the Director General of CGD, gave an overview of the organization of CGD and its role in the implementation of the credit line component. The afternoon sessions were three discussion groups, each focusing on a SEP I component, as follows:

Group 1: Line of Credit
Group 2: Training and Capacity Building
Group 3: Land and Property Rights and the Business Development Center

A summary of the discussion groups were presented by the Session Leaders/Rapporteurs during the final plenary session. The results of the workshop were then presented to the Project Director.

A summary of the proceedings of the Stakeholders' Workshop, including the recommendations of the participants, is presented in the following section.

Line of Credit
Overall: The SEP I was the first credit program available in Timor-Leste immediately following the violence in 1999. It provided small-scale entrepreneurs with loans ranging from US$500 to US$50,000 to restart economic activities in the urban areas and to generate employment. The interest rate of these loans was 10 percent. Under the credit line of SEP I, a total 341 entrepreneurs were granted a loans by the Banco Nacional Ultramarino (BNU), now the Caixa Geral dos Depositos (CGD). Even with the repayment process still ongoing until 2004, it can already be said that the repayment rate is very low and the default rate is at 75 percent. This poor performance may be attributed to some critical problems and the participants made the following recommendations:

· The SEP I lending program was set up under an emergency condition. Due to the need for a rapid revitalization of the economic sector in early 2000, the issuance of credit was not always based on a careful analysis of business prospects. This became obvious especially with the downturn of economic activities after the UNTAET and other international staff left Timor-Leste in 2002.
Recommendation: Future issuance of loans under SEP II should be based on a better analysis of the economic opportunities, the economic viability of the enterprises, and sustainability of individual business plans.
· Cases of collusion from the side of CGD staff have been reported, which led to the dismissal of the individuals involved.
Recommendation: CGD staff should be selected more carefully and the system for monitoring the CGD lending operations should be improved.

· The commodities produced in Timor-Leste face strong competition from imported goods. Even the Government sector tends to prefer imported products over products available in the local markets.
Recommendation: An increase of import taxes could strengthen the market position of locally produced goods. The Government may want to reconsider its policies for purchasing material for the reconstruction and the furnishing of its buildings. Promotional activities (e.g., an exhibition of locally produced goods) could improve the business perspectives of Timor-Leste entrepreneurs.
· There is unclear and confusing legal situation in land and property rights causing serious limitation for CGD to recover the credits through legal action in cases of unwillingness from the borrowers to repay their loans.
Recommendation: Legal regulation for land and property issues are urgently needed as a basis for securing future credit through effective guarantees.
· The social environment and level of education pose additional difficulties in the development of a vibrant private business sector.
Recommendation: While the overall education level would improve on the long-term, in the meantime special attention should be given to carefully explaining the credit system to the borrowers and in training business people especially in the area of financial management.
· The loan repayment scheme and, therefore, the whole credit line is not adequate to the specific situation of borrowers from the agricultural sector.
Recommendation: A separate credit scheme should be set up for the agricultural sector, with a repayment scheme stretched over several years and repayment rates due only every six or twelve months.

Training and Capacity Building
Overall: Although little information about the activities of the training component of SEP I was available, the discussion group agreed that its implementation contained many weaknesses. The group came up with the following conclusions:
· The training program should have been based on an assessment of the needs of the business community. Special training in financial management would have been necessary and the single training of borrowers should have been four to six days instead of three days.
· The training component should have been in line with the other components of SEP I and better targeted to the borrowers in the credit line component. In addition, coordination with other agencies conducting business training in Timor-Leste would have been helpful.
· A certain degree of institutionalizing the contacts with the master trainers would facilitate the planning of future training activities. The use of local trainers could reduce the costs for future training activities significantly.

Land and Property Rights and the Business Development Center
· The land certificates, used as a guarantee for the credit, turned out to be of little value for the CGD because of the poor legal framework and the resulting constraints in actually taking over the land used as a guarantee.
· In order to react more adequately to the needs of the business community, in the medium term the Business Development Center (BDC) should become an independent institution run by the private sector. In spite of this, the BDC will remain dependent on external funding for at least two years following the closure of SEP II.
· In order to reach more people, the knowledge about the existence of the BDC and the services provided through its staff should be improved. The BDC should become a center of information exchange and training for the whole private sector.

