Document of
The World Bank

Report No. 18815-MZ

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 19 2 MILLION
(US$26 MILLION EQUIVALENT)

TO THE

REPUBLIC OF MOZAMBIQUE

FOR THE

ENTERPRISE DEVELOPMENT PROJECT

December 29, 1999

Private Sector and Finance Unit
Country Department 2
Africa Region

CURRENCY EQUIVALENT

(Exchange Rate Effective December 1, 1999)

Currency Unit	=	Metical (Mt)
Mt 12,965	=	US$1
US$0.000077	=	Mt1

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

BOM	Bank of Mozambique
CBC	Capacity Building Component
COD	Credit Operations Department
CMBP	Coastal and Marina Biodiversity Project
CPI	Investment Promotion Center (Centro de Promoção para o Investimento)
CTA	Commission of Economic Associations
DFID	Department for Institutional Development
EPZ	Export Processing Zone
FC	Financial Component
FCO	Firm Competitiveness Office
FZ	Free Zone
IERP	Industrial Enterprise Restructuring Project (IDA Credit 2081)
IPEX	Institute for the Promotion of Exports (Instituto para a Promoção de Exportações)
LPO	Linkage Program Office
MC	Management Contractor, Technical Learning in Firms Component
MFP	Ministry of Finance and Planning
MICTUR	Ministry of Industry, Trade, and Tourism (Ministério da Indústria, Comércio et Turismo
MOZAL	Mozambique Aluminum
PFI	Participating Financial Institution
PoDE	*Projecto para o Desenvolvimento Empresarial*
PSC	PoDE Steering Committee
PSDU	Private Sector Development Unit, MICTUR
PFI	Participating Financial Institution
RBSI	Regional Business Support Initiative
RPED	Africa Regional Program for Enterprise Development
SMEDP	Small & Medium Enterprise Development Project (IDA Credit 2082)
SSI	Sector-Specific Initiatives
TAO	Training Advisory Office
TLC	Technical Learning Component
UASP	*Unidade de Apoio ao Sector Privado*

Vice President	:	Callisto Madavo
Acting Country Manager/Director	:	Philippe H. Le Houerou
Sector Manager	:	Demba Ba
Team Leader	:	Brian Levy/Simon Gray/Marilyn Manalo

Mozambique

Enterprise Development Project
(*Projecto para o Desenvolvimento Empresarial – PoDE*)

CONTENTS

ANNEXES

Mozambique
Enterprise Development Project
(Projecto para o Desenvolvimento Empresarial – PoDE)

Project Appraisal Document
Africa Region

Date: December 29, 1999	**Team Leader:** Brian Levy/Simon Gray/Marilyn Manalo
Country Manager/Director: Phyllis Pomerantz	**Sector Manager/Director :** Demba Ba
Project ID: MZ-PE-49874	**Sector:** Private Sector and Finance
Lending Instrument: Specific Investment Loan	**Theme(s):** Private sector development
	Poverty Targeted Intervention: [ ] Yes [x] No

Project Financing Data
[ ] Loan [x] Credit [ ] Grant [ ] Guarantee [ ] Other [Specify]

For Loans/Credits/Others:
Amount (US$26 million):
Proposed terms: [ ] To be defined [x] Multi currency [ ] Single currency
[ ] Standard Variable [ ] Fixed [ ] LIBOR-based
Grace period (years): 10
Years to maturity: 40
Commitment fee: Not to exceed ½ of 1 percent per annum

Service charge: ¾ of 1 percent per annum on outstanding principal

Financing plan (Annex 1):

Source	Local	Foreign	Total
IDA	7.6	18.4	26.0
Government	0.5	0.0	0.5
Beneficiaries	4.0	2.8	6.8
Parallel financing	4.3	10.0	14.3
Total:	16.4	31.2	47.6

Borrower: Republic of Mozambique
Guarantor:
Responsible agency: Ministry of Trade, Industry and Tourism

Estimated disbursements (Bank FY/US$M):

FY	2000	2001	2002	2003	2004	2005
Annual	2.1	3.9	5.5	7.0	4.9	2.6
Cumulative	2.1	6.0	11.5	18.5	23.4	26.0

Project implementation period: 1999-2004
Expected effectiveness date: March 2000 **Expected closing date: June 30, 2005**
Implementing agency: MICTUR
Contact person: Mr. Luis Sitoe
Address: Ministry of Industry, Trade and Tourism, Av. 25 de Setembro 1502, Maputo, Mozambique
Tel: 431418 **Fax:** 431418 **E-mail:** lsitoe@mictur.imoz.com

A. PROJECT DEVELOPMENT OBJECTIVE

1. Project development objective (see Annex 2)

The Project's overall objective will be to help broaden the base of private participation in Mozambican economic growth. This would be achieved by: (i) boosting the competitiveness of Mozambican private firms by strengthening their access to, and use of, support services external to the firm; (ii) providing a more efficient market for training and capacity building services and establishing forward and backward linkages to existing and new local and foreign buyers and investors; (iii) enhancing access to term finance by both first-time and other borrowers; and (iv) helping to strengthen the capabilities of the Ministry of Industry, Trade, and Tourism, the Investment Promotion Center, and business organizations with potential to improve the business environment.

2. Key performance indicators (see Annex 2)

Project benefits would be measured through an assessment of the:

- demand for participating firms' products domestically and internationally as reflected by increased production, investments, exports, and new job creation within participating firms;
- impact of training and capacity building services on enterprise productivity;
- services delivered by participating public and private agencies; and
- participating banks' increasing responsiveness to lending medium-term resources to private enterprises as a result of high levels of repayment performance of borrowers and subsequent profitability of banks.

B. STRATEGIC CONTEXT

1. Sector-related Country Assistance Strategy (CAS) goal supported by the project (see Annex 2)

Document number: IDA/R97-157 Date of latest CAS discussion: December 18, 1997

This Project will support the CAS objective of "promoting broad-based private sector-led growth" by facilitating the participation of an increasing number of Mozambican firms in the growth process.

2. Main sector issues and Government strategy

Mozambique has successfully undertaken a highly ambitious program of "first-generation" economic reforms. As a result, the overall macro-economic environment currently is highly favorable. Inflation decreased (down from 70 percent in 1994 to effectively zero in 1998 as a result of tight fiscal and monetary policies), the exchange rate stabilized, and food production increased. Also, the Government implemented an ambitious structural reform program: price controls were eliminated, non-tariff barriers were lifted, and the exchange rate became market determined. With the privatization and liquidation of over 800 enterprises (out of 1,250), public enterprises' share of industrial output fell from over 66 percent in 1990 to below 25 percent by 1997. GDP grew by over 10 percent annually in each of 1997 and 1998.

Though growth stimuli remain strong, the currently favorable conditions represent a recent reversal of an exceptionally difficult, long-term historical legacy of colonial domination, a

disastrous subsequent experiment with central planning, and civil war. Mozambique's difficult historical legacy is evident both in the unpropitious structure of its domestic private sector -- fragmentation, small size, and inward-orientation – and in continuing micro-level obstacles to doing business. In addition, the environment for technical learning in Mozambique is extremely under-developed. With little exposure to technological innovation and limited access to information flows, the Mozambican private sector is at a significant disadvantage with respect to the latest manufacturing techniques, industry marketing trends, and modern management practices. This raises the risk that, once the momentum of recovery slows, continuing economic growth will be dependent on a small number of mega-projects initiated by foreign investors, and will increasingly be perceived as narrowly-based both regionally and in terms of domestic ownership (Annex 3).

In order both to sustain rapid economic growth, and to broaden the base of private sector participation, the Government is committed to a "second generation" program of reforms to address a wide variety of continuing weaknesses in its business environment. Following the completion of a study prepared by the International Finance Corporation and the Foreign Investment Advisory Services in 1996 on "Mozambique – Administrative Barriers to Investment: The Red Tape Analysis," an inter-ministerial working group was created to implement an action matrix to track reform initiatives. Measures to reform policies, practices, and institutions were taken. These include revisions to the commercial and industrial policies and the textile and clothing sector strategy; modifications to the labor and land laws; business registration, licensing and reporting requirements; import procedures; and the transformation of the Investment Promotion Center from a regulatory body to a promotional and facilitative agency. On-going work includes: further simplification of the regulatory environment (for example, commercial code and the industrial licensing law reform and the introduction of alternative resolutions to disputes). Other on-going and proposed Government projects, including the Economic Management Reform Operation, Railway and Port Restructuring Project, Roads and Coastal Shipping Project and the National Water Development Project are addressing the required investments in infrastructure, achieved in part by increasing the role of the private sector in the provision of infrastructural services.

In the finance sector, following the restructuring of the central bank and the privatization of state-owned banks, there are now more effective monetary controls, a more diversified and competitive system, and the availability of basic banking services. With the dramatic improvement in the macro-economic environment and an interest rate structure more conducive to term lending, several Mozambican banks are beginning to seriously consider expanding their lending activities.

During the 12 months ending September 1998, average lending rates per the Bank of Mozambique (BOM) statistics, dropped from 34 percent to 25 percent in nominal terms, while average deposit nominal rates dropped about 6 percent to 8.8 percent. Although some banks are still reducing their rates on new lending to 20-22 percent, interest rates remain high in real terms. Bankers, however, do not see these interest rates as adding much risk to term lending because they are of the view that the true level of inflation if measured on a broad basket of services inclusive of the non-monetized sector is about 10 percent, bringing real term lending rates to reasonable levels.

Lending interest rates may be holding at artificially high levels relative to the cost of funds due to credit ceilings which place nominal limits on the amount of defined credit each bank can extend. However, virtually all term lending has been excluded from the ceilings. This keeps spreads above the 6 to 8 percent several large banks believe they need to be profitable at higher loan deposit ratios. As term lending is viewed as more risky than short term lending, it may have an indirect effect on long term interest rates as well. The Authorities plan to further liberalize credit

ceilings in 1999 and to eliminate them in the year 2000.

The credit disciplinary environment remains a serious problem and a previous "culture of non-repayment" is proving difficult to eradicate. System-wide, non-performing loans (NPLs) are estimated at 15 percent of total portfolio and they have reportedly increased during 1998. Some bankers attribute the reported increase to significantly improved banking supervision and tightened regulations with respect to defining NPLs. Also, the slow and undependable judicial system directly contributes to a problematic credit disciplinary environment. Nonetheless, bankers believe risks of non-repayment are significantly decreasing as environment risk is decreasing and useful formal and informal credit information systems have come into operation.

With the improvement in market conditions, considerable medium term lending is already taking place. However, the vast bulk of the term lending is for periods of 2 years or less and is predominantly available to large borrowers. Deposits of one year or more represent a very small portion of total deposits at this juncture and banks are reluctant to lend for more than one year on the basis of short-term deposits because of concerns on interest rates and liquidity risk. Bankers are unanimous (i) in their opinion that the demand for 2-to 5-year credit is substantial and growing and (ii) in their desire to increase their own term lending to the extent they have an appropriate funding base.

3. Sector issues to be addressed by the project and strategic choices

The "second generation" program of reforms outlined above calls for a sustained long-term commitment across multiple fronts. The immediate challenge is to make sufficient progress in addressing the obstacles so that, period-by-period, progressively more private actors can share in the fruits of economic growth. Given Mozambique's institutional weaknesses, one key strategic choice is that IDA help support this reform agenda through a variety of distinct initiatives, each of which has the potential to achieve progress in some specific domain.

The present project thus comprises just one element of a broader program of pro-private sector reform: capacity building -- of private firms (by enhancing their access to finance, technical, and training services), and of selected Government and non-governmental agencies which interact most intensively with private firms. Assistance will focus on supporting private firms by: enhancing their competitiveness domestically and internationally, increasing their access to appropriate training services, facilitating supply linkages with joint-venture or foreign-owned firms, and meeting firms' investment and financing requirements. Accompanying these support activities would be assistance to Government agencies to enable them to better provide professional business facilitation and promotion services to private firms and to identify and ease bureaucratic rigidities which contribute to high business costs for Mozambican entrepreneurs. Other reform vehicles will complement PoDE in the promotion of regulatory simplification and investment in infrastructure (including infrastructural sector reforms to promote private participation).

C. PROJECT DESCRIPTION SUMMARY

1. Project components (see the Table 1, Annexes 4 through 7 for detailed description and cost breakdown).

A. Technical Learning in Firms Component (TLC)

This component would focus on building the technical capabilities of majority Mozambican-owned firms, in manufacturing and services supporting manufacturing and exports (including tourism). It comprises three sub-components: the Firm Competitiveness Office (FCO), the Training and Advisory Office (TAO), and the Linkage Program Office (LPO).

(i) ***Firm Competitiveness Office.*** The objective of this office will be to boost the competitiveness of private firms doing business in Mozambique by supporting technology transfer, and to strengthen their access to, and use of, support services external to the firm. The primary means of achieving this objective will be to provide cost-sharing grants to firms, in order to part-fund the costs of using outside services and travel. All grants will be on a 50 percent cost-sharing and reimbursable basis.

(ii) ***Training and Advisory Office.*** This sub-component seeks to address the constraints that the market does not provide a sufficient supply of business and technical training and firms do not yet take full advantage of external training opportunities. The objectives of this office would be to support the development of an active business and technical training market in Mozambique. Cost sharing grants, on a 50/50, reimbursable basis, will be made available to qualified trainers to provide training services which support the PoDE focal sectors. These training services will include: existing local or overseas developed training courses for which a local market has not yet developed, and/or additional training courses for which a market demand can be demonstrated through local market research or feedback from within the local private sector.

(iii) ***Linkage Program Office.*** The objective of this office will be to facilitate supply linkages between Mozambican supplier firms and joint-venture or foreign-owned firms, where decisions to purchase goods and services are taken within Mozambique. The office will facilitate the process of re-orienting local supplier firms to the international standards of performance expected by such purchaser firms.

These sub-components are related to one another in the following ways:

- All three foster technical learning through the private marketplace. The LPO directly links buyers and suppliers. The FCO and TAO empower purchasers of services, allowing them to choose what services make best sense for them, and allowing them to select their own service providers – and thereby strengthening the market for business development services. The cost sharing features of the FCO and TAO (firms themselves must pay 50 percent of the cost of services they use) ensures that the demand for technical learning is credible.

- The FCO and the TAO target different segments of the private sector: the FCO focuses on firms that already have achieved an initial baseline of planning, technical and financial capability; the training supported by the TAO will benefit not just established SMEs but also the smallest firms who are difficult to support on a one-to-one basis, and for whom generic training in basic business skills can yield substantial returns.

- Management is delegated to the newly appointed TLC Management Contractor (MC), who has substantial international experience in providing technical and marketing services to firms. The joint management of the three sub-components by a single contractor will facilitate information sharing, make it easier to guide firms towards appropriate services, foster evolution of firms from one program to another – and take advantage of potential economies of administration. This initiative is time-bound, i.e. intended to strengthen, not substitute for, the marketplace for business services.

- Responsibility for oversight of the three sub-components will be vested with the PoDE Steering Committee (PSC).

B. Finance Component

Mozambique represents a satisfactory environment for term lending at this juncture from a macroeconomic, interest rate, and banking institutional environment perspective. The credit disciplinary environment, while not satisfactory, is improving. Effective demand for local currency loans in excess of 2 years exceeds the available funding viewed as suitable for such lending by bankers. Two financial products will be available for firms in all sectors (excluding trading, finance and real estate) under this component: (i) a special facility designed to provide very small, first-time bank borrowers with loans amounting to a maximum of $15,000; and (ii) a traditional facility to finance loans up to $300,000 for small and medium-scale borrowers.

The special facility is designed to catalyze commercial bank lending to largely indigenous and small-scale entrepreneurs who often have considerable difficulty in obtaining a first loan as they are viewed as high risk borrowers involving high transaction cost relative to potential revenue generation. Parallel "quasi-equity" funding, equal to 25 percent of total project cost, will be available through the PFI at the Government's risk. This funding will have no debt servicing requirements during the scheduled life of the PFI sub-loan, and will, therefore, create de facto total equity and quasi-equity of at least 35 percent of project cost which, as it is subordinated to the bank's loan, significantly reduces lender risk. Under this arrangement, the borrower will have a major incentive to repay the bank loan on time as the 25% quasi equity would become a grant to the borrower upon full repayment of the loan. Funding under both facilities would be available to finance investment assets including permanent working capital for private sub-borrowers in all sectors (including industry, agro-processing, tourism, transportation, construction and services).

Funds relating to approved sub-projects would be made available to PFIs in meticals without foreign exchange risk at the market-based average interest rate paid for six month deposits, to be adjusted quarterly. Sub-loans would be for periods of 2-1/2 to 7 years with a maximum grace period of one year. Interest rates to sub-borrowers would be freely determined by the PFIs, variable and adjusted quarterly.

C. Institutional Capacity Building Component

This component is designed to address two key objectives: (i) enhancing the capabilities of private and public institutions to deliver business support services; and (ii) supporting Government agencies in their transformation process from maintaining control functions to providing business facilitation and promotion services, including improving their capability to identify and ease bureaucratic rigidities. Capacity building assistance will be extended to the Investment Promotion Center (CPI), the Ministry of Industry, Commerce and Tourism (MICTUR), and the Commission of Economic Associations (CTA). Parallel funding proposals are being considered for initiatives focussed on solidifying sectoral contributions to economic growth and development.

(i) ***Investment Promotion Center*** (CPI). This sub-component will: (i) support CPI's investment promotion and facilitation activities; and (ii) support the Development of Export "Free Zones" in Mozambique including: capacity building assistance, together with the Environment Ministry, with respect to conducting environmental impact assessments and activities related to industrial permitting and compliance monitoring; and structuring environmental requirements for inclusion in the financial models and in FZ tender documents.

(ii) ***Ministry of Industry, Trade and Tourism*** (MICTUR). The Project will support the Ministry's objectives of addressing continuing weaknesses in the business environment and will enhance its role as a channel for dialogue with the private sector, in the development and delivery of business facilitation and promotion services, and in regulatory reform (including commercial code reform). Studies on, for example, the collateralization and transfer of immovable property in urban areas; metrology, standards, testing and quality control in light of the regional capacity and performance; other measures that will enhance private investment and improve the enabling environment for these activities will be conducted, and the resulting recommendations would be translated into concrete policy and legislative proposals.

(iii) ***Regional Business Support Initiative*** (RBSI). Another initiative to stimulate broad based economic and private sector growth is the RBSI. This component will seek to build and strengthen geographically-focused member-based business organizations, motivated by a shared vision of developing the local economy and engaged in a common program of action for realizing that vision.

(iv) ***Sector-Specific Initiative*** (SSI). To broaden and sustain the base of private sector participation in continuing economic growth, this component will aim to develop networks of buyers, producers, traders and support institutions in up to three identified sectors of economic activity. The project will also support proactive, sector-specific, business advisory services for Mozambican firms. Parallel funding for this initiative is being considered by other donors.

Table 1. Estimated Project Cost and Financing

Component	Category	Indicative Costs (US$M)	% of Total	Bank Financing (US$m)	% of Bank Financing
1.0 Technical Learning in Firms		13.9	29.1	6.0	23.5
1.1 Firm Competitiveness Office	Capacity building, grants, project management	5.9	12.4	2.0	8.0
1.2 Training and Advisory Office	Capacity building, grants, project management	6.3	13.2	2.8	10.8
1.3 Linkage Program Office	Capacity building, grants, project management	1.7	3.5	1.2	4.7
2.0 Finance		12.7	26.8	10.0	38.4
2.1 Special Facility	Credit, grant	3.8	8.0	3.0	11.5
2.2 Traditional Facility	Credit	3.8	8.0	3.0	11.5
2.3 ***Unallocated***	Credit, grant	5.1	10.8	4.0	15.4
3.0 Capacity Building		17.4	36.6	7.0	26.8
3.1 Investment Promotion Center	Policy, institution bldg., project management	9.9	20.8	4.7	18.0
3.2 MICTUR	Policy, institution building, project management	1.2	2.5	1.2	4.5
3.3 Regional Business Support Center		1.1	2.4	1.1	4.3
3.4 Sector Specific Initiative		5.2	10.9	0.0	0.0
4.0 Project Implementation		1.2	2.5	0.6	2.20
Unallocated		2.4	4.9	2.4	9.1
Total		47.6	100.0	26.0	100.0

2. Institutional reforms supported by the project

PoDE will address 3 capacity building objectives: (i) enhancing the capabilities of private firms in manufacturing and services supporting manufacturing and exports (including tourism); (ii) developing the capabilities of providers of business support services; (iii) supporting Government agencies in providing business facilitation and promotion services and improving their capacity to identify and ease bureaucratic rigidities.

