

PROJECT INFORMATION DOCUMENT (PID) CONCEPT STAGE

Report No.: PIDC961

Project Name	Second Private Sector Competitiveness and Economic Diversification (P144933)
Region	AFRICA
Country	Lesotho
Sector(s)	General industry and trade sector (50%), Other industry (40%), SME Finance (10%)
Theme(s)	Micro, Small and Medium Enterprise support (50%), Export development and competitiveness (30%), Other Private Sector Development (20 %)
Lending Instrument	Investment Project Financing
Project ID	P144933
Borrower(s)	Ministry of Trade, Industry, Cooperatives and Marketing
Implementing Agency	PSCED-PMU
Environmental Category	B-Partial Assessment
Date PID Prepared/ Updated	15-Jul-2013
Date PID Approved/ Disclosed	15-Jul-2013
Estimated Date of Appraisal Completion	15-Aug-2013
Estimated Date of Board Approval	31-Oct-2013
Concept Review Decision	Track I - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

1. Lesotho is a lower middle-income country with per capita gross national income of US \$1,210. The economy has grown at an annual rate of 3 percent in per capita terms—modest for its income level but comparable to the rest of the SACU region, the African continent, and small states. The accompanying structural changes have involved shifts from subsistence agriculture and remittances toward natural resources, manufacturing exports, and services.

2. The main growth engine before 2007 was manufacturing exports, mostly from the textile and apparel industry. Since then, public investment has taken over as the main driver. The manufacturing sector's contribution to GDP declined from about 20 percent in 2006 to 11 percent in 2011—the result of stagnation in the textile and apparel sector after the global economic crisis,

increased competition from low-cost Asian producers, and the rapid growth in other sectors, notably mining.

3. The country now finds itself at a crossroads—requiring new engines of growth, a more streamlined role of the state and the emergence of a dynamic private sector. Lesotho’s economic growth has been predominantly export led. Unemployment in Lesotho stood at 24 percent in 2008, among the highest in the world. Only 230,000 of the 608,000 employed people engage in formal wage employment. The manufacturing sector, was until recently a growing source of employment, and thus holds a key role in creating jobs. While FDI in the textile and apparel industry has created jobs, the expected backward linkages to the local economy have been limited, with practically no spin-offs or subcontracting activities. The challenge facing Lesotho’s private sector is twofold: (i) the need to diversify into other sectors by attracting FDI into new sectors and (ii) establishing stronger linkages between FDI and the local SMEs.

Sectoral and Institutional Context

4. Lesotho’s key challenge is inclusive growth, as recognized by the National Strategic Development Plan (NSDP). The plan also recognizes that the most effective way out of poverty is through high, sustainable and private sector-led economic growth coupled with faster job creation. It recognizes that the sustainable engines of growth are agriculture, manufacturing and tourism. In addition, it mentions that Lesotho needs to exploit better its comparative advantages such as: a) its location within South Africa, which provides access to its markets and advanced infrastructure that creates links with the rest of the world; b) trade preferences; and c) a relatively large, young, competitive and literate human resource base.

5. Lesotho’s private sector growth is hindered by a number of factors. Improving the overall business environment will be essential to attracting new FDI. The NSDP acknowledges an “uncompetitive business environment” as one of the most binding constraints to the growth of private enterprises, adversely affecting both foreign investment and the growth of local SMEs. All quantitative measures (Global Trade Reports, Doing Business Indicators, and Enterprise Surveys) suggest that business regulations are a serious constraint to growth. Lesotho’s Ease of Doing Business rank was 136 out of 185 countries in 2013 . While Lesotho has made important reforms, notably in streamlining the process of starting a business, reflected in its improved ranking – by 17 places – in the 2013 Doing Business rankings it still lags behind many of its competitors. There remain a number of factors that hinder private sector growth, at almost every business stage – from accessing land to obtaining construction permits, engaging in cross-border trade with South Africa, and accessing finance. For example, for a foreigner to establish a firm in Lesotho, it can still take more than two years; while in countries such as South Africa, Rwanda and Vietnam take less than a year. The country is losing ground to be competitive as several reform-minded African governments have implemented policies to cut high transaction costs. Productivity enhancements are essential to support the growth of real wages, and, therefore incomes and living standards.