List of Participants in the SEP I Stakeholders' Workshop, February 24, 2003

	Name	Organization		Name	Organization
	PROJECT IMPLEMENTATION UNIT:			**CAIXA GERAL DO DEPOSITOS:**	
1	David Ives	SEP PIU/Inter. Consultant	39	Joao Correia Pinto	CGD, Dir. General
2	Daniel S. Simiao	SEP PIU/Inter. Consultant	40	Teofilo Fonseca	CGD, Credit Manager
3	Marcelino DCP	SEP PIU	41	Celice Sarmento	CGD, Dep. Credit Mgr.
4	Raul S. Lajes	SEP PIU	42	Dulce Soares	CGD Dili
5	Julia Sancha da C.Varela	SEP PIU	43	Amandio David	CGD Dili
6	Joao B. Santos	SEP PIU/Consultant			
7	Odete Peloy	SEP PIU		**DONORS:**	
8	Fernando Moniz	SEP PIU/Consultant	44	David Letechusky	Ambassador of Brasil
9	Venancio Ximenes	SEP PIU/Consultant	45	Jose M. Bendito	SRSG, UNMISET
10	Josefina Moniz	SEP PIU	46	B.M.Lim	Korean Embassy
11	Anito Matos	SEP PIU	47	Craig Wilson	World Bank
12	Julio da Cruz	SEP PIU	48	Dely P. Gapasin	World Bank
13	Carlos Alves	SEP PIU	49	Cosme Silva	ILO Project
14	Luis Bere Buti	SEP PIU	50	Fernandoda Encarnacao	ILO ISETS
15	Sergio Pereira	SEP PIU	51	Kimberly Jones	USAID
16	Kong Mu	SEP PIU/Inter. Consultant	52	Filipe Da Costa	USAID
17	Fernando Da Silva	SEP PIU/Consultant	53	Patricia Assis Teixeira	Embassy of Portugal
	GOVERNMENT AGENCIES:			**NON-GOVERNMENT ORGANIZATIONS:**	
18	Jose A. F. Teixeira	Tourism, Env. & Invest.	54	Henriqueta M .da Silva	ETSG
19	Constancio Cardoso	Cabineti Ministro	55	Fransisco da Costa Lai	UNAPE
20	Albano Salim	Dept. of Labor	56	Tomas Tamele	UNAPE
21	Carlito R.Cabral	Dept. of Labor	57	Crispin da Costa B.	UNAPE
22	Edwin Evaristo	DTP, Min. of Justice	58	Ricardo da Costa	UNAPE
23	Cristiano Gusmao	Min. Planning & Finance	59	Jose Gusmao	CRS/Tubarai Metin
24	Epifanio Faculto	Dept. of Industry	60	Antonio Correia	ABNS 74 Maritimo
25	Fernando Lobato	Dept of Industry	61	Leonel Pinto	Caritas Australia
			62	Sesilio Fernandes	Timor Aid
	DISTRICTS:		63	Julio Moreira	Timor Aid
26	Joao Vicente	DA, Bobonaro			
27	Victor dos S	Ermera District		**ENTREPRENEURS:**	
28	Carlos Pereira Gonsalves	Los Palos District	64	Jose F.F.Guterres	Entrepreneurs (ABNS)
29	Jose F.X.Smith	Aileu District	65	Fransisca de Jesus	Island Orient
30	Beatriz X.Martins	DDO, Liquica District	66	Rique Amaral BA	Salsa Leste Int. Ltd.
31	Marcelino F Neto	DDO, Baucau District	67	Julio De jesus	Suai Indah DILI
32	Joao Corte Real	DA, Ainaro District	68	Domingos A.Santos	Samedina PTY, Ltd.
33	Joao Mestre Madeira	DDO, Ermera District	69	R. Lemos	Entrepreneurs
34	Gaspar H.Soares	DDO, Manatuto District	70	Moises A.P.S	Association / Dili
35	Marito magno	Manufahi District	71	Jose Maria Alves	Entrepreneurs /Dili
36	Leonia da Costa Monteiro	Manatuto District	72	Jose Gabriel	Timor Post
			73	Armando Lay	BDC Dili
	MEDIA:		77	Antonia Soeres	Komoro
37	Aristides Gusmão	RTK	75	Raimundo G da Cruz	Taibesi
38	Napoliao da Silva	TVTL	76	Mateus Boavida	Comoro Market Mgt.

Additional Annex 10. Government ICR, Transition Plan, and Endorsement Letter

REPÚBLICA DEMOCRÁTICA DE TIMOR-LESTE
MINISTRY OF DEVELOPMENT AND ENVIRONMENT

SMALL ENTERPRISES PROJECT

IMPLEMENTATION COMPLETION REPORT

March 28, 2003

On a Grant in the Amount of
USD 4.85 Million

Trust Fund for East Timor
TF Grant No. 023631

SMALL ENTERPRISES PROJECT - IMPLEMENTATION COMPLETION REPORT

A. PROJECT DATA

1.0 Background and project preparation

The project was conceived by the International Development Association (IDA), in consultation with the United Nations Transitional Administration for East Timor (UNTAET), as a means to "jump start" the private sector, in the post-conflict period, through the provision of loan capital to private entrepreneurs. The project aimed to provide jobs, goods and reduce poverty in urban areas. The project was "fast-tracked" from identification to grant approval. Identification took place in February 2000 and negotiations were completed on March 27, 2000 See Annex 1 Key Data and PAD Annex 7.. The Grant Agreement was signed on April 11, 2000.

The Project was designed with three Components and a grant of US$4.85 million. Part A (Component 1) was a line of credit of US$ 4.00 million to be disbursed to small-medium enterprise borrowers through BNU (CGD) Banco Nacional Ultramarino subsequently designated as CGD – Caixa Geral Depositos. Part B (Component 2) was designed to improve institutional capacity in land administration with a focus on ownership disputes and use of abandoned government and private land. These activities were to be managed and coordinated for the Land and Property Unit by the United Nations Commission for Human Settlements (UNCHS). Part C (Component 3) provided technical assistance through –

(a) Structuring of the PMU/PIU
(b) Assistance and training to BNU/CGD

(c) Provision of training programs for business entrepreneurs
(d) Preparation of a program for grants to urban communities, in support of business

Subsequently, Part C(d) (Component 3(d)) was redesigned; Parts C1 and C3 were amended to allow purchase of vehicles and equipment as well as technical assistance; and a new Part D – rehabilitation of 4 business development centres (BDC's), with a budget of US$215,000, was added.