3. Benefits and target population

Benefits - Following extensive consultation with Government officials, leaders and members of the private sector and a survey of 150 firms carried out by the Africa Regional Program for Enterprise Development (RPED), it is clear firms face constraints relating to the development of business strategies, technical know-how, markets, finance, and Government regulations. By addressing these constraints, this project will improve the competitiveness of private Mozambican

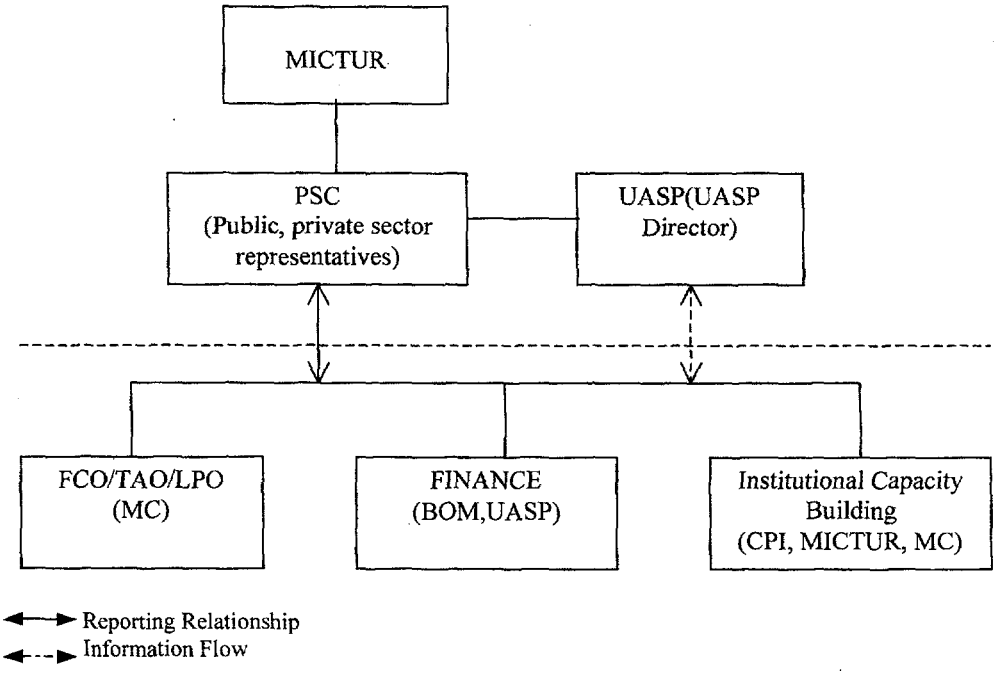
firms in the manufacturing, agro-processing, and handicraft sectors. This would result from: (i) a more robust technical learning environment for private sector firms; (ii) a deeper financial system supporting technological upgrading in private enterprises and investments through the provision of long-term loans; and (iii) a more capable set of institutions delivering support services to private businesses.

Target population - The primary target population will be: (i) approximately 200 small- and medium-sized businesses that are currently exporting or show potential to export (at least 20 percent of firms supported should have been established in 1995 or later and at least 30 percent should operate outside Maputo); (ii) at least 30 local firms that could become suppliers to larger foreign investors that are operating within the country; and (iii) local firms supplying the domestic market, especially the very many small firms likely to benefit from training. The secondary population to benefit from the project will be the employees of these firms, the firms and individuals that benefit from these employees' income, and the firms that provide inputs and services to the exporting firms.

4. Institutional and implementation arrangements

Executing Agency:	MICTUR
Project Coordination:	PoDE Steering Committee
Implementation Period:	5 years, January 2000 through December 31, 2004

PoDE Organizational Structure



The overriding principle guiding the institutional and implementation arrangements for the Project is to delegate the maximum feasible operational responsibility and independence to agencies and managers selected to implement the Project components. Overall responsibility for the implementation and coordination of the Project will be entrusted to the PoDE Steering Committee (PSC)[1] under the purview of MICTUR. The recently appointed *Unidade de Apoio ao Sector Privado* (UASP) will serve as the administrative arm of the Steering Committee and will be charged with ensuring adequate overall financial and administrative support to the designated implementing agencies of the Project components. Operational responsibilities for the Technical Learning in Firms Component and the Finance Component will rest with the Management Contractor and the Bank of Mozambique, respectively. The implementation of the Capacity Building Component will rest with the Investment Promotion Center and MICTUR for their respective component. Work under the Sector Specific Initiative and the Regional Business Support Initiative will be coordinated by the Management Contractor. The sector specific initiative will be separately managed under parallel financing arrangements. A Project Implementation Plan, prepared by the PSC in consultation with IDA, provides a detailed description of each project component, the institutional and implementation responsibilities, and guidelines for the PSC, UASP and component managers to fulfill their roles effectively.

Government. MICTUR, the Government's representative, has formally delegated project responsibilities to the PoDE Steering Committee.

PoDE Steering Committee. The PSC consists of four representatives each from the public and private sectors. The demands on it during the start-up phase of the Project are expected to be substantial requiring the delegation of some of its roles and responsibilities to a PSC Director. A Director would be appointed for one year, with the possibility of an extension depending upon how the work program evolves. The functions of the PSC would be to:

- assist the Management Contractor in resolving ambiguities and uncertainties associated with initial start-up of the scheme;
- provide the strategic direction of PoDE and ensure that the patterns of support for the private sector (by region, size and sector) are consistent with the Project objectives;
- review and approve all matching grants requests (i) costing over US$100,000; and (ii) from beneficiaries that have reached a cumulative threshold of US$100,000 on prior grant support under the Technical Learning Component. For beneficiaries falling under (ii), the PSC has the option of approving additional grants, up to the US$200,000 ceiling, without prior review (and based on the approval already given when the US$100,000 threshold was crossed);
- under the Technical Learning Component, receive and review quarterly reports to ensure that the decisions and processes of the Management Contractor are consistent with the eligibility and monitoring criteria specified in the Project Implementation Plan. In the event of poor performance on the part of the contractor, the PSC, in consultation with IDA, will have the right to take appropriate remedies;
- for the Technical Learning Component, review appeals for a reversal of the contractor's decision made by any applicant and bring these appeals to the attention of IDA for their review; and revoke an approval already granted in the event that fraudulent information has been provided within an application;
- meet obligations to exercise due diligence and ensure proper procurement, disbursement, accounting and financial auditing systems are established. It is anticipated that, beyond

[1] Comprising representatives from: the Commission of Economic Associations (four drawn from industry, service, commerce and finance sectors), Bank of Mozambique, Investment Promotion Center, Ministry of Planning and Finance, and the Ministry of Industry, Trade and Tourism.

helping to ensure that these systems are established in a timely way, operate efficiently, and generate the information the PSC needs to perform its strategic role, the PSC and its Director will not have direct operational responsibility for these systems;

- for the Technical Learning in Firms Component, the Steering Committee would (only if necessary, and at intervals no shorter than six months) prepare proposals justifying changes to the operating directives of the Management Contractor for IDA's consideration. Upon receipt of IDA's "no objection", it would send written directions to the Management Contractor as to the ways (if any) in which the contractor should redirect its efforts; and
- authorize, following consultations with IDA, the reallocation of resources across the various components of the project as lessons emerge as to patterns of demand and developmental impact.

Unidade de Apoio ao Sector Privado. The UASP, will be headed by the UASP Director and supported by staff, some seconded from MICTUR. It will: (i) provide procurement support to the PSC in the establishment of the Technical Learning in Firms Component; (ii) obtain the procurement and disbursement plans from the implementing agencies and liaise with BOM to ensure sufficient funding in the special account and prompt disbursement; (iii) transmit all requests for IDA's approval; (iv) receive from the implementing agencies, review, and transmit to the PSC, the Government and IDA all quarterly progress, audit, mid-term, and implementation completion reports; (v) carry out all support functions to the PSC; and (vi) serve as the credit administrator for the Finance Component under the supervision of the BOM (a listing of responsibilities under the Finance Component is provided below).

Management Contractor. The Technical Learning in Firms Component will be administered by the Management Contractor. The Management Contractor is a firm with substantial international experience in providing technical and marketing services to firms and will work under a term contract. The term contract signals that the initiative is time-bound and intended to strengthen, not substitute for, the marketplace for business services. The component will have three sub-components, the Firm Competitiveness Office, Training and Advisory Office, and the Linkage Program Office, which will foster technical learning through the private marketplace. These sub-components will be jointly managed by the Management Contractor, a manager and a deputy manager for each sub-component.

In response to firms' request for technical capacity building services, the functions of the Management Contractor would be to:

- advise firms in preparing programs designed to meet firms' capacity building objectives and based on the specific focus of each sub-component;
- ensure that services are geared towards what firms need, are focused on firms which can make the most effective use of the services, and are offered in a "private sector friendly" way (for example, under the TAO, a firm's overall program of support could be subdivided down to the size of the smallest feasible deliverable with reimbursement made for each sub-part; another option would be to follow group delivery mechanisms);
- based on the defined eligibility criteria for beneficiaries, as detailed in Annex 4, approve grant applications for the FCO and TAO below US$100,000;
- review and recommend for PSC's approval all matching grant requests: (i) for contracts costing over US$100,000; (ii) from beneficiaries that have reached a cumulative threshold of US$100,000 on prior grant support under the TLC;
- review to ensure IDA procurement rules have been followed, and send recommendation for approval to IDA for TLC supported contracts costing over (i) US$50,000 or more when the service provider is an individual consultant, or (ii) US$100,000 or more when the service provider is a consulting firm;

- ensure prompt payments to beneficiaries; strict reimbursement standards, including a turnaround time of not more than 5 days, will be followed;
- ensure that the strategic direction of the TLC and necessary recommendations made to the PSC to adjust the parameters of the sub-components are consistent with Project objectives;
- submit quarterly reports of all sub-components, including all grant approvals, to the PSC for their consideration at quarterly meetings;
- ensure proper procurement, disbursement, and financial reporting;
- promote the TLC to firms, associations, and sub-sectoral business groupings.

In addition to the above functions for the Management Contractor and the sub-component managers, additional component-specific responsibilities are detailed in the PIP.

Bank of Mozambique. The Finance Component will be managed by the Credit Operations Department (COD) at the Bank of Mozambique. BOM will designate UASP to serve as the credit administrator and to handle the day-to-day management responsibilities of the facilities. The COD will be primarily responsible for ensuring that the line of credit is accessed by participating financial institutions (PFIs) that are solvent, well-managed, and operating based on sound financial policies.

- The COD will confirm the eligibility of PFIs based on criteria established under this component. All commercial banks and leasing companies licensed to operate in Mozambique will qualify for participation based on an initial assessment of their financial strength. Initially, the eligibility criteria includes: (i) conformity with prudential regulation requirements (capital adequacy, liquidity, concentration and exposure limits, reserves, portfolio quality, loan loss provisions, accounting policies); (ii) a net profit during 1998 as evidenced by audited accounts prepared in accord with international standards; (iii) total non-performing loans of less than 20 percent of portfolio; and (iv) submission of a document describing and showing to be satisfactory the PFI's term-lending organizational structure, staff experience, policies and procedures and training program. The eligibility of PFI's will be certified by the Banking Supervision Department and confirmed by IDA. Once eligible, PFI's on-going eligibility to make new commitments would immediately cease if: (i) collections on sub-loans drop to less than 85 percent of amounts coming due; (ii) a qualified opinion is made on a PFI's audit report, required quarterly reports or annual audit reports are not received within 45 days of their respective due dates; or (iii) they no longer meet the other stated eligibility requirements. The Bank of Mozambique Banking Supervision Department will be responsible for verifying to what extent candidate PFIs meet the eligibility requirements. Following the mid-term review, additional commitments would be made only: (i) if BOM has lifted the credit ceilings; and (ii) to PFIs who, in addition to continuing to meet the above-mentioned eligibility criteria, finance at least one third of sub-project loan requirements from their own funds. Once the eligibility of a PFI is confirmed, the COD will record and communicate approval of the PFI's sub-loan to the UASP not later than 3 business days after receipt of the application.

- The COD will promptly disburse funds for eligible expenditures under the Project and will request replenishment of the special account based on the presentation of the required documentation as provided in the Project's Development Credit Agreement.

UASP, as the credit administrator will:

- ensure that sub-projects approved for funding by PFIs meet the PoDE Project eligibility criteria for beneficiaries described below. Funding resources would be available to finance

investment assets including permanent working capital for private sub-borrowers in all productive sectors including industry, agro-processing, tourism, transportation, construction and services, except finance, trading, and real estate. Individual borrower eligibility requirements for the special facility for small borrowers would include: (i) no history of previous borrowing from banks including no previous borrowing under this facility; (ii) minimum equity requirements of 10 percent of the amount of the PFI sub-project; and (iii) maximum borrower total assets of US$40,000. Eligibility requirements for borrowers under the traditional component would include: (i) no outstanding loans in default; (ii) minimum equity requirements of 25 percent of the sub-project; and (iii) a maximum US$500,000 in total assets. The PFI, which bears the entire credit risk, will carry out an evaluation of the economic and financial viability of the sub-project. Additional evaluations will not be required from the UASP as this would have been done prior to the approval and submission of the sub-loan application by the PFI. The sub-loan approval decision will be made not later than 7 business days after receipt of the application;

- advise BOM to disburse funds to the PFIs in accordance with disbursement schedules agreed by the PFI and the UASP. Based on preliminary disbursement schedules that accompany each sub-loan application, PFIs will provide the UASP, on a monthly basis, with an updated list of funding requirements for sub-loans which the UASP should instruct BOM to disburse against during the succeeding month. This procedure will be adopted to simplify the UASP's role. The UASP's functions would be limited to narrow administrative aspects and will not require advance approval on individual transactions or documents as in earlier IDA-financed operations, given that all intermediaries are private, commercially oriented, and competently staffed at senior levels. At the earlier of nine months after subproject approval or completion of disbursement, the PFI would be responsible for submitting full documentary support for all disbursements for a specific subproject. The UASP would review documentation for eligibility and insist on reimbursement from the PFI, to the extent that any ineligible or unsatisfactorily documented expenditures are discovered. Penalties, at twice the interest rate charged to PFIs, for amounts remaining undisbursed to sub-borrowers, or any disbursements not in accord with the agreed requirements, and not returned within one month of the scheduled disbursements will be imposed on PFIs;

- on all sub-borrowers, monitor and report on a quarterly basis their repayment performance and aging analysis of their arrears by PFI. Collect from PFIs their annual audited reports. Signal to the COD and IDA the need to suspend any PFI from participating in the line of credit once their loan collection rates fall lower than 85 percent of amounts due or annual audit reports have not been submitted within 45 days of their due dates; and

- take full responsibility for the preparation and submission of quarterly progress reports detailing the utilization of funds and providing implementation information by PFI: sub-project data (type of business, sector, job creation, etc.), repayment performance; and the implementation experience under this project component. The UASP will fully support the independent auditor charged with the preparation of annual audit reports for the Project. It will also liaise with the PSC for the preparation of periodic progress reports, the mid-term review for each of the sub-components of the line of credit, and the implementation completion report.

Investment Promotion Center, MICTUR, and the MC. The CPI and MICTUR will implement their respective components and the MC will coordinate the implementation of the RBSI. Each implementing agency will coordinate with the UASP on the administrative responsibility for the funds that are allocated for these components. Each agency will be responsible for:

- coordinating the contracting process with UASP including the submission of procurement requests to IDA;
- preparing a quarterly progress report for the PSC and IDA on the progress of the sub-components in achieving their objectives and their level of commitments and disbursements; and
- coordinating with the auditor in the preparation of the annual audit report for the Project.

The implementation arrangement for the Sector Specific Initiative will be defined and funded under parallel arrangements agreed between the Government and other sponsoring donors in consultation with IDA.

5. Procurement arrangements

The UASP will be the coordinating and responsible agent for all procurement funded by the Project. It will handle the procurement requests according to monthly procurement schedules submitted by each implementing agency. It will have staff who are fully familiar with Bank procurement procedures as they will be recruited from implementing agencies of other Bank-funded projects. In addition to the Procurement Action Plan to be developed by the Government and incorporated in the PIP (as a condition for project effectiveness), Annexes 4-6 and the PIP describe component-specific procurement procedures and Annex 8 summarizes the procurement and disbursement arrangements.

6. Disbursement arrangements

Disbursements from the IDA Credit will be made on the basis of incurred eligible expenditures. Each implementing agency will be responsible for furnishing the UASP with monthly disbursement plans based on disbursement and withdrawal procedures detailed in Annexes 4 through 6, Annex 8 and the Project Implementation Plan. The expenditure categories, projected allocation of Project proceeds, and IDA's financing percentages are also provided in Annex 8. The UASP will coordinate all disbursement requests and will transmit these to the BOM for disbursement.

All applications to withdraw proceeds from the Credit account will be fully documented by BOM. Full documentation will be transmitted to IDA except for: (i) expenditures under all components of the TLC for (a) contracts with an estimated value of US$100,000 or less for consulting firms; and (b) contracts with an estimated value of US$50,000 or less for individual consultants; (ii) all expenditures under the FC which may be claimed on the basis of certified statements of expenditure (SOE); and (iii) contracts for goods below US$200,000. Documents supporting these expenditures would be retained by the MC, the UASP, and other implementing agencies for their respective components and will be available for review as requested by IDA supervision missions and project auditors.

A provision for retroactive financing under the Project will be included to facilitate the prompt execution of the on-going reform work on the commercial code, which commenced under the Bank-financed Industrial Enterprise Restructuring Project and will receive continued support under this Project. Retroactive financing will be available for eligible consulting services, up to US$850,000 and made within 12 months after October 1999 and before loan signing. Procedures for procurement and disbursement for the use of consultants, including the processing and clearances will be subject to IDA's procurement and consultant guidelines.

A special account will be opened by the Government in the BOM under terms and conditions satisfactory to IDA to facilitate the payment of eligible expenditures for goods, works and

services under all the Project components. An authorized allocation of US$1.5 million for the special account will cover an estimated four months of eligible expenditures financed by IDA. Upon project effectiveness, the BOM will submit a withdrawal application for an initial deposit to the special account amounting to US$1.5 million. Subsequent deposits to the special account may be requested by the BOM, as needed. Replenishment of funds from IDA will be made upon evidence of satisfactory utilization of the advance, reflected in the Statement of Expenditures (SOE) or on full documentation for payments above the SOE thresholds. Replenishment applications should be submitted regularly, ideally every month but not exceeding three month intervals. If ineligible expenditures are found to have been made from the special account, the Government will be obligated to refund the cost and submit evidence with the next request for replenishment. In addition, if the special account remains inactive for more than six months, the Government may be requested to refund to IDA amounts advanced to the special account.

7. Accounting, financial reporting and auditing arrangements

The UASP, with support from all implementing agencies, will be responsible for the overall management and reporting of the principal financial resources for the Project, IDA and external partners. A Financial Procedures Manual will document the internal control procedures to be followed by the UASP and computerized systems will be set up to enable them to maintain accounting records in accordance with international accounting standards and practices. The PSC will review on a quarterly basis the UASP' program management report.

The UASP will keep the funds from IDA and, in due course, each other donor in separate accounts but will move toward common procurement, financial management and auditing procedures acceptable to all partners. Financial statements will show all expenditures and the source of funds. For IDA funds, the UASP will maintain accounting records including meticais, dollar and SDR movements in respect of the bank account and, in accordance with good accounting practice, accounting records will be reconciled monthly by the UASP with the bank statements for the account upon its receipt.

At this embryonic stage in the establishment of UASP's financial management system, UASP is not yet ready for Project Management Report (PMR)-based disbursements, as discussed in the World Bank's Loan Administration Change Initiative Handbook (LACI, September '98). Thus, in the short-term, existing disbursement procedures, as outlined in the World Bank's Disbursement Handbook, will be followed i.e., direct payment, reimbursement and special commitment. However, the development of UASP's financial management system, in accordance with the Financial Management Action Plan presented below, is expected to facilitate the introduction of PMR-based disbursements within about 18 months of credit effectiveness. Salient features of the action plan include: recruitment of and capacity building for support staff, preparation of a Financial Procedures Manual by the newly appointed External Systems Consultant and the Chief Accountant, establishment of a fixed assets register, monthly status of funds report and quarterly financial reporting, and cash flow management including variance analysis.

Independent auditors acceptable to IDA will audit program accounts annually and provide a management letter that recommends improvements to the financial management system. Two copies of the audit reports will be forwarded to IDA by the UASP within six months after the end of the fiscal year. The project will finance preparation of the audit reports except the final one which will be funded by the Government.

8. Monitoring and evaluation arrangements

The PSC will monitor and evaluate the Project based on the structure set up for implementation and the terms of reference for agencies within the structure. Each implementing agency will develop instruments for monitoring its respective component while the UASP will consolidate and analyze statistical, financial, and physical data on the implementation of the Project. Quarterly progress reports will be prepared by the UASP and submitted to the PSC and IDA. Independent technical quality audits for the TLC will be commissioned by the PSC and will be based on two weeks of fieldwork, primarily field visits to a sample of firms assisted. For the first year and a half, the TLC technical and financial audits would each be undertaken at six monthly intervals. The monitoring and outcome indicators provided in Annex 3 will provide the PSC, the Government, IDA and other donors with measures to determine progress and form the basis for joint supervisions.

Formal supervision will take place twice a year to review implementation progress. The Government, IDA and other donors will jointly prepare the terms of reference and will participate in the mission. A mid-term evaluation of the Project will take place no later than 24 months after the Credit effectiveness in accordance with terms of reference agreed upon by Government, PSC, IDA and other donors. The PSC will be required to prepare a mid-term report detailing implementation progress under all Project components and identifying implementation issues. This report will be submitted to the Government, IDA and other donors not later than two months prior to the mid-term review. During the mid-term review, in response to the implementation issues identified, solutions will be developed, and, if required, project redesign steps will be taken. An Implementation Completion Report will also be jointly prepared by the PSC and IDA within six months after the closing date of the Credit.

D. PROJECT RATIONALE

1. Project alternatives considered and reasons for rejection

Three options were considered and rejected. First, the Government and IDA considered focusing this project exclusively on a credit line serving as a follow-up project to the Small and Medium Enterprise Development Project (SMEDP). The results of the Implementation Completion Report for that project as well as the Operations Evaluation Department (OED) review of the Bank's PSD work in Mozambique, however, suggest that although medium-term credit is an important constraint for many firms, other problems, such as poor technical and managerial skills and poor worker skills in firms, also deserve immediate attention.

The second option considered a pre-shipment export finance and credit guarantee facility within the credit component of an expanded project (which included capacity building assistance for firms). This was rejected given the small and exceedingly inward looking characteristic of the private sector and a generally mixed implementation record of credit guarantee schemes. Instead, recent promising credit initiatives elsewhere in the world for reaching first-time borrowers were adopted under the Finance Component and incorporated in the PoDE Project together with updated methods for delivering technical services to firms under the Technical Learning in Firms Component.

