WORKPLAN
of
DEZENVOLVE SETOR PRIVADU

March 2006

INTRODUCTION

On 30 September 2005, DAI provided USAID an *initial* year one illustrative workplan. As noted in the forwarding letter it was expected that the plan would be revised as more information became available. Submission of the illustrative plan was followed by briefings for the project's current and future CTOs with verbal and written feedback being provided. Later a briefing of a modified plan, based on feedback from the CTOs, was provided the USAID Mission Director with a number of USAID staff in attendance. Additional feedback was provided at this briefing. The following document reflects the USAID feedback as well as additional information the project team has discovered about private sector needs and opportunities and market demand and supersedes the 30 September initial plan. Also, at USAID's suggestion, we are changing the name of the project from Bolstering Agriculture and Sustainable Agribusiness/Private Sector Reform (BASAR) to Dezenvolve Setor Privadu (Private Sector Development). The following sections of this revised plan provides a vision for the project, the context in which the project will be operating, the approach to conducting the project, a description of how the project intends to reach out geographically and to youth and women, the management and operational structure, and a first year program budget.

VISION

The project aims to increase employment and incomes through the private sector. Dezenvolve Setor Privadu (DSP) will position itself as a key focal point for private sector growth, working with enterprises, farmers, financial and commercial services providers, government and donors. The DSP team will, where appropriate, utilize value chain analysis as a tool for identifying interventions within sub-sectors that show potential. This process will also highlight key cross-cutting services and enabling environment reforms that need to be addressed for overall development and growth of the private sector.

The approach will remain flexible and responsive to the opportunities and needs of the private sector, responding to demand and potential for domestic and international markets as well as emerging constraints to enterprise and sectoral growth. Dezenvolve Setor Privadu has a limited programming budget, calling for an approach based on facilitation of commercial linkages and cooperation with other stake holders—including other donor projects.

CONTEXT

A number of constraints impact private sector development in the country and, particularly, the development or revival of a rural business infrastructure. Such

limitations are noted as external constraints, within the context of which Dezenvolve Setor Privadu must work – or try to change:

- At present, the economy in Timor-Leste is relatively flat[1], with limited activity or presence of traders, processors, distributors and producers. Poverty limits payment capacity for products and services, depresses demand and impedes the opportunities available for rural income generation.

- Market linkages are very limited. The small domestic market is dispersed across the country. The cost of reaching people by setting up enterprises within reasonable distance of people's residences or markets is higher than in neighboring countries due to the inflated cost of transport and communications, and the lack of access to finance. Limited infrastructure outside of the main city centers compounds – or is the cause for -- the problem, and security is still a concern in several areas.

- While unemployment is high and job creation therefore a key concern of government, the labor price levels are inflated and the level of training and skill of the available work force is extremely low. In addition, there are very few opportunities for high-quality training and other business support services in Timor-Leste.

- Adult literacy remains very low[2] and financial and other business management skills are in extremely short supply, constraining enterprise and sectoral investment, growth, and access to financial services.

- Pervasive subsidization of real costs of services during Indonesian occupation, inadvertently perpetuated with the influx of donor funds after independence, has led to inflated demands for and subsequent disenchantment with government support, unrealistic expectations of support 'due' by merit of past hardship and disengagement in self-reliant – and self-financed -- development.

- Land and property rights remain uncertain, discouraging both foreign and domestic investment.

- The "hassle" associated with getting various approvals for starting new ventures has a negative impact on investors.

- Weak enforcement of commercial contracts inhibits private sector growth.

- Corruption is a growing and pervasive threat to private sector growth. Corrupt tender and procurement in government administered projects has damaged competition and inhibited growth of enterprises.

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[1] According to the CIA Factbook, real GDP growth was 1 percent in 2004 with a population growth rate of 2 percent (estimate for 2005).

[2] Adult literacy is 50 percent according to the *Millennium Development Goals: Where Are We Now?(2005)*

APPROACH

In short, the project will be demand driven. Where the project finds a partner or partners willing to invest effort and resources and strong potential exists for financial or economic growth, the project will respond. If opportunity or demand doesn't exist in an area, the project will not expend resources – although if at some later date demand develops then the project can reconsider.

In the first two months of operation, DSP assessed the state of the private sector economy in general. As a part of this effort the following products and sub-sectors were examined.

- Dairy
- Cattle fattening
- Fisheries – tuna, snapper, shrimp, sea cucumbers and seaweed
- Coconut oil and other byproducts
- Avocado and its oil
- Candlenut oil
- Bamboo shoots
- Bamboo and rattan
- Cashew nuts
- Cocoa
- Vegetables -- green beans, french beans, baby corn, asparagus, sugar snaps, peas including snow peas, bell peppers, mushrooms (shitake) and sweet potatoes
- Sun dried tomatoes
- Cherry tomatoes
- Limes and lemons
- Mangos – fresh and dried
- Banana – red, fresh, chips
- Pumpkins
- Tapioca (cassava)
- Rice
- Wild black rice
- Palm oil
- Cloves
- Honey
- Olives
- Passion fruit and guava
- Pineapples
- Vanilla
- Mandarin oranges – fresh and juice
- Sugar cane
- Tamarind
- Forestry
- Tourism
- Construction
- Transport

Seven of these products and sub-sectors were selected for further analysis these were: fisheries, candlenuts, coconuts and associated products, vegetables, tourism, construction and transport[3]. Based on this analysis two – coconut products and construction – were selected for in depth value chain analyses[4].

The preliminary analyses highlighted several cross-cutting services that need strengthening. In terms of the economy in general, standing out is the need for additional and more widely geographically dispersed financial products and services[5]. Similar needs exist for commercial services and for greater access to information on private sector development and opportunities as well as coordination of government-private sector-donor efforts in this area.

In terms of the enabling environment constraints noted in an earlier section of this plan, there may be some that Dezenvolve Setor Privadu could make a contribution to alleviating. For example the project has been asked by USAID's Land Law II Program to assist it in representational efforts to move forward a drafted law that would ease the problem of ownership of land titles. After briefings from the Investment and Export Promotion Institute – concerned with foreign investment -- and the Entrepreneurship Support and Development Institute (IADE) – concerned with domestic investment – it appears the project may be able to assist in reducing the hassle associated with registering a company and becoming eligible for investment privileges. The project has discussed the need for anticorruption initiative with the World Bank. It is also possible that the project could contribute to establishment of a disputes arbitration mechanism to eliminate some of the problems associated with weak commercial contract enforcement.

Resulting from the currently identified demand – moving from the product specific to cross-cutting services and enabling environment reform -- the project components for year one follow.

COCONUT COMPONENT

Objective

To develop the coconut industry into an economically productive sub-sector by identifying market demand in the coconut sub-sector, and where appropriate facilitate information on market opportunities, linkages to buyers, and processing innovations and standards for traders, processors and producers.

Anticipated Outcomes

The anticipated outcomes from this component are:

- Increased value of domestic and international sales
- Increased employment

[3] See Table 1 of the Attachment.
[4] These value chain analyses are provided as Attachments 1 and 2.
[5] See Attachment 3.

- Income opportunities for producers, processors and traders of coconut products resulting from information on market demand, production, and processing.

Summary Strategy

The strategy is to expand markets for existing products and entrepreneurs, introduce new technologies to improve efficiency, and promote use of by-products to build overall financial sustainability of the coconut industry. This will be achieved by providing entrepreneurs with the tools to increase and improve production, including information on and linkages to markets/buyers, standards, and appropriate technologies.

DSP will work closely with MAFF Agribusiness to prioritize interventions, collect data on business sector activity, and identify policy constraints. MAFF Agribusiness has already asked that DSP take the lead on developing the coconut sector, and have allocated their commodities technician to work together with DSP on a weekly basis. Joint activities will include collection of commodities data, and the commodities technician will also participate in DSP field activities. Together with MAFF Agribusiness, DSP will coordinate with other key agencies involved in agribusiness, including FAO, CRS and GTZ. Furthermore, DSP will coordinate with private sector, government, and agencies to identify other opportunities, including the World Bank's energy mission investigating bio-fuel.

The strategy has been divided into three key tasks related to existing or new coconut product areas.

Tasks 1: Improve access to export market and processing technologies for virgin coconut oil. Timor Leste presently has one enterprise with linkages to a buyer in Australia. This enterprise is not operating at full capacity, and despite efforts to identify new buyers, this business is under threat, and is unable to make loan repayments. VCNO is a high value product that could provide opportunities for this and other entrepreneurs in Timor Leste.

This task will focus on increasing exports of virgin coconut oil. Initial priority is to facilitate an increase in demand for the existing business so it is financially stable and operating at full capacity. This will be done through market studies and networking. Following identification of opportunities, DSP will assist the local processor(s) to deliver samples with appropriate analysis, and meet specifications if for a new market.

Should higher demand be identified in excess of existing capacity, DSP will investigate models for expanding production either via the existing or new entrepreneurs. Next steps in terms of new technologies and support to entrepreneurs could be directed by focus group discussions involving potential investors, MAFF Agribusiness and donors. Depending on technology identified, the expansion could involve small-scale entrepreneurs or a larger operation. Identification of and training in new technologies will be as required. Attendance at trade fairs and study tours may be employed to assist identification of markets and appropriate technologies.

The expected result is improved market information and linkages, which in turn will lead to increased demand for and production of VCNO. This will contribute to an increase in private sector jobs, as well as value of international sales.

Task 2: Improve the domestic competitiveness and market share of coconut oil (CNO) as cooking oil. Cooking oil is an essential item for all households in Timor Leste, and is a contributor to meeting basic dietary requirements. Presently a large portion of cooking oil (palm oil) is imported from Indonesia. Recently many medical sources have claimed that coconut oil holds a higher nutritional value than competing oils such as palm oil. Local coconut oil is the only competitor to the imported oil, however there are issues with efficiency of processing techniques, quality control, packaging, and marketing.

This task will focus on assessing local demand for coconut oil, and ways to increase profitability and market share for coconut oil producers. Initial steps will include assessing the current market chain and technologies, and a basic assessment of consumer demand. Alternative technologies that offer higher efficiency and quality may be identified. These may also be trialed with key groups to assess operational cost and product quality. Tests may be required to assess nutritional benefits.

Should these presses prove viable, sources will be sought via local manufacture or import. Information on the equipment and operational cost, options for finance, as well as processing techniques and marketing strategies will be prepared as a package for promotion to producers/processors. Other marketing strategies, including health messages, may be employed to promote the product.

DSP will work closely with CRS who has supported coconut processors with equipment in the past.

The expected result is improved production and domestic marketing of cooking oil for participating entrepreneurs, which in turn will lead to increased demand for and production of cooking oil. This will contribute to an increase in value of domestic sales.

Task 3: Explore market opportunities and technologies for coconut products and by-products in domestic and international markets. Known as the 'tree of life', a multitude of products and by-products can be obtained from the coconut tree[6]. Many of these are high value products for export markets, but may also offer opportunities for domestic use and import substitution.

This task will focus on identifying market opportunities and technologies for coconut products and by-products. This will provide alternative uses for the resource to improve the overall financial stability of producer/processors through either offering alternative incomes or supplementary incomes to existing production.

The major products or by-products may include coconut oil for bio-fuel, coir, charcoal, copra, coconut milk, and desiccated coconut. Each product or by-product will be assessed on an individual basis for the domestic or export market, particularly those that offer immediate opportunities. This will include investigations into the potential expansion of copra exports as existing production and market channels are

[6] See Figure 1 in Attachment 1.

in place, as well as coconut oil for domestic bio-fuel which could offer rapid demand with limited quality and packaging requirements, and there is machinery in-country that can produce the oil.

Initial activities will include a market study of major products and by-products in the international market, a survey to assess current use of by-products in the domestic market, and an assessment of the existing market channel for copra through Atambua and Surabaya. For the bio-fuel, coordination with government, private sector, and the World Bank energy team will be necessary.

Based on market opportunities, activities to support industry will be developed. For copra, if processing techniques and quality specifications are an issue, information for producers/processors will be prepared and disseminated. DSP will also assist to address other constraints such as transportation and import regulations as required. For all export products, efforts will be made to facilitate linkages with buyers. If necessary, cost sharing of events to bring buyers and processors together (e.g. buyer visits, trade fairs, study tours), or buyer participation in terms of provision of technology, pilot models or training, may be necessary to promote new products[7].

For new technology introduction, DSP will collate and disseminate information on viable uses, including equipment and operational cost, options for finance, as well as processing techniques and marketing strategies. Should a technology/product prove viable, alternatives for local manufacture of the technology, or import via existing equipment suppliers will be investigated.

The expected result is the identification of business opportunities for coconut products, which in turn will lead to new business and income generation initiatives. This will contribute to an increase in value of domestic and international sales.

Resources

Task 1 will require initial STTA of ten days to conduct a market analysis of VCNO market/buyers. An additional six days STTA to investigate technologies may be required if expansion of production capacity is viable. Other resources may include cost-sharing for entrepreneurs to attend trade fairs or undertake study tours in order to find new markets and learn about new technologies. Cost-shared testing and preparation of samples will also be required.

Task 2 will require DSP staff inputs to conduct surveys. Up to six days STTA will be required to identify press/expeller technologies. Import of trial/demonstration units will be necessary. Tests of oil quality and composition will be required to determine nutritional content. An additional ten days STTA for training in oil production and quality control may be required.

Task 3 will require initial STTA of 15 days to conduct a market analysis of export opportunities. Funds will be required for cost-sharing of buyer visits, trade fairs, and

[7] DSP has had initial discussions with the USAID Small Grants Program about DSP steering entrepreneurs to the Small Grants Program for *matching* grants aimed at opening new markets or at opening higher levels of production or processing technology. (This would not include grants for the capital processing or production equipment itself.)

study tours. A three person market exploration trip to Atambua/Surabaya will be required. An additional five days STTA to investigate technologies may be required.

A total of 52 days of STTA may be required for this component.

CONSTRUCTION COMPONENT

Currently Timor-Leste's population is growing quickly and the government has recognized the need to create jobs. Timor is not only the newest nation in the world, but is also one of the youngest with over 50 percent of the population under the age of 18 and has the world's highest birth rate. These factors alone challenge the new nation to create jobs for 15,000 potential new entrants to the labor market every year. This challenge is not being met and is leading to higher unemployment and growing social pressures. As part of Timor-Leste's National Development Plan for 2005, the government estimates that it will carry out $200 million in reconstruction, construction and building maintenance projects – with similar annual funding commitments for the next five years. In addition, with the pace of labor market growth and the need for skill development within Timorese businesses, the government pledged to increase the number of government contracts awarded to Timorese firms.

DSP values the potential for private sector approaches within the construction market to increase jobs and household incomes in Timor-Leste. As previously mentioned, DSP carried out a value-chain analysis of the sector to identify the major constraints within construction to create new jobs and increase revenues. The Construction Sub-Sector Study presented to USAID found that there are three constraints hindering development of this market:

Government procurement processes and a lack of regulatory policies. There are several regulatory constraints to the development of a robust construction industry in Timor – these include problems related to land ownership and property rights, the procedures governing the procurement process for government-funded construction projects, and the lack of building or safety codes for construction. Addressing these issues would have a significantly positive ripple effect throughout construction – resulting in increased demand for quality construction materials, for higher skilled labor in selected trades, and an overall increase in foreign and domestic investment into land and property in Timor. Given the project's budget , none of these issues could be addressed solely by DSP. Fortunately, in most cases, another donor or project is engaged on some level at addressing these issues. DSP's role, then, will be to provide input and feedback on property rights and government procurement with regard to impact on construction and property development.

Lack of Timorese skilled/trade workers. Compounded by lax government procurement standards, but also caused by sub-par training available in Timor; construction firms search for skilled tradesmen in a market with a limited supply. This led to an influx of foreign skilled workers when the construction industry took off with the commencement of the rebuilding of Timor-Leste in 2000. A majority of those foreign workers are still in Timor, and many occupy full-time positions within local and joint venture construction firms.

Heavy reliance on imports for supplies and limited local value-added services to imported raw material. Timor has limited natural resources that can be used for construction inputs, subsequently most all supplies for construction are imported. There are two inputs where value-added processing in Timor can create jobs -- concrete blocks and lumber. For the former, there are already two factories producing cement blocks. At the moment they are meeting the demands of the market. For the lumber industry, the local suppliers are currently not meeting the demand for medium and high-grade lumber by the contractors. Most construction firms are importing their lumber directly from suppliers in Ambon and Surabaya or through the loose collection of wood "import facilitators" that serve as middlemen to the Wetar export wood market.

The Objectives of DSP in the Construction Sector

Create favorable market conditions to encourage true competition through reforms in government contracting and building standards, and provide an improved supply of inputs and services, thereby creating new jobs and increasing incomes and revenue for firms in the sector.

Anticipated Outcomes

- Industry adoption of building and hiring standards leading to increased jobs for Timorese skilled workers.
- With support to the World Bank, increased transparency in government procurement thereby reducing the barriers to entry to the construction market.
- Expanded markets for local lumber companies, leading to increased jobs and revenues.

USAID indicators: private sector jobs and increased revenues

Summary Strategy

DSP's overall strategy in construction is to improve the conditions in which businesses are currently operating, and improving upon the supply chains within the sector. As will be highlighted in the activities listed in the next section, DSP seeks to achieve this by working with:

- The World Bank/government to reform procurement practices and enforce contractors responding to and building to government design and materials specifications
- Medium to large construction firms to adopt an industry-wide classification of hiring qualifications for skilled workers (to be linked with the Ministry of Labor/ILO's initiative to create a Job Certification Board)
- Micro to small firms (skilled tradesmen and lumber shops) linking them to markets, training and credit

Working as a partner, and always mindful of creating linkages not only within markets, but to donor programs, DSP will seek to create the conditions for these strides to be taken within the construction sector.

Primary Tasks: Construction

Task 1: Facilitate the adoption and enforcement of building and safety codes that meet international standards. The adoption and enforcement of building codes would have a ripple effect throughout construction, requiring a minimum standard of quality inputs and an increase in demand for skilled tradesmen who can work with improved materials and adhere to international building techniques.

The key to the success of this task is obtaining both private sector and government support. In order to obtain this, past best practices must be shared. DSP will prepare a review of other relevant countries' building codes for applicability/appropriateness. With this as a guide, the project will lobby for government support to either (1) adhere to the building material standards as specified in the tender documents they put out to bid or through (2) drafting and enforcing building codes and standards. Activities to include:

- Identify and build relationship with counterpart ministry(ies) that will participate in developing the building codes, or enforcement of procurement specifications

- As needed, identify appropriate international consultant(s) to assist in drafting new codes

- Create working group of stakeholders (government, private sector, donors) to review and comment on draft codes

- Work with appropriate ministries to identify enforcement mechanisms (for example, inspectors), and the type/extent of training required to enable those individuals to enforce new building codes; work with appropriate ministries to identify donor support (most likely WB) for establishing and training new government functions

Key Indicators and Targets:

Adherence to design and material standards specification in government procured construction work, or development and adoption of building standards.

Resources:

This task will require an initial STTA of five days to complete a review of other relevant countries' building codes for applicability/appropriateness. If the adopted approach by the government and other donors is to pursue the drafting of building and safety codes for Timor, then an additional STTA allotment of 45 days will be required.

Counterparts:

World Bank**:** DSP has discussed potential collaboration with the World Bank to support their on-going work on procurement reform. The Bank is leading efforts to revise the legal framework, and may select three to four line ministries to pilot test a new procurement process. The Bank has invited DSP to participate with them in the

procurement efforts, and to help identify weaknesses in the area of construction procurement. The Bank is in the process of finalizing the scope for its new project, and DSP will continue discussions with them about a potential supporting role.

Task 2: Facilitate and develop higher level skills training to skilled workers and link training to commercial construction hiring standards and demand

The critical link between the training available and the skills demand of the 'purchasers' of skilled workers is missing. This is resulting in a gap between the skills that are being taught at various training facilities in Timor and the skill set that employers/contractors find desirable. Therefore DSP seeks to create a market link between the two to raise the quality of technical training being taught in Timor. However, the first critical step is assessing the market-wide demand for skilled tradesmen, therefore the first activities of this task will be:

- Survey of the market demand by firms employing skilled workers.
- A survey of independent Timorese skilled workers.
- Assessment of the courses/skills being currently offered at training facilities.

Using these baselines DSP will be able to quantify both the supply and demand side of the market. If the results are promising, then the project will pursue a multifaceted approach that could look as follows:

- Working with ILO, assist in the creation of hiring standards. DSP will work with the private sector and creating standards associated with skill levels for hiring. For example an apprentice plumber has X years of work experience and can complete job Y unsupervised.
- Working with independent skilled Timorese workers to support the development of their business, finance and technical skills.
- Link skilled tradesmen to microfinance to assist them in the growing of their businesses.
- Work with the private sector/labor union to create a training certification program
- Using industry adopted standards, and having a certificate that the industry believes in to verify that a plumber/electrician is a (apprentice, journeyman or master) should lead to firms replacing their expensive foreign workers with Timorese.
- Provide a linkage between the private sector demand and the technical schools to solve the lack of higher-level skilled training – including a possible adopt a school program by foreign electrical/plumbing companies, separate higher skill level training through KSTL or linkages through Adelphi for master-level training in Australia.

<u>Key Indicators and Targets</u>:

- Adoption of industry hiring standards.
- Development of a number of independent trades persons into small businesses
- Increase of skilled TL employees by construction firms by 10 percent over next year
- Access to business training and finance of z number of independent trades persons

Resources:

DSP does not anticipate any STTA needs for this task at this time.

Counterparts:

ILO/Ministry of Labor
KSTL and/or Adelphi
Microfinance Institutions

Task 3: Increase access to higher quality lumber for retail supply

The initial sub-sector study of construction conducted by the project found a lack in the availability of medium to high grade lumber available in the local market. Since that report, DSP has discovered that there are three firms in Timor (2 Timorese and 1 Indonesian owned) providing such. Currently DSP is seeking linkages of these firms to the local construction companies to increase their sales as well as for the construction firms provide for the timely delivery of lumber supply.

Activities to include:

- A study of the supply and demand of medium to high grade lumber in Timor.
- Conduct a linkage meeting between construction companies and local lumber suppliers to discuss issues and identify gaps in market, knowledge, quality, etc.
- Select lumber firms for, and conduct a needs assessment of their current technical and business skills to develop them further.
- Link firms to appropriate lines of credit

Key Indicators and Targets:

Increased sales by local lumber companies, and related new jobs.