B. ASSESSMENT OF DEVELOPMENT OBJECTIVE AND DESIGN AND QUALITY AT ENTRY

2.0 Design Objective

The project had the following objectives:
- restart viable economic activities in the private sector through lending on commercial terms,
- in this way ensure sustainable employment in urban areas,
- prepare complementary follow-on programs, and
- restore essential elements of a land and property administration system

The design objectives resulted from the recommendations of the Joint Assessment Mission and subsequent consultation between IDA and UNTAET as the first transitional administration.

3.1 Strategic contexts and rationale, and the beneficiaries.

The project conforms with IDA's assistance goals to the private sector under the Country Assistance Strategy: the desire to create sustainable employment in district capitals. More specifically the availability of finance to restart economic activity, particularly in the trading, transportation and hospitality sectors. It was expected that benefits would accrue to the entrepreneurs, their families and employees and secondary benefits to the community through the provision of services in areas lacking such services in the immediate post-conflict period.

Assistance to the land and property administration was to facilitate resolution of land disputes, occupation of abandoned land and initiate a system of land registration

	EXPECTED BENEFITS	OUTPUTS
*	**Entrepreneurs and their families**	**Yes – 294 families**
*	**Employees and their families**	**Yes - 1321 workers and their families**
*	**The community – from provision of services where none existed**	**Yes in rural districts**

Sustainability was envisaged to accrue through the delivery of needed, privately operated services and the establishment of a revolving fund from loan capital and interest repayments.

The strategic choices adopted for the project included –
- quick start financing to obviously viable enterprises using simple evaluation, funding and recovery procedures: funding to the poorest or most disadvantaged sectors was scheduled for a later phase in the program;
- utilization of existing commercial banking rather than creation of a "peoples bank" ;

- lending was for complete loans of small to medium size (US$500 to US$50,000) rather than partial funding of larger credit needs or rapid turnover micro-financing.

3.0 Institutional Benefits and Target Population

3.1 Institutional Benefits

The envisaged institutional benefits to accrue from the Project were –

(a) acceleration of titling especially for non-controversial land or property,

(b) help develop banking services under the loan component, with the ultimate goal of encouraging commercial lending

(c) improve capacity in land and property administration and the basis for a future East Timorese system

(d) develop the institutional and legal basis for

(i) communities to undertake works or services to support businesses, and

(ii) business training (capacity building) in the private sector

(e) expand the UNTAET/Governments business register; and

(f) development of organization which encourage collective support to private businesses.

Institutional Benefits

	Achievements/Outputs
• Speed-up land titling	Not yet
• Accelerate development banking services	Yes
• Improve administration of land and property	Partly ongoing
• Legal basis for community businesses & training in business for the private sector	Partly ongoing
• Expand the business register	Yes
• Develop support to private businesses	Yes

4.2 Target Population and Benefits

The Project targeted the urban population. The target for the private sector loan component (line of credit) was financial support for the provision of goods and services with emphasis focused on –

- transport sector through purchase of trucks and buses
- labor intensive small enterprises and trading operations
- guest house and small hotel redevelopment in order to fill an existing void in the post-conflict period
- business centers to assist with import/export contact and document processing.

Proportion of Lending by Sector	% Volume of Total Loans
* Transport – incl. fuel kiosks	48.7%
* Commerce/trading	22.6%
* Other trading	10.9%
* Services – restaurants/guest houses	7.9%
* Agriculture and fisheries	10.0%

NOTE: Services should be last in the list above.

Overall benefits from the project were assessed to be

(a) use of loan repayments for new loans through a revolving fund with the potential for up to US$2.0 million to be re-lent;

(b) financial return to the borrowers was estimated at not less than 15% and larger to the economy through indirect benefits;

(c) the potential to re-start commercial bank lending and provision of other banking services in urban capitals;

(d) development of institutional capacity amongst East Timorese employed under the project, and

(e) building the capacity of the entrepreneurial sector to understand the emerging business regulations and the advantages of banking services in assisting the development of the commercial sector.

C. PRINCIPAL PERFORMANCE RATINGS

Outcome	:	Satisfactory
Sustainability	:	Likely
Institutional Development Impact	:	Negligible
Supervisor/Bank Performance	:	Satisfactory
Borrower Performance	:	Marginally Satisfactory

D. ACHIEVEMENT OF DEVELOPMENT OBJECTIVES AND OUTPUTS

4.0 The outputs, targets and achievements

4.1 Component 1 (Part A) Small Loans for Private Businesses (US$3.99 million of the original allocation of US$4.0 million)

The targets, achievements and impacts from Component 1 (as at 31 December 2002).