The third rejected option was to combine the capacity-building and regulatory simplification elements of the private sector reform agenda into a single operation. The project will indeed provide support for further diagnostic work on reducing regulatory obstacles under the Capacity Building Component (for example, commercial code reform, collateralization and transfer of

immovable property, etc.). But it will be a complement, not the primary vehicle, for promoting an aggressive program of regulatory simplification. Pushing further on the latter objective was not incorporated into the project both to keep the agenda as uncomplicated as possible, and (against a backdrop of sometimes-controversial liberalization efforts) as a way of ensuring that the project would unambiguously be perceived as "win-win" – as an unequivocal signal of the commitment of the Government, IDA and other donors to support the strengthening of a competitive private sector in Mozambique. As Section B.2. above described, the Government currently has underway a variety of other initiatives to streamline the business environment.

Table 2. Major related projects financed by the Bank and/or other development agencies
(completed, ongoing and planned)

Sector issue	Project	Latest Supervision (Form 590) Ratings (Bank-financed projects only)	
		Implementation Progress (IP)	**Development Objective (DO)**
Medium- and long-term credit constraints to enterprises, rehabilitation and restructuring, including privatization, of enterprises, administrative barriers to investment	Industrial Enterprise Restructuring Project	S	S
	Small & Medium Enterprise Development Project	S	U[2]
Capacity building in the Bank of Mozambique, commercial banks, Ministry of Finance, financial sector	Financial Sector Capacity Building Project	S	S
Privatization of state-owned banks	Third Economic Recovery Credit	HS	HS
Removal of red tape and simplification of import procedures	Economic Management Reform Operation	HS	HS
Other development agencies			
Technical assistance for institution building	European Commission - Private Sector Development Program for Mozambique – Phase I (under development)		
Medium- and long-term credit constraints to enterprises	European Investment Bank (under development)		
Technical assistance to the CTA	USAID		

IP/DO Ratings: HS (Highly Satisfactory), S (Satisfactory), U (Unsatisfactory)

3. Lessons learned and reflected in the project design

Two key elements of design draw on lessons learned from the Industrial Enterprise Development Project and the Small and Medium Enterprise Development Project:

[2] Due to unsatisfactory repayment rates

- a simple and delegated project design: i.e., compatibility with political realities and institutional absorptive capacity of Government agencies. The scope and design of the project will be kept realistic and flexible to take into account existing and changing local conditions. The Government and the Steering Committee will delegate the operational responsibilities of the Technical Learning Component and the Finance Component to the Management Contractor and the UASP, respectively. In addition, in consultation with IDA, the Steering Committee will have clear levers for shifting the strategic direction of the Technical Learning Component, if needed; and

- stakeholder involvement in design and execution of the project and development of local expertise. Experience dictates that local ownership of projects results in a better definition of the constraints faced by the private sector and the initiatives to address them, effective project execution, and sustained achievement of project objectives. The Government delegated full responsibility to the PoDE Steering Committee, a committee comprising representatives from private enterprises and public sector agencies, to lead the development efforts on the Project. This Committee will continue to be given formal responsibility for providing vision on the matching grants and getting results as measured by monitorable targets. Also, where possible, procurement of consulting services will encourage local participation.

The design of project components also incorporates global lessons of experience as to what kind of support for the private sector is workable. Specifically:

- initiatives to foster technical learning in firms need to be firmly embedded in the private marketplace: private firms learn best from other private firms (buyers, vendors of specialist services and other inputs) – and they learn best where they themselves have recognized the value of these services. Under the Technical Learning Component, this will be demonstrated by the enterprises' willingness to pay some of the cost of learning;

- there is enormous diversity within the private sector – and both financing and technical learning initiatives need to be designed in ways which are responsive to this diversity. Within the context of approaches which strengthen financial sector development (i.e. avoid subsidized interest rates, and avoid approaches which remove from banks all risks, and hence all incentives to scrutinize creditworthiness), the incentive problems which make it difficult for potential first-time borrowers to gain access to credit are very different from the incentive problems which inhibit the provision of medium-term finance for established borrowers. These differences were taken into consideration particularly in the design of the Special Facility; it will provide quasi-equity funding to first time borrowers. In addition, the credit delivery mechanism has been: (a) developed to allow consistently sound financial institutions to participate; and (b) simplified to allow timely access to resources to meet the more demanding funding requirements of established and creditworthy enterprises. Similarly, under the Technical Learning Component, the target clients, focus, and design of the Firm Competitiveness Office and the Training and Advisory Office reflect the fact that the learning needs of established, medium-to-large formal enterprises using complex technology are very different from those of smaller, newer firms active in simpler lines of business. Enterprise support programs which fail to reflect these differences end up offering little value to firms. At the same time, boxing firms into excessively segmented programs risks foregoing the opportunities for larger and smaller firms to link and learn from one another, to improve technical capability, and move into more demanding markets. The Linkage Program Office will facilitate progressively such linkages.

4. Indications of borrower commitment and ownership

The difficult decisions taken by the Government to implement its structural reform, financial restructuring, and privatization programs and the resulting achievements (strong GDP growth, decreases in inflation, increases in exports, restructured central bank, privatized state-owned banks and enterprises, a CPI focussing on investment promotion, etc.) are evidence of its commitment to providing an enabling environment for private sector and export development. The Government requested support for its private sector development program fully recognizing the need to continue to include local entrepreneurs in the economy's growth, to obtain political support for their ambitious economic reform program, and the need to create jobs. The Government also sees this project as a necessary step in maximizing the benefits to local business from the large "mega-projects" and other foreign investments now entering Mozambique.

The creation of a joint public-private PSC to oversee the Project is a further signal of Borrower commitment. Following a series of private sector conferences (heavily attended by Mozambican entrepreneurs), the Government encouraged the formation of the PSC to explore what had to be done to increase the participation of Mozambican firms in private-sector led economic growth and development. The PSC is actively engaged, through a series of meetings (with and without IDA participation), in defining the PoDE project components and the implementation arrangements.

5. Value added of Bank support in this project

The Bank adds value by: (i) bringing to bear on the design of both the technical and finance components recent lessons of experience from PSD support initiatives globally; (ii) drawing upon its in-house expertise and, through its Regional Program for Enterprise Development, the body of research on how to increase the competitiveness of African firms; and (iii) helping to coordinate the Project's activities with the private and public entities concerned and with other donors to ensure they contribute towards a common goal of focused Mozambican enterprise development.

E. SUMMARY PROJECT ANALYSIS

1. Economic

Cost-Benefit Analysis : NPV = US$23.7 million; ERR = 24.7 percent

The Government realizes that it faces unusual challenges in fostering private sector development. While favorable circumstances (a successful transition to multi-party democracy, developments toward a market-oriented economy, ongoing investments in infrastructure, its emergence as an especially promising site for investment following South Africa's transition to a non-racial democracy) imply that over the next few years Mozambican economic growth will be rapid and likely in excess of 5 percent annually, the country's historical legacy raises the risk that this growth will be narrowly-based on a few large companies. Also, the domestic private sector, characterized as fragmented, small, and inward-oriented, has not been able to position itself to maintain competitiveness in a global economy (including domestically against imports).

To increase the number of participants in the country's growth process, the Government recognizes that Mozambican firms will need to close major information gaps (on production processes, marketing, business strategy etc.). However, the prospects for success of individual private firms depend not only on their own efforts, but on the broader business environment in

which they are embedded. Although the business environment has improved radically over the past five years and firms regard Government as supportive, access to credit, bureaucracy, and the uneven quality of infrastructure have been important obstacles to firms doing business. As in all countries, moving towards an unambiguously market-friendly business environment is a long-term process. Through discrete interventions in this project that provide technological, financial, and capacity building assistance to private firms and business support institutions, the Government envisages it would make sufficient progress in minimizing various obstacles so that, progressively more private actors can share in the fruits of economic growth.

Results from the economic analysis of the project, using a cost-benefit analysis framework, suggest that the project is justified in net present value and economic rate of return terms (see Annex 10) and would contribute to assisting the Government in meeting its objectives. The project would generate an estimated NPV of US$ 23.7 million discounted at 12 percent, and an ERR of approximately 24.7 percent. Additionally, other benefits from the project include: (i) an improved awareness of economic opportunities which do not directly result in increased output and employment by the supported firms; (ii) development of know-how which is put to use beyond the enterprise supported; (iii) banks are induced to become better capitalized and operationally sound to qualify for participation in credit lines; (iv) an increased consistency between project design and implementation, with the private and public sector as partners in providing the strategic direction and maximizing the responsiveness of the project management to the private sector; (v) gains from active collaboration by the public and private sectors, through the steering committee, in policy advocacy, (for example, in reforming business regulations; drawing together fledgling private sector representative groups, building cohesion, and creating advantages from mutually supportive work; establishing greater trust and respect between the two sectors to sustain development efforts); and (vi) increased capacity in the local consulting profession.

2. Financial

The project's financial objectives relate to: (i) implementing a process that contributes to increasing the overall financial soundness of participating financial institutions; (ii) assisting viable enterprises; and (iii) requiring sound financial management of the Project as a whole. The financial management system of the project will prompt the different private and public implementing agencies and commercial financial institutions taking part in the project to exercise due diligence and to establish proper procurement, disbursement, accounting, and financial auditing procedures and reporting systems. To participate in the project, financial institutions will be required to meet eligibility criteria that demonstrate conformity with prudential regulations, sound and profitable operations, and a performing loan portfolio. To qualify for financial assistance, sub-borrowers will be required to make sufficient investments in their business, demonstrate their creditworthiness by having no outstanding loans in default, and present a feasible business venture for financing. Clients under the matching grant scheme will be required to demonstrate their commitment to the learning process by covering 50 percent of the cost of the technical assistance they receive.

Fiscal implications. The project is designed to minimize the fiscal impact on the Government by: (i) requiring participating financial institutions to take full responsibility for the commercial risk of sub-loans; (ii) implicitly compensating the Government for the foreign exchange risk to the extent that it is reflected in market deposit rates that will be the basis for the reference interest rate imposed on participating financial institutions; (iii) obliging the Bank of Mozambique to certify the eligibility of participating financial institutions; and (iv) under the matching grant scheme, extending grants on an ex-post reimbursement basis. While the Government will cover 50 percent of the technical assistance cost to firms under the Technical Learning Component, this

represents modest national investments in activities that are expected to yield direct and indirect positive returns and generate annual net export income in multiples greater than the original investment.

3. Technical Not applicable.

4. Institutional

a. Executing agencies: see Section C.4. above and Annexes 4-6.
b. Project management: see Section C.4. above and Annexes 4-6.

5. Social

The provision of finance and technical support is unlikely to have a major direct impact in terms of social benefits to a large number micro businesses. However, it will provide short- to medium-term indirect social benefits resulting from increased investment and production, employment creation, generation of export earnings, and an overall stronger and broader economy.

6. Environmental assessment

The proposed project is classified as Category FI as it involves investment of Bank funds through a financial intermediary. The Project is not expected to present any specific environmental risk although IDA funds may finance investments that may result in adverse environmental impact. Parallel review procedures would be developed to ensure PFIs screen proposed sub-projects and sub-borrowers carry out appropriate environment assessments for each sub-project. Prior to sub-project approval, PFIs will verify that the sub-project meets the environmental requirements of appropriate national and local authorities and are consistent with applicable IDA environmental policies.

7. Participatory approach

As Section D.4. details, the Project was designed jointly with potential beneficiaries, as represented in the joint public-private PSC. No groups are expected to be affected negatively.

F. SUSTAINABILITY AND RISKS

1. Sustainability

Assuming peaceful conditions hold up in Mozambique and the transition to democracy endures, the sustainability of the project will critically depend on the success of the cost-sharing grant scheme in catalyzing a market for business services; the receptivity of public agencies to easing regulatory obstacles; the assessment, supervision, and repayment performance under the credit facility; the risk assessment and financial performance of banks; and the viability of the export processing zones.

2. Critical Risks (reflecting assumptions in the fourth column of Annex 2)

Risk	Risk Rating	Risk Minimization Measure
Project outputs to development objectives		
Banks do not comply with BOM regulations to maintain sound banking practices; enterprises do not see merit in servicing their loans.	S	Eligibility for banks' continued participation in the FC will depend on BOM's annual certification that PFIs meet prudential regulations, banks' lending portfolio reflects a collection rate of 85 percent.
Government is not committed to simplifying regulations, implementing measures to remove barriers to trade, and lowering rent seeking behavior.	M	Reducing regulatory obstacles is not the main focus of the Project although it will be supported.
Project implementation is not adequately insulated from political influence	M	Establishment of a joint public-private steering committee; arms-length implementation (with discretion delegated to independent private contractors).
Project components to outputs		
Beneficiaries may not be responsive to training received and consultant's recommendations for change.	M	Continued support for the program will depend on positive evaluations received from beneficiaries and fulfillment of performance indicators.
Potential foreign investors and collaborators are deterred by perceived risks.	S	Quick, flexible resolution to problems, aggressive investment promotion.
Untimely payment of contributions by participating beneficiaries.	M	Flexible resolution of problems, close supervision and monitoring.
Participating banks continue to respond to firms' need for long-term loans with funds they mobilize and through other long-term funds from competing lines of credit available to them in the country.	S	The design of the component incorporates favorable terms for banks including: a 10-year maturity period, interest rates determined by banks, and simplified approval procedures.
Lending will do financial harm to banks because collection rates are inadequate to achieve financial breakeven point	M	The component will be available to banks that meet initial eligibility criteria including non-performing loans not less than 20% of total portfolio; continued eligibility will require that the collection rate does not fall below 85%
Capacity building measures undertaken but public/private institutions unable to fully implement remedial measures.	M	Additional support conditional upon meeting monitoring and performance indicators.
Overall risk rating	**M**	

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

G. MAIN LOAN CONDITIONS

1. Effectiveness Conditions

- Participation agreements between the Bank of Mozambique and at least two PFIs are signed;
- Subsidiary Agreement between the Government and Bank of Mozambique is signed;
- Management Contractor for the Technical Learning in Firms Component is appointed;
- External auditor for the project is appointed;
- Project implementation plan is finalized and adopted;
- Financial procedures manual is developed and an accounting system is installed and operational;
- Special account is opened in the BOM and IDA advised of the check signatories; Borrower's counterpart account is also opened.

2. Implementation Conditions

- Credit ceilings are lifted by BOM by the mid-term review for this Project.

H. READINESS FOR IMPLEMENTATION

The Government continues to demonstrate its commitment to the Project and has taken the following steps:

- formally delegated project responsibilities to the PSC;
- appointed the UASP including its Director and the Chief Accountant; and
- appointed the external financial systems consultant to assist in the development of the financial system.

Following the approval of the Project by IDA's Board of Directors, the Government will present evidence of its fulfillment of the conditions for project effectiveness, enumerated above.

I. COMPLIANCE WITH BANK POLICIES

This project complies with all applicable Bank policies.

Team Leader: for: Brian Levy/Simon Gray/Marilyn Manalo, AFTPS

Sector Manager : Demba Ba, AFTPS

Acting Country Director: Philippe H. Le Houerou, AFC02

ANNEX 1

FINANCIAL SUMMARY

Years Ending

Table 1: Financial Summary

Implementation Period						
Financing Required	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Project cost						
Investment costs	7.3	9.8	11.2	9.8	6.3	44.4
Recurrent costs	0.6	0.7	0.7	0.6	0.6	3.2
Total Project Costs	**7.9**	**10.5**	**11.9**	**10.4**	**6.9**	**47.6**

Financing						
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
IDA	4.8	4.7	5.8	5.7	5.0	26.0
Government	0.1	0.1	0.1	0.1	0.1	0.5
Beneficiaries	0.9	1.3	1.6	1.8	1.3	6.9
Parallel financing	2.1	4.4	4.4	2.8	0.5	14.2
Total	**7.9**	**10.5**	**11.9**	**10.4**	**6.9**	**47.6**

ANNEX 2

PROJECT DESIGN SUMMARY

NARRATIVE SUMMARY	KEY PERFORMANCE INDICATORS	MONITORING AND SUPERVISION	CRITICAL ASSUMPTIONS AND RISKS
CAS Objective Support the promotion of broad-based economic and private sector led growth.	Annual GDP growth rate in excess of 5 percent per annum over the life of the Project	Periodic economic updates	(CAS Objective to Bank Mission) • Continued macroeconomic and political stability • Government's commitment to economic, financial, and trade reforms; • Continued support for private sector development through decreases in rent-seeking, fraudulent behavior
Project Development Objectives Broaden the base of private participation in economic growth	• At least 20 percent of participating firms were established in 1995 or later; • at least 30 percent of participating firms operate outside Maputo	Progress reports, supervision reports by implementing agencies	(Development Objectives to CAS Objective) • Sound policies for financial sector development, decisive enforcement of prudential regulations • Government is committed to simplifying regulations, implementing measures to remove barriers to trade, and lowering rent seeking behavior
Project Outputs • Mozambican firms competitively responded to increasing local and international demand for new, improved products • Training agencies provided firm-oriented, relevant technical assistance	• Increased production, investments, sales, exports, and new jobs created within participating firms • Increase in expenditure for technical training and consultancy services within Mozambican firms	Technical and financial audit of the program commissioned by PSC; survey of participating firms; progress reports	(Outputs to Development Objectives) • Firms and workers build on training received, are responsive to recommendations for change, favorably rate and increasingly utilize available technical and business services

Narrative Summary	Key Performance Indicators	Monitoring and Supervision	Critical Assumptions and Risks
	as indicated by demonstrated willingness to pay for technical and training services accessed under the FCO, TAO, SSI, LPO		
• Private local and foreign linkages were established	• At least 30 linkages formed with joint-venture or foreign-owned firms engaged in exporting locally produced products or serving the local market as a result of the assistance extended under the LCO	• Independent surveys of foreign firms on prospects and successes confirm this change	• Potential local and foreign investors and partners are not deterred by perceived risks
• The subsector-specific initiative added value as illustrated by the handicraft sector's increased integration into the global economy	• End 2000 Phase 1 completed: supply-side assessment; market survey; clustering of intermediaries and producers; buyers/sellers' meeting; sector strategy defined • 2001, 2002, 2003 - cumulative exports - US$200,000, US$800,000, US$1,500,000, respectively; number of suppliers: 10 per annum	Progress reports, survey of participating firms	
• Local business associations increasingly contributed to forming the strategy for the local and regional economy	• Business associations in at least 5 regions operate on basis of defined action plan, and contribute to economic and local development by working with other local stakeholders	Progress reports, survey of participating business associations	
• MICTUR and CPI effectively facilitated business entry into Mozambique	• 3 roundtable discussions held between Government and private sector resulting in a friendlier business environment • Establishment of one FZ in Maputo and consensus on future strategy with respect to EPZs and FZs	Progress reports, survey of participating firms	

Narrative Summary	Key Performance Indicators	Monitoring and Supervision	Critical Assumptions and Risks
• Banks continued to provide medium-term loans to private enterprises assessed as good credit risks	• Adequate environmental safeguards in EPZs • Collection rate of PFIs at least 85 percent reflecting changed repayment culture and subsequent increase in profitability of participating banks	Progress reports from participating banks, UASP	• BOM enforces sound banking practices • Participating banks continue to respond to firms' need for long-term loans with funds they mobilize and through other long-term funds from competing lines of credit available to them in the country. • Lending will do financial harm to banks because collection rates are inadequate to achieve financial breakeven point
Project Components [See Annex 2 for a detailed description.]			
1.0 Technical	**13.9**		
1.1 FCO Consultancy services Recurrent Expenses Vehicles Equipment, furniture	***5.9*** *4.4* *1.3* 0.1 0.1	Terms of reference, established monitorable targets and deliverables	• Firms can meet consultant service payments in a timely manner
1.2 TAO Consultancy services Recurrent expenses Vehicles Equipment, furniture	***6.3*** 5.6 0.5 0.1 0.1	Course evaluation reports	
1.3 LPO Consultancy services Recurrent expenses Vehicles Equipment, furniture	***1.7*** 1.4 0.1 0.1 0.1	Quarterly progress, supervision, mid-term, completion reports	
2.0 Finance	**12.7**		
Credit Grant Beneficiary contribution	9.8 0.2 2.7	Quarterly reports from participating banks	• Firms can meet debt service payments in a timely manner
3.0 Capacity Building	**17.4**		
3.1 CPI Consultancy services	***9.9*** 8.4	Progress, supervision, mid-term, completion	• Capacity building measures undertaken but

Narrative Summary	Key Performance Indicators	Monitoring and Supervision	Critical Assumptions and Risks
Recurrent expenses Vehicles Equipment, furniture Training	0.5 0.2 0.2 0.6	reports	public/private institutions unable to fully implement remedial measures
3.2 MICTUR Consultancy services Recurrent expenses	***1.2*** 1.0 0.2	Progress, supervision, mid-term, completion reports	• Capacity building measures undertaken but public/private institutions unable to fully implement remedial measures
3.3 RBSI Consultancy services Recurrent expenses Vehicles	***1.1*** 0.8 0.2 0.1	Progress, supervision, mid-term, completion reports	• Capacity building measures undertaken but public/private institutions unable to fully implement remedial measures
3.4 Sector Specific initiative Consultancy services Recurrent expenses Vehicles Equipment, furniture	**5.2** 4.3 0.2 0.2 0.5	Progress, supervision, mid-term, completion reports	• Capacity building measures undertaken but public/private institutions unable to fully implement remedial measures
4.0 Implementation Recurrent expenses Vehicles	***1.2*** 1.1 0.1	Progress, supervision, mid-term, completion reports	• Capacity building measures undertaken but public/private institutions unable to fully implement remedial measures
5.0 Unallocated	**2.4**		
Total	**47.6**		

ANNEX 3

THE CHALLENGE OF PRIVATE SECTOR DEVELOPMENT IN MOZAMBIQUE

Fostering private sector development in Mozambique poses some unusual challenges. On the one hand, an unusually favorable array of circumstances implies that over the next few years, Mozambican economic growth will be rapid, likely in excess of 5 percent annually. On the other hand, Mozambique's historical legacy raises the risk that this growth will be unusually narrowly-based, with quite limited participation by the country's domestic private sector. Broadening the base of private sector participation will require a multi-faceted strategy (of which this project is just one element).