Resources

18 Days STTA to conduct a wood processing technical needs assessment. 18 days of STTA to conduct an overall training needs assessment.

Counterparts

Private sector
Business Development Centers

FINANCIAL SERVICES

The financial services activities presented in the 30 September Workplan reflect demand primarily, but not exclusively, identified in the construction and coconut sub-sectors. Preliminary analyses of other sub-sectors and completion of a rapid assessment of demand and supply of financial services led to a more broadly based strategy, linked to but not limited by findings in DSP's sub-sector development activities. The financial services component will respond to identified enterprise demand while anticipating future demands and financial constraints to growth throughout Timor-Leste's private sector.

Significant constraints faced by financial services providers were also identified and while solutions to overcome these constraints are of course not specific to selected productive sub-sectors, they will improve the business infrastructure by lowering systemic risk and improving future access to finance for micro, small and medium enterprises (MSMEs).

The Objectives of Financial Services Component

The overall objective of DSP's financial services strategy is to address financial constraints to the growth of income and employment through private sector development in Timor-Leste. The project will facilitate improved MSME access to credit, savings and other financial services, strengthen the enterprise level financial management capacity and improve the bankability of loan proposals. At the same time, it will improve financial service provider capacity to meet enterprise demand. The result will be that MSMEs generate income and employment through more convenient access to appropriate financial services.

Anticipated Outcomes

There are three main outcomes anticipated.

Outcome 1: By the end of June 2008, a target percentage of MSMEs in the targeted districts (base-line figures by end 2005) have access to diversified financial services provided by sustainable financial institutions.

Verifiable indicator: Number of MSMEs accessing services from sustainable financial institutions is increased by 25 percent pa.

Outcome 2: By the end of June 2008, a good practice-based finance industry (including banks, MFIs, and cooperatives) collaborates based on reliable performance data to provide safe, convenient and appropriate financial services to an increasing no. of profitable MSMEs.

Verifiable indicators: MFI borrower data included in BPA's Credit Registry; Bank law passed includes category for non-bank financial institutions (NBFI); Banking system loans and advances to private sector increase by 25 percent; MFI loans to MSMEs increase by 25 percent pa; Min. 10 financial providers and five donor agencies have adopted and use a standardized performance reporting format by end of project; Associations of Financial Service Providers have developed and introduced three new/adapted financial products and have established linkages to effective serve MSMEs in all 13 districts; MSME access to credit increased.

Outcome 3: By the end of June 2008, a target percentage of MSMEs in the targeted districts and Dili (base-line figures by end 2005) have access to demand-driven training and TA provided by public and private suppliers to facilitate bank readiness.

Verifiable indicator: Number of MSMEs accessing training and BDS services is increased by 30% per annum (p.a.)

Summary Strategy

DSP will facilitate the improvement of enterprise level financial management, auditing and bank-readiness skills while improving the capacity of banks, non-bank financial institutions and micro finance institutions (MFIs) to offer sustainable services. This will be accomplished by integrating with DSPs sub-sector interventions to target market-led demand for credit, savings, leasing and financial management services; Strengthening the Banking Association of Timor-Leste (BATL) and the Association of Microfinance Institutions in Timor-Leste (AMFITIL), Forging cooperation and links between lenders, improving information to reducing risk, setting sustainability benchmarks and incentives (AMFITIL) and developing consensus on prudential standards (Banks); Improving enterprise capacity to approach banks.

DSP will take the lead on financial sector donor coordination to maximize investments and support the development of appropriate policy and regulatory frameworks. Donor coordination for AMFITIL members will consolidate targets and improve MFI report quality while decreasing reporting time requirements.

Primary Tasks: Financial Services

Below is a listing of activities planned for Year One. Links to existing and future sub-sector activities are explained to highlight the project's integrated approach. Some activities depend upon results of sub-sector activities, for example, leasing product development will await the results of DSP's assessment of coconut product market viability.

Tasks for Outcome 1 -- Access to diversified financial services provided by sustainable financial institutions.

Task 1: Strengthen the Banker's Association of Timor-Leste (BATL). Four formal financial service providers currently meet at the BPA to discuss issues but do

not yet operate as a coordinated group. DSP will strengthen the BATL to create a platform on which a set of minimum requirements for SME lending can be discussed and as the lenders are familiarized with the market niches, specific issues and solutions sought. DSP will seek to for example to advocate for adoption of International Accounting Standards and to address the lack of conventional collateral among many MSMEs and the possibilities for alternatives.

Task 2: Develop the current performance monitoring system of AMFITIL into effective self-regulating tool to provide incentives for improvements. Most AMFITIL members have received software and been trained in a donor approved Performance Monitoring Tool (PMT) for own use (management and donors), and can be used as an industry-wide performance monitoring system. The number of MFIs that use the software is unclear, as donors require other formats. A performance base-line (benchmark) for MFIs in TL was established as at March 2004, and all AMFITIL member MFIs report performance to the Secretariat quarterly, but data is neither always accurate nor complete. The Secretariat does not have the resources to track progress and provide feedback to members.

DSP will facilitate refresher training for all MFIs in the PMT software and an update of the benchmarking system used for performance monitoring[8]. AMFITIL's secretariat will be strengthened to analyze the quarterly data received and provide feedback to each member MFI on progress against peer-group averages. Summarized data also forms an important part of AMFITIL's advocacy and public information tasks.

In addition, members will be encouraged to consider reporting to (or at least comparing performance to) one of the international databases such as the MIX (www.themix.org) to link to good practice in the region.

Task 3: Establish effective coordination among all MFI-funders (resident/non-resident) to consolidate targets (such as FSS, financial self-sufficiency, at end year three[9]), reporting requirements, and funding inputs to identify gaps. MFIs in TL spend excessive time and efforts on applying for funds, managing donor relations and reporting in disparate formats. There is no overview of which donor provides what amounts to which MFI for which activities. DSP will offer itself as Secretariat for a practical Funders' Forum for resident and non-resident (though e-mail) donors. The tasks of the group/secretariat will include:

- Compile a complete matrix of all funds (amount, content, start/expiry date) currently availed and under appraisal, and disseminate quarterly for review

[8] See Hansen L. and Agus N.: "Developing a Code of Conduct and a Performance Monitoring Tool for the Microfinance Working Group of Timor-Leste", 30 April, 2004.

[9] FSS measures how well an MFI can cover its costs taking into account a number of adjustments to operating revenues and expenses. The purpose of most of these adjustments is to model how well the MFI could cover its costs if its operations were unsubsidized and it were funding its expansion with commercial-cost liabilities

- Establish consensus on a set of objectives (e.g. FSS by end year three) and good practices for donor support to MFIs in TL

- Coordinate appraisals, reviews, and field visits to minimize MFIs' "servicing time"

- Establish consensus on and formally adopt *one* common reporting format for all MFIs. The PMT is user-friendly, has already been formally adopted for Uganda by most resident donors, and is well-known to the MFIs, and is thus recommended as the common reporting format. Once adopted, using the PMT will be an eligibility criteria for further funding, and all MFIs willbe required to report in the PMT (but only in the PMT).

Task 4: Consolidate Training/TA needs, performance targets, available funding (by donor) and funding gaps; Ensure funding for remaining gap into Partnership Agreements for at least IMfTL, Moris Rasik, OTL and Tuba Rei Metin, detailing content, timing and source of funds for input required to reach FSS by end Year 3. The Funders' Forum will review the Training/TA/Capacity building Needs profile compiled by AMFITIL against the current and planned funding to identify gaps. DSP will facilitate access to timely funding for any gaps in the capacity building plan for the strongest MFIs.

DSP has consulted closely with UNDP/UNCDF on their Microfinance Mission (scheduled for December 2006) to ensure their upcoming investment of $600,000 and future investments are well-coordinated with DSP activities. DSP will facilitate access to funds through USAID/DAI Small Grants Program and other USAID sources, as needed.

DSP will facilitate an MFI Funders' Forum to monitor performance against targets set, and facilitate access to input required (TA, training, templates, software, manuals, contact to GoTL, identification of and coordination with new funders etc.). DSP will act as Secretariat to the Forum.

Task 5: Process catalogue of products/services into a map of current and potential linkages between financial service providers in TL to explore opportunities for expanding access where there is demand but no branch network. This activity will await the strengthening of AMFITIL and the Banker's Association to enable the two Associations to meet and discuss closer cooperation, as well as the establishment of the Funders' Forum so that the current and planned funding available for potential linkage banking opportunities is known. There are many possible options for linkage banking, but many will depend on bank interest and the planned expansion of CGD and IMfTL's networks. STTA will be called in to conduct feasibility studies of any promising options, for example through the following activities:

- *Quantify and specific demand for lease-purchases for trucks and improved processing equipment for the CCN and other productive sub-sectors.* This rapid demand assessment will inform/confirm DSP's reporting baseline. It will take place in January 2006.

- *Compile list of manufacturers, cost and expected lifetime of equipment/ machinery selected for a potential leasing product.* This activity will await the results of activities under coconut and construction sub-sectors (studies of market for coconut products and feasibility of improved wood processing) which will inform the selection of appropriate new technologies for processing.

- *Design of a lease-financing product.* The design of an actual lease-financing product requires specialized TA to ensure demand-responsiveness and sustainability. The activity will await the formalization of AMFITIL and a Banker's Association and the dialogue among suppliers of financial services, and the TOR for the TA will be presented for discussion at a meeting of the two associations as one of the opportunities for new product development, i.e. in conjunction with activities in sub-sectors.

- *Feasibility study of Cash in Transit Service (CIT).* This activity will await the planned expansion of the branch networks of CGD and IMfTL, and thus could be conducted in the last quarter of 2006 or in 2007.

Tasks for Outcome 2 -- Good practice-based finance collaborates based on reliable performance data to provide safe, convenient and appropriate financial services to an increasing number of profitable MSMEs.

Task 1: Facilitate the inclusion of MFI data in Credit Registry to be housed at BPA. DSP will coordinate with the BPA and Banks while improving the reporting capacity and of AMFITIL to facilitate the inclusion of MFI loan information in the credit registry and their access to the "bad loans list" from commercial lenders.

Task 2: Compile a detailed and updated catalogue of products/services available from each of the existing financial service providers, specifying location, market segment and terms and conditions, as well as scale, performance, and risk assessment of product/market segments. While collecting the product data from each financial service provider (building on Annex 5 to Financial Services Sector Assessment of December 2004), the project established contact points and has begun to explore ideas for new products. The product data will include data on products for both rural and urban, ME- and SME market segments, enabling subsequent in-house compilation, development and dissemination to relevant MSMEs of:

- Loan application check-list for urban MSEs

- Loan application check-list for urban SMEs

- Any licenses for/interest in leasing finance (especially from CGD)

- Long-list of standards and requirements for lending to SMEs

Task 3: Compile standards and requirements for credit-worthy SMEs. This will require gaining trust and better communication with Banks via the Banking Association and individual meetings. Data needed from financial service providers will be compiled in conjunction with activities to strengthen the Association. Business

registration requirements and standards will be obtained from the Land and Property registry, the business licensing office and other agencies of the GoTL.

Task 4: Facilitate the exposure of especially CGD and IMfTL to MSEs. Once MSEs are better informed about requirements, standards and training opportunities, and the bankers have developed a consensus on what a credit-worthy SME is, this process can be extended to MSEs, initially with IMfTL.

Tasks for Outcome 3 -- Access to demand-driven training and TA provided by public and private suppliers to facilitate bank readiness.

Task 1: Review management systems of SMEs; their training needs and budgets; facilitate access to commercial financial management services. DSP will conduct at least two trainings with a small number of firms (3-5) participating each time. DSP as a project will identify SMEs for review and trainings which will be conducted in a combination of Tetun, Bahasa and English by two Chartered Accountants currently operating commercially in Dili. Given the small number of firms in any given sub-sector, these firms will be chosen for their potential to create jobs and income.

DSP found that SME need for training is urgent while willingness to pay for the urgent need will take some time to develop. For example, every SME identified in the coconut sub-sector was found to have current or imminent problems with loan arrears. One major firm is defunct. One firm identified for its potential in candlenut export is currently unable to access finance due to lack of financial management skills.

The first training is planned for January 2006, preparation of training materials is underway. Potential participants in the training include Colega PTA, CV Acelda, Naroman Kristal, Setia Kawan, Jomi Sadar, an Information Technology start-up firm, Freelance Plumber, Construction Supply Firms, and maybe CCT.

Task 2: Link MSEs to existing training/TA providers. For smaller businesses with more limited credit demands, DSP (via coordination of financial and commercial services components) will provide the link to available ILO training and other TA providers to facilitate 'bank-readiness'. A survey of providers is underway.

Task 3: Strengthen AMFITIL to conduct a Training and TA needs assessment among member MFIs and identify relevant providers of training/TA. MFIs are essentially SMEs with money as their commodity. Not unlike other SMEs in TL, capacity is the top-most constraint of the MFIs, and capacity building (training, TA, operational policies, systems, governance, market research, and asset quality management) is required and to a certain extent provided through multiple and currently un-coordinated channels of funding. A detailed, consolidated development (business) plan for each MFI will be produced to pinpoint needs for capacity-building. Once needs are known, providers of TA and training will be contacted, and an Inventory of available resources compiled and disseminated to the MFIs. The secretariat of AMFITIL will be supported and facilitated to conduct this demand survey and compile a list of currently used or recommended providers.

Task 4: Compile Provider's Inventory for Customers. Market linkages for support services like training and TA are all but non-existent in TL. Compiling the information received from providers into a Providers' Inventory and disseminating this information widely to SMEs could in itself begin to create market linkages, and more affluent SMEs may well seek providers' services in an attempt to meet the requirements in the SME Code.

During the life of DSP, information on increasingly available services will be expanded into a "Training and BDS Service Provider Directory" for each region, adding information on other BDS services. The Directory could be updated annually, and disseminated to all stakeholders. This will likely occur Year Three.

To promote better market linkages, DSP will facilitate opportunities for demand (MSMEs) and supply (service providers) to meet and align expectations. This will be arranged through informal visits, Round Tables, workshops and, branch openings, and Association meetings.

Task 5: Incentives for Performance (SME Award). DSP will institute a "Blue Chip SME Award" for a market led, financially sound SME. The prize will be publicized in DSP's Newsletter and winner's success detailed. DSP will seek to link the award to a 'fast-track appraisal' by a lender.

Resources

The strategy above relies heavily on DSP long-term staff time and expertise. An estimate of the amount of short-term technical assistance, training and other support resources is described in the attached budget.

A total of 91 STTA days are scheduled, with $30,400 in the program budget. In order to accomplish some of the tasks described above, DSP financial service component will rely upon a larger "off-line" budget. These activities are listed with indicative budgets.

Activity	Funds	Possible Source
International study tour and training for linkage banking	10,000	SGP
MFI Partnerships (USAID portion)	150,000	USAID
AMFITIL member training	175,000	UNDP/UNCDF, USAID, various bi-lateral donors, IFC

All of the above activities depend upon positive results from other activities. For example, there will be no need for study tours for linkage banking if banks and MFIs link through planned expansions from CGD and IMfTL.

COMMERCIAL SERVICES COMPONENT

The value chain analyses undertaken in coconut and construction sub-sectors as well as the other more preliminary assessments of sub-sectors highlighted the need for enterprise level access to commercial services including financial and business management training, accounting and transportation. With the abundance of donor work since Timor's independence, and the entrance in the business training market of the government's Business Development Centers, there are significant subsidies within this area. However, there is also an absence of linkages between those that need the training and those offering it.

In addition, to support the government's economic development strategy to:

- Create an open economy based on competitiveness
- Develop a market economy led by private sector
- Create a business friendly economic environment
- Strengthen the domestic private sector
- Create attractive investment opportunities,

there are numerous areas where DSP can add value though the support of commercial services.

Objectives of DSP in Commercial Services

DSP's objective will be to provide small and medium businesses access to the services they need to strengthen their business, thereby increasing revenues and strengthening Timor's economy.

Anticipated Outcomes

- Directory of business training available in the market place
- Directory of business associations and services available
- Linking with microfinance institutions (through DSP Financial Services Team) to link clients to the appropriate skills training
- Development of commercially available business services in the areas of auditing and accounting.

USAID Indicators: access to credit, new jobs, increased income/revenue

Summary Strategy

DSP's overall program approach is to be flexible and responsive to the opportunities and needs of the private sector, responding to demand and potential to domestic and international markets as well as emerging constraints to enterprise and sectoral growth. As DSP has a limited programming budget, this calls for an approach based on facilitation of commercial linkages and cooperation with other stake holders—including other donor projects. This approach is the way by which DSP will encourage linkages to, and in time provide growth in business services.

Task 1: Identifying and documenting current business services being offered in Timor commercially and by government and donors. To properly link clients to the services that are available to them a catalogue of services will be created. DSP will utilize previous donor reports, such as those by GTZ under SEP II and the ILO, as well as conduct additional research of current services offered by the government's Business Development Centers (BDCs), business registration centers/requirements, financial service products available, and so forth.

DSP has an opportunity to assist the BDCs in expanding their market. As a part of the larger institute under the Ministry of Development to encourage and support domestic private sector investment, DSP through its outreach can link potential clients to the BDCs. The clients benefit from training and improving their ability to conduct their businesses, the BDCs expand their outreach and in time, tailor their products to meet the demands of the market. In addition, through the BDCs DSP can register these new, or yet to be registered, businesses.

Key Indicators and Targets:
Defining and linking DSP clients in all sectors to appropriate skills training, new business registered.

Task 2: Cataloging business associations in Timor -- their members and the services offered. Potential key resources for enterprises are their industry specific associations and/or chambers of commerce. DSP will conduct a survey of what associations there are currently in Timor, their membership base, fees, and the resources they provide their members. As with cataloging business training, in time DSP can link new enterprises into these associations. Additionally, DSP will conduct an overview of the viability of the associations, and where linked with DSP sector investment will develop programs to strengthen said associations.

Linked with DSP's "Information Hub," the project will seek to strengthen interested associations by linking them to business training and other business services. DSP will also mentor associations in their lobbying efforts by assisting them in identifying key industry-related or other enabling environment issues to be presented to the government.

Task 3: Identifying opportunities to grow and support commercial business services. It is DSP's belief that as more sectors are explored, more cross-cutting business services will be identified as needed. With this initial foundation of knowledge of the training available and services offered through associations, DSP will be able to link businesses to existing providers of service, and/or develop services that are needed to strengthen business.

In addition, DSP will be able to identify where commercially viable services are required and will explore those opportunities and identify businesses that can expand into such markets.

INFORMATION AND COORDINATION SERVICES

For the project to reach its objective, it is going to need information on the economy, markets, technologies, policies and undoubtedly in other areas. To have a nationwide impact, it will be necessary for DSP to provide packaged and targeted information to its stakeholders, thus a mechanism to accomplish this is needed. For stakeholders to act on information in a coherent manner, dialogue will be required among the private sector, government and donors.

Objectives for Information and Coordination Services

The objectives of this component are to:

- Provide a mechanism for storing and retrieving information needed by the project and eventually for broader private sector development

- To provide information via a newsletter to various stakeholders concerned with private sector development, which will enhance their abilities to carryout their functions in areas of production, marketing, commercial services, development and policy

- Develop a public-private sector dialogue -- linked to the donor community -- aimed at spurring the growth of the private sector

Anticipated Outcomes

The outcomes anticipated for the three bulleted objectives above follow:

- The project will have stored and retrieved information -- related to agricultural and industrial production, services and policy -- as was needed by the project to spur private sector growth. If the hub proves as useful as we believe it will, we will determine whether we can separate and protect privileged information and whether it would be desirable to progressively open the unprivileged portion of the hub to other organizations for on-line access – perhaps starting with USAID. By the end of the first year, we target having the information hub used by USAID. If year one targets are met, by the end of the project, we target having a number of private and public sector organizations using the hub. We may also target, or least be able to identify, other project outcomes, in latter years, that are relevant to USAID's indicators of "accelerated economic growth".

- A project newsletter will have stimulated private sector growth by providing information on production and service technologies and techniques that will have been incorporated into Timor Leste production and services resulting in additional income and employment within the private sector; new markets will have been accessed as a result of information found it the newsletter and the newsletter will have educated policy makers and other stakeholders regarding pro-growth policies such that an improved environment exists for encouraging private sector growth. Targets for the newsletter by the end of year one are (1) that it exists, (2) that it is distributed to private sector businesses in 80 percent of the country's districts (3) that it goes to all ministries associated with private sector development including at least, the Council of Ministers, the Ministry of Planning and Finance, the Ministry of Transports and Communications, the Ministry of

Development, the Ministry of Agriculture, Forestry and Fisheries, and the Ministry of Justice and (4) that all donor agencies that support the private sector receive copies. In years two and three, the project will attempt to measure impact the newsletter has had on the USAID indicators of accelerated economic growth.

- A platform will have been created where a public-private sector dialogue – linked to the donor community -- is occurring that is leading to an improved environment for private sector growth.

Summary Strategy

Information storage and retrieval mechanism. This mechanism, called the information hub, will be built into the project's electronic management system. We will create a hub, which all the DSP staff can input, store and retrieve meeting notes, relevant reports and publications, data tables and figures and other such useful information. This will be stored by sub-sector, cross-cutting area or both. In years two and three, of the project, the hub may be opened to other private sector stakeholders.

Project newsletter. A staff person must be hired to design, create, edit and publish the newsletter. The *Agribusiness Bulletin* of the Bangladesh Agrobased Industries and Technology Development Project and the *Rural Business News* of the Gobi Initiative of Mongolia will serve as models for development of the newsletter. The strategy will be to provide articles that educate private sector business men and women about new markets, technologies and techniques that may improve their businesses including farms (which should begin being viewed as businesses); articles that inform policy makers and others concerned with private sector growth about the effect of present laws, policies and business regulations and the potential for improvement. The newsletter will start off small, with as few as four pages, and grow to as much as ten pages of text per month. A small number of issues will be prepared in English for the donor community and international businesses and a larger number in Tetun for local businesses and government officials.