Total Loans	341	
Businesses still functional	294	86.2%
Loans Liquidated	43	12.6%
Performing Loans	47	13.8%
Capital & Interest Repayments	US$2,160,238	54.0%
Non -Performing Loans	251	73.6%
Loans in Default		50.1%
Capital Repayments in Default	US$805,641	20.1%

CGD Participation

Application forms for small loans were made available for collection from CGD in Dili and District Offices on April 5, 2000. CGD was inundated with applications for loans. Project design anticipated about 400 applications by end June 2000 but by July 2000 CGD had received in excess of 2,100 applications and the high demand led to protests by potential borrowers in Dili in late June. The deluge of applications and the public protests on CGD had adverse effects on the processing of loans. The well-meaning encouragement of applications for loans from the Districts by a supervision mission at that time may have further added to the difficulties faced by CGD.

Processing of applications for the first phase of the credit line was completed by end 2000. CGD reviewed 2104 applications for a total value of US$30,484,293 and approved 267 for financing. The US$1.20 million balance of uncommitted funds was then disbursed through a second phase. From March 1 to April 15, 2001, additional 843 applications (valued at US$12,563,190) were received. Of these number, 74 were approved. Loans were made for periods of 24 and 36 months but no loan period was to exceed August 31, 2003. Again, there were delays due to processing and approval of loans and disbursements for most second phase credits did not occur until August – December 2001.

The performance of CGD is rated as **SATISFACTORY** with respect to targets. The number of loans approved and disbursed exceeded the target by 3.33%. CGD reviewed three times the expected number of applications. An 11.7% approval rate is satisfactory despite the 15% approval rate target based on a lower number of applications. The processing period, between receipt of application and approval, remained at about 120 days through Phase 2 despite changes and additional staff allocated by CGD to these activities. This suggests that the initial target of 15 days may have been unrealistically low. Female beneficiaries exceeded initial targets by 70.5% although the 1,321 direct jobs created did not reach the expected 2,000 target.

Repayments, despite problems with late payers and defaulters, have achieved 70.5% of the amount due (December 31, 2002) resulting in a credit of US$1,96 million. This is held by CGD as a deposit for a revolving fund. At grant closing (December 31, 2002) no new loans had been made from this amount.

Defaults

Non-performing loans (NPL), those for which there has been no repayment for the previous three months, have been categorized as follows –

Category A : Borrowers who have capacity to repay but make no effort to do so

Category B : Borrowers who have used the money for alternative non income-generating purposes

Category C : Borrowers who cannot sustain their business due to current economic climate.

In December 31, defaulters in these three categories amounted to 58.4% of all loans, distributed as follows:

Category A :	66	Total sum : US$	398,401
Category B :	1	Total sum : US$	1,823
Category C :	132	Total sum : US$	462,417
TOTAL (Capital plus interest)		US$	862,641

Almost half (45%) of the defaulting loans occurred in the four month period from June to September 2002. CGD expressed the opinion that the rapid increase in defaulting repayments was due to:

(a) overall reduction in commercial activity in Timor-Leste due to massive reduction in personnel;

(b) significant reduction in number of international personnel and loss of the (artificial) elevated purchasing capacity; and

(c) lack of legal instruments supporting credit recovery.

Sustainability : Of 341 loans for small to medium businesses, 294 are still operational, and 90 of these have either fully repaid or will shortly liquidate their loans. Businesses of 86% of borrowers funded remain operational and at present 31% of these debt-free. The outstanding loans although of concern are manageable. Repayments of capital and interest have already created a fund of almost US$2.0 million for future lending. Loan screening, management and monitoring procedures developed by CGD are effective given the accessibility limitations.

The outcome of this Component is **SUSTAINABLE** and the performance of the implementing sub-agency, CGD is rated **SATISFACTORY.**

4.2 Component 2 (Part B) Strengthening land and property administration (US$0.264 million of US$0.266 million allocation)

Targets and achievements from Component 2:

No.	Activity	Target	Actual Delivery
1.	Review of land and property legislation and recommendations for action	Mid -2000	May – August 2000
2.	Synthesis of background data into a succinct summary	March 2001	March 2001
3.	Initial compilation of guidelines for regulating immovable property	As soon as possible – late 2000/early 2001	Was already in place in December 1999
4.	Passage of legislation for immovable property ownership and transactions	As soon as possible – late 2000/early 2001	December 2002

The assistance was channeled through UNCHS (Habitat) and resulted in the production of a series of seven reports which eventually were reduced to a single a summary
Brown, Michael: March 2001. Summary of the Consultants' Reports Prepared by the Land and Property Administration Project (*FS/TIM/00/S01).* report.

Land issues, particularly in a post-conflict situation, must be addressed with caution and a full comprehension of all issues. The scope of the studies undertaken was comprehensive and detailed, and review and implementation of these a daunting prospect. Given the pre-existence of regulations allowing the temporary use/occupation of land it is understandable that the documents were sidelined (by both UNTAET and LPU) until capacity building within LPU had been completed and land ownership and conflict resolution policies formulated.

The incorporation of some of the recommendations into recent land and property legislation is indicative that the information supplied has met a need and therefore can be considered **SUSTAINABLE**. However, the haste with which UNTAET and UNCHS (Habitat) approached this task, the need to have an extra study to distill the recommendations and then the delay in implementation because of the unprepared ness of LPU leads to an **UNSATISFACTORY** implementation rating.