Growth stimuli are strong..... Three inter-related stimuli are likely to provide the impetus for rapid Mozambican growth into the twenty-first century. The first is a "peace dividend". By the early 1990s, a combination of a misguided experiment with central planning, and civil war had resulted in Mozambique's per capita GDP falling in real terms to one-quarter of its pre-independence levels. Since that time, the debilitating civil war has been ended, peace has been consolidated with a successful transition to multi-party democracy, and the country has moved from a planned to a market-oriented economy. As other sub-Saharan African countries (e.g. Ghana, Uganda) have demonstrated, this favorable reversal of economic fortune generally is accompanied by a period of quite rapid economic growth.

The second stimulus comes from Mozambique's strategic location as Southern Africa's coastal outlet to the world. Prior to 1975, Mozambique's three ports – Maputo, Beira and Nacala -- were major coastal outlets for South Africa, Zimbabwe and Malawi. As of 1974, 14 million tons of cargo transited through Maputo harbor, with over 60 percent trans-shipped by rail to and from countries neighboring Mozambique. In 1975, 3 million tons per annum were shipped through Beira port, well over 80 percent shipped by rail from Zimbabwe (plus additional shipments from Malawi). Throughput in Nacala port amounted to 0.8 million tons, with the rail link to Nacala accounting for 0.5 million tons of traffic (about 60 percent from Malawi). By the mid-1980s, as the civil war intensified, volume shipped through all three ports collapsed. Subsequently, Beira has recovered almost to its 1974 levels. In 1998, just over 3 million tons of traffic passed through Maputo port – but new rail, port and toll road concessions along the Maputo Corridor, and major associated investments, point to substantial recovery in the near future. As for Nacala, the rail link which brought the harbor much of its traffic was destroyed in 1984, and remains out of operation to this day, Since mid-1997, direct negotiations have been underway with a private operator that expressed interest in a concession on the line.

The third stimulus comes from South Africa's transition to a non-racial democracy, and its associated economic repositioning within the Southern African sub-region. During the apartheid years, South Africa was virtually isolated from the rest of the region. Today, it perceives prosperity in Southern Africa as vital for its own future, and is actively encouraging the South African private sector to invest throughout the region. Within that context, Mozambique has emerged as an especially promising site for investment – as evidenced most vividly by the fanfare surrounding the Maputo Corridor, and the associated US$1.3 billion in the Mozal aluminum smelter.

.....but the Mozambican private sector is underdeveloped..... Powerful growth stimuli such as the above can provide strong momentum for sustained domestic private sector development, but they need not be sufficient to ensure a broad-based supply response. In the specific case of Mozambique, the legacy of history has burdened its private sector with an unpropitious structure: fragmentation, small size, and inward-orientation.

Prior to independence, the Mozambican economy was tightly bound to its Portuguese colonial masters: trade and production was structured to be complementary to – and generate rents for – the Portuguese economy; Mozambican firms generally were Portuguese-owned. Following independence, the country shifted to a planned economy. The vast majority of the quarter million Portuguese resident in the country fled, and their businesses were nationalized – although (other than so-called "strategic" industries) the businesses of those who chose to remain largely were left untouched. In the early 1990s, Mozambique reversed course again and, in one of the most ambitious privatization programs in sub-Saharan Africa, turned more than 800 parastatals over to the private sector.

A 1998 survey of 153 Mozambican manufacturing firms, undertaken as preparation for this project, reveals how this history is evident in the character of the contemporary private sector. A first fact revealed by the survey is how small the country's private sector actually is. The survey focused on four subsectors of manufacturing: food processing; garments and textiles; wood and furniture; and metal products. Aggregate data reveals that food processing alone accounted for 61 percent of total Mozambican manufacturing (this high share of food processing is typical for countries in a very early stage of industrialization), and the remaining three subsectors an additional 12 percent. Comparing the aggregate data with the survey results suggests that the surveyed firms account for about two-thirds of total Mozambican production in the relevant subsectors, and included (according to the survey enumerators) virtually all of the subsectors' larger firms.

The patterns of ownership and history of these firms mirrors the history of private sector development in Mozambique: about half date back to the pre-independence period; 30 percent were established between 1975 and 1991 (one fifth of these as parastatals); the remaining 20 percent started-up once peace was re-established in the early 1990s. Forty-six of the 153 firms are recently privatized parastatals; virtually all of the remainder have always been in the private sector (although the state continues to have a minority equity share in some of these). One-third of the firms are majority foreign-owned. Among the somewhat over fifty percent which were sole proprieterships or partnerships (overwhelmingly Mozambican owned), there is a striking diversity in the ethnicity of the owners: 41 percent are owned by indigenous Africans; 36 percent by Asians (overwhelmingly from India, and located disproportionately in the Northern part of the country); and 23 percent by entrepreneurs of European origin (primarily Portuguese).

The peace dividend is evident in the recent growth rates of these firms: the mean growth rate in output (in US$) between 1995 and 1997 was over 70 percent. Note, though, that this output growth was not matched by employment growth, which grew by less than 5 percent over the two year period – suggesting that much of the output expansion was a recovery from very low levels of capacity utilization. Note also that the distribution of this growth was uneven – with very rapid growth by a minority of firms accounting for much of the increase.

For all that growth has been rapid, other indicators suggest that, once an initial bounce-back has been achieved, the firms will find it increasingly difficult to maintain (let alone advance) their competitive position. For one thing, the firms are overwhelmingly inward-oriented. Over two-thirds of the firms sampled do not export at all. Among those which do export, two-thirds sell their exports only to South Africa or other neighboring countries. Less than 10 percent of the

sample are significant exporters into world markets – in the sense both that exports account for 20 percent or more of their sales, and that some of these exports go beyond the African continent. For another, only 35 percent of respondents reported that they had made any significant investment in buildings or equipment in the last three years. Since half of the firms started up prior to 1975 – and, until very recently, have been operating in a business environment which was unfavorable for private investment -- there clearly are many firms which operate with seriously outdated technology.

As these patterns (and Mozambique's history) imply, for the most part the Mozambican private sector has been bypassed by the global trend of firms to position themselves to maintain competitiveness (including domestically against imports) in a globalized economy. Instead, (in one of the poorest countries in the world, with a population of under twenty million) the focus of the vast majority of even the larger firms remains on the domestic marketplace – and on efforts to win subsidies or protection through the political arena. Clearly, Mozambican firms will need to close major information gaps (on production processes, marketing, business strategy etc.) if they are to be successful participants in the country's growth process – and one important goal of this project is to facilitate efforts by firms to close these gaps. This task is complicated, though, by an unusually wide array of constraints in the country's business environment.

.....and the business environment continues to pose some obstacles to enterprises. The prospects for success of individual private firms depend not only on their own efforts, but on the broader business environment in which they are embedded. A large majority of the 153 firms surveyed confirmed that the business environment has improved radically over the past five years, to the point that, overall, they regard Government as supportive, rather than a hindrance to private sector development. Even so, when firms were asked what were their three largest problems to doing business in Mozambique, they highlighted access to credit, bureaucracy, and the uneven quality of infrastructure.

Inadequate credit was identified as one of the three most severe obstacles by 56 firms, and most severe by 25 of these (47 firms also identify high interest rates – an artifact of monetary policy – as one of the three most severe obstacles). Mozambique recently has achieved a far-reaching financial reform; as Annex 5 describes, today – for the first time in many years – the country's banking system seems to be in a healthy state, though the number of participants remains small. Even so, of the 153 firms surveyed, only 35 percent reported having bank loans, and those that did were mostly the larger firms: over 50 percent of firms with more than 100 employees – but just 23 percent of those with 10-49 employees – had loans. Not only do firms perceive lack of access to credit as a problem, banks concur that there is excess demand for term finance, which they would meet if they had available longer-term sources of finance. The credit line included in this project addresses this need directly.

Problems with Government bureaucracy were identified as the most severe obstacle by 33 firms, and as one of the three most severe by an additional 63 firms. While a few specific regulatory obstacles can be identified and warrant reform (labor laws, property laws, and rules governing imports), as Table 1 shows most of the problems are described as general ("official corruption", "bureaucratic burden", "Government regulation") rather than traceable to individual offending rules. The remedy for this problem lies in a long-term program of civil service reform not simply some legalistic "quick fix". In the interim, the environment appears to offer sufficient flexibility for initiatives along the lines of those outlined in the present project to nonetheless be useful.

Inadequate infrastructure comprises a third obstacle to firms – identified as most severe by 12 firms surveyed, and as one of the three most severe by an additional 33 respondents. The extent and patterns of these infrastructural deficits varies by region. Maputo-based firms identify roads

as their worst obstacle; Beira-based firms highlight waste disposal and electricity; and firms in Nampula highlight roads and electricity. In absolute terms, infrastructure worsens as one moves north. For power, 28 percent of Maputo-based firms -- but 50 percent of those based in Beira and fully 86 percent of those in Nampula – reported having their own generators. (The average number of days for which firms reported significant power outages jumped from 5 per month in Maputo, to about 20 per month in Beira and Nampula). For water, 55 percent of Maputo firms – but 71 percent of those in Nampula, and 83 percent of those in Beira – have their own generators. Improving infrastructure nationwide is, again, a long-term process. In the interim, focused initiatives (such as industrial estates adjoining Mozal, or pilot export processing zones) can offer enclaves in which competitive manufacturing production can proceed, even as the broader deficiencies are addressed.

Table 2: Types of Problems with Government

	Number of firms identifying some problem with Government as their:		
	Largest problem	**Second problem**	**Third Problem**
Bureaucratic burden	11	6	13
Land and buildings	6	5	-
Official corruption	4	7	5
Government regulations	4	3	4
Tax regulations	4	5	6
Labor regulations	3	6	2
Starting a business	1	-	1

Viewed through the lens of history, it is hardly surprising that the business environment continues to pose an array of obstacles for Mozambican firms. The surprise is in the extent of dynamism and optimism which was evident in the survey. As in all countries, moving towards an unambiguously market-friendly business environment is a long-term process. The immediate challenge is to make sufficient progress with each of the various obstacles so that, period-by-period, progressively more private actors can share in the fruits of economic growth. The present project thus comprises just one element of a broader program of pro-private sector reform.

ANNEX 4

TECHNICAL LEARNING IN FIRMS COMPONENT

Concept and Overview

The environment for technical learning in Mozambique is extremely underdeveloped. The mechanisms by which private firms transfer technology and raise their technical capabilities are weak or missing. International buyers and suppliers are not visiting Mozambique on a regular basis; so technology transfer is not occurring as part of day-to-day business transactions, as happens so frequently in other countries. Direct foreign investment is relatively low; so technology transfer and learning via this channel is very modest. Expert consulting services are few-and-far between and local public and private training services are quite limited, with the result that firms have a difficult time hiring technical expertise or conducting in-house training of the work force. In addition to these weaknesses in firm learning mechanisms, basic technical education for workers is inadequate -- the formal education system is just beginning to be built back up to its pre-war level and public vocational training is very weak. Private learning institutions are virtually non-existent. As a consequence, the basic technical skills of workers and managers are low, reducing task-level efficiencies in firms.

With little exposure to technological innovation and limited access to information flows, the Mozambican private sector is at a significant disadvantage with respect to the latest manufacturing techniques, industry marketing trends, and modern management practices. Today, in the wake of trade liberalization, these firms are being compelled to compete with skilled international rivals. There is an urgent need for a program of assistance to help firms build up their technical capabilities.

This Technical Learning in Firms Component (TLC) comprises three subcomponents: the Firm Competitiveness Office (FCO), the Training and Advisory Office (TAO), and the Linkage Program Office (LPO) – which are related to one another in the following ways:

- All three subcomponents foster technical learning through the private marketplace. The LPO directly links buyers and suppliers. The FCO and TAO empower purchasers of services, allowing them to choose what services make best sense for them, and allowing them to select their own service providers – and thereby strengthening the market for business development services. The cost sharing features of the FCO and TAO (firms themselves must pay 50 percent of the costs of services they use) ensures that the demand for technical learning is credible.

- The FCO and the TAO target different segments of the private sector: the FCO focuses on firms that already have achieved an initial baseline of capability; the training supported by the TAO will benefit not just established SMEs but also the smallest firms who are difficult to support on a one-to-one basis, and for whom generic training in basic business skills can yield substantial returns.

- Management is delegated to the Management Contractor (MC), who has substantial international experience in providing technical and marketing services to firms. The

contractor will work under a term contract. The contractor's private orientation and experience should (in combination with the cost sharing and linkage features described above) help ensure that services are geared towards what firms actually need, are focused on firms which can make the most effective use of the services, and are offered in a "private sector friendly" way. The term contract signals that the initiative is time-bound – intended to strengthen, not substitute for, the marketplace for business services.

- The joint management of the three sub-components by a single contractor will facilitate information sharing, make it easier to guide firms towards appropriate services, foster evolution of firms from one program to another – and take advantage of potential economies of administration.

- Responsibility for oversight of all three sub-components will be vested with the PoDE Steering Committee (PSC). All approvals for grants below US$100,000 will be delegated by the PSC to the MC. The PSC will approve any grants above that limit. Quarterly reports of all subcomponents – including all grant approvals – will be made by the Management Contractor to the steering committee at quarterly meetings, in order for the steering committee to give guidance on future approval policy where needed. The PSC can only revoke an approval already granted in the event that fraudulent information has been provided within an application. Any applicant refused by the MC may appeal to the committee for a reversal of the decision. Such cases will be reviewed by World Bank Supervision Missions.

- Following operational reviews, the Steering Committee would (at intervals no shorter than six months) prepare proposals justifying changes to the operating directives of the Management Contractor for IDA's consideration. Upon receipt of IDA's "no objection", it would send written directions to the Management Contractor as to the ways (if any) in which the contractor should redirect its efforts.

The following sections summarize how each sub-component will operate. Additional details are provided in the Implementation Manual, and in a background paper written as part of project preparation.

1. THE FIRM COMPETITIVENESS OFFICE (FCO)

Objective and Description

The objective of the FCO will be to boost the competitiveness of private firms doing business in Mozambique through the provision of technology transfer support, and to strengthen their access to, and use of, support services external to the firm. The primary means of achieving this objective will be to provide cost-sharing grants to firms, in order to part-fund the costs of using outside services and travel. The cost-sharing grant mechanism puts resources into the hands of purchasers of services, allowing them to choose what services make best sense for them, and allowing them to select their own service providers.

Experience with grant schemes has shown they work best when directed at the more capable firms within a developing economy. The FCO will therefore focus its efforts on those firms in Mozambique that can demonstrate the planning, technical and financial capacity required to make good use of outside services and travel so as to boost competitiveness. As an indicator, firms will need to have had at least one set of accounts accepted by the corporate tax authorities. Firms approaching the FCO considered on this basis not yet ready for its specific assistance can be referred to the Technical Advisory Office or the Linkage Program Office, as appropriate.

The FCO office will provide matching grants to firms to encourage the use of support services and travel, and "handholding" support to facilitate effective use of these matching grants by firms. All grants will be on a 50 percent cost-sharing basis. No application will be considered for a grant of under US$2,000. No single recipient firm or conglomerate may receive total grants in excess of a cumulative limit of US$200,000. Recent World Bank survey work suggests that there are probably in Mozambique around 200-300 firms that have the required planning, technical and financial capability to make good use of FCO grants. It is reasonable to assume that out of this population, around 100 could be persuaded to utilize FCO grants, each contributing an average of, say, US$20,000 to the supported activities, to be matched by equal grants from the FCO. On this basis, the FCO will have responsibility for a fund totaling US$2 million, to be committed over three years, and to be fully disbursed by the end of one further year.

The FCO will be managed by the Management Contractor for the component, who will be answerable to the PSC. The contractor will provide the services of one international expert for three years, to act as FCO Manager. The contractor will also provide the services of one locally-recruited professional for five years, to act as Assistant FCO Manager. The FCO Manager will spend most of his time on client contact. In addition to assisting the FCO Manager with client contact, the Assistant Manager will run the office systems for grant progress tracking, bookkeeping, report generation, etc.

Qualifying Criteria for Grant Support

Only private, majority Mozambican-owned firms in manufacturing and services supporting manufacturing and exports (including tourism) are eligible. The scheme will support firms in the development of the following business activities: (i) the production of goods and tradable services within Mozambique; and (ii) the trading of goods and services from Mozambique into export markets. Financial services are not included. Producers of agricultural commodities, where there is no firm-specific product differentiation in what is sold, are specifically excluded from this scheme. (Note that efforts by agro-processors to strengthen their arms-length supply chain upstream – by, say, exploring the development of an outgrower scheme, where agro-processors provide advice, inputs etc. to smallholders – *is* eligible for cost-sharing support, so long as it meets the other eligibility criteria; by contrast, the direct development of agricultural production upstream by vertically-integrated firms would not be supported.)

The primary requirement is that the firm must have a written "competitiveness improvement plan," which describes its current competitive situation, and indicates how it intends to improve that situation, and in what direction (e.g. by improving product reliability, or by developing a new export marketing strategy in order to sell into the South African market. (It is not intended that this plan has to be a fully comprehensive "business plan," as typically required for obtaining a substantial bank loan, with cashflow forecasts and the like.)

The plan must be realistic, in the sense that it must have a reasonable chance of being implemented successfully, given the realities of the firm's current situation. There is no requirement that the specifics of the plan are to be "approved" or vetted by any expert or committee. However, the plan must demonstrate that the firm has properly considered key planning issues:

- why one particular development direction was chosen instead of others; on what assumptions this direction depends; and why this development direction can be considered realistic and achievable;

- what steps are required for that development;
- what resources are likely to be needed within these steps, and where will they come from;
- how long will the process take; and
- what benefits are to be expected.

Typically, a plan aimed at expanding sales might take a firm through these three stages:

- *investigation of the target market,* be it domestic or foreign, typically starting with desk research or limited phone research, followed then by field interviewing, either carried out by the firm's staff or by an outside service supplier;
- *supply package adaptation,* on the basis of information collected from the market, in order to bring what is being supplied presently into line with customer preferences, and to meet existing competition; for instance through changes in product design, rationalizing production to reduce costs, or through improved quality assurance; with the adaptation completed,
- *active selling* of the improved supply package.

Once support to a particular plan has been completed, and the plan is in the process of being satisfactorily implemented by the firm concerned, then the firm would be free to submit a further follow-on plan for support, up to the maximum per firm of US$200,000.

Any usage of an external service which is charged for, or of travel, and which can reasonably be expected to contribute to the achievement of an eligible competitiveness improvement plan will be eligible for cost-sharing support. The following examples of service/travel usage that would normally be eligible under this definition are provided purely for guidance. The list is not intended to be exhaustive.

- In-factory consultancy and short-term contract management services, say up to six months in duration per introduced expert, would normally be eligible, but new permanent staff appointments would not. The length of time for which temporary contract management could be supported would depend on a case being made as to how long the required transfer of know-how, skills, etc. could reasonably be expected to take.
- Consultancy or short-term contract management assistance directed specifically at improving labor productivity or yields on raw materials would normally be eligible.
- Assistance in improving in-house capabilities in design-related techniques such as pattern-making, prototyping, grading, sizing, counter-sampling, etc., would normally be eligible. Buying in a set of designs for one season only, with no longer-term enhancements aimed for, would normally not be eligible.
- The expenses of exposure tours for factory personnel, to view alternative techniques and technologies in factories elsewhere would normally be eligible, as would market exploration tours by marketing personnel, to explore new export market opportunities.

Expenditures on service fees, and expenditures on travel and incidental expenses charged at cost, incurred wholly and exclusively on an eligible service/travel usage, will be eligible for grant support. Salaries for staff employed by the supported firm are not eligible, nor are recurrent costs such as royalty fees. No expenditures on hardware can be supported.

For each eligible service/travel usage for which grant support is being sought, the firm concerned will be expected to define monitorable targets and at least one "deliverable," the sight of which will verify that the activity had indeed taken place, as described. Experience has shown that, although travel can be extremely helpful within a program aimed at boosting competitiveness, it is particularly prone to abuse. The FCO Manager will therefore take particular care to ensure that travel is supported only when it forms a clear integral part of an eligible plan, and that it has clear, verifiable outputs that are essential to the plan.

The choice of service supplier will be made by the recipient firm, and will not be restricted to suppliers on any central register. However, the FCO Manager will seek to satisfy himself/herself as to the supplier's competence for the task intended, and that there is a genuine arms-length commercial relationship between supplier and user. The FCO Manager will also seek to satisfy himself/herself that fee rates being charged for services are broadly in line with market realities.

With grants provided only on ex-post reimbursement basis, smaller firms may face some cash flow burdens. To ease this burden, assistance to firms could be structured so that the overall program of support for the firm is subdivided down to the size of the smallest feasible deliverable with reimbursement made for each sub-part. Also, the Management Contractor would be held to strict reimbursement standards including, for example, a turnaround time (including receipt of the necessary documentation, confirmation of the provision of the consultant service, and verification of a deliverable) of not more than 5 days following the completion of a task.

Experience and research has indicated that the biggest risk with cost sharing grant schemes is that the pressure to disburse the funds committed within the World Bank project results in the quality of grant help being compromised. Unsuitable firms are assisted, that are quite unable to make proper use of outside services. One-off travel is supported, without being related to any larger competitiveness improvement plan. In order to manage that risk, the PODE Steering Committee will commission independent technical quality and financial audits (semi-annual for the first year and a half, annual thereafter), based on two weeks of fieldwork, primarily field visits to a sample of firms assisted.

