ICR Review
Operations Evaluation Department

Report Number : ICRR11600

1. Project Data:		Date Posted :	09/16/2003	
PROJ ID :	P070283		Appraisal	Actual
Project Name :	Small Enterprises Project	Project Costs (US$M)	4.85	4.79
Country:	Timor-Leste	Loan/Credit (US$M)	Grant of 4.85	4.85
Sector(s):	Board: PSD - Micro- and SME finance (86%), Central government administration (11%), Law and justice (3%)	Cofinancing (US$M)	0	0
L/C Number:				
		Board Approval (FY)		00
Partners involved :		Closing Date	06/30/2002	12/31/2002

Prepared by :	Reviewed by :	Group Manager :	Group:	
Jeffrey Balkind	Soniya Carvalho	Kyle Peters	OEDCR	

2. Project Objectives and Components

a. Objectives

Project objectives were to: (i) help restart viable economic activities in the private sector through lending on commercial terms; (ii) promote sustainable employment in urban areas; (iii) prepare complementary follow-on programs; and (iv) restore essential elements of a land and property administration system.

b. Components

The three main components were: (1) 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, Caixa Geral do Depósitos (CGD); information dissemination by CGD staff and facilitators to potential borrowers, providing assistance to borrowers, screening and approving loan applications, monitoring the utilization of loans and repayments; and intermediation by CGD, and loan portfolio administration
(2) support to the United Nations Center for Human Settlements (UNCHS or Habitat) to provide and manage technical assistance to strengthen the service delivery of the United Nations' Transitional Administration in East Timor (UNTAET) 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 ($265,750).
(3) 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); preparation and implementation of business skills training programs (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).

The three main components of the project remained unchanged, except that an activity 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) for the rehabilitation of four buildings to serve as Business Development Centers (BDCs) in Dili, Baucau, Maliana, and Oecussi districts (US$200,000 for Civil Works and US$15,000 for Consultants' Services).

c. Comments on Project Cost, Financing and Dates

The project had no cancellations and the closing date was extended by six months to December 31, 2002. Although the project was financed by a grant from the Trust Fund for East Timor, the project concept was built around a credit line involving on-lending to small firms. According to the PAD, lending terms were expected to carry an interest rate of 10 percent, in line with commercial lending.

3. Achievement of Relevant Objectives:

The first objective (restart viable economic activities) was partially achieved. Approximately 12 percent of 2,947 applications were approved (the PAD indicated no more than 15 percent to instill quality). 341 small businesses were established in 13 districts (the PAD indicator was at least 300 businesses to be created). Of these, 82.6 percent were still operating at project closing. However, of these only "31 percent have either repaid or are on schedule to repay the loans..." (ICR page 46, section 9.1). "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....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" (ICR page 4, section 4.2). Component One (the credit line) which supported this objective had to overcome many operational difficulties in start-up. Loans to new or revived small businesses supported road transport, retailing and agricultural processing--lending also involved restaurants and personal services, which proved more vulnerable to the economic downturn after withdrawal of the UN in 2002. Clients faced competition from privately-financed businesses, and from enterprises funded with grant assistance from NGOs, and from the Community Empowerment and Local Governance Project (CEP).

The second objective (promote sustainable employment), was also partially achieved. The project financed 341 enterprises and created 1,200 jobs (average of 4 jobs per enterprise). Due to structural changes in the economy and business cycle fluctuations (boom construction period ended after the UN handed over authority to the new Government), the ICR rates half of the jobs created by the project to be sustainable (see Section 6).

The main beneficiary of the land and property studies was the Directorate of Land and Property (DLP) of the Ministry of Justice. There were weaknesses in design and implementation. According to the ICR, the reports on the land and property system added little value to policy makers within UNTAET, and in the Government, particularly the local leadership. There was insufficient political buy-in from the Transitional Administration, especially the Timor-Leste leadership, which was often influenced by political imperative and institutional constraints. The more technically focused reports, such as cadastre and mapping, were utilized to some extent. Donors found the reports of the UN Center for Human Settlements (UNCHS) to be useful. Thus, the fourth objective was partially achieved.

The third objective linked to Component Three (follow-on programs) -- the ability of the Project Management Unit (PMU) to provide technical assistance to GCD-- was not achieved. 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) delays 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.