4.3 Component 3 (Part C) Technical assistance (US $ 0.329 million of the US $ 0.361 million amended allocation)

4.3.1 Training of Master trainers and Business skills training

	Activities	Planned (June 2001)	Revised (December 2001)	Actual
1.	Contract signing and submit to IDA	Sep. 18, 2001	Jan. 2, 2002	April 7, 2002
2.	Commencement of assignment	Oct. 01, 2001	Jan. 14, 2002	January 28, ‘02
3.	Completion of assignment	Feb 28, 2002	May. 14, 2002	May 06, 2002
4.	Number of Master Trainers trained			24
5.	No. attending Business Skills Training			156 men/58 women

The training was designed to provide a pool of trainers who would train borrowers in a range of small – medium business skills, loan management and repayment responsibilities. The recruitment of the training consultants was delayed and the training of master trainers and subsequent Business Skills Training (BST) did not take place until in early after all loans had been disbursed. As a result only 7% of borrowers attended BST.

Master trainers were selected from a number of sources. It is likely that only 5 – 8 of the original 24 will be available to conduct future training and all will need refresher training. However, the training material and trainers manuals are likely to be useful for future training.

Division of Industry staff	3
PMU/PIU staff	2
BNU	3
District/sub-district administration	6
NGO’s	8
Business Centre – Viqueque	1
Private Sector	2

This sub-component is not sustainable without follow-up training and so has been rated **UNSUSTAINABLE**. The training was delivered in a professional manner and produced usable enduring manuals and materials. The delays in recruitment and mobilization were due to PIU ineptitude and affected the ability to reach the target group. The implementation is rated **MARGINALLY SATISFACTORY**.

4.3.2 Technical Assistance to the PMU

No full-time management staff were assigned to the PMU/PIU. UNTAET junior staff, lacking in PSD experience, were initially assigned and continued for 18 months. When Timorese were appointed in a full time capacity they were contracted and not government servants. Consequently, there was no development of capacity within the Government (MDE and its predecessor). Nor was there a sense of ownership as the PIU was variously run by UNTAET and then on a day-to-day basis by consultants. The appointment of an international Project Management and Procurement Advisor in April 2002 was too late to influence the direction of the Project. In general the PIU did little to coordinate the various aspects of the project. They did not foster a cordial relationship with BNU and procurement was constantly delayed. These aspects reflected a lack of leadership.

In the form which existed over the larger part of the Project, the PIU was **NOT SUSTAINABLE** and the performance was **UNSATISFACTORY**.

4.4 Component 4 (Part D) Construction of 4 Business Development Centres (US$0.208 million of US$0.215 million reallocation)

Ser.	Activity/Event	Planned Date	Actual Date
		Dili	Bacau, Oecus-si and MalianaDiliBacau, Oecus-si and Maliana
1.	Contracts awarded	12 Sep.01	12 Sep.0123 Apr.0222 Feb.02
2.	Works commenced	1 Nov.01	1 Nov.018 May 029 Mar. 02
3.	Work completed	28 Feb.02	28 Feb.0221 Oct. 0226 Sep.02

By March 2001 there was a clear demand from the business community for the establishment of Business Development Centers (BDC's) in four district capitals. Part D was added and the grant agreement amended accordingly. Public Works Division was asked to prepare a number of plans that were delivered by October 2001. There was no formal contract with PWD for the survey, design and supervision of the works.

The tendering process for construction was handled by the PIU. This was delayed by 8-10 months from the original schedule. Construction was eventually completed 7 – 8 months behind schedule. This resulted in cost over-runs on three of the four contracts.

The output from these civil works is rated **SUSTAINABLE**. While the design and supervision was SATISFACTORY the tendering process is rated **MARGINALLY SATISFACTORY.**

5.0 Institutional and Implementation Arrangements

5.1 Project Coordination

UNTAET and CGD were designated with responsibility for implementation of the Project; BNU for the implementation of the line of credit program. In addition, CGD was to manage the Special Account Special Account – an account established at BNU by IDA using Trust Funds approved for the Project to facilitate approved disbursements. on behalf of UNTAET (as the implementing agency) and make payments both for loans and for services approved by IDA and the PMU. A Project Management Unit (PMU) was established by UNTAET with responsibility for management of consulting services and procurement and including preparation of TOR for training and grant programs.

The first PMU was established in April 2000 with the assignment of a senior UNTAET staff member as Project Director and two junior UNTAET staff. The tasks of the PMU were:

- contracting and payments,
- coordination with UNTAET services,
- reporting, and
- liaison with the IDA.

UNTAET and East Timorese staff were funded by UNTAET.

Because of the inexperience of initially assigned PMU staff, UNTAET played a major role in the assignment of responsibility to the Land and Property Unit to work with UNCHS to undertake studies on land ownership and related conflict resolution and registration. Public Works Division was instructed to undertake survey and prepare design (tender) documents for rehabilitation of four BDC's (Part D). The PMU had the responsibility for coordinating these activities.

The coordination process could have been improved if a project committee had been established, comprising DEA and representatives (Project Managers) from CGD, Land and Property and Public Works. This would have strengthened the role of the PMU, removed a feeling of isolation and improved the dispatch with which the Project was implemented.