6. The Bank-financed Private Sector Competitiveness and Economic Diversification Project (PSCED) supported the implementation of major reforms to improve the business environment in Lesotho. This proposed operation builds on the Lesotho Private Sector Competitiveness and Economic Diversification Project (PSCED Project-P088544, US\$8.10 million), the principal instrument to support private-sector development, scheduled to close on June 30, 2013. The project supported the Government on a range on issues that helped (i) improve the business environment; (ii) develop the financial system and promote access to finance; and (iii) increased diversification by

targeted support to skills development, tourism and horticulture. One of the major reforms was the establishment of a One Stop Business Facilitation Center (OBFC), which brings several functions under one roof. These functions include the issuance of trading enterprise licenses, industrial licenses, work permits, import permits/rebates and export visas (although a restricted list of products still require approval in the various ministries). The enactment of the Companies Act, the digitization of the Companies Registry and its transfer to the OBFC, has substantially reduced the number of days it takes to start a business. The Companies Act (supported by the PSCED project) - the first since 1967 - came into force in October, 2011 and has helped to streamline business registration requirements further, make provision to protect investors and strengthen the OBFC, reflected in Lesotho's improved ranking – by 17 places – in the 2013 Doing Business Report.

7. The implementation of the industrial licensing bill and the new business reporting bill will further the progress laid out under PSCED. In addition, the implementation of the leasing regulations that were passed under the current project will help improve access to finance for SMEs who need to play a greater role in the economic growth of the economy. With these objectives in mind, the government has shown a keen desire to undertake further reforms to strengthen the business environment and increase economic diversification by encouraging new growth sectors such as horticulture and tourism.

8. Private sector growth requires businesses to access credit at an affordable price. There is a small banking sector in Lesotho, predominantly foreign owned. There are four banks in Lesotho, three of which are South African subsidiaries (Nedbank; Standard Bank; and FNB). There is one government-owned bank, Postbank. The banks are regulated by the Central Bank of Lesotho, although they usually adhere to South African standards for internal regulation (which are stricter standards). There is no credit bureau (although a nascent project has started under the Millennium Challenge). There is no collateral registry yet for movable property and asset-financing is still a small market. The banks reported problems with the Land Registry for immovable property i.e. incorrect or fraudulent entries, a paper-based (and inefficient) system, etc. All of these elements have resulted in a tight credit environment, whereby banks' exposure is high and there is no effective way of tracking a borrower's credit history.

Relationship to CAS

9. The proposed operation is integral to the Bank's assistance to Lesotho as outlined in the Country Assistance Strategy (CAS) which covers a four-year period (FY2010-14) and the Country Partnership Progress Report (2013). The CAS focusses on three broad areas of engagement: (i) fiscal adjustment and public-sector efficiency; (ii) human development and service delivery; and (iii) competitiveness and diversification. The CAS was developed within the context of the Government's strategy for growth and sustainable development, expressed in the GoL's National Vision 2020 and the Interim National Development Framework. The CAS is also well aligned with the World Bank Strategy for Africa that focuses on competitiveness and employment as one of its two themes. In addition, this operation is relevant to the National Development Plan (NSDP) covering 2012/2013-2016/2017.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The development objective of the proposed project is to contribute to increased private sector investments, firm growth and jobs created in non- traditional sectors. This will be achieved by (i)

improving business environment; (ii) increasing access to finance; (iii) supporting investment promotion in new sectors with increased backward linkages to the local economy and (iv) targeted support to new growth sectors such as horticulture and tourism all of which will benefit both micro entrepreneurs and SMEs.

Key Results (From PCN)

11. The success in achieving the PDO will be reflected by the following indicators: (i) new investments in non-textile sectors; (ii) number of direct beneficiaries of the project (of which women); and (iii) improvements of Doing Business indicators in the areas of assistance such as access to credit, obtaining construction permits and starting a business.

III. Preliminary Description

Concept Description

12. The new project aims to build on reforms initiated under PSCED I as well as looks at supporting new areas to support government priorities that would lead to greater private sector development. This will be achieved through improved business environment, greater access to finance, supporting investment promotion activities in new sectors and enhancing linkages to domestic SMEs and improved economic diversification in the economy through targeted support to new growth sectors such as horticulture and tourism. In addition, the project design has been informed by the recent World Bank (2012) technical assistance note that analyzed policies to increase economic diversification through FDI and improved backward linkages to the local domestic economy. The project design is also closely coordinated with the ongoing Financial Sector Development Strategy (2013).