Public-private sector dialogue. At present the "dialogue" between government and the private sector consists of government calling a meeting of private sector representatives and informing them or instructing them with little actual dialogue taking place; or of a well connected private sector business person approaching a high-level government official seeking special privilege. The project wishes to attempt to facilitate a broader more positive dialogue between the private sector and the government. The initial strategy will be to assess whether a cross section of leading business persons, perhaps heads of the major business chambers and associations, would be interested in coming together to discuss crosscutting issues that are effecting them all adversely and see if they can reach a common private sector position, with which they can go to government and attempt to correct the identified issue or issues. If such initial initiatives go well, perhaps regular meetings may be organized with the government. Simultaneously, the forum would be encouraged to initiate a dialogue with the donor community where it is likely they will find a kindred ally in their discussions with government. The ultimate aim would be to establish a mechanism or platform for continued dialogue on the requirements for private sector growth, the joint design of needed policies, procedures and initiatives

involving a broad cross section of the private sector and government at the highest level. A possible model for this would be the process in Zambia which lead from a business forum (a body composed of the heads of the county's leading business chambers and associations) to the establishment of a domestic business council (composed of the country's leading business people and the key economic ministers and advisors and chaired by the head of state).

Primary Tasks

Tasks aimed at accomplishing the previously discussed objectives will include:

Task 1 to create an information hub:

- The DAI electronic management system, TAMIS, will be used to create an information hub for DSP. The hub will store the information by sector and crosscutting service or area of enabling environment reform
- DSP staff will input data, information and publications into the hub
- Design a channel to permit access for other interested parties to the non-privileged information contained in the hub.

- Task 2 is to establish a project newsletter:

  - Hire a staff member to serve as advisor for the creation of the newsletter
  - Design the project newsletter taking into account previous successful examples of such
  - Organize, prepare, edit and publish the first edition
  - Implement an ongoing process of identifying articles for the newsletter that encourage and enable private sector growth

- Task 3 is aimed at establishing a public-private sector dialogue:

  - Identify leading business chambers and associations and their heads as well as other key business people in Timor Leste.
  - Determine which of the above should be invited to a meeting to assess the desirability of creating a "business forum" to discuss and identify major cross-cutting issues facing the private sector.
  - If a forum is deemed desirable by the private sector leaders, facilitate the formation of the forum and support its work including initiating a dialogue with the government and proceeding to creation of a platform for continuing private-public dialogue. If not deemed desirable explore if there are other more promising routes to a dialogue.

Resources

The following costs and resources are for year 1 of the project.

Task 1 will require one day of STTA to develop and install the information hub within the electronic project management system. Other possible costs could result from the purchase and copying of documents to be input into the hub. This cost is estimated to be $ 2,000.

Task 2, it is estimated, will use 20 days of STTA to assist in newsletter design and for developing articles. It is estimated that publishing and distribution costs will be $ 25,000.

Task 3, it is estimated, will require $ 2,000 for meeting related costs. Other costs would accrue if it was decided that some of the business forum and government officials should visit a country where there is a active and successful public-private dialogue to observe and learn lessons for Timor Leste.

ENABLING ENVIRONMENT REFORMS

As noted in an earlier section of the workplan, there are a number of serious enabling environment constraints to the development of the private sector. There may be some that Dezenvolve Setor Privadu could make a contribution to alleviating. For example the project has been asked by USAID's Land Law II Program to assist it in representational efforts to move forward a drafted law that would ease the problem of ownership of land titles. In another case, based on briefings from the Investment and Export Promotion Institute – concerned with foreign investment -- and the Entrepreneurship Support and Development Institute (IADE) – concerned with domestic investment – it appears the project may be able to assist in reducing the hassle associated with registering a company and becoming eligible for investment privileges. The project has also discussed the need for an anticorruption initiative with the World Bank. As a final example, it is possible that the project could contribute to establishment of a disputes arbitration mechanism to eliminate some of the problems associated with weak commercial contract enforcement.

Objective

The goal of this component is to aid and facilitate the formation of a pro-business environment in Timor Leste. The ability of the project to contribute to this goal depends on many factors most of which are outside the control of DSP. A prime consideration will be whether the project can find influential partners to work with in such endeavors. For the four enabling environment endeavors observed above as possible areas wherein DSP could contribute, one could identify more specific objectives associated with each.

The objective of working with USAID's Land Law II Program would be to remove a major barrier to private sector investment created by the uncertainty associated with land titles. The joint work would be aimed at having the drafted law -- concerned with setting up a National Land Council to resolve disputes over land ownership and issue titles -- promulgated.

The objective of working with the Investment and Export Promotion Institute and the Entrepreneurship Support and Development Institute to reduce hassle associated with registering a company and becoming eligible for investment privileges would also be aimed at increasing investment and thus jobs and income in the country.

The objective of working with the World Bank to reduce corruption would be to increase the financial efficiency of business operations in Timor Leste, which should also lead to more investment, jobs and income for the country.

The objective of contributing to a disputes arbitration mechanism would be eliminate some of the problems associated with weak commercial contract enforcement which again would lead to increased financial efficiency of firms' business operations and thus again to more investment, jobs and income.

Outcomes

As all of the referenced enabling environment initiatives require further assessment before determining if DSP should invest resources, outcomes should be viewed as theoretical as opposed to anticipated. The possible outcomes for the four bulleted objectives above follow:

- Increased investment along with more jobs and income resulting from reduced uncertainty associated with the validity of land tiles because of the promulgation of the law to create a National Land Council, which will make decisions about who holds land titles.

- More investment because of the reduced hassle associated with (1) the registration of companies and (2) their qualification for investment privileges. This should also lead to more jobs and income. It would reduce the number of days required to start a business and increase the number of firms registered.

- Less corruption would lead to a more efficient economy leading to higher levels of increase in the growth of GDP. A faster growing economy should lead to more jobs and income.

- Better commercial contract enforcement would also lead to a more efficient economy again leading to a faster growing economy.

Summary Strategy

Promulgation of the law creating the National Land Council. DSP would work with USAID's Land Law II Program to attempt to convene a coalition of interest in getting the land law passed and facilitate and supplement their representational efforts with government. If the project were to pursue this activity, the first step would be to work with the Land Law Program to design a strategy.

Reducing hassle associated with company registration and investment incentive qualification. DSP would meet with IEPI and IADE to assess their interest in working with the project for the purpose of improving this area of the enabling environment. One would need a "roadmap" of what was involved in registering a company and making an investment. Once possible points for introducing greater efficiency and reducing hassle are identified, strategies for encouraging government to take corrective action will have to be devised. One possibility would be to organize a broad segment of the private sector to lobby on behalf of introducing efficiency.

Reducing corruption. A major area of donor and government expenditures as well as apparent corruption is in the construction industry. This results from a lack of international standard building codes, lack of requirement that bidders demonstrate how they will meet specifications for construction jobs and lack of attention to bidders capacity to carry out tendered work. The project would discuss further with the World Bank an approach to working jointly in this area. A strategy would need to be devised.

Disputes arbitration. DSP would meet with IEPI to assess if it would like to join the project in exploring the need and mechanism for disputes arbitration as a means of strengthening commercial contract enforcement. According to IEPI, there were earlier discussions about setting up such a mechanism, which reportedly "fell through the cracks". If it were determined this was a useful area for project activity, the project would determine the degree of warranted involvement and a strategy for such.

Primary Tasks

Initial tasks for this component are aimed at assessing whether the project should invest resources to pursue the objectives of this component. They include:

- Task 1 to explore need for DSP support for promulgating the draft land law
    - Meet with USAID's Land Law II Program to agree on an approach.
    - Possibly jointly meet with the Minister or Vice Minister of Justice to articulate the importance of the draft law for stimulating the country's investment.
    - Meet with heads of business associations that could form part of a private sector lobbying group to support promulgation of the law. If results are positive, support the group in their representational efforts.

- Task 2 to explore the desirability of DSP expending resources aimed at reducing the hassle associated with company registration and qualification for investment privileges
    - Meet with IEPI and IADE to determine their support for this task.
    - If a positive decision is made, prepare roadmaps for (1) company registration and (2) qualification for investment privileges.
    - Promote the removal of bottlenecks and impediments to registration and qualification. One approach could be to attempt to organize the private business sector to support the needed reforms.

- Task 3 to explore the desirability of DSP, through its Construction Component, initiating an effort jointly with the World Bank to reduce corruption more broadly[lf1]

- Task 4 to explore the desirability of DSP initiating a task aimed at creating a disputes arbitration mechanism

- Meet with IEPI to determine the nature of earlier discussions about a disputes arbitration mechanism. Identify the major players of which the Ministry of Justice will undoubtedly be key.
- If the decision is to move forward arrange meeting with the Ministry of Justice to determine if the concept is feasible and if the response is positive, develop a strategy for the task.

Resources

Resources for all of the task of this component are dependent on a decision to move forward after the initial assessments. Resources for such new programs as these are programmed for the New Programming line item in the budget.

Task 1 may require funds for organizing and holding meeting aimed at promoting the land law's promulgation for ministry officials and parliamentarians.

Task 2 could require considerable STTA to prepare roadmaps for company registration and investment privilege qualification.

Task 3, for year 1, would be funded out of the Construction Component.

Task 4 could require considerable STTA if the decision is to move forward with the design of an arbitration mechanism.

NEW PROGRAMMING

Objective

As the project progresses, it will identify new opportunities and new demand for project activities, which it will wish to pursue in order to reach the projects overall goal of increasing jobs and income.

Anticipated Outcomes

Well identified new project components and tasks the lead to a successful project creating significant numbers of new jobs and additional income for Timor Leste businesses.

Summary Strategy

In carrying out the projects activities, the project will be open to encourage stakeholders to come forward with new demand or opportunities with which the project can be of assistance. The project will then evaluate these opportunities in light of their potential to aid the project in reaching its goal and in light of available resources. The opportunities will first be discussed in project staff meetings and if a positive decision is reached there and considerable resources are involved, with USAID before undertaking new programs.

Resources

The resources needed for new programs are roughly estimated to be between a quarter and a third of the project's total resources for the year.

OUTREACH

The geographic focus of Dezenvolve Setor Privadu will be driven by market opportunities for the project to achieve impact on employment and incomes. As a major portion of the Timor Leste economy is focused on agriculture and agricultural products[10] – including fisheries and forestry – the project will naturally result in attention to rural areas of the country. The project will make a special effort to target the priority districts identified by USAID, including Viqueque, Lautem, Baucau, Bobonaro, Suai and Oecussi. For example, the main business activities related to coconut are presently located in Viqueque, with Colega Pty Ltd providing part-time employment for over 120 people from 3 villages. In addition the company is buying coconuts from 193 farmer families. If DSP can create linkages to other coconut product markets, thus creating a need to expand processing of coconuts, possible interventions could take place in other USAID priority districts that produce coconuts, including Suai or Lautem.

The project's focus on financial services will benefit targeted districts and populations. For example, improved business leads to increased demand for financial services in an area. Tuba Rei Metin, an MFI operating near the Colega Pty Ltd factory, recently expanded to register more than 120 new clients in the Colega villages as a result of increased economic activity. DSP will improve the ability of MFIs to respond throughout the country with particular focus on Viqueque, Lautem, Baucau, Bobonaro, Suai, and Oecussi.

DSP understands that USAID is funding an economic advisor to the secretary of state of Timor-Leste for Oecussi, placed through the UNDP. Dezenvolve Setor Privadu sees this as an excellent linkage to this disadvantaged district, and once the person is in place, the project could conduct a specific analysis of the markets in Oecussi and assess possible market-based interventions.

Similarly to the geographic focus, the activities of DSP will naturally lead to a focus on socio-economic groups within Timor-Leste that are a concern to USAID, namely youth and women. While the process will be commercially driven, it is likely that the activities selected under each sub-sector will impact particularly on youth through the anticipated increase in employment opportunities. The activities will also directly and indirectly impact on and involve women through expanded access to financial services. Women will be the main beneficiaries of expanded financial services in rural areas.

A goal of the project will be to encourage economic friendly and sustainable economic growth. Timor Leste has a wonderful opportunity to preserve an environment that is, in many respects, still unspoiled and indeed as a result offers major opportunities – for example in fisheries and tourism. These are both sub-sectors where Timor Leste has an international comparative advantage. They are also areas that could be easily environmentally degraded though short-sighted, uncontrolled exploitation. Dezenvolve Setor Privadu will pay special attention in its

[10] See the list of products and sub-sectors listed in the "Approach" section.

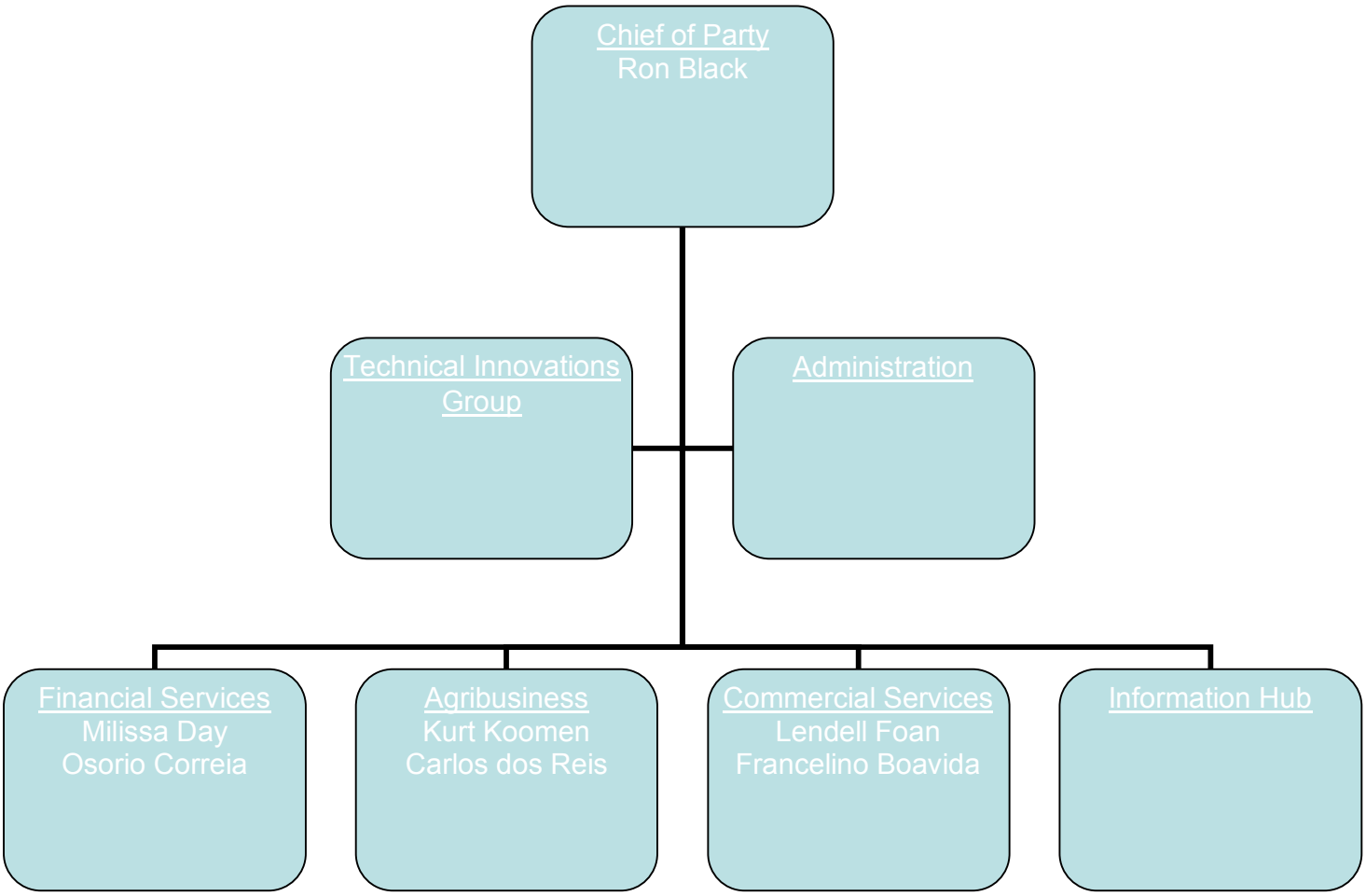
interventions to encourage long-term economically sustainable private sector development.

MANAGEMENT AND OPERATIONAL STRUCTURE

As a small staff Dezenvolve Setor Privadu will remain flexible, responsive and operate as a team. The project structure is shown below. The project is composed of the following units: Financial Services; Commercial Services; Agriculture and Agribusiness; and Information, Coordination and Monitoring.

The Chief of Party (COP) has appointed a leader to coordinate activities under each unit; and specific activities will be delegated as they relate to each unit. DSP has a management team – the COP and a Technical Innovations Group (TIG) that meets weekly. The TIG, under the direction of the COP, provides guidance for the project by developing strategies, planning activities, and reviewing progress of the different units and sub-sectors. The TIG also provides a forum for ideas and the integration of the sector-based activities of the various units.

DSP Organizational Structure



BUDGET

Dezenvolve Setor Privadu has a limited programming budget, calling for an approach based on facilitation of commercial linkages and cooperation with other stake holders—including other donor projects. The attached budget highlights this efficient approach.

The costs detailed in this budget are for programmable funds and do not include DSP staff time, operational costs, or STTA time and costs. Rather the budget focuses on the project funds available for targeted, market-based, interventions taken by DSP. In addition, DSP has added an off-line budget column to highlight the need for additional funds for the optimal investment for successful interventions in some sectors of the economy[lf2]. DSP envisions allocating funds through the cooperation with other USAID and other donor projects.

Task	Program Budget	STTA Days
SUB-SECTOR DEVELOPMENT		
Coconut		
Task 1: Access to expanded export market and improved processing technologies for Virgin Coconut Oil	28,000	17
Task 2: Improve the domestic competitiveness and market share of coconut oil	4,000	16
Task 3: Expand market opportunities for coconut and coconut by-products and improve the use of appropriate technologies in the value chain	32,000	20
Total Coconut	**$64,000**	**53**
Construction		
Task 1: Facilitate transparence in government procurement and the adherence to building standards		50
Task 2: Higher skills available to skilled workers that meet market demands	$1,000	
Task 3: Increased access to higher quality lumber for supply retail		36
Total Construction	**$1,000**	**86**
SECTORS TOTAL	**$ 65,000**	**139**
CROSS CUTTING SERVICES & ISSUES		
Financial Services Development		
Task 1: MSME access to diversified financial services provided by sustainable financial institutions	16,750	50

Task 2: Good practice-based finance collaborators based on reliable performance data that provides financial services to an increased no. of MSMEs	4,500	10
Task 3: Access to demand driven training and TA to facilitate bank readiness	9,150	31
Total Financial Services	**$30,400**	**91**
Commercial Services		
Task 1: Document current business services being offered in Timor	0	0
Task 2: Catalogue business associations, members and services offered	0	0
Task 3: Identify opportunities to grow and support commercial business services	0	0
Total Commercial Services	**$ -**	**0**
Information, Coordination and Monitoring		
Task 1: Information hub		1
Task 2: Newsletter	25,000	20
Task 3: Public-private sector dialogue	2,000	
Total Information and Coordination and Monitoring	**$ 27,000**	**21**
Enabling Environment		
Resources included under New Programming		
Total Enabling Environment	**$ -**	
New Programming		
Estimate for New Programming	**$ 62,000**	**110**

TOTAL CROSS CUTTING SERVICES and ISSUES	**$ 119,400**	**299**

GRAND TOTAL	**$ 184,400**	**438**

ATTACHMENT 1

VALUE CHAIN ANALYSIS: COCONUT

I. Overview of the Timor Leste Coconut Resource and Market

The resource base. The Asia-Pacific region produces 90% of the world's coconuts. Timor has substantial acreages of coconut palms, estimated to cover between 8,000 and 12,000 hectares in various parts of the country. Increasing the commercial utilization of this resource has been the focus in the three Eastern districts of Baucau, Viqueque, and Lautem in recent years more than in other parts of the island. A production estimate from 1997 indicated that 9,900 tons of coconut were produced or marketed (Bill Messiter, 2001), although the trees if well maintained can easily produce up to 20 tons of nuts per hectare (Foale, *The Coconut Odyssey*, 2003). At that nut yield, 8,000 hectares would produce 160,000 tons of coconut (or enough to export more than 200 times the current exports of virgin coconut oil).

There are two basic varieties of coconut palms: "tall" varieties and "dwarf or hybrid" varieties. In Timor Leste most of the trees are "tall" and date from Portuguese times (many are 60 or more years old and over 18 meters tall). There was limited introduction of high yielding dwarf (hybrid) varieties during Indonesian times. A serious insect infestation in the Baucau district killed a large number of trees, but was successfully brought under control through a MAFF biological control activity (the breeding and release of ladybugs) which began in 2002. Old trees produce fewer, smaller nuts with "thinner"/smaller meat content. Timorese trees seem to suffer from a generalized potassium deficiency and Foale estimates that per tree production could be increased by 20 % with application of potassium-rich fertilizer, although the cost and returns to doing this have not been assessed.

Maintaining and improving the productivity of the national coconut tree resource base is an important issue, which is complicated by the unsettled nature of TL's land tenure system. Some portion of the trees is in plantations where there are still residual property claims by previous Portuguese owners or are in plantations that are GoTL un-maintained property. Without clear title to existing or new plantations, neither local farmers, absentee landowners, nor future investors will have obvious incentives to invest in maintaining or improving the resource. If business development opportunities continue to develop for this sub-sector, then these issues need focus in the near future.

Coconut products and market opportunities. There are a great number of possible products that can be derived from Timor Leste's coconut resource. Figure 1 on page 10 gives some indication of the wide range of both current and possible products for both export and domestic consumption. In the initial work done by BASAR have concentrated our efforts on three products in the coconut value chains: virgin coconut oil (VCNO), coconut oil for the Timor Leste domestic market (CNO), and copra.

Virgin Coconut Oil (VCNO). This is a new product for Timor which is produced by one start-up firm (Colega Pty Ltd) in Viqueque. Similar to virgin olive oil, VCNO is called

"virgin" since it is produced by a cold pressing technique such as the DME (Direct Micro Expeller) technology, recently developed in Australia. This oil (in contrast to "copra oil" made in industrial processing of copra) has interesting demonstrated characteristics such as being very low in free fatty acids and having a high content of lauric oil. It has uses for human consumption, cosmetics, and pharmaceuticals.