5.2 Project Implementation Unit

East Timor Transitional Administration (ETTA) gained some ownership of the project in April 2001 when Sr Candido da Conceição was appointed as Project Director although the PMU was still not integrated fully within the ETTA structure. In late 2001, the PMU changed its title to Project Implementation Unit in order to improve its image. This appears to have been accepted by the Mid-term Review Mission and reflects the appointment of a third PIU Director (Mr. Manuel M. Alves of DEA) and the PIU loosely integrated with the DEA. The tasks of the PIU were reiterated, at that time, as responsibility for overall implementation of the Project namely all non-CGD components including Business Skills Training, BDC survey and construction, and to take steps to promote Timorization of the PIU to ensure sustainability.

5.2.1 Timorization and Staffing of PIU.

With the appointment of three national consultants in October 2001, the PIU was effectively nationalized. The UNTAET staff did not have project management skills to transfer to the new staff. An international PIU Advisor with responsibility for procurement and project management skills transfer was recruited under SEP II. He was also responsible for overview for SEP I. Unfortunately the appointment was not effective until April 2002 and only lasted eight months.

Mr. Jose Teixeira, the State Minister for Industry, Investment and Environment, replaced Mr. Manuel Alves as Project Director. This is an added responsibility additional to an already full workload.

While provision was made under Component 3 to fund small-scale EIA studies. the PIU did not see a need to assess the impact of loan projects on the environment.

5.2.2 Monitoring and Reporting Responsibilities

CGD initially exerted firm control on borrowing under Component 1 and maintained a detailed record on the status of loans and repayments. Constant monitoring of borrower performance was aided by the regular repayment collection visits of their facilitators. CDG completed a beneficiary status form on each visit and from these monthly reports on the status of the line of credit component have been compiled by CGD.

The PIU was responsible to oversee the performance of CGD and the recovery operations. While initially the PIU staff accompanied CGD staff on field visits, these rapidly became ad hoc rather than routine monitoring by PIU. Reporting by the PIU has been of a low standard both before and after Timorization

5.2.3 Financial Management and Control

The preparation for SEP II identified substantial weaknesses in the financial management capability of the PIU. About 18 months into the Project the PIU had not established an acceptable accounting function. The appointment of a Financial Specialist in October 2001 was a positive move to remedy this deficit. This was further aided through assistance from the audit teams.

Project Account audit reports, for the periods ended December 31, 2000 and June 30, 2001 have been completed. These first 2 audits received qualified opinions. The audit of the FY to June 30, 2002 has been delayed due to an ongoing problem with the preparation of financial statements. Completion is expected by the end of March 2003. In the interim, there is a summary of disbursement to December 31, 2002. These accounts show an unspent residue in the grant of about US$62,000. Many of the problems stemmed from:

- the lack of a suitable international financial management advisor;
- inability to effectively communicate and monitor CGD activities on credit line issues;
- misuse of funds through ineligible expenses; and
- CGD made withdrawal applications for replenishment of the SA without coordinating with the PIU.

A Financial Advisor has been contracted part time under SEP II to work with the Financial Specialist. Together they will implement controls needed to assess the internal control weaknesses as identified in the audit reports and put in place an effective system of dialogue with the CGD through regular meetings.

6.0 Qualitative survey

6.1 Introduction and methodology

A rapid assessment of the loan impact was undertaken in six districts. This survey was separate to the Beneficiary Assessment Survey reported elsewhere. The survey was conducted using a questionnaire designed to provide the following information –

(a) visual confirmation that the business was viable and still operational;
(b) current status of loan repayments as perceived by the borrower;
(c) reasons for defaults;
(d) confirmation of numbers of employees and beneficiaries;
(e) security available as collateral for lending; and
(f) assessment of the viability/sustainability of the business

6.2 Main observations

6.2.1 Viability

The QS visited 32 businesses. Most (27 of the 32 businesses) were operating effectively except for:

(a) two goods transport businesses – insufficient funds to meet cost of repairs;
(b) two poorly sited small shops with limited turnover; and
(c) one transport business had moved from Ainaro to Dili and was reported to have failed, and one tailor shop closing.

6.2.2 Reason for defaults

Of 19 respondents 59% said repayments had not been made because they needed money for food or family matters; 18.75% were of the belief that at the liquidation date all outstanding debt would vanish. 18.75% reported unprofitable businesses.

6.2.3 Beneficiary assessment

Answers recorded from the 32 respondents indicated an average of 2 – 4 persons employed per business (average 3.25) and on average 6.5 persons benefiting directly from an enterprise. If these figures are *pro rated –*

Category	**Average/enterprise**	**Total Number – pro-rated on:**
		initial 341 loans for enterprises294 enterprises still operating
Employees	3.25	1108956
Direct beneficiaries	6.53	22271920

This confirms previous assessments of 1,321 employees reported by CGD. It can be concluded therefore that the project provided employment for about 1200 persons and a further 800 persons (for a total of 2,000) directly benefited in some way from the Component 1 loans.

6.2.4 Availability of security for borrowing.

Real estate ownership, as perceived by the borrowers, was investigated. Twenty-eight (87.5%) owned their own home, 27 (84%) owned their business site/buildings and of those seven owned other property and three persons reported owning property other than either their home or business. Of these > 80% of each group held a certificate of title of some form This may have been either "hak milik" from the Indonesian period, Portuguese title or traditional rights as recognized by the district administration..