13. The project will comprise two mutually-reinforcing components: (i) Improving the business environment; and (ii) Increasing economic diversification through targeted support to new growth sectors.

COMPONENT 1: Improving the Business Environment

Sub-component 1A: Business Registration, licensing and construction permit reform

14. The objective of this component is to reduce the time and cost for registering a business and obtaining construction permits. This component will support the drafting and implementation of the Business Registration Bill which aims to cover all businesses, including sole proprietors and partnerships. This will enable the benefits of the OBFC system to go beyond company registration and register sole proprietors and partnerships, and also increase formalization of businesses.

15. Inspired by the success of the company registration under the OBFC, the GoL has undertaken steps to modernize its industrial licensing regime. The GoL recognizes that the current licensing system of Lesotho is cumbersome, involving multiple agencies. In order to tackle these shortcomings, GoL was supported by the PSCED Project to draft the 2013 Industrial Licensing Bill which is to replace the outdated 1969 Industrial Licensing Act. The new project will support GoL to implement this new Industrial Licensing Bill. In addition, the introduction of a streamlined risk-based environmental and health inspection procedure during the business registration and licensing procedures can further improve the process of business start-up and operation, and remove unnecessary regulatory burden for the private sector, resulting in saving time, cost and increasing

numbers of compliant businesses.

16. One of the worst performing DB indicators for Lesotho is the process of obtaining construction permits. Currently the country is ranked 145 out of 183 economies globally. While in Lesotho, there are only 11 steps, which is below the average of 15 steps for Sub-Saharan Africa and the 14 steps for OECD countries, it takes an average of 330 days to obtain a construction permit in Lesotho. A major reason for that is the lack of coordination between the Maseru City Council (MCC) and the different departments and agencies, taking an average of 106 days and 3 separate procedures for an entrepreneur to obtain a building permit to use the building. The project will help streamline the construction permit system within the MCC, by automating the document workflow, digitizing the back-office functions of MCC and digitizing the archive wherever possible in order to create automated, predictable and transparent systems, thus reducing time, cost and regulatory burden for the private sector, and at the same time reducing the transaction costs for the MCC.

Sub-component 1B: Improving Access to Finance

17. The objective of this component is to improve the access to finance in Lesotho, by providing a stable and predictable loan market and credit worthiness system (credit bureau), providing a diversified set of the financial services (financial leasing and movable collateral) and extend these new services to the unbanked population. The establishment of a credit bureau will cover the entire population and provide creditors with information for assessing credit worthiness of borrowers, thus ensuring stability and predictability in the market. The introduction of a movable collateral registry will allow borrowers to use movables to secure loans, thus removing the burden from banks to require only immovable security, and include unbanked population. This registry will aim at including information on financial leasing, thereby implementing the leasing regulations that were finalized under the PSCED I project. These reforms together help modernize the financial services market, by allowing lenders and borrowers new forms of asset-financing.

18. In addition, the availability and cost of credit are positively correlated with the strength of creditor rights' protection. The protection of creditor rights includes an effective debt enforcement regime for individual creditors to recover their debt, and a robust and efficient insolvency regime, which regulates collective creditor recovery. The project will provide technical assistance to help modernize the Insolvency Proclamation and ensure coherency with the liquidation provisions.

COMPONENT 2: Supporting Economic Diversification

Sub-component 2A: Supporting investment promotion and increasing linkages to the local economy

19. This component of the project will aim to provide the GoL with support towards achieving sustainable diversification of the country's export manufacturing program as well as provide support to strengthen the local SME capacity. This diversification needs to be achieved such that there is horizontal diversification – where non-textile industries need to be attracted, combined with increased localization – where local participation in the manufacturing sector increases in terms of providing technical and managerial skills and supplying export-oriented firms.

20. The project will focus on delivering a mixture of strategic and operational outcomes in an integrated, sequential way. There is evidence to show that the existing factory sites do not provide the desirable infrastructure and services to foreign investors due primarily to the very low rents that

are paid for these sites. There are likely several options for the commercialization of factory sites, including: i) fully private development, ownership and operation of the industrial estate as a going concern; and, ii) private construction and leasing of individual factory shells on LNDC serviced industrial land. The project would support the technical evaluation of options for the commercialization of a site which can meet unmet demand for factory sites from new investors. The TA provided will support designing a PPP deal that would attract private developers to construct and manage the factory site on a commercial and sustainable basis.