Coconut Oil (CNO) for Domestic Consumption. Prior to the Indonesian occupation, Timor Leste's locally produced coconut oil was widely consumed. Under Indonesian rule traders began to import substantial quantities of industrial cooking oil (mostly oil palms), which is widely marketed today under the brand name *Bimoli.* While locally produced coconut oil still has a substantial market share in rural areas, it does not compete well with Bimoli in urban areas and among upper income consumers. Over the years some attempts have been made to introduce improved pressing technologies to increase productivity of local oil extraction. The critical question on this value chain is whether the product and production process can be improved sufficiently to gain significant market share at the expense of the low cost imported Bimoli.

Copra: Copra refers to dried pieces of coconut "meat" (at 6-7 % moisture for preservation), which has been widely used for many years as an input to the large scale industrial production of "copra oil." Copra oil, when further refined, has been a traditional ingredient in soaps, margarine, and other industrial products. Prior to Timorese independence copra was traded to other parts of Indonesia. In 2001-2 this trade was re-established but the future of this value chain is in doubt due to declining prices and demand in recent years. There are still substantial direct copra exports to EU countries, which may offer a greater value added opportunity for Timor farmers and processors.

II. Existing Markets

There are a broad range of products and by-products from coconut that can be used to generate income, substitute imports, and/or substitute less sustainable alternative resources (see Figure 1 on page 10).

Presently only a small number of coconut products and by-products are being utilized to generate income. These are all oil related products to be utilized for the edible oil, cosmetics, soap, and pharmaceutical industries. The products and the present markets in relation to Timor Leste are as follows:

Product	Current Market
Virgin Coconut Oil	International market in Australia
Copra	International market in Indonesia
Crude Coconut Oil	Rural domestic market

A. The International Market

Virgin Coconut Oil was first exported from Timor Leste in 2004. It is presently sold only through a single buyer in Australia, Kokonut Pacific (KKP). An assessment of the market for VCNO has yet to be conducted, and therefore it is difficult to predict the extent of demand for

VCNO, and more specifically organic VCNO. In general, coconut oil has had a revival after bad press relating to the health properties of coconut, which have since been discredited.

Kokonut Pacific has purchased 40MT of VCNO in the past year and has exclusive right to sell the oil from Colega Pty Ltd to buyers in Australia and New Zealand. However, the volume purchased by KKP has not been as large as anticipated. KKP has links with producers in the Pacific who use their Direct Micro Expeller (DME) technology. The VCNO is purchased by KKP at $3-3.50/litre FOB Dili.

Copra became a traded cash crop for TL during the Indonesian administration. The product appears to have always been exported to Surabaya either directly or via Atambua. Export of copra ceased following the troubles in 1999, but was re-established again in 2002. Recently there has been a significant decline in demand for copra in Indonesia, with reports from one trader that demand has decreased in the last year from 20MT/month to 10MT/month. This has also led to a decline in price from $0.24-0.25/kg to $0.15-0.17/kg for farmer/processors selling to Dili traders.

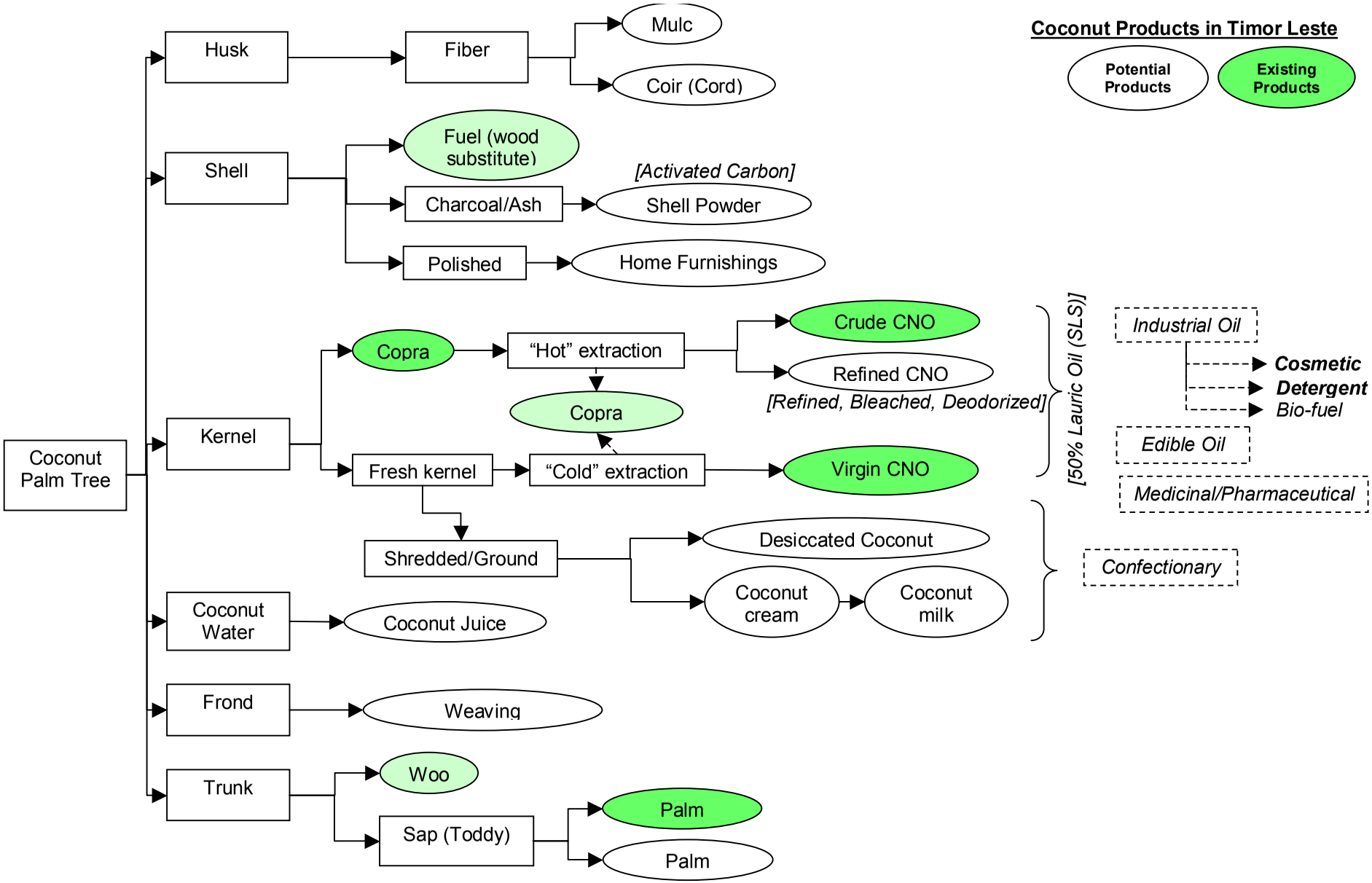
There are at least four main Dili-based traders who export copra as well as coffee, candlenut, and in some cases vanilla, cashews, peanuts, cloves, and honey. It is assumed that the bulk of the copra is re-exported after processing in Indonesia. Copra is generally refined as industrial oil and for use in margarine, cosmetics, or pharmaceuticals.

B. The Domestic Market

Locally produced ***CNO*** is widely consumed in rural areas by farmer/processors and other rural consumers who buy the product in local markets. As this product is predominantly traded locally and only packaged in plastic water bottles, at a local level it is presently able to compete with imported alternatives, as the costs of refining, transport, packaging, have not been added to the product. Although predominantly traded within communities, a small amount of the locally produced CNO is transported to urban areas in TL by farmer/processors or traders.

The competition, Bimoli, is a branded commercial cooking oil with high palm oil content imported from Indonesia. Bimoli was introduced to TL during the Indonesian administration and now has assumed market dominance. Previously it appears that coconut oil was the predominant cooking oil.

Figure 1: Coconut Products and By-Products

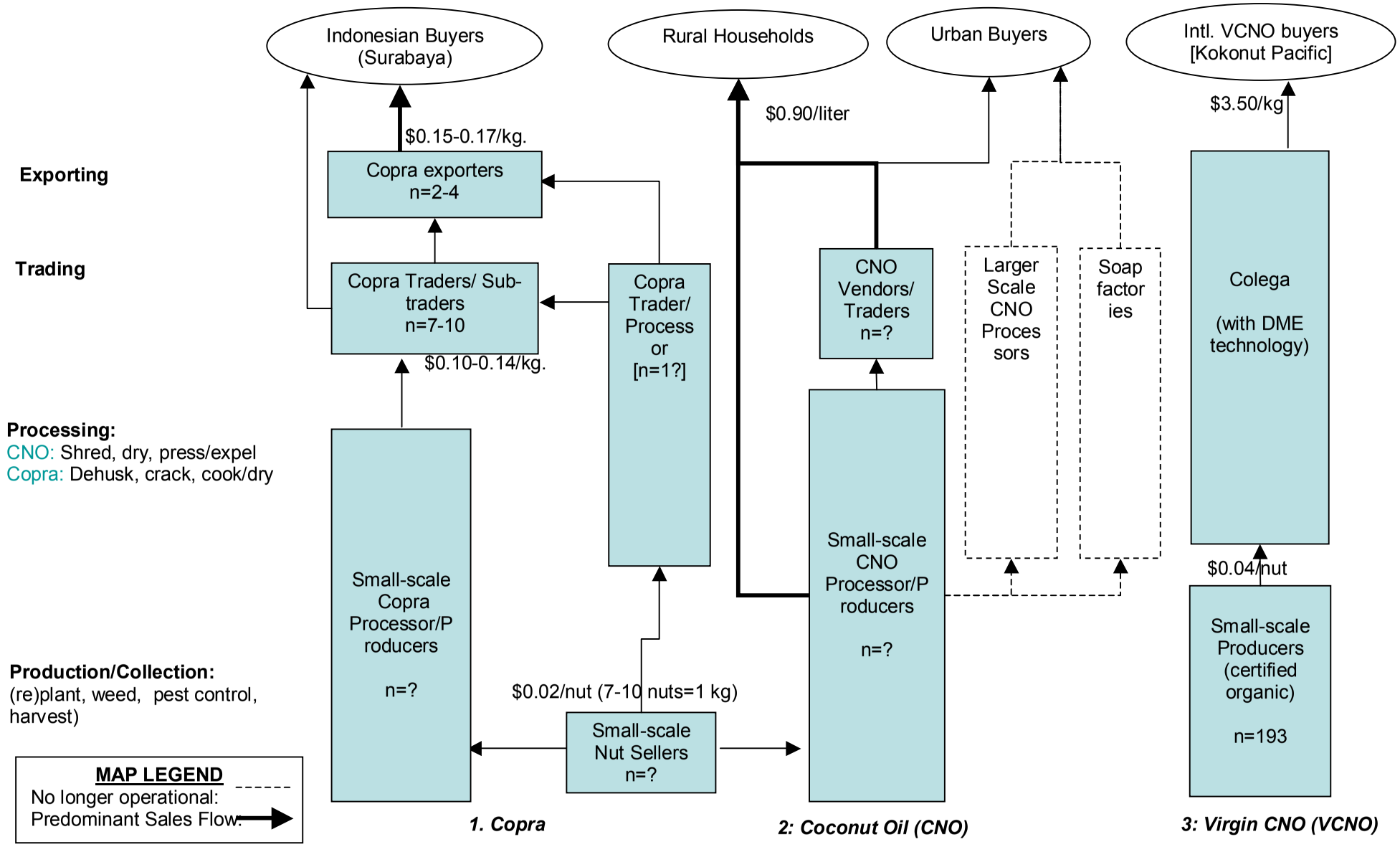


III. Value Chain Map and Participants

A value chain map showing the inter-relationships of the coconut value chain participants is presented in Figure 2 below. The primary functions in the value chain are presented on left-side of the map, with the value chain participants presented in boxes to the right of the function(s) they perform. Following the map are more detailed descriptions of the functions, where possible, and the relevant value chain participants.

Given the three predominant product channels in the coconut value chain in TL (VCNO, CNO, and copra), the map and participant descriptions are presented in a similar manner.

Figure 2: Timor Leste Coconut Value Chain Map



A. Timor Leste Coconut Value Chain Participants

1. Virgin Coconut Oil (VCNO)

a. Production/Collection:

Small-scale Producers (certified organic) – these are coconut producers who have been certified organic (by NASAA - Australia) and sell their nuts to Colega directly at factory-gate. It was stated that Colega purchases coconuts from these producers at $0.04 per nut (a premium over the prevailing price of $0.02/nut). Most of these small-scale producers are also employees of Colega.

b. Processing/Exporting:

Colega – Colega is currently the only processor of organically certified virgin coconut oil (VCNO) in Timor Leste. Colega was established in 2004 and uses direct micro expeller (DME) technology to produce VCNO. The DME technology was developed and supplied to Colega by Kokonut Pacific—a coconut processing technology and trading company in Australia. With a processing capacity of over 100 MT per year, Colega is the now largest VCNO producer using DME technology in the world. Colega has also been certified as an organic processor (by NASAA in Australia) of VCNO.

Kokonut Pacific is Colega's only buyer to date and has an agreement to be the sole buyer of Colega's VCNO in Australia and New Zealand. Colega stores its VCNO in 200 liter drums and transports it directly to Dili for export.

2. Coconut Oil (CNO)

Coconut oil (CNO) from Timor Leste is defined here as coconut oil that has not been refined, bleached, and deodorized. The global trade in coconut oil is generally differentiated by the level of processing and refinement: unrefined/crude CNO or refined CNO.

a. Production/Collection

Small-scale Nut Seller – these are coconut producers who only sell whole coconuts and are not engaged in any further coconut processing activities. It is estimated that the number of small-scale whole coconut sellers in Timor Leste is quite small. The majority of smallholder coconut producers in Timor Leste are also engaged in further coconut processing.

b. Processing

i. Small-scale CNO Processor/Producers. Most of the CNO in Timor Leste is made by small-scale producers who process their own coconuts. They may buy limited quantities of coconuts from small-scale nut sellers, but most of their coconuts come from their own production. CNO processing technologies used in Timor Leste vary from traditional manual techniques for small-scale processors, to more mechanized techniques (e.g. hydraulic press, screw press, etc.) for larger-scale scale processors. The exact number of small-scale CNO processor/producers in Timor Leste is not currently known.

The main market channels for these small-scale CNO processors are household consumption or local rural markets (either sold directly or through CNO traders/vendors). CNO traders also transport and sell CNO in larger urban markets.

ii. Larger-scale CNO processors. There were efforts to establish a larger-scale CNO processing facility (Egas) in Dili, using a mechanized screw press extraction technology, but while facility and equipment is still in place, the business is not presently operational. The assessment team was not able to determine the actual reasons for the business failure (whether technological, economic, managerial, etc.) nor were the final markets for this CNO identified.

iii. Soap Factories. It was determined that two soap factories (in Dili and Los Palos), using CNO as a raw material, were started but are no longer functioning. The Dili factory used a traditional manual manufacturing process, while the Los Palos facility used a more mechanized process. Both facilities provided expanded market outlets for local CNO, but were established by a local NGO (Alola) and are no longer operational.

c. Trading

CNO Traders/Vendors – These are rural traders/vendors who buy CNO from small-scale processors and sell either to rural consumers or to larger-scale buyers in major urban centers. The exact number of CNO traders/vendors in Timor Leste is not currently known.

3. Copra

a. Production/Collection

i. Small-scale Nut Seller. See above description.

b. Processing:

i. Small-scale Copra Processor/Producer. Similar to CNO processing, most copra in Timor Leste is produced by small-scale producers who primarily process their own coconuts. They may buy limited quantities of coconuts from other small-scale producers, but most of their coconuts come from their own production. These small-scale copra processors/producers appear to specialize in copra production and are not engaged in CNO processing as well.

ii. Copra Trader/Processor. These are enterprises involved in both copra processing and trading. It is estimated that these trader/processors do not have their own production of coconuts and must purchase coconuts from local small-scale nut sellers. Their copra is then sold to larger copra traders or directly to copra exporters in Dili.

c. Trading

i. Copra Traders/Sub-traders. There appears to be two levels of copra trading: at the sub-district level and at the larger district/regional level. There are major copra traders in Viqueque (Agricultural Service Center (ASC)/Viqueque and two independent traders) and in Bacau (4-8 traders, including Acelda -- although Acelda is no longer engaged in copra trading). There is also a level of sub-trading taking place in Viqueque and Los Palos (2 identified sub-traders in each location) that supply copra to the major district/regional traders.

The major copra traders will then sell directly to Indonesian copra buyers or transport it to Dili for sale to copra exporters. Most of these copra traders and sub-traders are also involved in trading other commodities including candlenut.

d. Exporting

i. Exporters. There are approximately two to four main copra exporters; all based in Dili. These exporters will buy from traders and sub-traders and sell to copra buyers in Indonesia (Surabaya). Naroman Kristal is the largest copra exporter and appears to be the most commercially viable. Similar to copra traders, the copra exporters are also involved in exporting other commodities.

IV. Value Chain Constraints and Opportunities & Potential Solutions

Table 2: Coconut Value Chain Constraints and Opportunities & Potential Solutions

Function, Value Chain, and No.	Key Value Chain Constraints	Commercial Solutions	Decision on BASAR activity
Market Access 1. VCNO	Lack of linkages to multiple international buyers leads to dependence and limited sales for VCNO exporter(s); VCNO market size unknown	Access to expanded export market	Top priority
2. All chains	Limited availability of information on international demand/price trends (i.e. size of market), and regional and international standard compliance for coconut products	Access to market and price information for coconut products (VCNO in world markets, crude CNO, and copra).	High priority
3. CNO	Local CNO does not compete well with imported *Bimoli* in the domestic cooking oil market.	Access to expanded markets for CNO processors.	High priority
4. All chains	Lack of alternative uses for coconut	Access to expanded market opportunities for other coconut products and by-products for small-scale coconut processors, traders, and exporters.	High priority
5. Copra	Global demand for copra appears to be waning with outlets for Timor copra limited to buyers in Indonesia (Surabaya)	Access to alternative markets for copra (Philippines, Thailand, EU, etc.)	Lower priority but should do market assessment
Technology / New Product Development 6. VCNO	Limited access to product testing facilities (for FFA, water, color, taste. etc.) limits market opportunities of VCNO exporters (X-cutting constraint)	Access to laboratory testing services (pre-shipment)	Note potential importance for future agribusiness development
7. VCNO	Current manual press technology (DME) may limit expansion and sales of VCNO processor/exporter	Access to improved VCNO processing technologies	If VCNO market can be expanded then this rises in priority
8. VCNO	Cost of initial organic certification and on-going inspections may limit expansion of VCNO processor/exporter sales	Access to affordable organic certification services	Lower priority
9. All channels	All coconut product profitability limited due to lack of processing of by-products.	Access to, and availability of, appropriate technologies for small-scale coconut processors, traders, and exporters to produce other coconut products and by-products that meet the identified market opportunities.	Linked to No. 4: high priority

Function, Value Chain, and No.	Key Value Chain Constraints	Commercial Solutions	Decision on BASAR activity
10. CNO	Unknown technical and cost effectiveness of alternative CNO production technologies limits sales opportunities for processors	Access to improved CNO processing technologies	Linked to no. 3: high priority
11. Copra	Traditional copra production is inefficient and results in lower quality product	Access to quality norms on copra and best practices in quality production; quality requirements for EU market	Lower priority; only proceed if promising markets revealed
Organization/ Management 12. VCNO	No alternative sites for training services for replication and expansion of VCNO processing (expansion scenario)	Access to expanded training services for VCNO replication/expansion	If VCNO expansion, then this to be addressed
Regulatory 13. All channels	USD as legal tender in TL increases costs and decreases competitiveness (cross-cutting)	Provision of indigenous currency linked to key trading partners	See paper on enabling environment
14. All channels	Some GoTL/donor interventions displace and distort market-based and sustainable PS development, e.g. input supply delivery/Grants, free credit (Cross-cutting)	Provision of commercially viable business solutions; e.g. tendering all input supply	See paper on enabling environment
15. CNO	Low import tariffs on commodity products replaceable by local products, e.g. edible Oil (cross-cutting)	Provision of advocacy for increased import tariffs if local products can substitute for imports	See paper on enabling environment
Finance 16. VCO, CNO	Limited enterprise-internal financial analysis, projection & management skills hampers access to and servicing of debt-finance and accurate profitability calculations (adjustment for subsidies), especially at start-up	Improved capacity of current and potential VCNO and CNO/coconut product processing SMEs to accurately project, present, analyze and manage their business finances.	Medium Priority
17. CNO	Limited commercial pre-financing for MSMEs to acquire improved press/production technologies hinders investment in better technology. (Related to more general scarcity of well-managed MSME agribusiness finance).	Access to finance for improved processing technologies for edible oil, copra and other coconut products, and for the transport of products to markets.	Medium Priority
18. CNO, Copra	Current low and falling copra-prices and low, inelastic sales prices of CNO severely limits profitability of rural ME producers and traders	Identification of profitable income generation opportunities for growers and processors in and outside of the coconut value chain.	Medium Priority
19. All channels	Lack of CIT and limited remittance services across country increases risk to traders/MSME employers; cost (transport, loss provisioning) and decreases cash flow stability	Prepare suppliers for anticipated increase in demand for microfinance services as markets grow (see solution 1), and expand remittance/transfer services.	Medium Priority

Function, Value Chain, and No.	Key Value Chain Constraints	Commercial Solutions	Decision on BASAR activity
Input Supply 20. All channels	Old tree resource will need replanting investment to be sustainable long term. Limited knowledge of resource base.	Availability of knowledge on resource base and identify replanting options.	Medium priority Should be started in 2006 if substantial CN value chain work goes ahead
21. All channels	Potential for land ownership and usage issues for plantations/land tenure	Access to GOTL finalize land tenure law service.	Note importance (enabling environment)
22. CNO	High cost of materials for improved presses	Bulk purchasing to reduce cost	Drop; would be part of CNO activity

Within the overall value chain analysis of coconut there are clear opportunities and priorities based on market opportunities and potential to increase jobs and income. The Ranking of Solutions table below prioritizes the solutions for BASAR intervention. Generally, the coconut products within the chain were prioritized based on the following rationale:

- VCNO is a high priority due to international market demand and competitiveness in meeting the niche market demand for organic VCNO.
- CNO is a medium-high priority due to potential to create a large market by substitution of the imported Bimoli oil as well as other potential uses (e.g. bio-fuel).
- Other CN products & by-products are a medium-high priority as they can improve the overall financial viability of oil processors as well farmers by supplementing incomes.
- Copra is a medium-low priority due to overall low value; however it still retains potential to generate income for farmer/producers at the rural level.