2. Training and Advisory Office (TAO)

Objective and Description

Industry surveys in Mozambique have indicated a significant unmet demand for business and technical skills upgrading in the manufacturing sector. The shortage of such skills in Mozambique are a reflection of the dearth of tertiary and vocational training opportunities in past years in the country. International experience suggests that the provision of training and capacity building assistance should be as closely related to existing market-driven signals and existing providers as possible. This sub-component, through the Training and Advisory Office (TAO), seeks to support the development of an active business and technical training market in Mozambique.

The TAO will support the development of private business training initiatives in Mozambique; these initiatives can be targeted at manufacturing industries (including agro-processing), export trading in manufacturing products, and key service businesses including transport, tourism and financial services. Cost sharing grants, on a 50/50 basis, will be made available to qualified

trainers to provide training services which support the PoDE focal sectors. These training services will include (a) existing local or overseas developed training courses for which a local market has not yet developed ("A" Type Courses), or (b) additional training courses for which a market demand can be demonstrated through local market research or feedback from within the local private sector, ("B" Type Courses).

Training firms, or individuals with training experience, will be registered under the TAO training initiative according to a process described below. It is expected that such "trainers" will include both existing training providers in Mozambique and overseas firms, and that the PoDE project, through the TAO, will result in both a broadening (more "trainers" providing business and technical skills training for manufacturing industries), and a deepening (more "training courses" being provided) of the training market within Mozambique.

Training courses to be funded under this sub-component might include, inter alia, courses such as those listed in Table A. below. More important than the suggested list of possible courses given here is the essential sub-component aim to help to create a richer market of privately available training courses in Mozambique, which will assist in upgrading the business acumen and technical skills of management and employees in the Mozambican private sector. It is the intention of this component to build on the existing small base of private sector business and technical training providers, rather than to substitute these with training providers who are primarily publicly funded, nor to create or enhance a dual market of private and donor funded training providers.

Courses for which training materials already exist (Type "A") will be funded on a 50/50 cost sharing basis, with respect to course delivery costs only. A qualified trainer providing a PoDE approved course (as defined below) will be reimbursed 50 percent of the costs of delivering training on a per participant basis. Where the market assessment, or applicant trainers, demonstrate that the market is not providing relevant training in a specific set of skills, Grant Support can contribute up to 50 percent of course development costs for these Type "B" courses. Total grant support is estimated at US$2 million equivalent, which is derived from estimates of the number of courses, average number of participants, and costs related to delivery and development.

Table 4: Possible Courses to be Funded under the TAO

Course Category	Titles and examples of Content
Business Skills·	Marketing (including product selection, promotion, pricing, and competition)
	Financial Management (inc. financial statements, accounting systems, budgeting and forecasting)
	Production Management (including manufacturing efficiency, quality management and inventory control)
	Business Strategy (including feasibility studies, business planning, and personnel management)
Technical Skills	Training in selling or other specialist business services
	Training for shop-floor skills for employees such as in welding, machining, assembly or finishing
	Training in manufacturing services such as quality control techniques and supervisory skills
Professional Skills	Training in accounting, cost control and personnel management
Other Skills	As identified by market assessment or demand from trainers.

In order to increase overall capacity in the training provision market, no more than US$200,000 of the total Grant Support will be allocated to any one firm during the life of the project. Where any one firm reaches this limit, no further allocation will be permitted unless and until the PoDE project's annual technical audit check confirms that the project is obtaining value for money from each of these firms, and that this judgement is endorsed by the project steering committee.

The TAO will be managed by the MC, who will be answerable to the PSC. The MC will provide the services of one international expert for four years, to act as Training Coordinator. The MC will also provide the services of one locally-recruited professional for four years, to act as Assistant Training Coordinator. The Training Coordinators will be responsible for carrying out an initial assessment of the Mozambique training market, inviting and registering potential trainers and their proposed training courses, and monitoring the delivery of these courses.

Qualifying Criteria for TAO Grant Support

All private or not-for-profit (i.e. those not receiving publicly funded support) training firms and trainers are eligible to apply for grant support for relevant training courses. To receive support under the TAO as approved applicants, training firms and trainers must pre-qualify as *registered training organizations*. To pre-qualify, training firms and trainers must have relevant experience in business and/or technical training, and will demonstrate their level of experience to the TAO through presentation of resumes of trainers, list of past training activities, and samples of course materials. The TAO will approve registration of applicant training organizations on a case by case basis.

Registered (i.e. pre-qualified by the TAO) training organizations will be able to submit single proposals for grant support for "Type A" training courses. Eligibility requirements for approval of a training course for grant support will include:

- Training course is to be advertised and made publicly available
- Training course fee for participants is in line with current market rates
- Course materials and delivery methodology are appropriate to the project target group
- Course design includes registration and feedback forms to facilitate monitoring and impact assessment
- Proposed Trainers have suitable experience in delivering the proposed course content

For Type A courses, market assessments will provide a guideline price per participant per day for the offered course in each of the three principal geographic areas (eg., Maputo, Beira, Nampula).

The TAO staff will be pro-active in seeking out training gaps in the market, and in encouraging qualified firms to carry out this Type "B" training, including through the use of development grants as described above. Competitive bidding processes will be used to set the price of these Type "B" grants.

As designed, the Technical Advisory Office will only offer ex-post reimbursement, which may impose unmanageable cash flow burden on smaller firms. To ease this burden, following the completion of a task, receipt of the necessary documentation confirming the provision of the consultant service, and the verification of a deliverable, the Management Contractor would be held to strict reimbursement standards including, for example, a turnaround time of not more than 5 days. In addition, assistance to firms could be structured so that the overall program of support for the firm is subdivided down to the size of the smallest feasible deliverable with reimbursement made for each sub-part. Group delivery mechanisms could also be employed.

Based on concerns expressed by the members of the Steering Committee that the 50:50 grant arrangement might be inadequate for the smallest firms, the key intended beneficiaries of matching grants for training, it was agreed that the component would initially offer only a 50% grant to benefit from maintaining simplicity and a single subsidy amount. Six months after start up of disbursement, the Management Contractor and the Steering Committee would revisit whether this grant arrangement for training was indeed compatible with the objective of reaching the smallest firms. If this objective was not being met, the Steering Committee, in consultation with IDA, would make an explicit decision as to whether benefits of a special window (with 75:25 subsidy for training oriented to smallest firms), outweighed the costs of added complexity. If this transpired, it would be preferable to fund this additional subsidy from a source outside PoDE.

The TAO should make special efforts to enhance the availability of training opportunities for the smallest firms, and for firms outside Maputo. The PSC should monitor performance in this regard and, as necessary suggest adjustments in the targets of the TAO sub-component in this regard.

The PODE Steering Committee will commission independent technical quality and financial audits for this sub-component (semi-annual for the first year and a half and annual thereafter), based on two weeks of fieldwork, primarily field visits to a sample of firms assisted.

3. THE LINKAGE PROGRAM OFFICE

Objective and Description

The objective of the Linkage Program Office (LPO) will be to facilitate supply linkages between Mozambican supplier firms and joint-venture or foreign-owned firms, where decisions to purchase goods and services are taken within Mozambique. The office will facilitate the process of re-orienting local supplier firms to the international standards of performance expected by such purchaser firms.

A pilot linkage activity has been operating within CPI since mid-1998, funded under the World Bank's Industrial Enterprise Restructuring Project (IERP), and aimed specifically at exploiting the immediate and short-term linkage opportunities provided by the building of the Mozal aluminum smelter. One early lesson from the pilot activity is that there are advantages in locating a linkage "contact point" within a one-stop service for foreign investors. A second early lesson is that effective linkage activity is very time intensive – and requires detailed knowledge of the capabilities of local firms, knowledge of a kind which is central to the success of the TLC sub-components, but which would not naturally be acquired by CPI in the ordinary course of its business. The Project will build on the experience and market knowledge gained by the pilot.

The PODE will support the establishment of a Linkage Promotion Office, operated by the MC. The MC will provide the services of one international expert with specific experience in linkage facilitation schemes. Over the four-year implementation period, the contractor will also provide the services of one locally-recruited professionals to assist this manager, as a Linkage Facilitation Officer.

In addition to the LPO, within its institution-building component the Project will fund, for the four years of the project, the direct employment costs of employing a locally-recruited Linkage Contact Officer on the staff of CPI. This officer will be wholly responsible to the management of CPI, and not to the LPO Manager. However, he/she will provide a contact point within CPI to the LPO linkage activities. He will keep himself regularly informed as to LPO activities. He will be invited to participate in LPO meetings, where appropriate. From his knowledge of CPI investment promotion and facilitation operations, he will look out for possible linkage opportunities, and pass these leads on to the LPO team. He will use his knowledge of LPO successes to promote local supplier capabilities to potential foreign investors.

Operation of the LPO

The LPO will start each specific linkage activity by obtaining the willing co-operation of the target purchaser firm. In discussions with those responsible for purchasing decisions within a co-operating target purchaser firm, the LPO will agree on a short-list of product and service requirements which could realistically be supplied by local firms within the time horizon of the project. For each of these short-listed products or services, it will obtain from the target purchaser firm a full and comprehensive specification of exactly what is to be purchased.

The LPO will then aim to locate and sign up for participation in the linkage program three client supplier firms for each specification being worked on. The purchaser firm may decide to select its supplier for a particular specified opportunity by means of some process of competitive bidding or tendering. In this case, all three client firms being assisted on this opportunity will be working to the same deadline. Only private, majority Mozambican-owned firms will be eligible for LPO assistance as potential suppliers. Consideration will be given to size; track record in the

local market; production, marketing and management capabilities; existing appreciation of international performance standards; and existing workloads. To maintain a reputation for helping purchasers get the best local suppliers available, it will be important not to exclude good firms from the program. There will therefore be no limits set on the number of opportunities within which one supplier firm may be assisted.

Selected firms which choose to participate will not be expected to pay for the assistance being given, but will be expected to commit in a written agreement letter to full co-operation with the LPO. The agreement will also commit both parties to maintaining the confidentiality of business-sensitive information revealed during the facilitation process. The co-operation agreement may be terminated by either party by giving one week's notice in writing.

Through a process of discussion, the LPO Officer will obtain the agreement of the client supplier firm to an action plan. This will be directed at addressing any mismatch between the product or service offering the firm is currently able to deliver and the purchase requirement, as per the specification. The action plan will include milestone dates, and indications of what outside assistance might be required to achieve the improvements planned. The responsible LPO officer will monitor progress through the implementation of the agreed action plan, giving advice as needed. The ideal is for this to continue through to the time when at least one assisted client firm obtains its first purchase order, and then fulfills this order to the satisfaction of the purchaser. (Purchaser firms of course retain the right to let it be known at any time that either their needs as specified have been fully met, or that they have no further interest in co-operating with the linkage program on some specific opportunity).

In the majority of cases, it is expected that the client firm will require outside expert help within its action plans. The responsible LPO officer will assist the client firm in making an application to the FCO for cost-sharing grant assistance, as appropriate. This application will be evaluated on its merits by the FCO team, without any special preferences being given to LCO clients. Where employee training in business skills is required within an action plan, the LPO officer will use his links to the TAO to help the client firm take advantage of suitable project-supported training courses.

4. SUPPORT FOR OTHER GOVERNMENT INITIATIVES

Under the Technical Learning Component, efforts will be made to support the Governments' initiatives in advancing its gender equality, enhancement of skills and welfare, and HIV/AIDS prevention and reduction objectives. The implementation procedures for this component would incorporate relevant instructions on this support which do not undermine the component's core technology transfer objectives and the overriding principle that technical assistance be provided to enterprises on a demand-driven basis. As the component is currently designed, in the absence of gender discrimination, women entrepreneurs will benefit from the matching grants. The operating procedures will stipulate against gender discrimination and require that the gender of applicants, grantees, and rejectees be recorded and monitored. Numeracy and functional literacy will be addressed in the market-based grants as many private firms in Mozambique have already indicated that these elements will be part of the training programs they will apply for under the scheme according to their individual needs. To ensure the national labor standards, including child labor laws, are followed, the operating procedures will incorporate language instructing the management contractor to only approve grants to firms respecting these standards. HIV/AIDS awareness and training programs would be offered free of charge to the grantee at the time the grant is approved. Implementation arrangements for the support to the HIV/AIDS initiative will be defined and funded under parallel arrangements agreed between the Government and the sponsoring donors in consultation with IDA.

The PoDE Steering Committee will commission semi-annual (for the first year and a half and annual thereafter), independent Technical Quality Audits for this sub-component, based on two weeks of fieldwork, primarily field visits to a sample of firms assisted.

ANNEX 5

FINANCE COMPONENT

Environmental Conditions

Although the now closed IDA-financed Mozambique Small and Medium Enterprise Development Project (SMEDP, Cr. 2082) line of credit was viewed as a failure, both in terms of disbursement and repayment effectiveness, environmental conditions for a second line of credit for essentially the same purpose have improved dramatically.

Macro-economic Environment. The macro-economic environment now provides an adequate foundation for term lending and, indeed, several Mozambican banks are beginning to seriously consider expanding term lending as a portion of portfolio, even from own funds as a result. Inflation, as officially measured, is essentially 0 percent over the 12 months ending September 1998 (it was about 49 percent when the first line of credit was appraised) and the metical has stabilized, dropping only 3.6 percent against the dollar during that time period. The real sector and infrastructure, extremely fragile during the earlier postwar period, is now sufficiently robust that real GDP grew 9 percent during the past year, and both industrial production and new industrial investment have grown steadily.

Interest Rate Environment. As environmental uncertainty has steadily dropped, the interest rate structure, while remaining high in real terms, has also become more conducive to term lending. During the same 12 months ending September 1998, average lending rates per Bank of Mozambique (BOM) statistics, dropped from 34 percent to 25 percent in nominal terms, while average deposit nominal rates dropped about 6 percent to 8.8 percent. Ninety day T-bills, as of September, earn 9.7 percent or less than 10 percent in real terms, and a positive yield curve has developed with deposits of over one year--albeit small in amount--earning an average 1.7 percent more than short term deposits.

Anecdotal evidence suggests significant additional improvement in the interest rate environment in late 1998 with one major bank now posting a prime rate of 19 percent and several banks reducing most interest rates on new lending to 20-22 percent. The yield curve is now flattening with one major bank paying less for long term deposits than for short term deposits as the market widely anticipates additional declines in interest rates. Bankers do not see the seemingly high real interest rates as adding much risk to term lending because there is a prevailing view that the true level of inflation if measured on a broad basket of services inclusive of the non-monetized sector is about 10 percent, bringing real term lending rates to affordable levels.

Lending interest rates may be holding at artificially high levels relative to cost of funds due to credit ceilings which place nominal limits on the amount of defined credit each bank can extend. While these ceilings "bite" sharply for most banks with respect to short term and revolving loans, they do not "bite" significantly for term lending, as virtually all of it has been excluded from the ceilings. This keeps spreads above the 6 to 8 percent several large banks believe they need to be profitable at higher loan deposit ratios. As term lending is viewed as more risky than short term lending, it may have an indirect effect on long term interest rates as well. The Authorities plan to further liberalize credit ceilings in 1999 and to eliminate them in the year 2000.

Credit Disciplinary Environment. Despite a significantly strengthened real sector and macro environment, the credit disciplinary environment remains a serious problem and a previous "culture of non-repayment" is proving difficult to eradicate. System-wide, non-performing loans (NPLs) are estimated at 15 percent of total portfolio and they have reportedly increased during 1998. Some bankers attribute the reported increase to significantly improved banking supervision and tightened regulations with respect to defining NPLs.

The legal infrastructure related to debt collection is not satisfactory The judicial system is viewed as slow and undependable and there are problems with securing collateral, particularly when related to land. Nonetheless, bankers believe risks of non-repayment are significantly decreasing as environment risk is decreasing and useful formal and informal credit information systems have come into operation. Moreover, one large bank is changing all its loan agreements such that they provide the bank with power of attorney to convey titles on collateral into their own name in the case of default. If this proves feasible as they expect, it should make a huge contribution to improving the credit disciplinary environment and reducing bad debt risk.

Banking Institutional Environment. The banking system has strengthened substantially since the first line of credit was approved. At that time, two Government banks dominated both market share and SMEDP line of credit usage, financing 84 percent of the subprojects and committing 87 percent of the funds. Today these two banks have been privatized, have foreign management, and have been substantially re-capitalized. There are now eight commercial banks and one leasing company in Mozambique. All are privately controlled, all, prior to indepth analysis, appear to be in reasonably sound financial condition, and most have direct access to considerable foreign expertise both to fill senior management positions and to provide technical assistance as needed. The banking culture at senior management levels is commercial and ensures that all sub-project applications will be subject to serious creditworthiness screening. Also, most banks are investing in significant training programs for their staff.

Effective Demand for Credit. This PoDE includes a modest US$10 million line of credit to support small and medium scale term investment. Proposed EIB lines of credit, containing about ECU15 million for term lending, are expected to be approved by Fall 1999. On a combined basis, these lines involve considerably less funding than the approximately US$29 million that IDA provided under the SMEDP. Meanwhile, total GDP is about 12 percent higher than the GDP during the last implementation year of the SMEDP (1997), GDP growth averaged about 9 percent per annum during the last three years, the number of creditworthy borrowers is steadily increasing, and interest in new investment is on the rise, given the increasingly attractive investment and lending environment. Indeed, the private enterprise development program within this project anticipates providing effective support to approximately 75 entrepreneurs creating potential demand for over US$10 million in term credit.

With the improvement in market conditions, considerable medium term lending is already taking place. For example, while it needs to be tested over a longer time period, the BOM Statistical Bulletin reports for the most recent month (June 1998), total "investment credit used" for industry, construction and transport added to US$27 million inclusive of the commitments under the IERP and SMEDP programs. Unfortunately, the vast bulk of the term lending is for periods of 2 years or less and it is predominantly available to large borrowers. Deposits of one year or more represent a very small portion of total deposits at this juncture and banks, with one notable exception, are reluctant to lend for more than one year on the basis of short-term deposits. Concerns with respect to interest rate and liquidity risk dominate the thinking.

Bankers are unanimous in expressing the view that the demand for 2 to 5 year credit is substantial and growing and in their desire to increase their own term lending to the extent they have an

appropriate funding base. Most view potential access to long term local currency money at market interest rates, adjusted semi-annually, an attractive funding base for such lending. The availability of EIB funds could affect the potential attractiveness of this money in the short term. IFC has provided a line of credit in foreign currency and several banks with extensive foreign participation have access to unsubsidized foreign currency finance from other sources and may use little of this line of credit.

In summary, Mozambique represents a satisfactory environment for term lending at this juncture from a macro-economic, interest rate, and banking institutional environment perspective. The credit disciplinary environment, while not satisfactory, is improving. Effective demand for local currency loans in excess of 2 years exceeds the available funding viewed as suitable for such lending by bankers. While credit ceilings increase the price of term loans, they appear to have relatively little negative direct effect on the quantity as most investment lending is excluded from the amounts counted against the ceilings.

The Proposed Line of Credit

A total of US$10 million would be made available for lending to subprojects in two sub-components including: (i) US$3 million in a special facility designed for very small first time bank borrowers; (ii) US$3 million for traditional loans in support of medium and small scale borrowers. An initially unallocated US$4 million to be allocated to one or both of the other sub-components will be available following a mid-term review.

Sub-borrower Eligibility Requirements. Funding under both sub-components would be available to finance investment assets including permanent working capital for private sub-borrowers in all sectors (including industry, agro-processing, tourism, transportation, construction and services) other than finance and real estate. Individual borrower eligibility requirements for the special facility for small borrowers would include: (i) no history of previous formal borrowing from banks including no previous borrowing under this facility; (ii) minimum equity requirements of 10 percent of the amount of the sub-project; and (iii) maximum borrower total assets of US$40,000. Eligibility requirements for borrowers under the traditional component would include: (i) no outstanding loans in default; (ii) minimum equity requirement of 25 percent of the amount of the sub-project; and (iii) a maximum US$500,000 in total assets.

Financial Terms and Conditions.. Funds for on-lending would be provided by the BOM to PFIs in meticals without foreign exchange risk at a cost equivalent to the market-based average interest rate paid for six month deposits, adjusted quarterly. The Government would receive implicit compensation for foreign exchange risk to the extent that it is reflected in market deposit rates. PFIs would take full responsibility for commercial risk. Repayments by PFIs to BOM will be in accordance with the fixed amortization schedule of each sub-loan. The Government has indicated also that the BOM would establish a revolving fund to be funded by the repayments of the PFIs. Proceeds of the revolving fund would be on-lent to PFIs in conformity with the objectives and the terms and conditions of sub-loans and investments as provided in this component. Overall responsibility for the line of credit and the revolving fund would remain with the BOM including access to the line of credit but the day-to-day operational requirements would be delegated to the UASP. The principal amount of the subsidiary loans will be fully repaid by BOM to the Government at the end of a 10-year grace period.

PFIs would make loans to eligible sub-borrowers for periods of 2-1/2 to 7 years with a maximum grace period of one year. Interest rates would be freely determined by the PFI, but variable on a quarterly basis.

Maximum subproject loan sizes would be US$15,000 equivalent for special facility loans and US$300,000 in the case of the traditional loans sub-component. PFIs would, of course, be free to augment project funds with their own funds to make larger total loans available as they wished.

The special facility is designed to catalyze commercial bank lending to very small first time borrowers who often have considerable difficulty in obtaining a first loan as they are viewed as high risk borrowers involving high transaction cost relative to potential revenue generation. Government places high priority on catalyzing increased lending from banks to these largely indigenous borrowers. Therefore, for approved special facility subprojects it will make available through the PFI parallel "quasi-equity" funding at the Government's risk equal to 25 percent of total project cost. This funding will have no debt servicing requirements during the scheduled life of the PFI sub-loan, and will, therefore, create de facto total equity and quasi-equity of at least 35 percent of project cost which, as it is subordinated to the bank's loan, significantly reduces lender risk.