21. The project will also provide technical assistance on implementing targeted programs that would facilitate linkages between these foreign investors and domestic SMEs. Support measures would help facilitate improved information flows and targeted instruments to help increase business opportunities between the two groups while simultaneously also improving capacity of the local SMEs.

Sub-component 2B: Supporting the Tourism Sector

22. Another vital source of growth for Lesotho could be the development of the tourism sector. The Lesotho PSCED Project to date has supported activities targeted to address fundamental tourism sector constraints. Increased competitiveness in the tourism sector mandates efforts that a) better quantify and track sector performance, (b) improve standards, (c) strengthen the country's unique offerings, and (d) support an enabling institutional framework. This sub-component will support tourism value chain development through targeted activities including development of tourism statistics and continuing the implementation of the star grading system for accommodation.

23. Further, support will also be provided to the handicrafts sector by increasing their capacity to both produce domestically and export. In order to spur tourists and domestic demand and provide a sustainable retail market outlet, the project will support the development of a privately managed centrally located handcraft marketplace in Maseru. The marketplace will be financially sustainable and include a tourism information hub, attracting the tourist market. The tourism information hub will offer market based services in order to meet the needs of tourists and generate income to cover operational costs.

Sub-component 2C: Expanding Commercial Horticulture

24. The pilot farms under the PSCED Project, were created to demonstrate the potential for commercial fruit farming in Lesotho, test various varieties of fruit under Lesotho growing conditions and work in conjunction with Government to ensure that policies and regulations are in place to support sector development. The pilot farms have realized a number of successes, including Lesotho's first fruit exports and production of the first Grade 1 apples in the country. Also, lessons learned from the horticultural pilot farm project are being applied to a national rollout of larger commercial farms using block farming, starting with a village association in Mahobong (Village Rollout) in March 2013.

25. Applying lessons learnt from Phase 1 of the Horticulture Component, the primary development objectives of Phase 2 are as follows:

i) Transform strategic areas in Lesotho into major producers and exporters of early variety tree crops by demonstrating that commercial deciduous fruit production is competitive and sustainable.

- ii) Improve livelihoods of rural farmers through the production, export and processing of high value tree crops.
- iii) Facilitate shift from reliance on maize as the main source of income to a more diversified cropping structure.
- iv) Develop a competitive value chain for tree crops including:
 - Sales of fresh produce in local and export markets;
 - Juicing, canning and drying facilities for products of Grade 3 and lower quality; and
 - Food processing industry based on derivatives from tree crops.

26. The project will help support to expansion of upstream activities, including seedling nursery development, expansion of commercial production of deciduous fruits (35 hectares), and strengthen capacity of local on-farm technical support services; and downstream activities beginning in 2016 when the project anticipates increasing volume of marketable crop entering the market from existing and new farms. Of the marketable products, Grade 1 products will be targeted for export markets, Grade 2 products for domestic markets, and Grade 3 and lower for local value added processing. In this regard, downstream activities will focus on the development of local supply and value chains for deciduous fruit, farm certification (Global Gap) which will enable Basotho farmers the opportunity to export Grade 1 products to any market in the world and expand marketing options for local products both within and outside Lesotho.

Sub-component 2D:Lesotho Enterprise Assistance Program

27. The LEAP matching grant scheme was designed to help strengthen business capacity of the private firms, mostly Basotho-owned MSMEs, as well as their representative organizations through provision of financial and technical assistance to buy business development services with the aim to increase their competitiveness. The LEAP program will be managed under this component and will be funded using government counterpart funding.

Component 3: Project Implementation

28. This component will support the costs of the Project Management Unit, which is intended to be re-hired given the good performance and to ensure continuity and efficiency. The implementation arrangements used under the PSCED Project will be used in the new proposed Second PSCED Project.

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01	x		
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09	x		
Physical Cultural Resources OP/BP 4.11		x	
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12		x	

Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

V. Financing (in USD Million)

Total Project Cost:	15.00	Total Bank Financing:	13.10
Total Cofinancing:		Financing Gap:	0.00
Financing Source			Amount
BORROWER/RECIPIENT			1.90
International Development Association (IDA)			13.10
Total			15.00

VI. Contact point

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