V. Ranking of Solutions

Table 3: Ranking of Solutions in Coconut Value Chain

Potential to				
	High		3/10 (CNO market/technology)	1 (VCNO)
	Medium	5/11 (Copra market/technology)	2 (market information) 7 (VCNO technology) 18 (promoting other products)	4/9 (CN by-products) 17 (pre-finance/leasing) 16 (financial planning/management)

	Low	6 (lab services) 8 (organic certification services)		
		Low	Medium	High
	Potential to Increase INCOMES			

Not all of the constraints and commercial solutions identified in the table above have been included in the Ranking of Solutions table above. Many of these were macro level or cross-cutting constraints that could not directly be addressed by BASAR.

The activities that fell within the range of high-high to medium-medium (dark grey) were identified as a priority for intervention. Although copra was only selected as a medium-low priority, it was felt that initial investigations to confirm trends in the market are warranted, as copra is a traded product that provides immediate income to farmers.

A number of services to the coconut industry were identified and ranked. The market information constraint/solution was identified for intervention as a medium priority. However, it was deemed too early to prioritize services such as organic certification and laboratory services until the markets for coconut products had been expanded.

Following the short-listing of the solutions and interventions, task lists were prepared to outline activities in year 1. For this purpose solutions have been in some cases combined into a single task relating to the value chain channel (e.g. solutions relating to market and technology of VCNO have been combined into 1 task sheet). While not all activities within a task sheet are sequenced, there is an implicit logic that should a market opportunity prove to have little potential, investment in new technology may not be warranted.

VI. PLANNED BASAR INTERVENTIONS

Task 1: Access to expanded export market and improved processing technologies for Virgin Coconut Oil

This task combines the priority solutions relating to VCNO for the international market. The two priority interventions identified were increased access to markets (solution 1) and access to improved extraction technology (solution 7). The main activities in the task are sequenced, with access to markets the initial focus. Initial indications are that international markets for VCNO are small but growing steadily with good future prospects. As this is confirmed in our market assessment, BASAR will facilitate access to improved cold press technologies (as available) and promote production expansion, either at Colega in Viqueque district and/or by other rural production groups, consistent with maintaining the high quality that international markets demand.

Task 2: Improve the Domestic Competitiveness and Market Share of Coconut Oil

This task combines the priority solutions for domestic market coconut oil. The two priority interventions identified were improving product quality and expanding access to urban markets (solution 3) and accessing improved technologies for larger scale, but still local, coconut oil production (solution 10). For the first solution additional field work on higher productivity technology will be required as well as work with consumer focus groups to better understand price/quality tradeoffs in Timorese cooking oil markets. A number of improved mechanical/hydraulic pressing technologies, plus the use of screw expellers must be further explored and cost of production data developed before BASAR can decide (toward the end of 2005) whether further investment of effort in this product line is warranted.

Task 3: Expand market opportunities for Coconut and Coconut By-Products in Domestic and International Markets and Improve the use of Appropriate Technologies in the Value Chain

This task also combines needed assessment of both international and domestic market opportunities for diversified coconut products and by-products (solution 4) with applied technology investigations (solution 9), which needed to be costed out in the Timorese environment. Those that look promising could move to equipment acquisition and pilot testing, perhaps with the financial support of the Small Grants Program or other cooperating institutions.

Task 4: Increase local copra exports through access to alternative markets and linking local exporter with new markets/buyers

This task is focused on rapid investigation of the current export market for copra (Surabaya), alternative markets (Philippines, and EU) and key quality and price parameters, especially for access to the latter markets (solution 5). If any of these looks promising, then it may make sense, sequentially, to address needed technology requirements to produce to the desired market quality standard (solution 11). In addition, there are two moribund soap factories which might be able to use coconut raw materials (copra, expeller oil, CNO).

Task 5: Improve Market Information for Coconut Value Chain Actors

This task involves constraint solution 2 (access to market and price information for all coconut products and by-products) for which there are remunerative international and domestic markets. The biggest challenges in this task area will be determining appropriate distribution channels and finding options for sustainable post-project local provision of these services.

Task 6: Increase access to finance for improved processing technologies for edible oil, copra and other coconut products, and for the transport of products to markets

This task results from solution 19 and addresses the constraints identified among two groups of stakeholders: traders who need finance for trucks to get produce to market; and small-scale processors who need to acquire more appropriate equipment, but cannot afford to buy it with cash. While a lease-financing mechanism will be designed and pilot-tested after demand has been quantified and specified, the timing for roll-out of this new

product through financial and lease-management providers will await the assessment and recommendations under Task 2 of appropriate processing equipment.

Task 7: Improved capacity of current and potential VCNO and CNO/coconut product processing SMEs to accurately project, present, analyze and manage their business finances

Responding to constraint solution 16, this task addresses the need to enhance the credit and business risk profile of newly started (and future) processing SMEs. BASAR will facilitate the access of SMEs to training and TA in financial analysis, projection and management skills. At the same time the development of a transparent, commercially viable market will be promoted for demand-driven training services in TL, which is currently non-existent. In cooperation with providers of regulatory and financial services, standards for 'blue-chip SMEs' will be developed as a benchmark against which SMEs can measure their own credit-worthiness and performance. Stronger financial management within SMEs will decrease the risk of business failure, and enhance long-term profitability.

Task 8: Prepare financial service providers for anticipated increase in demand for microfinance services as markets grow and expand remittance/transfer services

Increased markets and income opportunities for rural micro-enterprises increases their demand for microfinance services to further augment their businesses, but the financial service providers are not immediately ready to serve this anticipated increase in demand. Equally, the expansion of productive markets will require an expansion of the service markets, especially of financial services across the country. This task results from constraints solution 19 and addresses the demand for institutional capacity building to improve performance among existing MFIs, while developing closer linkages among providers within the financial sector to ensure that cash can be transferred around the country faster, safer and further than is currently the case. The feasibility of a Cash in Transit services will also be assessed.

ATTACHMENT 2

USAID BASAR Project

TIMOR LESTE CONSTRUCTION SUB-SECTOR ANALYSIS

Prepared by DAI

September 30, 2005

OVERVIEW OF CONSTRUCTION MARKET

At the end of the Indonesian occupation of Timor the Indonesian troops and supported militias engaged in a campaign of destruction – burning down private, government and commercial buildings while the UN was preparing to land Australian troops. An estimated 70% of private homes and public buildings were destroyed in 1999. The UN, the World Bank, the Asian Development Bank, USAID and other donors quickly engaged in construction projects to help rebuild the physical infrastructure of Timor. Massive construction projects were started to rebuild bridges, roads, the airport, as well as schools, hospitals and government buildings. Most of these contracts were rewarded to large foreign construction firms that had both the equipment as well as the experience to manage projects at such a scale. When possible, these firms hired Timorese unskilled and skilled labor, however due to an extreme shortage of the later firms brought in workers from China, the Philippines, Malaysia and Indonesia.

Currently, Timor-Leste's population is growing quickly and the government has recognized the need to create jobs. It is not only the newest nation in the world, but is also one of the youngest with over 50% of the population under the age of 18 and the world's highest birth rate. These factors alone challenge the new nation to create jobs for 15,000 potential new entrants to the labor market every year. This challenge is not being met and is leading to higher unemployment and growing social pressures. As part of the Timor-Leste's National Development Plan for 2005, the government estimates that it will carry out $200M in reconstruction, construction and building maintenance projects – with similar annual funding commitments for the next 5 years. In addition, with the pace of labor market growth and need for skill development within Timorese businesses, the government pledged to increase the number of government contracts awarded to Timorese firms.

BASAR values the potential for private sector approaches within this sector to increase jobs and household income in Timor-Leste. Therefore the project has carried out an analysis of the construction sector to determine if there are effective solutions to achieve these ends via market driven interventions.

Domestic Market

It is estimated that there are roughly 600 firms in the construction industry. In 2003 when the government of Timor-Leste emerged from UN management, the government started to register firms to 'pre-qualify' them for government procurements in the sector. The government pre-qualified firms into three broad categories:

A: A-level firms can undertake projects between $500K and $1M; there are 6-7 firms qualified within this category.

B: B-level firms are divided into 2 sub-categories, B1 firms can undertake work on projects between $250K and $500K; and B2 firms from $150K-$250K. In total there are about 20 firms registered with the government in this category.

C: C-level firms are divided into 3 classifications, C1 firms can be awarded contracts from $75K-$150K; C2 firms from $25K-75K; and C3 firms for work under $25K. It is estimated that there are around 570 firms within this category

Firms that have registered with the government include mostly Indonesian/Timorese joint ventures and Timorese firms, and there are widely believed to be a number of shell-companies within this total number. The number of actively operational construction firms is likely to be many fewer. The estimated number of firms in each of the categories does not include domestic and international firms that did not register to pre-qualify for government work. Those not registered include Jackson Properties, JJ MacDonald and Sons, Caltech, Tobishima, and others that are engaged only in private sector or donor-funded work. Smaller, specialized trade firms or local contractors are also missing from the registry as most did not register because they found the process to cumbersome.

International Markets

At the emergence of independence, Timor itself became an overseas market for numerous Australian, Portuguese and Indonesian construction firms. They worked directly, or later through joint ventures with Timorese firms to implement massive reconstruction projects funded by the UN, the World Bank, the Asian Development Bank, USAID and other donors. There is significant work yet to do, however in general this market is shrinking and these firms will only remain invested in Timor as long as there are donor sponsored projects. However, the firms that are specializing in this market have chosen not to qualify for government work. If the government opened the procurement process to a higher level of transparency then perhaps these firms would be thinking of their business in Timor in the longer term.

Approach

The BASAR team conducted qualitative interviews with key participants and players within the sector (see Appendix A – Meeting Schedule). As a result of the information collected and through the mapping of the sectors in this report, BASAR now has a clear picture of the sectors, the current size and potential of the market as well as the constraints.

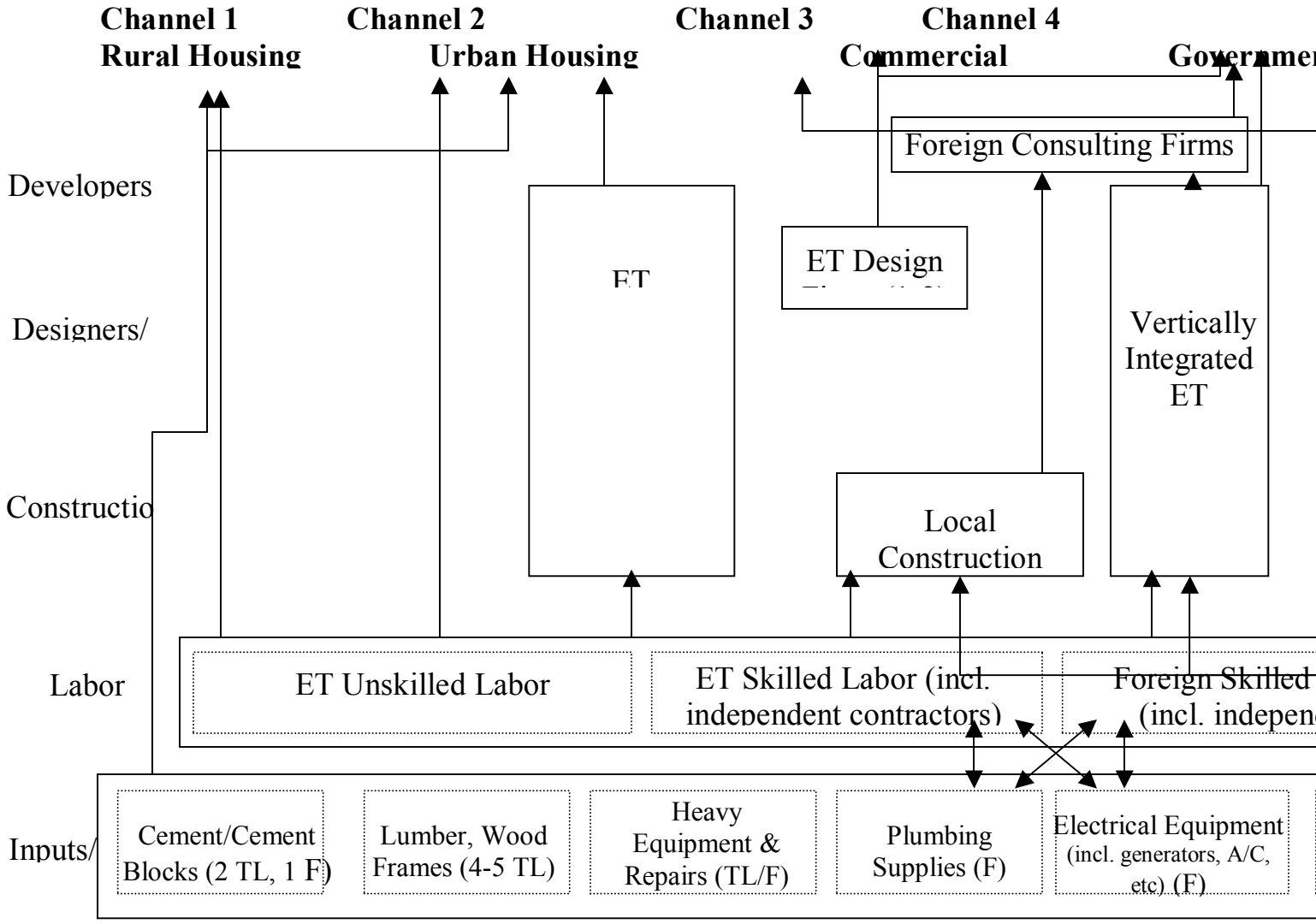
Understanding the general constraints of the sector, BASAR then was able to address solutions. BASAR then further ranked the constraints by using a matrix measuring both the potential to create new jobs and to increase revenues/income. Preference for solutions to be explored by BASAR are ordered from those providing high jobs/high revenues to a high/medium mix to medium/medium. Identifying these ranked solutions BASAR then listed the existing providers of the solutions to the constraints and areas where there are opportunities for BASAR to provide assistance to overcome the

identified constraints within the sector. Identifying these gaps, the report then provides possible BASAR-led solutions.

VALUE-CHAIN MAP AND PARTICIPANTS

The construction value chain is presented visually through a map of the sub-sector. The purpose of the map is to outline flow through differentiated channels from inputs/suppliers to market delivery (construction sites) and to highlight the different economic relationships between the different enterprises and actors within the system. The map delineates the various functions required to complete a construction project and the key participants that carry out those functions and services. The map serves as the focus of discussion and is the basis of displaying key information.

Construction Sector Map



*ET Gov't budget includes $200m/year, next four years; combined ADB, WB, Japanese Gov't, other donors is around $200m/year
Inputs/Services: ET – inputs sourced locally; F – inputs sourced through imports

A. Sector Functions and Participants

Inputs/Supplies: Also known as supplies and materials. These are the raw inputs that all construction firms need in order to implement their projects. Inputs include cement/cement blocks, lumber, electrical equipment, electrical services/suppliers, plumbing (installation and materials), heavy equipment and hardware, to name a few. Most inputs for the construction sector in Timor are imported (see Table 1).

Table 1. Source of Timor-Leste's Construction Input Supplies*

Input	Domestic Production (y/n)	Imported From
Cement	Y – limited	Indonesia
Cement Blocks	Y – Timor Block	N/A
Lumber	N	Wet Lumber (low quality) – Wetar, Indo. Dried Lumber (high quality) – Ambon, Surabaya, Java (teak) Indo.
Electrical Equipment	N	Low Grade – China/Indo. High Grade – Australia
Electrical Services	Y	Timorese and Australian owned firms operating in Dili
Electrical Supplies	N	Low Grade – China/Indo. High Grade – Australia
Plumbing (Installations)	Y	Low Grade – Timorese formal and informal companies High Grade – Australian owned firms
Plumbing Supplies	N	Low Grade – China/Indo. High Grade – Australia
Heavy Equipment	N	Imported by international construction firms from Australia and Japan
Equipment Leasing	Y	Provided by both foreign

		and Timorese firms. Provide skilled operators as part of lease.
Hardware (nails, roofing, etc.)	Y – Tin roofing only	China/Indo.

* Shaded areas represent a service, not a material supply

There are various firms operating within this layer of the value chain, however there are no wholesaling facilities. For example, electrical and plumbing companies have limited stock in their inventories and place their overseas orders as they win large contracts. The same is true for cement and cement block. Lumber companies generally do have stock on hand, but are not involved in providing clients with high quality wood. However, all lumber companies bring their stock in via middlemen whom work as an association/cartel and control the trade within this market.

Labor: Though it could be considered as an input, labor serves its own important role within the sector. In addition, the creation of new jobs within Timor is a priority of both the government and USAID and therefore warrants a specialized focus.

Labor within the construction sector of Timor can be divided into two broad categories – unskilled and skilled as described herein. With an urban unemployment rate of 20% (2001) and there being no accounting for the under employed, and 40% of the population living in poverty; there are large numbers of potential workers in both areas.

Unskilled Labor

Unskilled labor is defined as individuals who lack formal training in trade skills (carpentry, electrical, plumbing) who are hired for manual, labor-intensive jobs on a work site. There are large quantities of unskilled labor in both the rural and urban areas and are hired by contractors as needed. Many contractors meet resistance from local residents when they start a construction job, and under threats of retribution from the community they typically hire local workers to do the manual unskilled jobs (digging, stacking concrete blocks, clearing land, etc). Donor-tendered jobs (such as the WB-funded school construction project) require contractors to hire 80% of the unskilled labor from Timorese labor pools.

Timorese Skilled Labor

There are skilled Timorese workers in electrical, plumbing, architecture/design, and mechanical/structural engineering. Most large contractors have a small number of local skilled workers, almost all of whom they have trained on the job over a period of five years. Most indicated that the local labor pool lacked the proper skills, knowledge of the type of materials used on imported parts, and the type of technologies used within the industry.

Foreign Skilled Labor
There are a large number of foreign skilled workers active in the Timor construction industry with most coming from the Philippines, China, Indonesia, Malaysia, and Singapore. For example, most site managers are from the Philippines. Electricians and plumbers come primarily from China, Indonesia or Singapore. Most construction firms would prefer to hire locally – not only would it help them with public relations but foreign skilled labor is paid at least 2-3x's local skilled labor.

Construction Companies: At the onset of the reconstruction of Timor, large international construction firms arrived to implement donor-funded efforts (see vertically integrated construction below). At that same time a number of Timorese construction firms started, however most were as a result of a foreign investor partnering with Timorese silent partners. These firms were awarded subcontracts from the foreign firms. As the market expanded and the government of Timor engaged in it own procurement of construction projects, many Timorese "paper firms" emerged. Those winning contracts turn around and "sell" (for an average of 10% of contract value) or subcontract all the work out to a larger, legitimate, and often times, foreign, firm.

Vertically Integrated Firms (foreign and local)
There are a handful of large firms that integrate several functions – from general contractor management, to design and engineering specifications, to construction, to procuring inputs. Many of them maintain a considerable staff of skilled labor (mostly foreign but also some local), and pick up unskilled labor as needed for each job. Most of these firms are foreign-owned, many having established joint ventures with Timorese partners in order to qualify as local firms. These firms are the main players when it comes to large-scale urban residential construction (e.g., Jackson Lay), commercial/retail construction, as well as government and donor construction (roads/bridges, water/wastewater, schools/hospitals, government buildings, etc.). They may subcontract out some of the specialized trades – electrical and plumbing, but this is rare.

Designers/Architects: We found a small number (2) stand-alone design firms, providing land surveyors, engineering or architectural designs. These firms work in both the design of private residential/commercial construction and government/donor projects. In the case of the latter, they are contracted for building design, structural specifications and supervision/management of a project. They are not involved in construction. However, in some cases the firms are hired to supervise construction to insure that the materials being used meet the client's specifications. With the exception of these two firms, in almost every case the design/engineering specialists we met worked for one of the larger integrated construction firms. There is little/no formal education in this field; almost all of the skills are obtained abroad.

Timorese Developers: In the private residential market, there are a few firms (2-3) that are developing residential properties. These include Jackson Lay Construction – developing a group of 50-60 homes behind the Australian Embassy, and a Singaporean/Timorese firm developing a smaller group of 4-5 private residences behind the U.S. Embassy. These firms are vertically integrated – they combine land development (utility installation, etc), design/architectural activities, and the actual construction. They do occasionally subcontract out for specialized trades – plumbers or electricians – but only as needed. They tend to use firms/individuals they have used before. These firms estimate that the market for private residential and commercial development in Dili is between $8-$10M/year.

Foreign Consulting Firms: There is as at least one foreign construction consulting firm in Timor, Tobishima. Due to the conditions attached to Japanese donor funds, allowing for only Japanese companies to implement Japanese donor-funded work, Tobishima established its presence here for just that purpose. It implements designs for road and building construction/reconstruction projects and then manages the implementation process. All of projects that they are charged with implementing are subcontracted down to other international and local construction firms. However, do to Japanese set standards on item like cement and steel, Tobishima imports those supplies directly. They then, in turn sell the supplies to the construction firms for installation.

II B. Channels

Channel 1 – Rural Housing: Typified by the building of rural homes using local, basic housing stock – bamboo or homemade brick walls and thatched roofs. Homeowners purchase supplies locally, or as with thatched roofing and some lumber, harvest their own. Beyond hiring family members to assist with the construction, there is a limited market in this area.

Channel 2 & 3 – Urban Housing and Commercial Construction (est. $10m/yr): There are currently two housing development projects on-going in Dili. There is a large project called The Palm Springs, which is being implemented by the vertically integrated Timorese developer, Jackson Lay. With this project he is creating a gated community with up to 50 – 60 single-family homes and bungalows for rent. The target market is expatriates. There is a similar project being carried out at a much smaller scale by a Singaporean firm, with 4 – 5 Balinese style villas behind the U.S. Embassy.

The rest of the market is dominated mostly by housing renovations carried out by families looking to rent their houses out to expatriates, and the development of some commercial enterprises where investors have sound land title.

The continued development of this sector is hampered by the murkiness of land title within Timor. There is no clear definition as to what one needs in order to

get clear land-title to their land. It appears that all cases are reviewed individually. In addition, the government itself is restricting development in areas that it in the future may want to claim and develop on its own. This greatly hampers owners ability to develop their properties or for external investors to invest in Timor's economy.