Under this arrangement, the borrower will have a major incentive to repay the bank loan on time, as this 25 percent quasi-equity would then become a grant to the borrower when repayment is complete. If the sub-borrower does not repay the bank loan as scheduled, the 25 percent funding would be converted into a loan under terms and conditions identical to the PFI loan to be collected for a fee on behalf of Government by the PFI starting at the date the bank loan should have been fully repaid. While this arrangement would create a relatively high budgetary cost per borrower, the cost to the economy is less than for subprojects financed by state-owned banks under previous lines of credit, given the high default rates. Moreover, the design of this component is putting in place powerful incentives to change the culture of non-repayment.

While no portion of the line of credit funds will be specifically reserved for small and medium sized enterprises participating in the PoDE business facilitation components, it is anticipated that such projects will have a comparative advantage in competing for funds by virtue of the specialized advice they will receive.

Intermediary Eligibility Requirements. Initial eligibility criteria, to be ascertained based on December 1998 financial statements, would include: (i) being in compliance with all BOM prudential regulatory requirements, e.g., capital adequacy, maximum loan concentration limits, loan classification and provisioning, and foreign exchange risk exposure; (ii) a net profit during 1998 as evidenced by audited accounts prepared in accord with international standards; (iii) total non-performing loans of less than 20 percent of portfolio; and (iv) submission of a document describing and showing to be satisfactory the PFI's term-lending organizational structure, staff experience, policies and procedures and training program. The BOM Banking Supervision Department will be responsible for verifying to what extent candidate PFIs meet the eligibility requirements and IDA will confirm each PFI's eligibility to participate in the Project. It is anticipated that a majority of Mozambique's banks and leasing companies will meet these criteria.

After the initial assessment, all commercial banks and leasing companies in Mozambique which continue to meet the eligibility criteria outlined above and verified by BOM and confirmed by IDA annually would be eligible to participate. Access to uncommitted funds under both sub-components would be on a first come first served basis subject to a maximum 25 percent of the initial US$6 million or 10 percent of a PFI's net worth, whichever is lower, being available to any one institution.

PFIs will be required to submit detailed quarterly reports on sub-loans which inter alia includes information on amounts collected, amounts overdue, and aging of overdue amounts. Also, PFIs

will be required to submit annual audited reports within six months following the end of their fiscal year, prepared in accordance with international principles by auditors satisfactory to IDA. While disbursements would continue under previous approved subproject commitments, once eligible, PFIs ongoing eligibility to make new commitments would immediately cease if: (i) collections on sub-loans drop to less than 85 percent of amounts coming due; (ii) required quarterly reports are not received within 45 days of their respective due dates; (iv) a qualified opinion is given on the PFI's annual audit reports or the audit reports are not received within 45 days of their respective due dates; or (iv) they no longer meet the other stated eligibility requirements. After the mid-term review, in addition to meeting the above eligibility criteria, PFIs would be required to supply matching funds equal to at least one third of the project fund amounts made available to individual sub-projects to continue to qualify for additional commitments.

When all of the initial funds have been committed in one of the sub-components, a mid-term review will be undertaken prior to the release of the unallocated resources under this component, which will: (i) ensure that credit ceilings have been fully eliminated as scheduled; (ii) thoroughly review individual PFI performance and eligibility; (iii) review the suitability of existing procedures, terms and conditions and make appropriate adjustments, if required; and (iv) allocate the remaining US$4 million between the two sub-components.

Credit Delivery Arrangements. The Finance Component will be managed by the Credit Operations Department (COD) at the BOM. BOM has designated the UASP as the credit administrator. COD will be primarily responsible for ensuring that the line of credit is accessed by PFIs that are solvent, well-managed, and operating based on sound financial policies. The UASP will be responsible for: ensuring the line of credit is accessed by eligible firms; assisting PFIs in efficiently, effectively and timely intermediating funds under this component; and monitoring the repayment performance of sub-borrowers.

The COD's role in the approval process would be limited to ascertaining the eligibility of the PFIs. The COD will inform the UASP of a PFI's eligibility within 3 business days from receipt of the application from the PFI. The UASP's role would be limited to narrow administrative aspects given that all intermediaries are private, commercially oriented, and competently staffed at senior management levels. It would, within 7 days of receipt of the COD's confirmation of the PFI's eligibility and receipt of the application, approve or disapprove individual subprojects based only upon whether or not they meet eligibility requirements. No effort will be made to assess feasibility or other appraisal elements. As all lenders and borrowers are private and commercially oriented, and maximum loan sizes are small, procurement processes would be in accord with normal local practice and would not need to be reviewed.

Disbursement and procurement procedures would be simplified. Disbursement would be drawn from a special account and made up-front, at the time of sub-loan approval, based on a pro-forma statement of project costs to be financed. The UASP would play no role in approving in advance individual transactions or documents except for new banks with no prior experience with IDA-funded lines of credit. In this case, IDA's prior approval will be required for the first three loans approved by a PFI under the Traditional Facility and the first two under the Special Facility. At the earlier of nine months after subproject approval or completion of disbursement, the PFI would be responsible for submitting full documentary support for all disbursements for a specific subproject. The UASP would review documentation for eligibility and insist on repayment from the PFI, to the extent that any ineligible or unsatisfactorily documented expenditures are discovered. Penalties, at twice the interest rate charged to PFIs, for amounts remaining undisbursed to sub-borrowers, or any disbursements not in accord with the agreed requirements, and not returned within one month of the scheduled disbursements will be imposed on PFIs.

The UASP will receive from PFIs their detailed quarterly reports on sub-loans and will monitor the information on amounts collected, amounts overdue and the aging of overdue amounts. The UASP would receive a fee from Government for its approval, disbursement and monitoring services.

ANNEX 6

INSTITUTIONAL CAPACITY BUILDING COMPONENT

The Institutional Development Component will address two key objectives: (i) enhancing the capabilities of private and public institutions to deliver business support services; and (ii) supporting Government agencies in their transformation process from maintaining control functions to providing business facilitation and promotion services, including improving the capability of these agencies to identify and ease bureaucratic rigidities. Capacity building assistance will be extended to both the private and public institutions including the Investment Promotion Center (CPI), the Ministry of Industry, Commerce and Tourism (MICTUR), and the Commission of Economic Associations (CTA).

Investment Promotion Center

The Investment Promotion Center (CPI) supports the objectives of PoDE, and warrants substantial support under the Institutional Capacity Building component of the project for three inter-related reasons. First, for reasons explored in Annex 3, CPI's efforts to attract investment are critical for the continuing dynamism of Mozambique's domestic private sector – and hence for the success of this project. Foreign investment helps sustain the rapid aggregate rates of growth, and hence continuing demand for the goods and services which can be provided by local firms. New investors into Mozambique bring with them new technologies, new skills, and new linkages with international markets. Moreover, in facilitating entry by new investors, CPI is engaged in continual learning as to regulatory and other obstacles in the Mozambican business environment, and is on the front-line in easing these obstacles. Indeed, an important rationale for supporting CPI via the PoDE is to ensure that CPI continues to work to ease these regulatory obstacles in ways that benefit the private sector broadly, not only individual investors which are the immediate targets of attention.

Second, the world over, the task of attracting inward investment (that is, of "promoting a country") is recognized as a public good, with high economic and social returns but limited potential for private profit – and hence a strong candidate for the use of public funds. Public monies are only worth spending on investment promotion, however, if there indeed exists an agency capable of undertaking the task efficiently and effectively. Over the past two years, with IDA support under the IERP, CPI has successfully transformed itself from a regulatory to a promotional and facilitative agency, and indeed is rapidly becoming an exemplar of global best practice.

Third, Mozambique needs to broaden its appeal to foreign investors engaged in labor-intensive, employment-creating activities, not just those active in the capital-intensive mega projects which have thus far been the primary focus of achievements. The world over, export processing zones (if well-designed) have proven useful in attracting outward-oriented foreign investment in countries in an early stage of industrial development, and with correspondingly weak institutions and infrastructure. As discussed below, within Mozambique CPI is ideally positioned to act as a catalyst for the development of such export "free zones".

Ongoing Support for CPI's "Core" Activities and Development

A Three Year Strategic Plan for CPI, approved by Mozambique's Council of Ministers in August 1997, set the objective of transforming CPI from a regulator to facilitator and promoter. Donor support was central to CPI's successful achievement of this objective; virtually the entire budget of CPI was covered by IDA under the IERP. The PoDE will continue to provide budget support for CPI's "core" activities and development. Over the next few years, these resources will support the following CPI activities:

- Its on-going work which centers on further revisions of the investment registration process; modification of its internal structure; development of an investor tracking system and promotional presentations on privatization opportunities in Mozambique, and implementation of a pilot linkage program between small, local producers and enterprises and large, foreign-owned companies;

- A renewed focus on actively promoting certain sectors to attract investors particularly in the light industry, agro-industry, tourism, infrastructure, fisheries, and mining sectors.

- establishing offices in key municipalities of the country including Beira, Nampula, Cabo Delgado and Inhambane and external offices in South Africa and an antenna office in Mauritius.

Through its promotional efforts, CPI expects to directly affect the creation of at least 60 mid- to large-scale projects from foreign direct investments and at least 23,000 jobs and attract an incremental US$440 million investment inflows.

Support for the Development of Export "Free Zones" in Mozambique

CPI is ideally positioned to act as a catalyst for the development of "Free Zones" in Mozambique, and intends to take on this role. Mozambique's 1993 Investment Law made provision for industrial free zones, but cumbersome implementing regulations made such zones (which are to be privately developed and promoted) unattractive to investors. CPI staff are in the process of finalizing proposed new regulations regarding FZs in Mozambique, which they plan to submit to the Council of Ministers for consideration in early 1999. These proposed new regulations are consistent with international best practice, and are expected to attract considerable international interest.

As Executive Organ (EO) of the Conselho de Zonas Francas (CZF), CPI will not merely act in response to a potential developer coming forward with a request to assist in acquiring a lease on a particular site and granting it FZ status. It will be pro-active, seeking to establish an appropriate land use and development policy for FZs, and identifying specific sites, which would then be put out to tender to interested developers. Interested potential developers would then undertake the necessary studies for site development and any additional required infrastructure (such as wastewater pre-treatment and/or treatment facilities) as well as environmental impact assessments.

This work to catalyze the private development of Free Zones will proceed on two parallel tracks – both financed under PoDE. The focus of the first track, which is already progressing rapidly (with initial support from IERP), is on establishing a pilot zone in the vicinity of Maputo. Two promising sites of about 100 ha. each (about 250 acres) have been identified, one of which will be offered for tender to potential zone developers. *A priori,* both appear to have adequate access to

infrastructure such as roads, power, water and telecommunications, and the Maputo port. Further studies of these two sites are currently in the process of being contracted out. Their goals are to: evaluate each site's suitability from a technical point of view, including checking that there are no obvious environmental impediments, and initiating work to address other environmental issues (see below); develop financial models, including estimates of the cost of developing either site; and prepare tender documents for the selected site.

The second track will explore options for Free Zone or "Freeport" (a more ambitious variant of a zone, which potentially can encompass an entire city) development in Beira and Nacala. One set of studies under this track will evaluate the desirability in principle for Mozambique of the "freeport" concept, and its potential viability in each of Beira, Maputo and Nacala. This set of studies will examine the revenue implications on corporate taxes for Mozambique via the free zones. A second set of studies will examine the infrastructure requirements for possible FZs in Beira and/or Nacala (US$500,000). Because infrastructure is considerably less well developed or, in some cases, not yet repaired after the civil war, around Beira and Nacala, it is expected that there would be some additional off-site infrastructure (e.g. water supply, power, telecommunications, roads, rail,) required in order for a viable FZ to be developed in either area. It will be important to study the possible needs at different potential sites, including those relevant for environmental sustainability, and to see how best to integrate such possible needs with the broader development plans of these regions.

In all, the "free zone" subcomponent of the PoDE will provide three sets of support for CPI, in its role as EO of the CZF:

- Funding for necessary additional staff, plus additional office furniture and equipment and vehicles. The project would also finance both formal and on-the-job training in FZ issues and procedures for relevant CPI staff.

- Funding for studies – the contracting of external legal, engineering, environmental and financial expertise to assist CPI in the preparation and publication of tendering documentation, as well as in the review of bids, negotiation and follow-up with bidders ; and also more general studies to explore the options -- including the infrastructural requirements and options for developing appropriate mechanisms for making land available for FZ and industrial estate development – for the development of Free Zones/Free Ports in Beira, Nacala and elsewhere. (One question an early study should address is whether and when the role of EO of the CZF should be spun off entirely from CPI, enabling the agency – once its initial catalytic role has been achieved – to focus on broader concerns of investment promotion).

- Funding for the requisite environmental work needed to support free zone development, including the preparation of appropriate environmental guidelines – both for developers of free zones, and for individual investors planning to locate within a zone -- and approval and monitoring mechanisms. (Private FZ developers and private investors will be expected to prepare their own environmental impact assessments, which they would present for review as part of their bids for the site and/or investment applications). CPI will co-ordinate this work with the Environment Ministry, both with respect to preparation of these guidelines, and the establishment of appropriate approval and monitoring mechanisms.

As CPI has been a significant recipient of resources from the IERP project and is programmed to continue to receive IDA (and perhaps other donor) resources through this Project, the transition from one source of project funds to another provides a natural opportunity for an external review of the organization's record thus far, and its proposed future strategy. This review will be

initiated in the context of the completion of the IERP and will serve to confirm the support to be provided under PoDE. The total cost of this sub-component is about US$10 million.

Ministry of Industry, Commerce and Tourism

The Private Sector Development Unit (PSDU) within the Ministry of Industry, Commerce and Tourism (MICTUR) has been instrumental in providing policy advice to the Ministry, reforming the regulatory environment as defined in an IFC/FIAS report, "Mozambique - Administrative Barriers to Investment: The Red Tape Analysis," and obtaining the necessary political support to sustain these reforms. Under the guidance of the Economic Council of Ministers, measures to reform policies, practices, and institutions were taken. These included revisions to the commercial and industrial policies and the textile and clothing sector strategy; modifications to the labor and land laws; business registration, licensing and reporting requirements; import procedures; and the transformation of the Investment Promotion Center from a regulatory body to a promotional and facilitative agency. Ongoing work include: further simplification of the regulatory environment (for example, commercial code and the industrial licensing law reform and the introduction of alternative resolutions to disputes). The PSDU also established and maintains an on-going dialogue and consultative process with representatives of the local business associations (CTA) to ensure the private sector's concerns are reflected in Government policies and in mechanisms designed to enhance local business participation in investment opportunities. It supported the publication of CTA's Business Directory and a Practical Guide to Doing Business in Mozambique, and the development of regional cooperation programs with a focus on cross-border trade. Funding for this policy and business support work was provided under the IDA-financed Industrial Enterprise Restructuring Project.

Under the sub-component for MICTUR, the Project will support the enhancement of the Ministry's role in: the development and delivery of business facilitation and promotion services, regulatory reform (including further work on the commercial code reform), and as a channel for dialogue with the private sector. Regular roundtable discussions between the Ministry and the private sector would be established to identify new policies and resolve policy implementation constraints to private sector development. Studies on, for example, the collateralization and transfer of immovable property in urban areas; an assessment of the metrology, standards, testing, and quality control and support capacity in the country and considering regional practices and performance; other measures that will enhance private investment and improve the enabling environment for these activities will be conducted, and the resulting recommendations would be translated into concrete policy and legislative proposals. An allocation of approximately US$1.2 million will cover consultancy services, studies, and training programs.

Regional Business Support Initiative

There appears to be consensus within Mozambique that, to foster the continuing consolidation of CTA, its member associations also require strengthening. Can PoDE support this in a way which is consistent with its overall approach.

The fundamental principle underlying PoDE is that support for the private sector should be market-oriented and demand-driven. Building on this principle, the "regional business support initiative" (RBSI) outlined below might perhaps be an attractive way of supporting economic dialogue and the strengthening of associations at the regional level.

The objective of the RBSI would be to build and strengthen geographically-focused member-based business organizations, motivated by a shared vision of how their local economy might thrive, and engaged in a common program of action for realizing that vision. With parallel

financing from other donors, possibly the Department for International Development (U.K.), materializing, RBSI would support this objective in the following ways:

- Step 1: In consultation with the steering committee, the RBSI manager will explore in which regions there exists an initial group of forward-looking private sector actors interested in participating in the RBSI, plus provincial and local authorities open to dialogue with the private sector. The three regions with the strongest interest will be selected for the RBSI's first round. (The goal will be to include all regions over the life of the initiative[2]).

- Step 2: In the regions selected, an external consultant will be invited to work with local participants to prepare a medium-term local economic strategy. This strategy should include: (a) identification of the region's potential competitive advantage (so-called "cluster" analysis); (b) an identification of the primary regulatory, infrastructural and policy constraints which inhibit the achievement of the region's potential, with special emphasis on those constraints which it is in the power of local public and private actors to change; (c) a sequenced set of actions for eliminating the constraints.

- Step 3: As important as the substance of the analysis, is the process of engaging local players in dialogue about the region's future. Throughout, the consultant should work in close consultation with interested local participants – *and progressively work to broaden the circle of interest and participation.* The consultant's work program should thus include – and its success benchmarked against -- an explicit program for fostering such participation.

- Step 4: The RBSI would use the resultant "shared vision" as a platform for strengthening local business associations by: (a) supporting, where needed, the formal process of establishing such an association; (b) supporting the development of a business plan for the association to follow through on the actions identified above; (c) providing some support for the association to follow through in its first year of operations.

Expenditure per region is estimated at US$80,000 (with a minimum of 40 percent reserved for step 3).

The implementation arrangements for the RBSI will be coordinated by the MC.

Sector-Specific Initiatives (SSI) Sub-component

Proactive sector-specific support to business advisory services for Mozambican firms would be provided in the event other donors provide parallel funds. This is aimed at developing the network of buyers, producers, traders and support institutions in up to three identified sectors of economic activity aimed at stimulating broad based economic and private sector growth. International experience has shown that the provision of general business advisory services are

[2] The RBSI offers a special opportunity in relation to the three districts -- Mocimba da Praia, Palma (Cabo Delgado) and Nacala Porto (Nampula) -- supported by the Global Environmental Facility's forthcoming Mozambique Coastal and Marine Biodiversity Project (CMBP). One aim of the CMBP is to demonstrate how environmental sustainability and private sector development can be jointly achieved. To help achieve this goal, the CMBP will make available $100,000 additional matching funds for any of these districts which might be selected for participation in the RBSI; these districts would use, as a backdrop for the RBSI initiative, the environmentally and socially sustainable spatial development plan prepared as part of the RBSI (Note that these three districts could, of course, choose to apply for RBSI support, independent of the CMBP. Note also that the RBSI framework and management structure can be made available to use the CMBP funds directly -- ie without PoDE resources -- along lines directly parallel to the RBSI exercises conducted elsewhere, even if the three districts are not selected directly to be part of the RBSI initiative).

complex, expert intensive, and relatively expensive, although such services have their own contribution to make in deepening business growth activity within the private sector.

As part of the broadening of the private sector in Mozambique, the PSC and the management team in the TLC will select up to three sector initiatives which exhibit two basic sets of characteristics. Firstly, such sectors should be among those that demonstrate significant market opportunities through research from the World Bank or other agencies, and from data within Mozambique. Secondly, these sectors should demonstrate both geographic spread and potential to employ poor people through relatively labor intensive activities with the objective of enhancing broad based growth and employment.

Based on these criteria, the sector-specific initiative will commence with a four year program to assist private enterprises in the handicraft sector, which will be implemented by a sub-contractor through a competitive bid. Key features of the arrangements for the handicraft SSI pilot initiative (and any subsequent initiatives) include the following:

- The SSI will be managed and monitored internally by a Sub-Contractor, with oversight by the PSC. The initiative will be subject to the general review procedures of PoDE.

- It is expected that the Sub-Contractor will provide a sustained presence in Mozambique with an experienced handicrafts expert during the duration of the project. A presence will be necessary at important times in the areas of production.

- The SSI will be implemented in two phases. During the first phase, the subcontractor will assess the marketplace (regional and foreign buyers, intermediaries and producers); initiate contacts among the participants in the cluster, and new individual buyer-seller links; and develop a strategy for the sector.

- During the second phase, the contractor will work to achieve pre-specified participation and export targets for the sector.

- The SSI will work in tandem with the cost sharing grants offered by the FCO and the training services provided by the TAO, enabling industry cluster participants which might otherwise not be reached by virtue of their very small size, and very remote location, to make more effective use of the grants.

If it is shown that an SSI can be successful, up to two other sectors of manufacturing activities will receive similar business advisory services support, at a total cumulative cost, including handicrafts, of US$5 million. Based on studies of enterprises and the above criteria, future candidates for sector initiatives are expected to be the wood processing and food processing sectors.

The implementation arrangements for the SSI will be defined and funded under parallel arrangements agreed between the Government and other sponsoring donors in consultation with IDA.