The training program also did not achieve its objectives. The main target was the CGD borrowers, to help them manage their debt and businesses. However, training delivery was severely delayed. The 341 sub-borrowers received loans in 2000 and 2001 -- before the business skills training was started in January 2002. Only 7 percent of 94 respondents in the beneficiary survey said that they participated in business skills training. This delay in training and small coverage worsened the performance of individual businesses and the overall SEP I lending portfolio.

The objective of the (added-on) Fourth Component (construction and operation of the BDCs) was partially achieved. The BDCs were constructed and are expected to serve as a delivery vehicle for technical services to clients, but provision of such services has still to commence in full.

4. Significant Outcomes/Impacts:

The project helped to re-start economic activities immediately after the violence in 1999. 341 businesses were started in 13 districts of which 82.6 percent were still operating at project closing.

5. Significant Shortcomings (including non-compliance with safeguard policies):

The proportion of projects in default was high and repayment rates were rapidly deteriorating by the time of the ICR with the prospect of eventual write-off of 40 percent of initial capital. See section 3 above.

Most of the subloans have been for transportation, trucks, buses and taxis, shops, hotels, and restaurants, but little information is given on environmental safeguards. e.g. air and water/sewerage pollution. The financial audit report for FY 2002/03, which was submitted in March 2003, contained a qualified audit opinion on breaches in the Grant and Project Agreements; the inadequacy of the provision for doubtful debts; and inadequacies in internal controls. Problems were due to the lack of a suitable international Financial Management Advisor, and inability to effectively communicate and monitor CGD activities on credit line issues. A Financial Management Specialist has been contracted to work with the Financial Officer, to put in place the controls needed to remedy the internal control weaknesses, together with the CGD. This specialist needs to have line responsibilities, not just an advisory function.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Unsatisfactory	The project achieved its major relevant objectives with major shortcomings. See section 3 above.
Institutional Dev .:	Negligible	Negligible	
Sustainability :	Likely	Non-evaluable	The ICR rates more than half of the jobs created by the project to be sustainable. However two factors need to be considered: (i) sub-loan repayment performance has been lower than targeted, with progressive deterioration over the project. Three-quarters of sub-loans were in default (more than one month late in repayment) in February 28, 2003. Moreover, repayment rates were trending downwards by the time of the ICR, with the prospect of eventual write-off of 40 percent of initial capital" (ICR page 4, section 4.2); and (ii) economic activity (and business momentum)

			has declined after the UN Transitional Administration left in 2002. The likelihood of maintaining sustainability of these project benefits over the medium term will require a substantial reduction in repayment arrears and a pick-up in client business activity. The ICR has also commented on the difficulty of operating a line of credit when parallel grant-funded operations are underway. For these reasons, and in the absence of further information, the sustainability of the project is rated as non-evaluable.
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Unsatisfactory	Unsatisfactory	Performance of the UN Transitional Administration (UNTAET) was weak. The performance of the financial intermediary (CGD) was satisfactory.
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

1. The Bank needs to be clear in its mind whether projects are to be designed as a sustainable, cost recovery mechanism or as a community support instrument? The SEP I Project embodied the former approach. The ICR notes that the explicit objectives of SEP I could probably have been achieved at a lower social/ economic cost by issuing grants, approved on commercial principles, to entrepreneurs with viable business proposals, instead of through a credit program. The report concludes that "it is difficult to operate a line of credit in an environment where grant-giving to firms is occurring side-by side."
2. In a post-conflict environment, both borrowers and lenders face massive information deficiencies. The misreading of market conditions and opportunities could lead to unanticipated loan losses and unviable businesses being supported

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR is candid (it was written by a different team from the supervision team, which increased the objectivity). The quality of the report could have been much enhanced if the team had presented a clearer discussion of financial performance, provided more information on outcomes and results achieved by the project, and had calculated the net present value and economic rate of return (ERR). The aide-memoires of the Mid-Term Review Mission (December 2001) and ICR mission (March/April 2003) were both complete, though the Mid-Term Review mission could have gone into more detail on the technical assistance and training program problems that were being encountered at the time. The ICR mission aide-memoire contains useful information on sub-borrowers (profiles of seven cases are illustrated).

The ICR received funds from the Bank's Intensive Learning Budget. This enabled a detailed Stakeholder Workshop to be held on February 24, 2003 at the Dili BCD. The workshop analyzed the experience under the project and the main lessons learned, such as the need to strengthen financial appraisals, programs of implementation assistance, and assessment of market opportunities.