Channel 4 – Infrastructure/Government Contracting: Currently, this is the dominant channel in Timor with more that $400M in government and donor contracting. Planning forward the government of Timor plans to implement $200M a year in new construction, refurbishments and maintenance contracts for the next 5 years. This market has a multitude of functionaries. It supports large international, international/Timorese joint venture and Timorese construction firms carrying out both government and donor projects. Some of the Timorese firms are "paper firms" and therefore there has been the growth of small to medium sized companies providing construction and other services to the larger companies to implement the work. In addition there is a cadre of professional companies (plumbers, electricians), input suppliers, independent skilled contractors and unskilled laborers that all rely on this market.

Sub-Sector Constraints and Opportunities (Solutions)

CONSTRAINT	SOLUTION / SERVICE
SKILLS	
Insufficient supply of skilled Timorese labor in electrical, plumbing and carpentry trades	1. Higher level skills training available to skilled workers and linked to commercial construction standards and demand. 2. On-the-job training available to apprentice workers in electrical, plumbing and carpentry trades.
No mechanisms to place or find skilled Timorese labor	3. Facilitate the creation of mechanisms to link skilled labor with job opportunities.
Lack of business and financial management skills among suppliers and local construction companies. ▪ Lack of product differentiation ▪ Little firm level marketing ▪ Lack of entrepreneurial vision ▪ No/little cash flow analysis ▪ Weak knowledge of bank requirements	4. Access to business and financial management training to construction supply and local construction companies.
INPUTS/SUPPLIES	
Lack of timely delivery of imported and domestic inputs.	5. Access to timely delivery of imported and domestic inputs.

Lack access to higher quality lumber	6. Access to higher quality lumber.
Lack of timely access to lumber	7. Increase in the efficiency of lumber supply chains.
Lack of sufficient access to loans among skilled tradesmen to purchase tools and equipment.	8. Increased access to credit in the $300 - $3,000 range for skilled tradesmen.
BUSINESS ENVIRONMENT	
Inadequate access to loan products from $5,000 - $25,000 to finance working and investment capital loans for construction supply and construction companies.	9. Increase access to loans in the range of $5,000 - $25,000 for construction supply and construction companies.
Weak procurement regulations	10. Strengthen procurement regulations
Procurement regulations are not enforced	11. Regulations are enforced
Property rights are weak, discouraging both foreign and domestic investment	12. Access to land titling and registration for property developers. 13. Government consistency in honoring private property rights 14. Creation and operation of a collateral registry
Nonexistent building and safety codes reduce demand for high quality labor and inputs	15. Building codes and safety codes that meet international standards are adopted and enforced 16. Increased awareness of the demand for international building and safety standards by donors, government and the general public.
Customs systems delay and add costs to finance price of inputs	17. Improved and more efficient customs services.
Lack of port facilities to handle smaller boats delivering imported construction supplies	18. Expanded port facilities to handle smaller, non-container, boats (Tiabar).
Poor infrastructure and roads limit distribution of inputs/equipment outside Dili	19. Improved infrastructure to/within the regions

RANKING SOLUTIONS

USAID is holding BASAR accountable to deliver on the required results of the project contract: increased number of new jobs created and increased income/revenue by USAID-assisted private sector clients. In determining which

of the solutions that BASAR should consider exploring, those listed above were ranked according to their potential impact on the results framework established by this contract. The ideal is to invest/pursue an option that is a High/High in its delivery of both a high level of new jobs and a high increase in revenues/income. High/Medium, to Medium/Medium should also be considered. The target area for potential BASAR solutions is shaded in the matrix below.

Table 2. Ranking of Solutions to Constraints within the Construction Sector

JOBS	High		**19** (Improve infrastructure)	**12/13** (Land titling & Gov. respecting title rights) **15** (Building & safety codes adopted)
	Medium		**6** (Access to higher quality lumber) **8** (Access to credit $300 - $3,000) **14** (Collateral registry)	**1** (Higher level skilled training) **9** (Access to credit $5,000 - $25,000) **10/11** (Strengthen and enforce procurement regs.)
	Low	**16** (Increase demand for international building/safety codes)	**2** (On-the-job training) **3** (Linking skilled labor to jobs) **4** (Business and financial management training) **5** (Timely delivery of imported goods) **7** (Increase efficiency of lumber supply chain) **17/18** (Improved port and customs processing of imports)	
		Low	Medium	High
	INCOME			

Table 3. Ranking Solutions (with Providers) for BASAR Consideration

Constraint	Solution	Existing Providers	BAS
High/High			
Property rights are weak, discouraging both foreign and domestic investment	12. Access to land titling and registration for property developers.	USAID Land Law Program II	*See Ena Section*
	13. Government consistency in honoring private property rights		*See Ena Section*
Nonexistent building and safety codes reduce demand for high quality labor and inputs	15. Building codes and safety codes that meet international standards are adopted and enforced		Yes
High Jobs/Medium Revenues			
Poor infrastructure and roads limit distribution of inputs/equipment outside Dili	19. Improved infrastructure to/within the regions	WB, ADB, UNDP – road works programs	No
High Revenues/Medium Jobs			
Insufficient supply of skilled Timorese labor in electrical, plumbing and carpentry trades	1. Higher level skills training available to skilled workers and linked to commercial construction standards and demand.	Don Bosco (Dili and Baucau), Portuguese and Brazilian supported tech. schools, Hera Technical College	Yes
Inadequate supply of loan products from $5,000 - $25,000 to finance short-term working and investment capital for input and small construction companies.	9. Increase access to credit products in the range of $5,000 - $25,000 for construction supply and construction companies.	CGD, Bank Mandiri, IMfTL	Yes
Weak procurement regulations	10. Strengthen procurement regulations	WB	*See Ena Section*
Procurement regulations are not enforced	11. Regulations are enforced		*See Ena Section*
Medium/Medium			
Lack access to higher quality lumber	6. Access to higher quality lumber.	Imports from Java and Surabaya	Yes
Lack of sufficient credit products among skilled tradesmen to purchase tools and equipment.	8. Increased access to credit in the $300 - $3,000 range for skilled tradesmen.	AMfTL, CGD	Yes
Property rights are weak, discouraging both foreign and domestic investment	14. Creation and operation of a collateral registry	N/A	*See Ena Section*

BASAR INTERVENTIONS

Now that areas have been identified for BASAR to design programs, the current constraints faced by both those in need of the solution (users) and those that presently exist (or could) in the market place providing the solution need to be examined. Understanding these dynamics BASAR is able to identify where, and in what form, the project can intervene.

Building Codes and safety codes that meet international standards are adopted and enforced.

Currently there are no uniform standards for construction in Timor-Leste. Without building and safety codes to regulate and enforce quality, construction companies can produce sub-standard work with substandard inputs, reducing the demand for quality construction and inputs. The sub-sector analysis revealed incidences of corruption and substandard work as a result. Adoption and enforcement of building codes would have a ripple effect throughout construction, requiring a minimum standard of quality inputs and increase demand for skilled tradesmen who can work with improved materials and adhere to international building techniques. Of all the enabling environment constraints the project identified, this was the one in which we found no other donor efforts and which would have a significant direct impact on the income and number of jobs for skilled tradesmen in Timor.

Higher level of skills training available to skilled workers and linked to commercial construction standards and demand.

Currently there are skilled training courses being offered by various institutions including:

- Don Bosco Training Schools in Baucau and Dili
- A technical training school in Dili sponsored by the Portuguese Embassy
- A technical training school in Dili supported by the Brazilian Embassy
- The technical training college in Hera
- The Becaora technical high school

During the course of the sub-sector assessment it was found that there are skilled electricians and plumbers in the market place that are picking up work on construction sites as hired hands. Most have only basic training in their trade, and therefore large construction companies are hiring more expensive foreign workers to conduct higher standard/skilled work.

The critical link between the training available and the demand by the purchasers of skilled workers is missing. This disconnect is resulting in the following constraints for both the users and the providers of technical training.

User Constraints	BASAR Linkage	Provider Constraints
No advanced level of technical training available.	Promote design of	Providing rudimentary skills in technical fields.

	advanced training courses that is linked to the skills demands of the market.	Funding constraints to expand course offerings.
No standard for technical certification in Timor	Link training providers with employers of skilled tradesmen	Training does not provide skill set for Australian standards.
Training courses are not linked to employment opportunities		Training programs are not designed in response to the needs of the sector.

The detailed approach to creating these linkages and assisting in the improvement of the quality training available for skilled tradesmen is detailed in Construction Task #2.

C. Increased access of construction MSEs to loans in the range of $5,000 – $25,000 for working and investment capital

The sub-sector assessment revealed that supply input enterprises and small local construction companies (both at the micro and small enterprise level, MSE) have limited access to capital and weak networks of supplier credit. This contributes to delayed delivery of key inputs to the sector, limited ability of the input suppliers to respond to market demand for their inputs and subsequent loss of business and therefore growth potential of those MSEs.

In general, relationships between suppliers and their input sources are not strong in part due to the fact that nearly every input to the construction industry (from cement mix, wood/timber, wiring, steel, roofing to machinery and hardware) is imported through middlemen who maintain contact with the vender. In some cases, such as imported wood/timber, middlemen enjoy near monopoly position for their market, based not only upon their established networks with suppliers overseas but in some cases based upon virtually sole license from government. Credit extended to construction input firms by their suppliers is virtually nonexistent.

Through activities addressing both the SMEs as potential borrowers and the financial service providers, BASAR will facilitate a more successful linkage between SMEs in construction and the three formal banks operating in Dili: CGD, Bank Mandiri and ANZ. Potential borrower SMEs will acquire training and TA to enhance their skills in business planning and financial management, including preparation of verifiable financial statements and cash flow projections; as well as stream-lined information on the lending requirements of banks, including business registration, TIN, and acceptable collateral in lieu of land and property, e.g. account deposits. Potential lenders will be introduced to an adapted credit appraisal tool developed specifically for accurately assessing the credit risk of semi-informal SMEs, and consensus among the lenders on minimum requirements for SME loan eligibility and more effective client monitoring will be sought through a process of dialogue and market exposure. Links to SME credit risk raters will be facilitated along with the establishment by BPA of a credit registry.

User Constraints	BASAR Linkage	Provider Constraints

Lack of access to credit for working and investment capital	Link firms to Banks; Advocate for banking decree on enforceability of contracts.	Banks perceive firms as risky, require land certificate for collateral
Poor Financial and Business Management Skills	Improve responsiveness of IOB/CDE to demand of construction MSEs	IOB and CDE Tools have not provided practical access to banks, serve a generally lower segment of demand
Credit often requires documentation of land title	Facilitate uniform standard for credit worthy MSE firm with alternative to land as collateral.	Banks must protect against risk of lending in post-conflict environment

D. Access to higher quality lumber.

As detailed earlier in this report, all lumber for construction is imported from Indonesia. Currently the government of Timor has a moratorium on logging from local forests so the only supply that is available is from abroad. The imports are controlled by an "association" of expeditors that facilitate the clearing of lumber through the port and arrange for delivery to the purchasers. The "association" is a collection of about 23 whom set prices for port handling fees and monopolize the sourcing of lumber from Indonesia.

The lumber that is brought in is of low quality for it is from mixed tropical trees – some hard, some soft. In addition, due to the volume of container trade at the Dili Port Authority, the smaller boats used for the importation of the lumber are often delayed for customs clearance. This results in a higher exposure of the lumber to salt water and after excessive delays leads to the practice of dumping the wood into the harbor. This lumber is then dragged ashore and delivered.

All high quality wood that is brought in is done so via special orders. For example, an embassy may request high quality wood to be brought in from New Zealand. Foreign and Timorese/foreign joint venture contractors prefer higher quality wood for it reduces cracking and warping. He does have some supply contacts in Surabaya where he imports, but has to do so via the association.

In addressing the need for the access to higher quality lumber there are two issues. First there is no middle market between the current low quality imports and the high-end requests per client. Secondly, the lack of choices for lumber purchasers due to the fact that the suppliers are being dictated by the expeditor cartel. Such conditions have created the following constraints:

User Constraints	BASAR Linkage	Provider Constraints
No local supply of quality lumber	Investigate value added treatment to imported lumber to increase quality	Are not expanding their market into higher quality lumber

Supply controlled by expeditor association	Seeking market linkages to other suppliers providing higher quality lumber	Only provided via expeditors on a per job basis
Limited demand for lumber	Working to create standard building codes for Timor	

E. Increased access to credit in the $300 - $3000 range for skilled tradesmen.

Skilled Timorese plumbers, electricians, carpenters and stonemasons are in short supply in the construction sub-sector, with foreign tradesman filling the gap at higher cost to construction firms. Local tradesmen with the skill to compete are in great demand. Based on our interviews, an estimated 90- 200 local skilled tradesmen operate independently, working for several clients in any given period. Jobs vary from local house construction and refurbishment (at nearly pro bono wages) to high-end international construction firms and the tradesman mix these types of jobs in a given week. They are, de facto, sole proprietors of small businesses, although in general do not view themselves as such.

Local tradesmen have exceptional income opportunities. The highest skill segment report earnings up to $25/hr for high caliber work for international construction firms and local developers. This hourly wage does not represent full-time work[11] but one of the many income streams for the independent skilled tradesman in Dili.

One constraint to their growth and trades service delivery is that most do not own their own equipment and tools. This increases dependence on their own clients, produces delays and slows productivity. There is demand among these independent enterprises for individual loans of $300-$3000 to finance equipment, tools, capital investments (such as car repair) and high level training.

None of the tradesmen interviewed had ever taken a loan for their business. Two individuals reported being turned down for loans at CGD and Mandiri, respectively, on the basis of their proposed loan being too small ($600). Beyond loan size, the tradesmen are constrained by limited financial and business management skills and lack of experience in the financial sector. They did not operate formally as a business, were not registered.

In terms of loan size, the identified demand starts below the current reach of CGD, ANZ, and Mandiri and above that of the micro-finance institutions currently operating in Dili. Currently, IMfTL provides loans of up to $2000 but at 3.3% of total portfolio[12], it represents a small portion of its business. IMfTL could potentially expand its business loan outreach.

Beyond loan size, IMfTL will be constrained from meeting the demand by its operational and design flaws and the perceived high cost and risk of lending to the identified market.

[11] Independent plumber reporting $400 monthly wage in January 2005.
[12] Calculation based on IMfTL report Sept 8, 2005 on total amount of loan portfolio.

User Constraints	BASAR Linkage	Provider Constraints
Lack of sufficient credit among skilled tradesmen to purchase tools and equipment	Support expansion of IMfTL business loans	IMfTL has generally weak systems to gain information about potential new markets for their products.
Loan size falls above core business of MFIs and below commercial banks	Link to IMfTL	Banks perceive the market as high cost and high risk.
Limited financial and business Management skills	Link to CDE/IOB	CDE training programs are not linked to loan access.
Not registered as business, no business plan (requirement of IMfTL for loan)	Link to formal sector	IMfTL requires formalization of business to offer business credit

The detailed approach to creating these linkages to facilitate access to credit among skilled trades is presented in Construction Task 5.

Enabling Environment

BASAR Role in Addressing Enabling Environment Constraints in Construction

There are several regulatory constraints to the development of a robust construction industry in Timor – these include problems related to land ownership and property rights, the procedures governing the procurement process for government-funded construction projects, and the lack of building or safety codes for construction. Addressing these issues would have significant positive ripple effects throughout construction – resulting in increased demand for quality construction materials, for higher skilled labor in selected trades, and an overall increase in foreign and domestic investment into land and property in Timor. Few of these issues are within the purview of BASAR, given the project's scope and budget. Fortunately, in most cases, another donor or project is engaged on some level at addressing these issues. BASAR's role, then, will be to provide input and feedback on property rights and procurement with regard to impact on construction and property development.

Property Rights

One of the biggest threats to growth in the construction industry, and indeed to investment generally in Timor, is uncertainty with regard to property rights. Land ownership remains unclear. Property owners with Indonesian property certificates face considerable hurdles in claiming ownership. Several companies we interviewed indicated that there were two main problems:

- Clarifying ownership in order for a firm to purchase tracts of land for development;
- Government wavering on current ownership – in some cases requiring a stop to reconstruction/rehabilitation of property while ownership is 'clarified'; in other cases claiming government ownership of valuable beach-front property, for example, with questionable justification.

In the first case, the difficulty in identifying ownership slows the pace of development. In the second case, government claims on land are sending a chill through the construction industry, including current owners of hotels, restaurants, and various other buildings and structures. Growth in the construction industry, and Timor as a whole will require:

- Continued progress on land ownership, land titling, and property/collateral registries;
- Government honoring private ownership.

BASAR Role

A follow-on project to the ARD Land Law project will come on-line. BASAR will work closely with the selected contractor, providing inputs on unstable property rights and their impact on the construction industry.

Procurement

With World Bank support, the government is in the process of developing its procurement regulations. There are three laws in various stages of development. The first, procurement law, is under development. There are currently two versions of the draft and the World Bank is working with the government to resolve differences between the drafts. The second and third – contract administration and sanctions on infractions – are also under development and should be submitted this fall. In advance of the new legal framework, the 2000 UNCTAD procurement regulations are still in force. New drafts of procurement regulations should be drafted to include provisions that will maximize potential impact of construction funds on Timorese labor and incomes. Specifically:

1. Regulations should encourage the participation of Timorese firms.

As stated previously, current the "pre-qualification" process requires firms to register with the government, which in turn and divides firms into three size categories for government projects:

A – Level Firms ($500K - $1m);
B – Level Firms ($150K - 500K
C – Level Firms (under $25K – 150K)

In theory, pre-qualification requires a firm to be Timorese, or at least a JV with a Timorese firm. However, the government has the option, on every tender, to use the pre-qualification process (which would ensure some value of each contract going to local firms) or the 'post' qualification process. In the latter, government specifies the minimum requirement of participating firms, and all firms – local and international – can compete. By far the post-qualification process is the one utilized by government, which ultimately means that there is no regulatory guidance or requirement to use either local firms or local labor inputs.

Based on current drafts (though these are still a work in progress) the new set of laws follow international standards in the sense that it divides procurements into works, goods and services. Tenders worth less than $1m for works are domestic competitions only; less than $250K for goods; and less than $200K for services. Regulations following this pattern, particularly in a country like Timor where there are very few domestic firms that can fulfill all the activities required in each construction project and where there is a preponderance of foreign labor, most

often result in contracts going to Timorese firms with most of the input supplies and labor going to foreigners. A better strategy is for procurement regulations, regardless of the total value of the contract, to have some minimum requirement for participation of local skilled labor, so that Timorese workers are getting some of the higher construction incomes. If the project is able to affect/increase the supply of Timorese skilled labor, at the same time that the procurement regulations require more participation of local labor, the potential benefits for the local income and job levels is significant.

2. Government needs to be a customer with prompt payment

Regardless of whether foreign or domestic firms are awarded the construction contracts, government is notoriously slow in payment – even non-payments according to some firms. This is a major deterrent for participation from the Timorese private sector, many of whom face significant cash-flow obstacles and cannot afford to front the money while waiting for government payment. In some cases banks and other financing mechanisms can help bridge the gaps; a better solution is for government to address its payment problems and to keep short accounts with the private sector.

3. Procurement regulations should not be overly cumbersome

The current pre-qualification process is overly cumbersome. Presumably, if a firm is 'pre-qualified' they would not be required to submit authenticated corporate registration and tax registration document with every bid. In fact, this is not the case. For each tender a firm must submit an authenticated copy of their business registration form, taxpayer id, tax declaration (recent) and pre-qualification documents. This requires a visit to – at least – four agencies at least twice (to drop off the request and to pick up the authenticated documents), and puts the burden squarely on the firm to get authenticated documents each departments for each tender. Of course, this burden disproportionately affects burden on smaller firms. And it appears to defeat the purpose of being registered and pre-qualified, if the firm has to demonstrate its qualifications and paperwork with each tender.

Alternative approaches would be for the state to keep a list of pre-qualified firms and, as long as the firm is on the list, they are eligible to compete without resubmitting paperwork each time, or requiring verification of 'pre-qualification' status after selection of the firm but prior to award. That way a firm would only have to go through the process for those tenders they have won.

4. Procurement regulations must promote transparency and confidence in the selection process

According to the Director of Procurement of the Ministry of Finance and Planning, they do not provide results from the tender unless it is requested, and even then they will only tell the bidder how their proposal was scored – they will not compare it to the winning tender (which is of limited value for learning purposes). A better approach is for government to post the results of each tender, and to provide losing firms with information about the winning bid such that they can improve their submission in subsequent tenders.

BASAR Role

DAI has discussed potential collaboration with the World Bank to support their on-going work on procurement reform. The Bank is leading efforts to revise the legal framework, and may select 3-4 line Ministries to pilot test a new procurement process. The Bank has invited BASAR to participate with them in the procurement efforts, and to help identify weaknesses in the area of construction procurement. The Bank is in the process of finalizing the scope for its new project, and BASAR will continue discussions with them about a potential supporting role.

Appendix A

Schedule of Meetings by Consultants

Monday, September 12th

11:30 – East Timor/JJ McDonald and Sons Construction, Mr. Raja, Director of Operations

2:30 - Director of Procurement, Ministry of Finance and Planning, Senor Gregoriu

4:00 – Habitat for Humanity, Mr. Butch Batilong, National Director and Mr. Abilio Antonio Freitas Belo, Asst. Nat. Dir.