ANNEX 7

ESTIMATED PROJECT COST AND FINANCING

Table 1: Project Cost by Component

	Local Cost	Foreign Cost	Total
Technical Learning Component	***6.4***	***7.5***	***13.9***
Firm Competitiveness Office	1 9	4 0	5.9
Technical and Advisory Office	3.9	2.4	6.3
Linkage Program Office	0 6	1.1	1.7
Finance Component	***4.2***	***8.5***	***12.7***
Capacity Building Component	***4.5***	***12.9***	***17.4***
CPI	2.3	7.6	9.9
MICTUR	0.4	0.8	1.2
RBSI	0.4	0.7	1.1
Sector Specific Initiative	1 4	3.8	5.2
Implementation	***0.4***	***0.8***	***1.2***
Unallocated	***1.1***	***1.3***	***2.4***
Total	**16.6**	**31.0**	**47.6**

Table 2: Project Cost by Category

	Local Cost	Foreign Cost	Total Cost
Consulting services	6.9	16.1	23.0
Recurrent expenditures	2.5	0.6	3.1
Vehicles	0.7	0 2	0.9
Equipment, furniture	0.8	0.2	1.0
Training	0 2	0.3	0.5
Credit	3.1	9.4	12.5
Grant - Finance	0.2	0 0	0.2
Grant – Technical Learning	1.4	2.6	4.0
Unallocated	0.8	1.6	2.4
Total	**16.6**	**31.0**	**47.6**

Table 3: Project Financing by Component

	IDA	Co-/Parallel Financing	Others	Total
Technical Learning Component	***6.0***	***3.9***	***4.0***	***13.9***
Firm Competitiveness Office	2.0	2.1	1 8	5.9
Technical and Advisory Office	2.8	1.3	2.2	6 3
Linkage Program Office	1.2	0.5	0 0	1.7
Finance Component	***10.0***	***0.0***	***2.7***	***12.7***
Capacity Building Component	***7.0***	***10.1***	***0.3***	***17.4***
CPI	4.7	4.9	0 3	9.9
MICTUR	1 2	0 0	0.0	1.2
RBSI	1.1	0.0	0 0	1 1
Sector Specific Initiative	0.0	5.2	0 0	5.2
Implementation	***0.6***	***0.5***	***0.1***	***1.2***
Unallocated	***2.4***	***0.0***	***0.0***	***2.4***
Total	**26.0**	**14.5**	**7.1**	**47.6**

ANNEX 8

PROCUREMENT AND DISBURSEMENT ARRANGEMENTS

Institutional Arrangements

The UASP will be the coordinating and responsible agent for all procurement funded by the Project. It will handle the procurement requests of each implementing agency according to monthly procurement schedules submitted to it. It will have staff who are fully familiar with Bank procurement procedures as they will be recruited from implementing agencies of other Bank-funded projects. A Procurement Action Plan will be developed by the UASP and will be incorporated in the PIP prior to credit effectiveness.

Procurement of Consulting Services

The selection and employment of consultants will be in accordance with the guidelines, the Selection and Employment of Consultants by World Bank Borrowers (January 1997, revised September 1997 and January 1999). The Quality and Cost Based Selection (QCBS) methodology was used to select the firm serving as the Management Contractor. The selection and employment of consultants by private beneficiaries and sub-borrowers for the matching grant contracts amounting to less than US$50,000 will be in accordance with the Consultant's Qualifications (CQ) method, procedures summarized in the PIP, and other commercial procurement practices acceptable to IDA. Individual consultants will be recruited following Section V of the guidelines, the Selection and Employment of Consultants by World Bank Borrowers.

Prior to procuring consulting services, IDA's review will be required for: (i) the first six contracts procured under the Firm Competitiveness Office, the first six contracts procured under the Technical Advisory Office (three each for Type A and Type B courses), and the first three contracts procured under the RBSI component; (ii) all contracts with individuals with a contract value of at least US$50,000; (iii) contracts with firms with a contract value of at least US$100,000; and (iv) terms of reference for all contracts with the Steering Committee, the Investment Promotion Center, and MICTUR. Local teams will work with the expatriate management under the Technical Learning Component and technical consultants under the Capacity Building Component in order to promote and strengthen local capacity through the transfer of skills to the domestic industry.

Procurement of Goods

The purchase of goods and services would be in accordance with IDA procurement guidelines (reference Procurement Under IBRD Loans and IDA Credits, January 1995 and revised in January and August 1996). International competitive bidding is not envisaged under the project given that there will be a number of implementing agencies whose timing requirements for goods will differ throughout the project implementation period making it difficult to combine goods into packages. Also, procurement contract values will be small. When possible and practicable, procurement of goods would be combined into packages estimated to cost the equivalent of US$100,000 equivalent or more and procured under national competitive bidding (NCB) procedures. IAPSO and/or international shopping procedures may be used for the purchase of goods. International shopping procedures would be used for the procurement of goods (equipment, vehicles) for contracts with a maximum contract value of $50,000 (with an aggregate

value of $150,000) and local shopping procedures would be used for individual contracts amounting to US$30,000 (with an aggregate value of $100,000).

IDA's review will be required prior to procuring goods under NCB procedures for the first three contracts of all the implementing agencies and for all contracts above US$100,000 except for those under the Finance Component.

This Project has attracted the interest of a number of donors presently supporting private sector development. It is expected that the donors would agree on common thresholds for procurement under the different procurement methods, the use of pre- and post-review, standard documents and procedures for advertising, evaluating and awarding the contracts, and reporting formats.

Table 1: Project Costs by Procurement Arrangements[3]
(in US$ million equivalent)

	NCB	Others	Consultants	NBF	Total
Consultancy services	0.0 (0.0)	0.0 (0.0)	8.3 (8.3)	16.2 (0.0)	24.5 (8.3)
Recurrent	0.0 (0.0)	2.8 (1.6)	0.0 (0.0)	0.3 (0.0)	3.1 (1.6)
Vehicles	0.5 (0.3)	0.4 (0.4)	0.0 (0.0)	0.3 (0.0)	1.2 (0.7)
Equipment, furniture	0.1 (0 1)	0.5 (0.5)	0.0 (0.0)	0.6 (0.0)	1.2 (0.6)
Training	0.0 (0.0)	0 4 (0.4)	0.4 (0.4)	0.1 (0.0)	0.9 (0.8)
Credit, financing grant	0.0 (0.0)	10.0 (10.0)	0.0 (0.0)	2.7 (0.0)	12.7 (10 0)
Grant, TLC	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	4 0 (4.0)	4.0 (4.0)
Total	**0.6** **(0.4)**	**14.1** **(12.9)**	**8.7** **(8.7)**	**24.2** **(4.0)**	**47.6** **(26.0)**

NBF:	Government contribution	0.5 million
	Beneficiary contribution	6.7 million
	Other financing	17.0 million

Figures in parenthesis are the amounts to be financed by the Bank loan/IDA credit.

[3] For details on presentation of Procurement Methods refer to OD11.02, "Procurement Arrangements for Investment Operations." Details on Consultant Services can be shown more easily in the Table A1 format (additional to Table A, where applicable).

Table 2: Consultant Selection Arrangements (optional)
(in US$ million)

Consultant Services Expenditure Category	Selection Method							Total Cost (including contingencies)
	QCBS	QBS	SFB	LCS	CQ	Other	NBF	Total Cost
A. Firms	2.0 (2.0)				1.0 (1.0)			3.0 (3.0)
B. Individuals						5.3 (5.3)	16.2	21.5 (5.3)

Note QCBS = Quality- and Cost-Based Selection
QBS = Quality-based Selection
SFB = Selection under a Fixed Budget
LCS = Least-Cost Selection
CQ = Selection Based on Consultants' Qualifications
Other = Selection of individual consultants (per Section V of Consultants Guidelines), Commercial Practices, etc.

N.B F. = Not Bank-financed.
Figures in parenthesis are the amounts to be financed by the Bank loan.

Table 3: Thresholds for Procurement Methods and Prior Review[4]

Expenditure Category	Contract Value	Procurement Method	Contracts Subject to Prior Review
	(US$)		(US$)
1. Goods	<$30,000	National shopping	
	<$50,000	International shopping	
	>$50,000 - <$200,000	NCB	First 3 contracts below $100,000 and all contracts > $100,000 except those under the Finance Component
2. Services			
Firms			>$100,000 and first 3 contracts of TAO (for each of A and B courses) and RBSI All TORs of the Capacity Building Component
Individuals			>$50,000 All TORs of the Capacity Building Component

[4] Thresholds generally differ by country and project. Consult OD 11.04 "Review of Procurement Documentation" and contact the Regional Procurement Adviser for guidance.

Overall Procurement Risk Assessment:

High	
Average	X
Low	

Frequency of procurement supervision missions proposed: One every six month(s) (includes special procurement supervision for post-review/audits)

Table 4: Allocation of Loan Proceeds [5]

Expenditure Category	Amount (US$)	Financing Percentage
Goods including vehicles, equipment	0.7	100% foreign expenditures; 90% local expenditures
Consultancy services	6.7	100% of expenditures
Operating expenditures	1 6	90% of expenditures
Training	0.6	90% of expenditures
Credit	9.8	100% of amounts disbursed
Grant, finance	0 2	100% of amounts disbursed
Grant, TLC	4.0	100% of expenditures
Unallocated	2.4	
Total	**26.0**	

[5] Net of taxes for local expenditures

ANNEX 9

FINANCIAL MANAGEMENT

General

The *Uni*dade de Apoio ao Sector Privado (UASP) will be responsible for ensuring that financial management and reporting procedures for PoDE will be acceptable to the World Bank and the Government of Mozambique.

UASP's financial management system (FMS) must support management in their deployment of limited resources with the purpose of ensuring economy, efficiency and effectiveness in the delivery of outputs required to achieve desired outcomes. Specifically, the FMS must be capable of producing timely, understandable, relevant and reliable financial information that will enable management to plan, implement, monitor and appraise PoDE's overall progress towards the achievement of its objectives.

At this embryonic stage in the establishment of UASP's financial management system, UASP is not yet ready for Project Management Report (PMR)-based disbursements, as discussed in the World Bank's Loan Administration Change Initiative Handbook (LACI, September '98). Thus, in the short-term, existing disbursement procedures, as outlined in the World Bank's Disbursement Handbook, will be followed i.e. direct payment, reimbursement and special commitment.

However, the development of UASP's financial management system, in accordance with the Financial Management Action Plan presented below, is expected to facilitate the introduction of PMR-based disbursements within about 18 months of credit effectiveness.

Financial Management Action Plan

PoDE Steering Committee

Regarding financial management issues, the PoDE Steering Committee (PSC) will be responsible, in due course, for reviewing the PMR every quarter. The PMR will comprise:

(i) Financial Statements (see below). Members of the PSC will review and approve quarterly and annual financial statements; they will also examine material variances between budget and actual figures, seeking remedial action, as appropriate, within an agreed timeframe.

(ii) Project Progress, i.e., Output Monitoring Report (OMR). The format and details of the OMR will need to be developed. An important aspect of the OMR will be the accompanying narrative interpreting the Project's progress with agreed financial performance indicators and how costs to date relate to that planned at appraisal, and its likely effect on the Project at its completion.

(iii) Procurement Management (goods and services - as appropriate).

Staffing/Capacity Building

The UASP Director will be appointed to direct and guide the financial management operations of PoDE. Assisting the UASP Director will be a Chief Accountant and relevantly qualified and

experienced accounting, administrative, procurement and support staff to be appointed. The levels and number of such staff, including their terms of reference, will need to be finalized. Varying levels of training may be required in: financial and management accounting; information systems and computer applications; procedures relating to utilization of funds e.g. Special Accounts, SOEs, Special Commitments, Procurement etc. *"On the job coaching"* will also be provided.

Financial Procedures Manual – Internal Audit

The internal control procedures for UASP will be documented by the External Systems Consultant in a Financial Procedures Manual that will be prepared prior to credit effectiveness. Thereafter, the Manual will be a *"living document"* and will be updated regularly by the Chief Accountant to meet evolving needs.

The activities of the Project will be periodically reviewed by the Internal Audit Unit of the Ministry of Planning and Finance (MPF).

Information Technology

UASP's information technology requirements will be determined prior to credit effectiveness by the External Systems Consultants.

Planning and Budgeting

Counterpart Funding will be approved in line with Government's budgetary process.

In consultation with the PSC, the Director of UASP and the Chief Accountant and will be responsible for budget preparation, including the Project's quarterly and annual cash flow forecast. An indicative format of presentation is contained in Annex 6 of The Loan Administration Change Initiative Handbook (LACI, a September 1998 publication of the World Bank).

The budget will ultimately be approved by MPF in consultation with MICTUR.

Government Accounting – Cash versus Accruals

As UASP is an integral part of MICTUR, UASP must meet MPF's requirement for cash accounting. This requirement is not expected to change in the short/medium-term. Thus, for the foreseeable future, IDA and related counterpart funds will be accounted for by UASP on a cash basis.

In due course, for management reporting purposes, the PSC will decide whether to convert to an accruals basis of accounting.

Procurement of Goods, Works and Services

The UASP Director, Chief Accountant, and members of staff will be conversant with procurement procedures, as internal control issues and the incurring of liabilities on behalf of UASP will be matters of particular concern to the financial management function.

The PMR, showing procurement status and contract commitments as appropriate, will be prepared quarterly for consideration by the PSC.

Procurement procedures will comply with World Bank and Government requirements and will be documented in the Financial Procedures Manual.

Banking Activities - Flow Of Funds

For IDA and Government of Mozambique funding, UASP will maintain 3 bank accounts as follows:

(i) a special account in US Dollars/Meticais at a commercial bank acceptable to IDA that will show: (i) dollar and meticais cost of any direct payments to suppliers; (ii) dollar advances (meticais equivalent cost) from the IDA loan account; (iii) opening and closing balances.

(ii) IDA loan account (Washington) in US dollars, meticais, SDR that will show: (i) cost of transfers to the special account; (ii) cost of any direct payments to suppliers; (iii) opening and closing balances.

(iii) current account in meticais at a commercial bank acceptable to IDA to which counterpart funding by Government will be deposited. Initially, a 2 months float will be deposited and it will be replenished thereafter in compliance with Government procedures.

All three bank accounts will be reconciled with bank statements on a monthly basis. Reconciliations will be approved by the UASP Director and chief accountant on a timely basis; identified differences will be expeditiously investigated.

Control procedures (e.g. cheque signatories, supporting documentation, payments, transfers etc.) will be documented in the Financial Procedures Manual.

Withdrawals and Disbursement

At this embryonic stage in the establishment of UASP's financial management system, UASP is not yet ready for PMR-based disbursements, as discussed in the World Bank's Loan Administration Change Initiative Handbook (LACI, September '98). Thus, in the short-term, existing disbursement procedures, as outlined in the World Bank's Disbursement Handbook, will be followed i.e. Direct Payment, Reimbursement and Special Commitment.

The appointment of the Chief Accountant as well as the establishment and strengthening of UASP's financial management system, is expected to facilitate the introduction of PMR-based disbursements within about 18 months of credit effectiveness.

LACI/PMR has many merits. It integrates project accounting, procurement, contract management, disbursement and audit with physical progress through the Project Management Report (PMR). In due course, the adoption of LACI/PMR by UASP will enable it to move away from time-consuming voucher-by-voucher disbursement methods to quarterly disbursements to the Project's Special Account, based on the PMR.

Monitoring Activities

A Fixed Assets Register will be prepared, regularly updated and checked for capital expenditure.

Status Reports in respect of the activities undertaken by the Management Contractor and UASP will be prepared quarterly for consideration by the PSC.

The control and reporting procedures will be documented in the Financial Procedures Manual.

Financial Reporting

Monthly Cash Reporting

In compliance with Government reporting requirements, the Chief Accountant will be responsible for preparing a monthly return to the National Director of Public Accounting at MPF for incorporation into the National Accounts.

Quarterly and Annually

The Financial Statements, following determination by the PSC, are likely to include:

(i) Statement of sources and uses of funds by loan category and by activity;

(ii) Project balance sheet as at the reporting date;

(iii) Notes in respect of: significant accounting policies and accounting standards adopted by management when preparing the accounts; and any supplementary information or explanations that may be deemed appropriate by management in order to enhance the presentation of a *"true and fair view"*.

(iv) Special account statement and reconciliation showing deposits and replenishments received, payments substantiated by withdrawal applications, interest that may be earned on the account and the balance at the end of the fiscal year;

(v) SOE withdrawal schedule, listing individual withdrawal applications relating to disbursements by the SOE Method, by reference number, date and amount;

(vi) Cash Forecast for the next 2 quarters.

Indicative formats for financial statements are outlined in two World Bank publications i.e. Financial Accounting Reporting and Auditing Handbook (FARAH, January 1995) and The Loan Administration Change Initiative Handbook (LACI, September, 1998).

External Audit

Relevantly qualified, experienced and independent auditors will be appointed on acceptable terms of reference. The external auditor will also be expected to prepare a separate management letter giving observations and comments, and providing recommendations for improvements of accounting records, systems, controls and compliance with financial covenants.

ANNEX 10

ECONOMIC ANALYSIS

The approach

The economic analysis of this type of private sector development project presents an unusual challenge. The challenge lies in the fact that the project aims not to support investments that otherwise would not have happened, but rather to accelerate a process that in a liberalized environment might otherwise have evolved spontaneously – but much more slowly. Despite these difficulties, an attempt has been made to present a quantified measure of the benefits that are expected from the project.

A cost-benefit analysis framework has been used to calculate the Net Present Value (NPV) and Economic Rate of Return (ERR). As Table 1 summarizes, the economic analysis has produced an NPV of US 23.7 million at a discount rate of 12 percent and an ERR of 24.7 percent. These rates of return emerge straightforwardly from calculations of the difference between two paths of output expansion – with and without the project.[6]

Table 1: Economic Analysis Summary

Project Component	Present Value of Net Increases in Output (US$ million)	Net Present Value (US$ million)	Economic Rate of Return (%)
1. Technical Learning in Firms – Firm Competitiveness, Training & Advisory and Linkages Program	33 8	17 6	38.4
2. Capacity Building – Investment Promotion, MICTUR, Regional Business Support & Sector Specific Initiatives	20.5	2.6	15.2
3 Finance – Special and Traditional Facilities	15 98	3.4	20 8
Total Project	**70.3**	**23.7**	**24.7**

Assumptions and results

The economic analysis makes four sets of simplifying assumptions. A first set of simplifications is to narrow the scope of what to measure. While the projected acceleration in growth also accelerates the generation of externalities, both positive and negative, to keep the analysis tractable these impacts are assumed to offset one another and hence excluded from the quantitative analysis. Relatively, other than the "opportunity cost" adjustment described below, no effort will be made to adjust for differences between market and economic prices of, say, labor or capital.

[6] Same method has been applied by the World Bank on similar programs with Matching Grant Schemes See Report #16524-ZA. Zambia· Enterprise Development Project, SAR, 1997, Report #15062-ZIM - Zimbabwe. Enterprise Development Project. SAR. 1996 and Côte d'Ivoire: Private Sector Development - Capacity Building Project, PAD, 1998, Report # 17940-IVC.

The remaining three sets of assumptions comprise estimates of specific magnitudes needed for calculations of the economic rates of return to the project (and are implicit in Chart 1 and Table 2). These are:

- Assumptions as to the level of exports/competitive production that might be expected at a new "high equilibrium" from Mozambican firms in a liberalized environment, as compared with the pre-existing zero/low export equilibrium.

- Assumptions as to the extent to which the PoDE interventions accelerate the initiation of adjustment from the pre-existing, low level to the new, higher equilibrium (i.e., by how much time the PoDE brings forward the initiation of adjustment).

- Assumptions as to the opportunity cost of the resources drawn into export production (ie the extent to which the resources were either diverted from alternative, lower value uses or, at the limit, previously unutilized, implying that all production is incremental).

This annex calculates the economic rate of return for the project based on specific assumptions as to these values, then uses sensitivity analysis to explore the robustness of the results with different assumptions.

For the *Technical Learning in Firm Component*, empirical evidence in similar schemes in East Asian countries, points to an output increase equal to about 15 times of the matching grant amount; to be conservative, the calculations here presume an output increase of only 10 times the grant amount. The total grant amount equals US$6 million, so the assumption implies an export/competitive output expansion of US$60 million. Note that it is not being assumed that the matching grants *caused directly* a US$60 million increase in the export-related output of Mozambique's private sector. The fundamental cause is economic reform. Rather (as noted above), the assumption is that the PoDE *accelerated* the pace of this adjustment – by an assumed three years. Following a conservative logic (especially in the light of widespread low utilization of fixed investment, and widespread unemployment) it is further assumed that 67 percent of the resources used for this increased production are diverted from other economic activities (i.e. only one-third of the increase is presumed to be genuinely incremental).