6.2.5 Assessment of the viability/sustainability of the business

About 83% of the enterprises seen by the consultant were considered viable and sustainable. This is a similar figure to that reported by BNU – 294 of 341 businesses (86%) still operational. However, increasing competition in some sectors could affect long-term sustainability. Sub-sectors at risk, which may be affected by increasing competition are the passenger transport and guesthouses.

7.0 Factors affecting implementation

7.1 <u>Factors outside the control of Timorese representation</u>

The problems of project ownership, as outlined above, continued through to and beyond independence. A lack of assigned dedicated government staff, weak management and leadership with divided responsibilities within government, and strong management from the IDA review/supervision mission teams generated an environment in which staff suffered from lack of cohesive direction and accountability.

While government could have remedied individually some of these aspects, on the whole it presented a daunting task for subordinate staff. The coordinated management of the project during the period immediately before and after the MTR was simply beyond the capacity of the assigned staff. Appointment of a project management advisor was a solution but the appointment when it came was too late for SEP I.

7.2 Factors generally within the control of Government and the implementing agency

The Governments assumption of control at independence became more effective from September 2002 with the appointment of the present Project Director. Corrective measures in management have been introduced and while some of these are of little benefit to SEP I at least these actions will enhance the implementation of SEP II. Notable changes introduced in the second semester of 2002 are:

- re-establishment of the LPC with regular meetings designed to more closely manage NPL and effect recovery of overdue repayments;
- appointment of one national consultant staff as PIU supervisor; and
- a start in recruitment of government staff to PIU positions.

8.0 Project outcomes

The following have resulted from the project. Some of these outcomes will be further developed and instilled in government and the PS during SEP II. The skills and capacities developed can (and maybe already) applied on other credit initiatives –

(a) Loans & viability - procedures for review and approval of applications; disbursement monitoring and recovery have been established;

(b) Framework for legalization of small to medium loans for business and other developments – regulations and supporting laws are currently under consideration;

(c) Revolving fund to increase the grant from SEP II. Currently US$1.95 million of loan repayments are held by CGD for this purpose.

(d) Framework for cooperation between commercial banking sector and Government economic development agency.

(e) Injection of capital into rural urban centres - US$2.87 million has been injected directly into rural urban centres. In addition salaries of workers and owner income has added to the economy of these places.

(f) Development of business capacity – an expansion of business capacity amongst the population in rural urban centres and expansion of the private sector.

(g) BDC facilities for fostering of businesses in rural urban centres. Three BDC's have been established and will be staffed and operated under SEP II.

(h) Capacity building within the MDE - a framework has been laid down over the last 6 months (of the project) for development of a project management capacity in MDE.

9.0 Project Impacts

9.1 Establishment of viable economic activities:

341 loans made for establishment of businesses of which 294 (82.6%) still operating. Of these 90 (31%) have either repaid or are on schedule to repay the loans despite significant fluctuations in the economic climate over the transition period.

9.2 Creation of jobs and sustainable employment -

At least 1,200 (and may be as high as 1,320) jobs created with average monthly salary between US$100 and US$150. In addition there are probably another 800 direct beneficiaries who are supported from the proceeds of the lending.

9.3 Promotion of gender involvement –

About 75 businesses (22%) were owned by women and 341 women were directly employed (26% of jobs created). The opportunity for business training was of greater benefit to women than men and all women who attended training noted significant improvement in their business, which they attributed to the training received.

9.4 Revenue generation -

The initial grant on which loans were based injected US$4.0 million into the economy; of this US$2.87 million was distributed in 12 rural urban centres. There was therefore a widespread distribution of capital both directly and indirectly affecting the private sector.

9.5 Improvement in quality of life –

About 71% of borrowers perceived an improvement in quality of life that they attributed to the project. In particular women felt that the business experience gave then greater standing in the community.

9.6 Restoration of essential elements of a land and property administration system

The immediate impact was negligible. A temporary "use agreement" was already in place before the Project started. The studies funded did provide some material for a recent legislation on "immovable property".

9.7 Beneficiary participation and ownership

The principal beneficiaries were the borrowers and the Land and Property Unit. The bulk of the borrowers did not see the project as a government initiative. The borrowers felt that the funds were from a commercial bank and so there was little sense of ownership of the Project. Beneficiary involvement is rated **UNSATISFACTORY**.

9.8 Institutional aspects

Institutional development impact is rated **NEGLIGIBLE**. Initially the PMU was staffed and incorporated into the UNTAET structure. It never really had a home under ETTA and eventually was tacked on to MDE under ETPA and the government after independence. Staff was either seconded from UNTAET or consultants. Government staff assigned as Project Directors had other responsibilities and their project related responsibilities tasks were not assisted by a lack of leadership within the PIU.

9.9 Capacity building

No attempts were made to develop capacity amongst potential PSD staff within MDE. CGD staff benefited from the taster training course. The improvement in their capacity to manage small business loans is rated **SATISFACTORY**.

10.0 IDA Performance

10.1 Grant Management

The decision to use CGD as the conduit for loans was sound in view of the lack of capacity in the state sector. Similarly, close monitoring of implementation of components provided controls that were lacking in the then public sector.