Tuesday, September 13th

9:30 – Abidio, Timorese Plumber

10:00 – Jackson Lay – Developer

4:00 – Tam Electric – Electricians

4:00 – Caltech, Jean Vezina, Operations Manager

Wednesday, September 14th

10:00 - CIARQ Plan Consulting, Jose Medina, General Manager

11:00 – World Bank Fundamental School Quality Project (FSQP), Trevor Paris, Program Officer, 723-6476

2:15 – Asian Development Bank, Charles Andrews, Procurement Manager, candrews@adb.org

Thursday, September 15th

9:00 – Rocky Construction, Roque Mazaredo, General Manager

11:00 - Foudacao Oriente, Alvaro Manuel da Conceicao Antunes, Director

Friday, September 16th

10:00 – Bakkante Construction, Andreo Dumas Montero, Operations Director

2:00 – Expeditors Association, Antonio Amaral Ximenes, President

4:00 – Caltech, Jean Vezina, Operations Manager

4:00 – Eclipse II Lumber, Tony Corria, Owner

Monday, September 19th

9:00 – Esset Electrical Sales

10:00 – Kai Watu Kmanek, Fernando Afonso da Silva, Director

Tuesday, September 20th

10:30 – Konfederasaun Sindikatu Timor Leste (KSTL), Jose da C. da Costa, President

Wednesday, September 21st

8:30 – FSQP, Amerio, Project Manager

11:30 – Don Bosco, Baucau, Father XXXXXXX

4:00 – ILO, Jose Assalino, Chief Technical Adviser

Thursday, September 22nd

10:00 – Timor Block Building Industry, Suminto Amin, Director
2:30 – Tobishima Corporation, Shigeru Ohara, Administration Manager
4:00 – World Bank, W. Bernard Drum, Sector Development Specialist

Friday, September 23rd

2:30 – Arch Timor Engineering Consultants, Aderito Lca de Araujo, Director

Appendix B

Contact List

Arch Timor Engineering Consultant, Aderito Lca de Araujo, Director, 723-6509
Asian Development Bank, Charles Andrews, Procurement Officer Roads & Infrastructure Projects, candrews@adb.org
Bukkante Construction, Andreo Dumas Montero, Operations Manager, 723-0797
Caltech, Jean Vezina, Operations Manager, 723-0869
CIARQ Plan Consulting, Jose Medina, General Manager, 723-6739
Fundacao Oriente, Alvaro Manuel da Conceicao Antunes, 332-180
Habitat for Humanity
Butch Batilong, Nat. Dir. 726-9425
Abilio Antonio Freitas Belo, Asst. Nat. Dir. 723-4556
ILO, Jose Assalino, Chief Technical Adviser, 726-9717
JJ McDonald & Sons, Raja, Operations Manager, 723-0542
KSTL, Jose da C. da Costa, President, 723-9824
KWK Consultant, Fernando Afonso da Silva, Director, 723-4681
Rocky Construction, Roque Mazaredo, General Manager, 723-5373
Tam Electric, Eddie 724-1842
Timor Block Building Industry, Suminto Amin, Director, 331-0399 or 723-5189
Tobishima Corp., Shigeru Ohara, Admin. Manager, 321-622 or 726-9286
World Bank
Trevor Parris, Program Manager, Fundamental School Quality Project, 723-6476
W. Bernard Drum, Private Sector Development Specialist (DC) (202) 473-2038; dbrum@worldbank.org
Elisabeth Huybens, Country Program Manager

ATTACHMENT 3

Rapid Assessment of demand for and supply of financial services among MSMEs in the Coconut Sub-sector Value chain

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1. RAPID DEMAND-SIDE ASSESSMENT

1.1 General overview of demand for financial services

As per the census conducted in 2004, the resident population of Timor-Leste totals 924,600 people, up 17% from the Suco Survey conducted in 2001, Dili, Oecussi and Liquica having grown at the fastest pace by 20-39%. 40% of the residents live in the more urbanized districts of Dili, Baucau and Ermera[13].

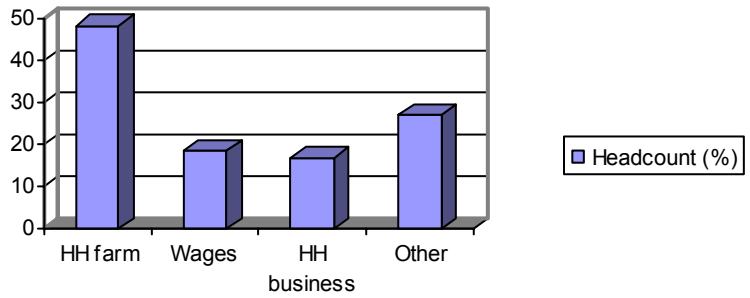
In 2001, the economically active (15-64 years of age) labor force comprised only 47% of the population, which corresponds to the reported 50% of the population being under the age of 15 years. While participation in the labor force in 2001 was markedly higher for men (81%) than women (40%), only 15% of the total work force is receiving wages or salary, primarily from GoTL civil service jobs. Extrapolated to today's figures, the total economically active population would comprise 434,575 people, which would be considered the total market for financial services, and of which the non-poor and the 15% wage earners could potentially access formal banking services.

Around 85% of the population is self-employed, the vast majority in agriculture. Whereas 86% of the population reportedly lived in households with access to land in 2001, and 95% of the households cultivated their land, the size of land holdings was only 0.2 ha per person, and productivity was low – so low, in fact that those *without* land access, both in rural and urban areas, were less poor than those with land access.

This correlates with the finding that non-poor rural households are more likely to have non-farm income sources than the poor, and earnings from these sources are higher than earnings from farming[14]. The capability to rely on non-farm sources of income, e.g. a micro business, is thus in general associated with low(er) poverty[15]. Households whose resources are at least in part gained from a *household business* (but not from wages), experienced substantially less poverty than households whose head only worked on their farm, as illustrated in Figure 1.

Among households whose head (in the the economically active age group) is generating income from farming alone, poverty is most widespread (49% are poor), while poverty is lowest among households, whose heads are either employed as civil servants and teachers or generate income as traders, especially in urban areas[16].

Figure 1: Poverty & Employment Status of the HH Head



Source: 2001 TLSS in "Poverty in a New Nation", Fig. 3.6, p. 29.

[13] UNFPA: Census Timor-Leste 2004, Provisional Sub-Districts Counts, 09/14/2005.
[14] Data from the Timor Livings Standards Survey 2001 as analyzed in Timor-Leste: Poverty in a New Nation, Analysis for Action, GoTL and Development Partners, May 2003.
[15] Ibid., p. 75.
[16] Poverty in a New Nation, pp. 72-73.

While income will move poor families toward self-sufficiency, acquiring assets is the key to their achieving economic security. Assets act as insurance against economic uncertainty and as wealth accumulation to prepare for future expenses. It is also essential for access to conventional credit. Material assets in Timor-Leste comprise primarily of land, housing and livestock. Rural poverty, however, does not decline markedly until the value of livestock of a household exceeds $ 300. Financial assets generally play a minor role in subsistence economies, but it is noteworthy that 46% of the population in 2001 had savings in cash or jewelry, averaging 140% of their monthly expenditures. The poverty gap suggests a close link between access to markets (major urban areas and the coffee market in rural center region) and the ability to build financial assets as well as a clear correlation between savings and wealth: Poverty dropped close to zero for per capita savings in excess of $150[17].

In 2001, 39.7% of the population lived below the poverty line. Assuming the same percentage, this would mean a current total of 367,000 people living below the national poverty line of $15.44 per month[18], the vast majority in large (average size 4.7), male headed households in the rural areas, surviving on subsistence agriculture, and having little education.

Most of the 78,100 poor households that these people represent[19] have access to land, even if unregistered, and most farm the land. In addition to farming, some 10% operate non-farm household businesses, and are better off for it. The existence of infrastructure (especially sanitation and electricity – surprisingly access to roads has little payoff) reduces poverty, and irrigation, high-value crops (e.g. coffee rather than maize) and a local market presenting income generating opportunities from non-farm activities affects both farm and non-farm income generation positively[20].

The estimated maximum market for financial services in Timor-Leste is thus small by international standards, at 434,575 people, and a total of 367,000 poor people traditionally excluded from the formal financial sector and served by MFIs.

Successful provision of financial services requires customers that can use and benefit from these services. Access to financial services for the poor is not a universal and all-encompassing panacea for eradication of poverty. Access to safe savings and credit for income generation is one of many services that poor households need to extract themselves from the grips of poverty, but the building of human capital (education, skills, empowerment); enhanced health (water, sanitation, birth spacing and access to health care and nutrition education); and most importantly, the infrastructure to generate increased wealth from livelihood activities (local cash economies, access to markets and market information) are crucial factors impacting the ability of poor people to succeed in improving their livelihoods.

Without an income generating household activity, credit in particular can over-indebt households, making them poorer. Adjusting for this factor by 25% due to the current low level of economic activity in rural Timor-Leste, we reach a total minimum market estimate of 58,575 poor households demanding and able to utilize microfinance services, of which 46,860 (80%) reside in rural areas (see Figure 2).

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[17] Ibid., p.81-82.

[18] The national poverty line of Timor-Leste was established in 2001 as the often quoted $0.51 per day or $ 15.44 per person per month, but using the accepted alternative calibration of the price per calorie to derive the Purchasing Power Parity adjusted exchange rates allowing for comparison across boarders, the line is actually $1.50. Timor-Leste Poverty in a New Nation: Analysis for Action, May 2003.

[19] As microfinance is normally serving only one member of the household, but benefiting the entire family, the market size is often given in number of households, which also adjusts for the young population of Timor-Leste.

[20] Poverty in a New Nation, pp. 207-210 – econometric simulations of changes in determinants and the effects on poverty levels.

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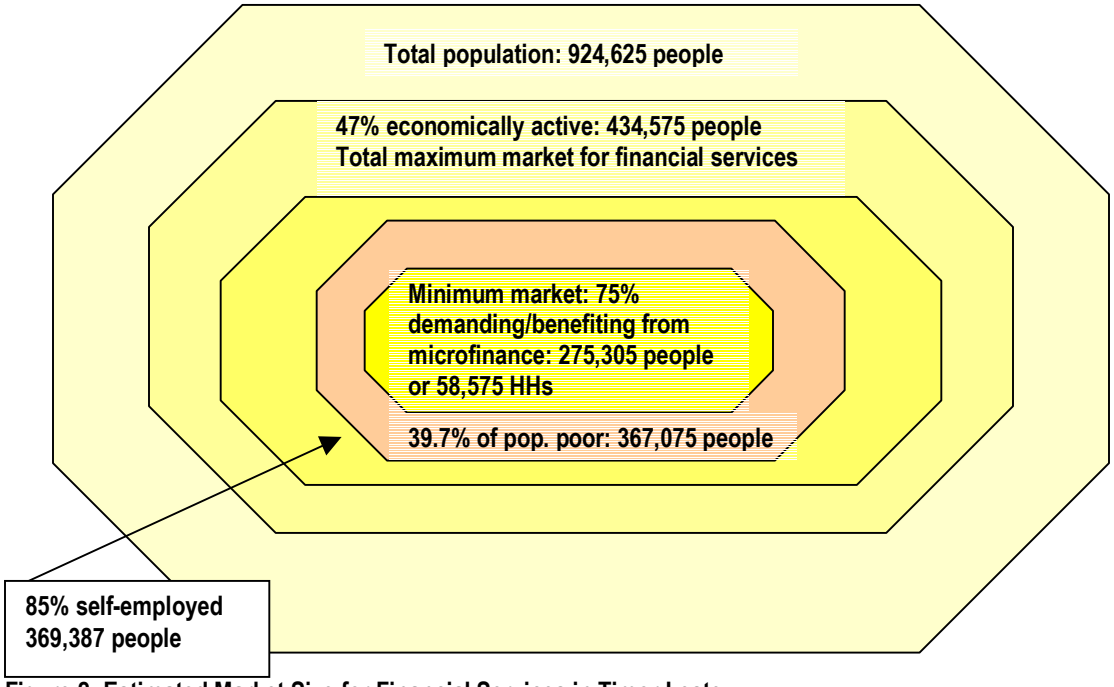


Figure 2: Estimated Market Size for Financial Services in Timor-Leste

1.2. Demand for financial services in the Coconut Subsector Value Chain

The total size of the coconut resource in Timor-Leste has been assessed by various studies over the past years, the results from which vary significantly. The most current estimate suggests that there is some 8,000 ha each holding around 150 coconut palms grown in the country, on plantations established by the Portuguese; on community land; and – primarily - under private smallholder ownership[21]. The disputed ownership of the Portuguese plantations is as yet not solved, and we could find no reliable data on the size of the community plantations.

If we assume that the vast majority of coconut (90%) are kept on small-holdings of 0.2-0.4 ha[22], totaling some 50 trees, as corroborated by information from MAFF officers interviewed, stating that most farmers own around 50 trees, this would suggest that there could be some 21,600 farm households growing coconut as a part of their farming activity. These would be located in rural areas at altitudes below 700 m in the East (Lautem, Viqueque and Baucau), South (Covalima, Ainaro and Mahufani), and West (Bobonaro, Liquica and possibly Aileu and Oecussi), and thus comprise some 20-22% of the rural households in those areas[23] or roughly 11% of the total population.

[21] Mike Foale quoted in the FAO proposal, 2003.
[22] FAO proposal, 2003.
[23] Calculated as % of total rural HHs, i.e. 80% of total households in the districts listed

1.2.1 Demand and structure at the production/basic processing level

Most of these estimated 21,600 farmers are intercropping and thus not basing their livelihood exclusively on the significant coconut resource, which has remained rather idle for some time in Timor-Leste. From coconut, the two key derived products at the base level is oil and copra, while coconut milk is infrequently produced for special dishes (catuba), and fronds and timber is used, but seldom marketed for construction (frames).

From the existing base of manual technologies for coconut oil pressing, it seems fair to assume that oil has traditionally been produced for consumption and the local market, but up till 1999, the majority of coconut growers in Timor-Leste were engaged in copra production, which was a significant export article to Indonesia. This trade ended abruptly with the unrest, and was only revived on a very limited scale in 2002 with 4-6 copra exporters re-establishing links to the refineries in Surubaya via Atambua and Kupang.

Primarily due to substitution by other oils, Copra prices have fallen sharply over the past years, the few (1-2) remaining copra exporters in Dili currently buying at $0.15-0.17/kg, down from $0.20-0.25/kg in 2004[24]. The trading prices at gate and in the sub-district markets have consequently fallen to $0.10-0.12/kg[25], and several traders have ceased buying this commodity altogether (e.g. CV Acelda in Baucau).

Oil continues to be produced and traded exclusively for household consumption in rural and urban markets at an average price of $0.90/liter[26]. While some traders and consumers prefer this oil for the preparation of certain dishes, locally produced coconut oil is in general regarded as a poor substitute to the heavily subsidized, widely available vegetable oil (Bimoli) imported from Indonesia (selling at an average of $0.50/liter).

Fresh nuts are sold at gate for juice consumption, to sub-district copra processors, and to the single current virgin oil processor (Colega PTA in Viqueque) at prices of $0.02-0.04/fruit. Pending the access to coconut, micro entrepreneurs/HHs in Timor-Leste can thus generate income on a very limited scale as follows:
Harvesting 10 nuts + approx. 6 hours work = 1 liter oil = $0.50
Selling 10 nuts to Colega: $0.40 (if certified)
Buying 10 nuts + 6 hours work to make edible oil to sell = $0.30
Selling 10 nuts to copra producers = $0.20
Harvesting 10 nuts + approx. 4 hours work = 1kg copra = $0.10
Buying 10 nuts to make copra to sell = LOSS of $0.10

[24] Interviews with exporters Naroman Kristal, Terima Hasil Bumi and CV Acelda, Sept. 2005.
[25] Interviews and FGD with growers/producers and sub-district trader/producer Mateus Aurez in Buicaren, Sept. 2005.
[26] Traders and retail vendors interviewed in Sept. 2005 quoted prices from $0.50-$1 for 600-750ml bottles

It is therefore not surprising that most coconut growers also produce other crops for consumption and sale (coffee, vegetables etc.), and that the demand for financial services to expand coconut processing among rural growers and primary producers/ processors at the bottom of the market is limited – the revenue attainable is in general insufficient to cover debt repayment at the current microfinance interest rates of 22-28% p.a. and generate a profit.

Several NGOs have been providing improved pressing technologies (presses/oil expellers) to farmers' groups free of charge, and while these were appreciated, the absence of maintenance services (or funds to pay for maintenance) combined with the limited profits attained have not fuelled an interest in debt-finance for more machinery at this level.

In the urban market, market vendors were using grating machines to sell grated coconut in addition to fresh and mature deshelled nuts. Machines were purchased in the local market and maintained, primarily by funds generated from the business.

Limited initial demand for financial services should not be confused with the widespread demand for additional cash/income, but rather be understood in the context of a stagnant rural economy. Growers would most definitely like more income, and to a certain extent cash from loans is considered income. Correlating data from the microfinance institutions, there is a general high initial demand among mono-cultural farmers (including coconut growers) for loans, but this demand plateaus quickly (after 1-2 loan cycles at around $100-150) as repayments become increasingly difficult to service from the limited revenue generated.

Encouragingly, a marked shift is seen in demand when basic income increases in the rural HHs, as demonstrated by the injection though jobs and sales of coconut to Colega pta (see below) of around $2,000 into a cash-strapped rural village economy every 6th week. On this basis, one MFI has extended its services to one of the three villages serving Colega (Buicaren) in September 2005, signing up a total of 135 new clients (30% of the district portfolio) in one day, and there is hope that the increased availability of cash from the processing plant combined with the input of debt-finance, even at the modest level of $50 loans, to the female members of the households, can generate the much needed growth and diversification of micro enterprises in the area.

1.2.2 Processing level

Like the economy as a whole, coconut as an economic subsector is only just beginning to be developed under East-Timorese management, and consequently, only 2-4 processing enterprises were identified during the brief assessment, the most successful appearing to be Colega PTA in rural Viqueque owned and managed by Mr. Vicente Ximenes.

In addition to personal investments, Colega PTA was established with a medium-term, fully collateralized investment loan of $200,000 obtained from Caixa Geral de Depositos (CGD), expected to be paid off in 3 years. While the owner would of course favor grant funds for further expansion of ancillary industry, including e.g. a fiber processing unit for export to China and

Thailand, it would appear that a sustained and increased export market for the virgin oil produced could support the servicing of additional debt-finance by this company at the level of $50,000-100,000[27].

Started in December 2004, this DME-based and certified organic virgin coconut oil processing plant currently employs 50 people at any one time, comprised of 10 supervisory staff and 3 teams of 40 primarily young, male workers in 8 groups of 5, self-selected from three adjacent villages that work in consecutive 12 day shifts. The workers and other farmers in the three villages (193 farmers certified organic) sell their coconut to the plant, currently at $0.04/fruit. The average monthly demand is around 15,000 fruit/month equivalent to $600, and each worker earns an average of $40 per 12-day shift.

A second processing plant in Viqueque opened in May 2004 to produce edible oil and soap from coconut using diesel-engine powered screw-expelling technology did not fare so well. In addition to personal investment, the initial financial service demand was $85,000 provided as a 3-year investment loan by CGD. After a month, during which 1,000 liters of oil was produced and found to be of substandard quality, the plant stopped operations, and no attempts to revive, sell or otherwise liquidate the substantial investment have been made since. While the financial service provider has been relatively accommodating in extending the loan term, it is questionable if the owner would qualify for a second loan. On the other hand, the investment is currently idly depreciating and the loan is frozen, and a solution including significant management input should be found.

A soap factory in Los Palos appears to be demanding coconut (oil) for its production of handmade soap for sale to tourists (e.g. through the airport shop). It was not possible in the short time available to visit this processing plant, nor was it possible to establish the current performance and demand of a soap factory in Dili, said to temporarily closed due to a shortage of imported supplies for the manufacturing process.

Taking into account the financial projection for a similar-sized processing plant for candlenut oil currently planned for establishment in Baucau, however, it would appear that the demand for expansion or replication of SME processing plants in the coconut (and similar processing) subsector comprises credit lines or loans for assets and working capital in the range of $ 50,000-100,000 over 3-5 years. In addition, it seems evident that there is a lack of financial analysis, projection and management skills for processing plants in general to produce bankable proposals, manage and service debt-finance, and project future need. Finally, there is a clear

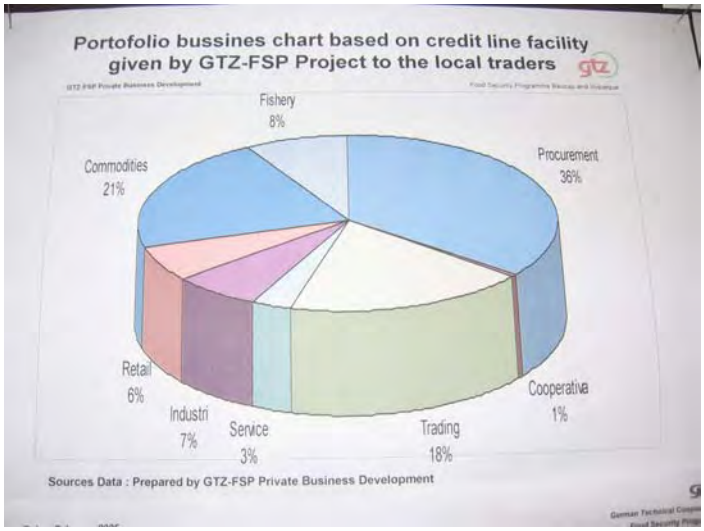
[27] It was not possible to review the financial statements of the company at the time of visit, and no external audit of books has yet been performed.

and steeply increasing demand for microfinance services once the rural economy begins to recover and reform after a period of almost complete stagnation at subsistence level.

1.2.3 Wholesale and Retail level

At the mid-section of the demand market among sub-district processing or non-processing traders of nuts, copra and oil, and at the top-end among exporters, a demand for financial services was identified comprising:

- Debt-finance, leasing or pre-financing for means for transport
- Remittance/transfer services linking Dili and produce collection points
- Cash in Transit facilities (non-bank service)



One donor-funded GoTL project has been providing interest free loans to traders, though not specifically in the coconut subsector. GtZ has availed 3-year loans to 4 medium-scale traders (average loan size USD 20,000), as well as 2-year leasing-type loans to farmers for farm equipment. Farmers must provide an upfront down-payment, and the equipment remains in GtZ ownership until 80% of the loan is paid back. The working capital loans to the traders has enabled an interesting on-lending of micro-loans as pre-financing from the traders to farmers at an average of USD 100, which a total of 215 farmers repay in paddy or cash (mostly paddy). While the loans to whole-sale traders at the higher end of the spectrum are being gradually repaid, the capital provided for pre-finance by traders further down-stream (to sub-traders and producers) has been more difficult to recover.

While in evidence from interviews with district-based traders, the constraint of limited financial service provision was not ranked as highly as better access to more lucrative markets for coconut or any other raw material (candlenut and coffee were currently regarded as the most profitable commodities).

Exporters seem to prefer to finance their business expansion by internally generated profits rather than debt, citing the fluctuating cash flow as a risk for servicing of repayments[28].