10.2 Supervision

IDA supervised the project eight times between July 2000 and October 2002. This meant that there was a mission in country, for about two weeks, every 10 weeks. After each mission the PIU was left with a schedule of actions (Action Plan) to be completed, generally, by the time of the next mission. While Gantt charts were developed during some missions there was no overall implementation plan developed at the beginning of the project, in part due to the accelerated design schedule. This resulted in *ad hoc* management driven by the Action Plans. This approach was understandable given the lack of capacity and lack of direct government involvement in the PIU. This “micro-management” approach was vital to ensure the non-line of credit components did not disappear between the cracks; but also allowed staff to absolve themselves from decision-making and use of initiative. The IDA performance is rated as **SATISFACTORY**.

REPÚBLICA DEMOCRÁTICA DE TIMOR-LESTE
SECRETARIO DE ESTADO DO TURISMO, AMBIENTE E INVESTIMENTO
PROJECT IMPLEMENTATION UNIT-SMALL ENTERPRISES PROJECT

TRANSITION ARRANGEMENT PLAN

Starting on August 11, 2000 when the Small Enterprises Project-I became effective, up its official closing date on December 31, 2002, the project focused on restarting viable economic activities in the private sector through lending on commercial terms.

The project also concentrated on ensuring sustainable employment in urban areas, preparing complementary follow on programs, restoring essential elements of a land and property administration system, and the rehabilitation of Business Development Centers.

The project was mainly organized as an emergency operation, which was the need of that period in Timor-Leste. However, the project was also aware that it had to create a bridge towards a future government sector operation that is more oriented towards continuing and sustainable development of the private sector. To attain this goal, a Transition Arrangement Plan has, therefore, been formulated.

TRANSITION TO SEP-II (Short Term)	**TRANSITION TO MINISTRY OPERATIONS (Longer Term)**
Continuation of the Credit Line	
1) Continue providing loans to small and medium-sized businesses under SEP II. 2) Refocus on more economically viable businesses and agribusinesses. 3) Focus on smaller loan sizes.	1) Continue providing loans from revolving funds after the project.
Private Sector Development and Capacity Building in MDE	
1) Start operating the rehabilitated Business Development Centers in 4 Districts (Dili, Baucau, Oecussi, Bobonaro) under SEP II. The BDCs will provide business training for local entrepreneurs especially the potential credit line borrowers under SEP II. 2) Continue refresher training of master trainers including training of local trainers for the BDCs..	1) Ensure that Government civil servants are involved in all aspects of the BDC operations to ensure sustainability. 2) Utilize the Master Trainers in the BDCs as civil servants or facilitate their

3) Train civil servants in Private Sector Development (PSD) theory and practices under SEP II to support the development of PSD issues within the Ministry of Development and Environment (MDE). 4) Create a Business Regulatory Framework for the Ministry of Development and Environment; contract East Timorese lawyers to assist in this activity.	involvement in NGOs or private training institutions. 3) Assign and train MDE staff as counterparts of consultants and involve them fully in the implementation of SEP II. Consultants should transfer their skills and knowledge to their government counterparts. '4) MDE to use the legal framework to review and prepare new legislation pertaining to business development.
Project Implementation Unit Strengthening	
1. Continue training for national staff on management, especially monitoring and evaluation, and technical topics. 2. Contract a Project Management Advisor who will be tasked to establish project management systems in the PIU and train staff.	1. Hire permanent civil servants as counterparts to the international advisors and consultants and involving them fully in project implementation to transfer skills.

JOSE AUGUSTO TEIXEIRA
SEP-PIU Project Director

REPÚBLICA DEMOCRÁTICA DE TIMOR-LESTE

SECRETARIO DE ESTADO DO TURISMO, AMBIENTE E INVESTIMENTO

PROJECT IMPLEMENTATION UNIT-SMALL ENTERPRISES PROJECT

DATE: 9 JUNE 2003

TO DESIREE GREEN

CC: RON ISAACSON

FROM: JOSE AUGUSTO TEXEIRA

Dear Ms. Green,

RE: SMALL ENTERPRISES PROJECT
GOVERNMENT IMPLEMENTATION COMPLETION REPORT (ICR)

I refer to your letter dated 21 May 2003 regarding the Government's Implementation Completion Review Report draft and your suggested changes. I have reviewed these suggestions and have referred them to the Government's ICR Team. They have made the changes accordingly. We consider these changes as minor and do not change the overall result of the original draft ICR that we endorsed earlier. The Government's ICR Team have reviewed the attached final version which they have now endorsed for submission to IDA. Please find attached, the following documents:

- Final Government ICR
- ICR Summary

Unfortunately I have not received any response from the Caixa Geral de Depositos (CGD) regarding their evaluation of Component 1 (Line of Credit) that they implemented. I suggest that we do not wait for this document and go ahead to finalize the ICR as your see fit.

Please do not hesitate to contact me for any remaining issues regarding the ICR. We look forward to your coming visit to Timor-Leste.

Yours Sincerely,

Mr. Jose Augusto Texeira
Secretary of State for Tourism, Environment and Investment
and Project Director, Small Enterprises Project