In conclusion, the key demands identified in the rapid value chain analysis includes:

Rural MSE growers/producers:

1. Microfinance services at rural HH level, following the initial generation of jobs and thus basic income.

Rural SME processors:

2. Credit lines or loans for assets and working capital in the range of $ 50,000-100,000 over 3-5 years.
3. Training in and external verification of financial analysis, projection and management skills to produce bankable proposals, manage and service debt-finance, and project future need.

[28] Interview with Naroman Kristal, September 2005.

Retail/wholesale traders:

4. Debt-finance, leasing or pre-financing for processing equipment and means for transport in the range of $ 500-5,000.
5. Remittance/transfer services linking Dili and produce collection points or Cash in Transit facilities (also a demand identified among financial service providers)

2. RAPID SUPPLY-SIDE ASSESSMENT

2.1. General overview of supply of financial services

The main financial service suppliers in Timor-Leste include three foreign-owned, commercial banks; four specialized microfinance institutions (MFIs), one of which is regulated by the Banking and Payments Authority (BPA) while the other three are NGOs; three savings and credit cooperatives with a membership of more than the 250 people, and at least eight non-financially specialized NGOs, of which four are members of the Association of Microfinance Institutions in Timor-Leste, AMFITIL.

As at September 2004, the total outreach of these financial service providers comprise 56,896 savers having deposited USD 88.09 million with the institutions, 97.6% of these deposits with the commercial banks; and 27,816 borrowers, 47% of whom are clients of the specialized MFIs. As such, the financial service suppliers currently reach 13% of the total (maximum) market with saving services, but only 6% are accessing credit. The total outstanding loan portfolio amounts to USD 67.82 million.

The providers serve each their core segment of the market, and especially the MFIs and the NGOs are reaching deep into the segments of very poor clients. As at September 2004, the average loan size outstanding ranged from USD 6,600 – 94,100 among the commercial banks, while loans from cooperatives average USD 420. Borrowers of MFIs have an average of USD 92 outstanding, while NGO loans average USD 77. While the geographic coverage of financial service providers spans 11 of the 13 districts in Timor-Leste, the client coverage in each district, with the exception of Dili, is still thin at 1-20%[29].

The quality of the portfolio as at September 2004 deteriorated with the level of specialization from a Portfolio at Risk (30) of around 4% for commercial banks to 6.3% for MFIs, 22% for cooperatives and 35% for NGOs. Of all the providers, only two banks and one cooperative were profitable in 2004. In terms of quality of portfolio, the banks range from 4-10% PaR as at June 2005, while several MFIs are experiencing serious difficulties (average PaR as at June 2005 is 18%). Progress towards full cost coverage has, however, increased to 69% among the MFIs as at June 2005, compared to 49% in September 2004, even if the current figure for IMfTL is slightly overstated, as per Table 3 below.

The range of products and services on offer is well developed and varied for the young industry and the small market. While the thresholds for savings services of two regulated financial institutions is remarkably low, the supply of credit for agricultural production and equipment is the least developed product line. This is a phenomenon seen in many countries, but it corresponds poorly to the agrarian economy of Timor-Leste. To fill this gap, free (grant-funded) in-kind input-supply has been channeled into the market through donor projects. In addition to the perceived high risks of agricultural lending, the continued input subsidization may, however, further displace debt financing in the private sector.

[29] For details, see "Financial Services Sector Assessment", January 2005.

While the number of suppliers of financial services is sufficient to serve the small market, the suppliers have not yet reached a scale that ensures access by all the people who demand financial services and could benefit from them to improve their livelihood and expand their businesses. Growth by expanded outreach, retention of customers and asset quality are the keys to ensure profitability for the suppliers - which are themselves SMEs in the East Timorese economy, facing exactly the same constraints as producers.

Given the limited cash economy and level of rural market development, it is doubtful that the financial service providers can attain the required growth in isolation. Just like conventional banks cannot lend without bankable proposals, MFIs, cooperatives and NGOs cannot – or should not – lend to households that cannot earn sufficient income from their businesses to repay the loans and make a profit. Similarly, there is little reason for rural households to indebt themselves, if they can acquire e.g. farm inputs for free. Even if they receive a loan, the repayment difficulties will most likely discourage them from taking another loan, and this appears to be the main reason for the early plateau'ing and high drop-out rates across the MFIs.

While the banks can maintain current levels of revenue from serving the top-end, urban market of enterprises, expatriates and civil servants, especially the MFIs that serve the poorer and more rural segment of society face significant external as well as internal constraints. Addressing the acute need for local market development would subsequently enable financial service providers to accelerate the rural economic development, if their access to appropriate capacity building services is facilitated so they are ready to serve the market as it develops.

Promotion of and adherence to a market development approach would facilitate the ability of the self-employed to generate income and curb the level of distortion caused by subsidies and supply-led interventions. If the market for selected local products increases, the income from sales would create new demand and improved local productivity, and hence the demand for business services, including finance, would also increase, providing the opportunity for financial service providers to grow and support the further growth and diversification of MSMEs, ultimately contributing to employment and income generation for national economic growth.

Table 3: Summary of Outreach and Performance of Financial Service Providers as reported June/August 2005

Service Provider	# Borrowers	$ loans outstanding	# Savers	$ savings	Par(30)	Caseload	OSS %	FSS %	As at:
Banks									
CGD*									
Bank Mandiri*	104								
ANZ	44	642,000	3,837	2,546,300	3%	15		98.49%	Jun05
Subtotal, Banks									
AMFITIL member MFIs									
IMfTL**	3,979	2,016,603	11,153	991,887	7.02%	265	152.00%	148.00%	Sept-05
MR	7,341	533,082	7,777	205,062	2.01%	198	58.00%	49.00%	Jun/Aug05
OTL	3,638	221,439	3,638	92,868	58.92%	140	74.54%	48.79%	Jun-05
CRS/TRM	1,973	98,380	1,898	17,409	3.4%	282	46.20%	30.00%	Jun/Jul-05
Subtotal, MFIs	16,931	2,869,504	24,466	1,307,226	17.84%	221	82.68%	68.95%	
NGOs – AMFITIL members									
CCF (MEDI)	2,562	257,775	3,411	74,150	0.00%	285	65%	n/c	Jun-05
Hotflima	1,546	107,962	1,546	70,460	2.0%	171	37%	8%	Jun-05
TimorAid	438	55,739	0	0	20.0%	127	n/c	n/c	Jun-05
Lana Mona	364	15,562	604	11,896	0.00%	121	n/c	n/c	Jun-05
Subtotal NGOs	4,910	437,038	5,561	156,506	5.5%	176	51.00%		
TOTAL:									
AVERAGE:									

* Data had not been received from CGD and Mandiri at the time of completion of the assignment, so subtotals from the banks are not calculated.
** The FSS figure is slightly overstated, as operational costs are adjusted by only 3% for market price of funds (should be min. 11%).

Compared to September 2004, there has been marked improvement in growth and profitability figures for the MFIs, but due to the spikes in PaR, the average portfolio quality is a cause for concern, as is well recognized among the MFIs. For comparison:

Change since September 2004 for the 4 MFIs:

no. borrowers: up 28% (+3,723); no. savers: up 29% (+5,540)
$ outstanding in loans: up 130% (+$1,619,412), $ in savings: 16% (+$184,081)
PaR up 9.15% from 8.69% in Sept 2004, chiefly due to a spike in OTL
Caseload as a measure of productivity up 28% from 172 in Sept 2004
OSS: up 20.43% and FSS up 20.2% since Sept 2004, driven by IMfTL (see **).

2.2 Supply of financial services in the coconut subsector value chain

CGD is currently the only commercial bank supplying the coconut subsector with at least two loans (debt finance of the soap factories not yet clarified) at a total exposure of $285,000, of which 5% has been repaid, while 30% of outstanding portfolio is at high risk, even if maturity is still years away.

While a full analysis of the portfolios of the MFIs to establish their current outreach to coconut growers in particular could not be accomplished during this assessment, the specialized MFIs (MF, TRM, OTL and IMfTL) report that around 30%, i.e. some 5,000 of their customers run micro-enterprises in primary crop production (rice, maize, vegetables, fisheries, coconut oil, candlenut, and livestock). The largest group of MEs served is petty traders (65% of portfolios). Several MFIs (IMfTL, OTL, TRM) also serve urban-based market vendors, including vendors of coconut oil and deshelled nuts. TRM has recently started providing credit services to coconut growers linked to Colega PTA, who comprise 31% of their Viqueque portfolio.

The products used by these customers range from individual business loans to the more traditional solidarity group guaranteed loans, as follows:

Micro-enterprise loans:					
Loan size	**Supplier**	**Requirements**	**Loan term In months**	**Cost (APR):**	**Processing time:**
$ 50-80	IMfTL Micro loan	Group membership; Land certificate, ID; Weekly repayments.	4 m	22.5% p.a.	4 weeks
$ 50-250	Tuba Rei Metin (TRM)	Group membership & training; Business proposal, ID; Weekly repayments; 10% Compulsory savings as deposit guarantee.	4-6 m	74.6% p.a. for initial 2 loans, 37.8% for subsequent loans	8 weeks for initial loans, 3 weeks for subsequent loans.
$ 50 – 400	Moris Rasik (MR)	Group membership; Group approval of proposal; Weekly repayments; Min. 10% savings.	6.25m	38% p.a. + 1 % fee	1 week
$ 50 – 325	OTL Trust Bank and Group 5 loans	Group membership & training; Business active for 6 months; Weekly repayments; Compulsory savings.	6.26 m	56% p.a. + 3% fee. 1% returned if on-time repayment	4 weeks
$ 100-2,000	Moris Rasik (probably not used for CCN)	Membership; Previous loans well serviced; Collateral (fixed/movable); Business plan and ID; Land certificate, if available Weekly repayments	6-18m	28.5% p.a. + 1% fee	2 weeks
$ 100-300	IMfTL market vendors	Business certificate for 6 months, TIN, ID Business address Daily/weekly repayments	3-12 m	22.5%	2 weeks
$ 100/ha max.	IMfTL Crop loan (probably not used for CCN)	Land certificate; Business license for min. 6m; Business proposal; Reference letter, ID;	3-12 m	22.5% + 5% fee	2 weeks

		Balloon repayment.			

2.2.1 Supply related to demand identified

Demand 1 Microfinance services for growers/producers

There are 4 specialized MFIs and 4-5 multi-service NGOs also providing credit and saving services, using different methodologies. MF providers are established in all districts where coconut growers/base level processors are assumed to reside, except Oecussi (Moris Rasik is opening a branch in Oecussi by end 2005)[30].

The MFIs would no doubt welcome a new market of 21,600 additional customers, but they would not be immediately ready to serve such an expansion, due primarily to internal constraints specifically related to management capacity, performance (asset quality), and internal controls. Developing their capacity to serve the market of new MSEs while developing the markets for the products of these MSEs would seem the most recommendable approach to ensure MSEs can be served appropriately, once initial demand for labor and raw materials provides the first injection of cash in the rural community economies.

Capacity is the top-most constraint of the MFIs, and capacity building to address this need must include management and staff training by TA specialized in financial service provision at the operational level, but also technical assistance, improvement of operational policies, procedures and systems, institutional strengthening (management and organization), market research and product development. Training can be offered in regular, conceptual and practical sessions at gradually increasing levels of complexity in a more structured environment. Such 'generic' training could be undertaken jointly with staff from different institutions participating in each course to enhance awareness of market developments, and to cut costs. Such a training process lends itself well to be coordinated by AMFITIL, as has already been the case in 2005. Training should be sequenced and defined based on training needs assessments and demand, but probably focusing on market research and linkage banking as well as asset quality management, given the high Portfolio at Risk ratios in some of the MFIs. Specialized TA for each of the MFI-specific problems is also necessary.

There are few training and TA providers in TL, and none that are specialized in microfinance. For this reason, it would be important for foreign TA to engage potential future training providers from Timor-Leste in the process to built technical capacity. The KLIBUR business training center and the Dili Distance Learning center could be approached along with the Dili-based accounting firm Johnson and Martins. Providers from West Timor and Darwin (e.g. Coopers and Lybrand) could also be contacted.

To support the development of a commercial market for training and TA services in TA, capacity building should be costed at market rates, and the institutions charged accordingly. It is, however, well recognized that few of the current providers (except perhaps Bank Mandiri and CGD) have the funds to afford market-rate capacity building. The MFIs are caught in the common 'Catch 22': to reach a scale where they can become profitable enough to allocate funds for training, they need capacity building which they cannot yet afford. Therefore, an interim matching grant facility may be

[30] See details and a map of Outreach in "Financial Services Sector Assessment", January 2005.

necessary to enable the MFIs access the capacity building needed to prepare them for growth.

As the MFIs are not yet sustainable, and therefore must rely on donor funding for a while to come, enhanced performance monitoring by funders of both current and future grants would promote the attention to business achievements. Performance monitoring indicators should focus on growth, risk management and sustainability. Indicators and specific, verifiable and time-bound (*not* cumulative) targets for each indicator should be negotiated prior to any funding. Rather than "head-count" indicators, quality improvements in services and operations as a result of the grants should be measured, improvements in asset quality, efficiency, financial management and profitability.

To the extent that loan capital is an immediate constraint to growth and the financial service providers have a respectable operational basis for managing such growth, capital for on-lending should be provided as SME loans – much like loans potentially foreseen for coconut processing. There is encouraging evidence of increasing linkage banking, with one commercial bank lending to an MFI, and TA may suffice to:

- facilitate further linkages and negotiations on terms and conditions between the banks and interested MFIs/SMEs;
- assist in the revision as needed of the documentation for the product;
- act as a third party Guarantor of the MFI/SMEs, signing a tri-partite agreement, and taking (loan book, assets) collateral from the MFI/SME as security for the guarantee.

Each financial service provider in Timor-Leste is striving to improve their operations with relatively disparate support from head quarters, INGO partners and donors, and the potential for cost-effective synergy in overcoming constraints is not fully exploited. There is a need to bring the financial service providers together to improve coordination and streamlining; facilitate lateral learning and advocacy; and enhance equitable access to mutually beneficial capacity building services in a more cost-effective manner. The chief reason for this need is the small market; the similarities in capacity constraints, and the need to professionalize service delivery for future growth. But there is also a perplexing lack of general awareness about financial service provision, outreach and quality in Timor-Leste, and an urgent need for more public information and 'education' about the industry, its achievements and constraints, which in turn could facilitate a higher level of coordination and coherence in policy making.

The commercial banks and IMfTL meet monthly at the BPA to coordinate issues, primarily of a 'vertical' nature (requests and issues raised by banks through BPA for the GoTL's attention and communication of decisions the other way). The BPA is keen to hand-over this "advocacy role" to an Association of Bankers, and ANZ has already drafted a constitution for such an association.

AMFITIL was registered as a local NGO in 2003 on Articles of Association akin to national MFI associations elsewhere, and has currently 11 members, including all of the specialized MFIs. In addition, members have signed what is probably the most specific and detailed Good Practice-based Code of Conduct in the microfinance world today. Members have agreed on a minimal performance monitoring system, and most members are reporting quarterly performance ratios to the secretariat. Recognizing the need for a permanently staff secretariat housed separately from any member, AMFITIL applied to the DAI SGP for funds to rent an office and employ a secretary in early 2005. A grant for the period till November 2005 was approved in anticipation of further support

under the microfinance component of BASAR. To continue the work started, the following next steps should be supported:

- Revision and adoption of Constitution at a constituting Annual General Assembly
- Formulation and adoption of bylaws and procedures
- Formal election of a representative BoD
- Appointment by the BoD of an Executive Director/Office manager
- Drafting by the Secretariat and adoption by the BoD of a 1-3 year business/work plan for AMFITIL with specific targets and budget for adoption
- Strengthening the performance monitoring system to provide feedback to members
- Exploring the opportunities for closer contact with the formal financial providers

Excellent strides have been made in a few years with the establishment of AMFITIL as a platform for increased coordination, information sharing and increased visibility, and while there are clear differences in the scope and issues of the commercial banks and the MFIs, it still seems indulgent to have two separate associations in the tiny market of Timor-Leste, comprising some 7-14 financial service providers. It would be pertinent to invite the SACCOs that agree to the Code of Conduct and can demonstrate a minimum level of performance to become members and to explore the possibilities of joining up with the commercial banks in an "AFITIL": Association of Financial Institutions in TL.

Demand 2: Credit lines/investment loans $50,000-100,000

This product is currently offered by all three commercial banks at interests of 7-15% p.a. against collateral. While ANZ does not aggressively promote its lending products and has local approval authority cap at $10,000, Bank Mandiri appeared slightly more interested in the market in 2004 than currently, probably due only to the settling-in of a new manager, as the Bank has ample experience in SME lending from Indonesia.

CGD may appear the most approachable of the three banks for any new SME, and is planning a significant expansion of branches.

Bank Mandiri has been approached to finance an SME venture for candlenut oil processing, and the successful conclusion and servicing of that loan could have increased the bank's interest also in the coconut subsector. Unfortunately, communication and documentation by the client to the bank was deemed insufficient for the bank to proceed with the loan, and it has been rejected. CGD remains interested in the project.

In general, loans in this range are thus available; the constraint to access is the ability of SMEs to present bankable proposals to financiers, and to manage and service their debt finance appropriately (See below).

Demand 3: Training in financial presentations and management

For any of the banks to consider debt-financing of a start-up SME in a perceived high-risk venture, a significant amount of effort would have to be invested in the preparation of a solid narrative and financial business plan with transparent and comprehensive projection scenarios. In addition, demand for secure and attachable collateral and personal guarantees should be expected. For new SME investors/managers without previous experience with banks, mentoring and technical support during the presentation, negotiation and servicing the loan would probably be necessary.

A non-financial service, it is not provided by any of the financial services providers in Timor-Leste at present, nor indeed by any other local providers to the extent necessary at the level of establishment of processing SMEs.

ANZ has made a commendable attempt to attract accounting and audit service providers (cooper & Lybrand) from Darwin, Australia to help potential borrowers prepare proposals and financial statements for review. This contact or others to externally based TA providers could be built on, as it would appear necessary to develop local expertise in this area through the initial training by TA from outside of Timor-Leste. Due to language barriers, bonafide TA providers from Indonesia should be considered.

Demand 4: Loans, leasing or pre-finance $500-5,000

There are loans available in this range, as follows:

- SME loans $ 3,500-10,000 from the 3 commercial banks at rates as above
- 12-36 month consumption loans at $500-2000 from CDG at 7-15% p.a. plus a 1.5% flat fee. This product was provided extensively in 2004 for vehicles, but is now offered for housing improvement and small investments only. The processing time is up to 14 months due to overload in the bank.
- 6-12 month Small Business loans at $500-2,000 from IMfTL at 22%p.a.
- 6-18 months Business loans at $2,000 from Moris Rasik, specifically for graduating clients at 28.5% p.a. plus 1% fee.

No financial service provider is currently offering leasing products. The sole provider of a leasing product and of capital specifically for pre-financing in agriculture is GtZ on non-commercial (interest-free) terms to traders under the Food Security Project in the East. No commercial machinery suppliers were found to offer pre-financing or leasing finance (some NGOs have been providing equipment for free), and no traders in the coconut sub-sector were found to offer pre-financing, probably because very little input supplies are required. Fruit, oil and copra were all traded on a cash-basis.

As input supply requirements to the current basic oil and copra production is negligible, the demand for leasing and pre-finance services for production equipment will be relevant only to the extent that a promising market for copra and edible oil can be identified, and the currently available expelling equipment is assessed to recommend specific type(s) of machinery (for small-scale production at HH or group level). Pending the cost (retail after import by e.g. Victory in Dili), and the complexity of the technology, the equipment could potentially be manufactured locally (e.g. by Firaku Workshop in Baucau), who might also manage a leasing scheme akin to the current scheme for hand-tractors, which involves trained operators and maintenance.

Alternatively, the option of developing regional whole-sale operators could be assessed as potential lease/pre-finance managers, or the capacity of the current and potential district-based traders to manage a leasing scheme could be reviewed. These players might well be interested and have or develop the technical capacity (warehouse, mechanical maintenance service, management of loan and repayments etc.), but would probably not have the capital required, as evidenced by GtZ.

A financial service provider would thus have to under-write and pre-finance the scheme (import of a quantity of machines). The commercial banks may be willing to consider a proposal for such a scheme, pending clear-cut and easily attachable collateral in addition to the actual equipment. For larger or more complex processing units (e.g. DME units), leasing would probably not be a logistically feasible option, and medium-term debt finance of the equipment should be considered instead (see above, Demand 2).

The feasibility of a leasing scheme for transport (trucks) would include similar considerations of financing and logistics management, and would potentially be better off in the hands of a garage, car rental company, or a district-based transport cooperative. As transport is needed by all traders and vendors across subsectors, the potential contribution of a transport leasing scheme to horizontal (regional/national) market linkages is significant, and there could be important economies of scale, reducing the transport cost per user.

Demand 5: Remittances/transfer and CIT services

The commercial banks offer the entire range of financial products, including Letters of Credit, forex, money transfers and debit cards etc., but have very limited outreach. CGD has a branch in Baucau and is opening a branch in Viqueque. IMfTL has a plan to open branches in each of the 13 districts by end 2009, starting with Aileo (Oct 05), Baucau (Dec05), Oecussi (Mar06), Same (Jun06) and possibly Los Palos. Western Union provides cash transfers, as does IMfTL for domestic transfers.

The prices for cash transfers vary somewhat in the market, and have become one of the niche products offered competitively by IMfTL and Bank Mandiri as depicted below:

Table 3: Prices for Money Transfers

Supplier	For clients of supplier	For public to transfer $500	For public to transfer $1,000
IMfTL (domestic only)	$ 0	$ 5	$ 10
Bank Mandiri	$ 15	$ 30	$ 30
CGD	$ 25	$ 25	$ 25
ANZ	$ 35	$ 35	$ 35
Western Union	-	$ 35	$ 40

There are no Cash in Transit services available in Timor-Leste, and CIT is not insurable. Clearly, it would not be feasible to establish a CIT service for the coconut subsector alone. A feasibility study of this service would need to assess in detail the demand by the entire range of potential users (GoTL agencies, financial service providers, large or medium-sized enterprises, and traders buying produce in bulk at gate or at sub-district level including e.g. CCT), as well as the willingness to pay for the service, before reviewing options on the supply side from e.g. security companies, the police force or similar providers with access to reinforced vehicles. If the initial financial feasibility looks

promising, options for under-writing and insurance should be assessed to decrease risk to the providers and users alike.