For the *Finance component*, it is assumed that investment and permanent working capital financing increases in output equal to the value of the amount lent. Average lending turnover is assumed at twice per project life of four years, and a five percent default rate per year is also postulated. The acceleration and opportunity cost assumptions are the same as for the *Technical Learning in Firm Component.*

Table 2: Cash Flow and Output Determinants of Economic Results

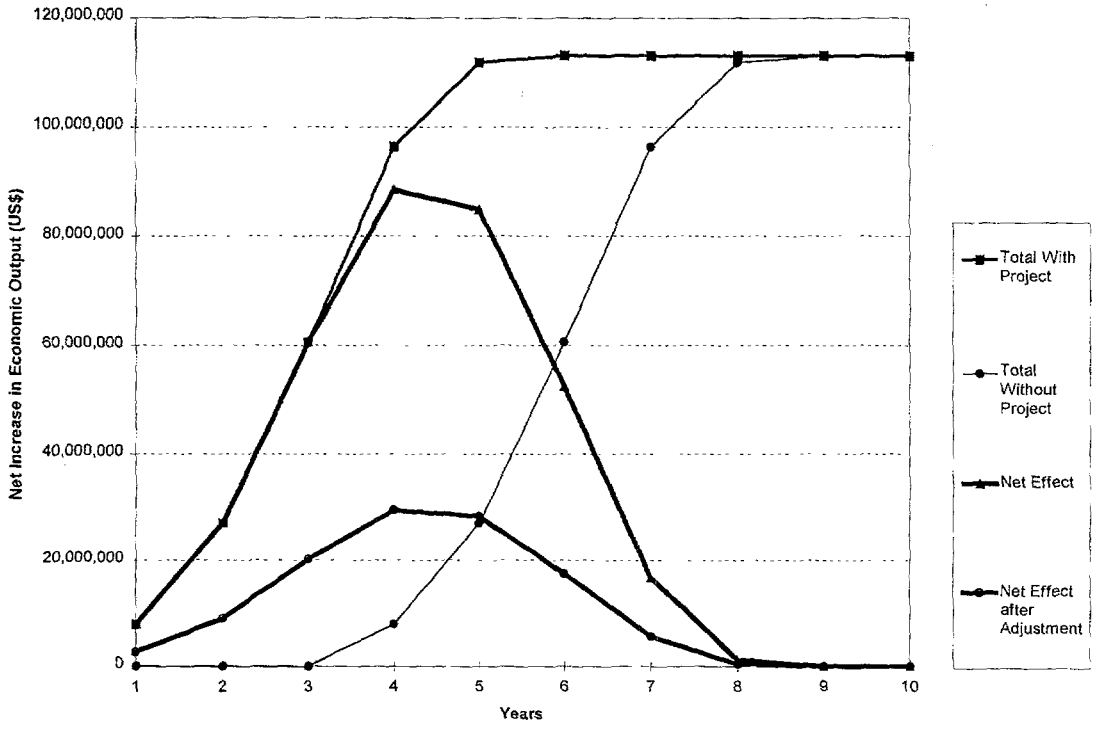
Project Component	IDA Project Cost (US$ million)[7]	Overall Project Cost (US$ million)	Net Increase in Economic Output Owing to Project[8] (US$ million)							
			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
1 Technical Learning in Firms – Firm Competitiveness, Training & Advisory and Linkages	6 8	16 1	1 7	6 2	11 8	15 5	11 0	5 5	-	-
2 Capacity Building[9] – Investment Promotion, MICTUR and Regional Business Support	8 4	17 9	-	-	3 4	7 6	11 7	8 6	4 5	0 4
3 Finance – Special and Traditional Facilities	10 8	13 6	2 7	5 0	6 4	5 6	3 3	1 0	-	-
Total Project	**26.0**	**47.6**	**4.4**	**11.2**	**21.6**	**28.7**	**26.0**	**15.1**	**4.5**	**0.4**

Measurement of economic benefits of *Capacity Building Component* support in the regulatory environment and investment promotion is difficult because they furnish provision of services to firms indirectly. For the sake of consistency, it was assumed that the support provided would increase efficiency of the supported recipients and would yield an increase in economic outputs at a multiple of five times the amount of support.

Table 2 summarizes the net increases in output implied by the assumptions described above. As Chart 1 illustrates, the economic results in Table 1 comprise the present value calculations of these net output increases -- the difference between the first scenario of increases in output resulting from the project and the same scenario, three years behind it. The results suggest that the overall project can be strongly justified in NPV and ERR terms. The *Technical Learning in Firms component* showed a high rate of return of 38.4 percent[10]. The pay-back period for the investment is estimated at three years.

[7] Includes $2.4 million Unallocated which has been divided by three and added to each component.
[8] Reduced by 2/3.
[9] Includes 0.5 million for Project Management costs
[10] Similar schemes in Zimbabwe showed an ERR of 46 percent and that of Zambia's showed 42 percent. It therefore means that the scheme is highly profitable.

Chart 1: Summary of Project Economic Effects



Sensitivity Analysis

The sensitivity analysis for the overall project switched values on the *Technical Learning in Firms* and *Finance components* and kept the *Capacity Building* disbursements as in base case scenario.

The first evaluation was done by elongating the disbursement over a period of 9 years, the effect on the project was that the NPV was reduced from US$ 23.7 million to US$ 16.0 million and the ERR from 24.7 percent to 18.9 percent. This suggested that a slower implementation period will not have a material effect on the economic impact of the project.

The second evaluation was done by modifying the reduction in the level of output attributed to diversion from other resources. Reducing the level of reduction in the level of output from 67 percent (the base case) to 50 percent, increases the NPV significantly to US$ 59.3 million with an ERR of 39.8 percent. Increasing the reduction to 75 percent still leaves the NPV positive, at US$ 5.8 million. Thus, although the outcomes are sensitive to the effects of modifying this variable, all of the outcomes presented positive NPV within the parameters (50-78 percent reduction) established in the theoretical foundation for this approach.

Table 3: Sensitivity Analysis Summary

Scenario	Sensitivity Performed	Cases	Variable Amount	NPV ($million)	ERR (%)
Overall Project					
Delayed Project Implementation	Elongated Disbursement period	(a) Base	(a) Regular	23.7	24.7
		(b) Alternate	(b) Slow	16.0	18.9
Change in Diversion Assumption	Percent reduction in increase in Output attributed to diversion from other sources	(a) Base	(a) 67% Reduction	23.7	24.7
		(b) Alternate	(b) 75% Reduction	5.8	15.4
		(c) Alternate	(c) 50% Reduction	59.3	39.8
Technical Learning in Firm	Increase in expected change in output for each firm	(a) Base	(a) 10 Times	17.6	38.4
		(b) Alternate	(b) 15 Times	34.6	57.0
Finance	Assumed turnover rate per project's life	(a) Base	(a) 2 Times	3.4	20.8
		(b) Alternate	(b) 3 Times	10.7	37.5
		(c) Alternate	(c) 1.7 Times – break-even case	0.0	12.0
Capacity Building	Output increases as a multiple of support amounts	(a) Base	a) 5 Times	2.6	15.2
		(b) Alternate	(b) 10 Times	22.6	32.7
		(c) Alternate	(c) 4.3 Times - break-even case	0.0	12.0

An evaluation was done on the *Technical Learning in Firms component* base case scenario by switching the expected increase in output for each firm from 10 to 15 as that of the East Asian countries and Kenya. The results showed an NPV of US$ 34.6 million and an ERR of 57.0 percent, thus twice the amounts in the base case. Meanwhile, on the other hand, the multiple value can go as low as 6 before the NPV becomes negative.

An evaluation was done on the *Finance component*, testing how changes in the assumed rate of turnover of the firms financed would affect the economic results (using the evaluation of three year lag as above). The base case assumes that, in the firms, turnover could be twice per project's life of four years, with output increasing at the level of financing. Thus, by reducing the assumed level of turnover from two times per four years to one, the sub-component resulted into a negative NPV. The break even point was 1.7 times turnover per project's life of four years. This suggests that the downside risk in these terms is relatively significant. On the other hand, the degree to

which output is affected depends on how much supported firms can increase production as a result of easing the financing constraint; the assumption above is a conservative one.

The evaluation of the *Capacity Building component* first examined the relationship between the level of support and the expected level of output. The base case assumed that for each US$1.00 of support, output increased by a multiple of 5 times the support, albeit two years after disbursement. Changing the ratio to 10 resulted in NPV of US$ 22.6 million with an ERR of 32.7 percent. The break-even point to reach 12 percent ERR threshold is for output to increase 4.2 times the level of support, two years after disbursement.

ANNEX 11

PROJECT PROCESSING BUDGET AND SCHEDULE

Project Schedule	Planned (At final PCD stage)	Actual
Time taken to prepare the project (months)	03/01/1998	05/18/1998
First Bank mission (pre-appraisal)	06/07/1998	06/26/1998
Appraisal mission departure	02/28/1999	03/10/1999
Negotiations	03/30/1999	08/16/1999
Planned Date of Effectiveness	07/15/1999	

Prepared by: MICTUR

Preparation assistance: PHRD Grant TF025088

Bank staff who worked on the project included:

Name	Specialty
Arnold Sowa	Private Sector
Brian Levy	Private Sector
Simon Gray	Private Sector
Marilyn S. Manalo	Operations Officer
Sherri Archondo	Operations Officer
Simon Bell	Financial Sector
Tyler Biggs	Private Sector
Omowale Crenshaw	Small Business
Mark Dorfman	Financial Sector
Lucy Fye	Economist
Anthony Hegarty	Financial Management Specialist
Paul Murgatroyd	Financial Sector
Judith Press	Export processing zones
Tomas Sales	Finance
Francesco Sarno	Principal Procurement Sepecialist
Andrew Singer	Cost-sharing grant schemes
José Sugar	Sr. Disbursement Officer
Gerald Tyler	Handicraft
Kishor Uprety	Counsel
Irene Chacon	Program Assistant
Judite Fernandes	Task Team Assistant

ANNEX 12

DOCUMENTS IN THE PROJECT FILE

A. Project Implementation Plan

B. Bank Staff Assessments

C. Other

RPED, "Review of Business Environment in Mozambique," mimeo, January 1999.

Center for Investment Promotion. Three year strategy plan, 1999-2002.

*Including electronic files.

Status of Bank Group Operations in Mozambique
Operations Portfolio

Project ID	Fiscal Year	Borrower	Purpose	Original Amount in US$ Millions IBRD	IDA	Cancel.	Undisb.	Difference Between expected and actual disbursements a/ Orig	Frm Rev'd	Last PSR Supervision Rating b/ Dev Obj	Imp Prog
Number of Closed Projects: 20											
Active Projects											
MZ-PE-1784	1990	GOVT	INDUSTRIAL ENTERPRIS	0.00	50.10	0.00	9.75	4.21	4.07	S	S
MZ-PE-1781	1992	GOVT.	AGR.SER. REHAB.	0.00	35.00	12.30	8.54	18.01	1.95	S	S
MZ-PE-1810	1993	GOM	LEG & PUB SEC. CAPAC	0.00	15.50	2.93	.94	3.91	1.23	S	S
MZ-PE-1797	1993	GOM	CAPACITY BUILDING(HU	0.00	48.60	0.00	17.31	19.02	0.00	S	S
MZ-PE-1796	1993	GOVERNMENT	RURAL REHABILITATION	0.00	20.00	0.00	4.23	4.09	0.00	S	S
MZ-PE-1811	1994	GOM	FINANCE SECTOR CAPAC	0.00	9.00	0.00	3.79	3.54	0.00	S	S
MZ-PE-1804	1994	GOVERNMENT	2ND ROAD AND COSTAL	0.00	188.00	0.00	77.74	54.53	0.00	S	S
MZ-PE-1780	1994	GOVT	GAS ENGINEERING(ENGY	0.00	30.00	0.00	9.73	9.33	0.00	S	S
MZ-PE-1792	1996	GOVT	HEALTH SEC RECOVERY	0.00	98.70	0.00	72.06	55.30	0.00	S	S
MZ-PE-39015	1998	GOVERNMENT OF MOZAMBIQUE	NATIONAL WATER I	0.00	36.00	0.00	32.80	2.81	0.00	S	S
MZ-PE-52240	1999	GOVERNMENT OF MOZAMBIQUE	NATIONAL WATER II	0.00	75.00	0.00	74.14	0.00	0.00	S	S
MZ-PE-1799	1999	REPUBLIC OF MOZAMBIQUE	AGRIC SECTOR PEP	0.00	30.00	0.00	29.04	2.01	0.00	S	S
MZ-PE-1786	1999	GOVT. OF MOZAMBIQUE	GEN.EDUC.SEC.EXP.PRO	0.00	71.00	0.00	68.38	1.38	0.00	S	S
Total				0.00	706.90	15.23	408.45	178.14	7.25		

	Active Projects	Closed Projects	Total
Total Disbursed (IBRD and IDA):	273.40	1,098.81	1,372.21
of which has been repaid:	0.00	7.96	7.96
Total now held by IBRD and IDA:	691.67	1,066.36	1,758.03
Amount sold :	0.00	0.00	0.00
Of which repaid :	0.00	0.00	0.00
Total Undisbursed :	408.45	23.53	431.98

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.
b. Following the FY94 Annual Review of Portfolio performance (ARPP), a letter based system was introduced (HS = highly Satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory): see proposed Improvements in Project and Portfolio Performance Rating Methodology (SecM94-901), August 23, 1994.

Note:
Disbursement data is updated at the end of the first week of the month.

ANNEX 14

Mozambique
STATEMENT OF IFC's
Committed and Disbursed Portfolio
As of 31-Jul-99
(In US Dollar Millions)

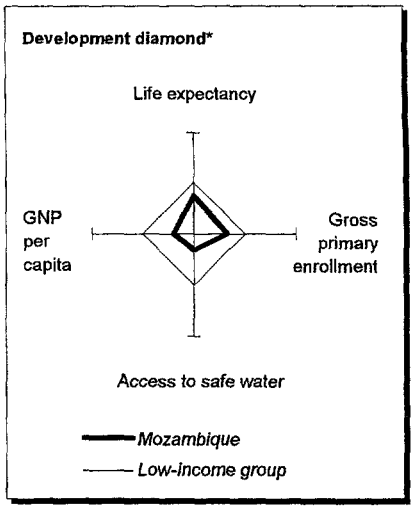
		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1992	Polana Hotel	1.58	0.00	0.00	0.00	1.58	0.00	0.00	0.00
1995	AEF Bonar	.26	0.00	0.00	0.00	.26	0.00	0.00	0.00
1996	AEF Cahora Bassa	.21	0.00	0.00	0.00	.21	0.00	0.00	0.00
1996	BIM	0.00	5.00	0.00	0.00	0.00	5.00	0.00	0.00
1996	Caju Mocita	2.57	0.00	0.00	0.00	2.57	0.00	0.00	0.00
1997	Agrimo	2.00	0.00	0.00	0.00	2.00	0.00	0.00	0.00
1997	MOZAL	55.00	0.00	65.00	0.00	7.50	0.00	32.50	0.00
1997	SEF CPZ	1.00	0.00	0.00	0.00	1.00	0.00	0.00	0.00
1997	SEF CTOX	.73	0.00	0.00	0.00	.73	0.00	0.00	0.00
1998	BIM-INV	0.00	.30	0.00	0.00	0.00	.30	0.00	0.00
1998	SEF Joao Jamal	.24	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1999	SEF ROBEIRA	.23	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Portfolio:		63.82	5.30	65.00	0.00	15.85	5.30	32.50	0.00

		Approvals Pending Commitment			
		Loan	Equity	Quasi	Partic
1997	AEF AFRISTEM	.57	0.00	0.00	0.00
1996	BIM	10.00	0.00	0.00	0.00
1999	MARAGRA SUGAR	10.30	0.00	0.00	0.00
1999	SEF CTN	.67	0.00	0.00	0.00
1999	SEF EXTRAMAC	.42	0.00	0.00	0.00
Total Pending Commitment:		21.96	0.00	0.00	0.00

Mozambique at a glance

9/22/99

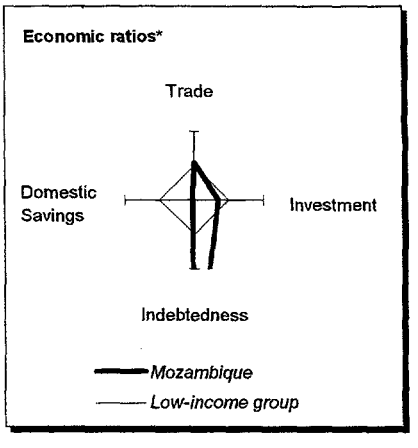
POVERTY and SOCIAL	Mozambique	Sub-Saharan Africa	Low-income
1998			
Population, mid-year *(millions)*	16.9	628	3,515
GNP per capita *(Atlas method, US$)*	210	480	520
GNP *(Atlas method, US$ billions)*	3.6	304	1,844
Average annual growth, 1992-98			
Population *(%)*	2.4	2.6	1.7
Labor force *(%)*	2.1	2.6	1.9
Most recent estimate (latest year available, 1992-98)			
Poverty *(% of population below national poverty line)*	69	..	..
Urban population *(% of total population)*	38	33	31
Life expectancy at birth *(years)*	47	51	63
Infant mortality *(per 1,000 live births)*	134	91	69
Child malnutrition *(% of children under 5)*	41	..	..
Access to safe water *(% of population)*	24	47	74
Illiteracy *(% of population age 15+)*	60	42	32
Gross primary enrollment *(% of school-age population)*	71	77	108
Male	79	84	113
Female	60	69	103



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

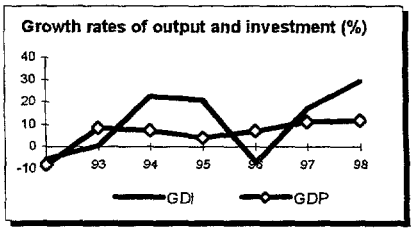
	1977	1987	1997	1998
GDP *(US$ billions)*	..	2.4	3.4	3.9
Gross domestic investment/GDP	..	12.0	19.1	20.4
Exports of goods and services/GDP	..	6.6	12.7	11.7
Gross domestic savings/GDP	..	-12.7	1.6	1.7
Gross national savings/GDP	..	-10.1	1.6	0.8
Current account balance/GDP	..	-19.6	-12.5	-15.9
Interest payments paid/GDP /a	..	0.6	1.5	1.5
Total debt/GDP /a	..	171.8	216.4	214.3
Total debt service/exports /a	..	18.1	20.9	27.4
Present value of debt/GDP /b	..	..	128.3	91.0
Present value of debt/exports /b	..	..	770.4	699.2

	1977-87	1988-98	1997	1998	1999-03
(average annual growth)					
GDP	-3.9	4.7	11.3	12.0	7.7
GNP per capita	-7.0	2.7	9.7	9.3	5.3
Exports of goods and services	-14.0	15.8	-1.9	6.5	23.4

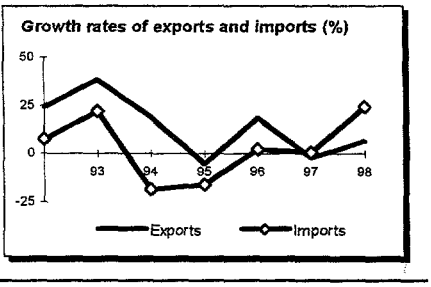


STRUCTURE of the ECONOMY

	1977	1987	1997	1998
(% of GDP)				
Agriculture	..	44.1	34.8	34.3
Industry	..	21.4	19.1	20.8
Manufacturing	..	..	11.3	10.5
Services	..	34.4	46.1	44.8
Private consumption	..	102.9	90.9	89.0
General government consumption	..	9.9	7.4	9.3
Imports of goods and services	..	31.4	30.2	30.5



	1977-87	1988-98	1997	1998
(average annual growth)				
Agriculture	..	3.1	7.6	7.0
Industry	..	5.3	23.9	22.9
Manufacturing	..	..	29.8	7.5
Services	..	5.7	7.1	9.7
Private consumption	-5.0	2.4	8.3	11.8
General government consumption	-4.8	-5.7	9.9	32.2
Gross domestic investment	0.5	7.4	17.1	29.4
Imports of goods and services	-6.7	0.1	0.7	24.2
Gross national product	-4.8	4.8	12.2	11.8

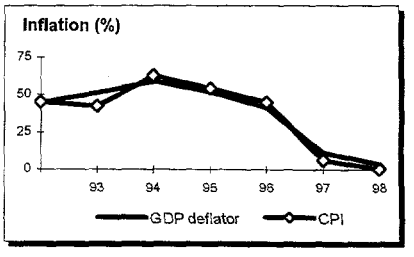


Note: 1998 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

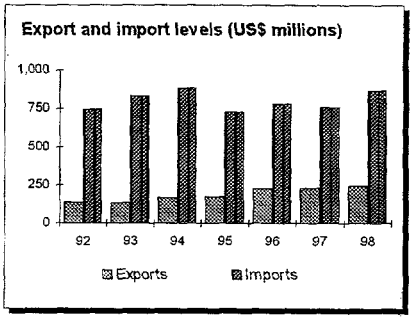
PRICES and GOVERNMENT FINANCE

	1977	1987	1997	1998
Domestic prices				
(% change)				
Consumer prices	..	164.1	6.4	0.6
Implicit GDP deflator	..	181.5	11.1	3.8
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	11.4	16.0	15.7
Current budget balance	..	-1.9	5.3	4.3
Overall surplus/deficit	..	-11.8	-7.5	-6.5



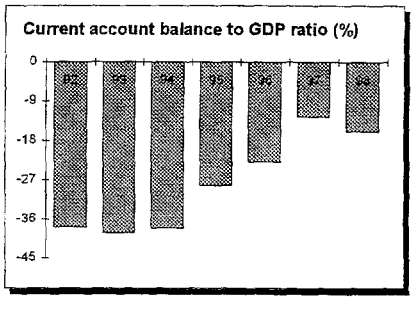
TRADE

	1977	1987	1997	1998
(US$ millions)				
Total exports (fob)	..	97	230	248
Cashews	48	31	29	41
Prawns	11	38	85	73
Manufactures	..	0	20	14
Total imports (cif)	..	642	760	868
Food	..	..	30	32
Fuel and energy	..	..	78	84
Capital goods	..	..	154	211
Export price index *(1995=100)*	..	104	99	95
Import price index *(1995=100)*	..	74	91	88
Terms of trade *(1995=100)*	..	140	108	108



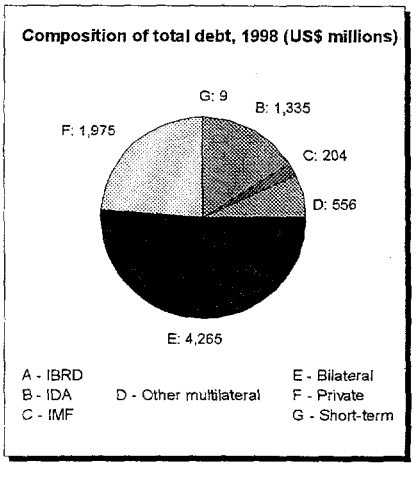
BALANCE of PAYMENTS

	1977	1987	1997	1998
(US$ millions)				
Exports of goods and services	..	176	509	534
Imports of goods and services	..	699	938	1,115
Resource balance	..	-523	-429	-581
Net income	..	-170	-183	-218
Net current transfers	..	233	181	179
Current account balance	..	-460	-431	-619
Financing items (net)	..	519	546	681
Changes in net reserves	..	-58	-115	-62
Memo:				
Reserves including gold *(US$ millions)*	..	139	532	571
Conversion rate *(DEC, local/US$)*	33.0	290.7	11,545.6	11,850.3

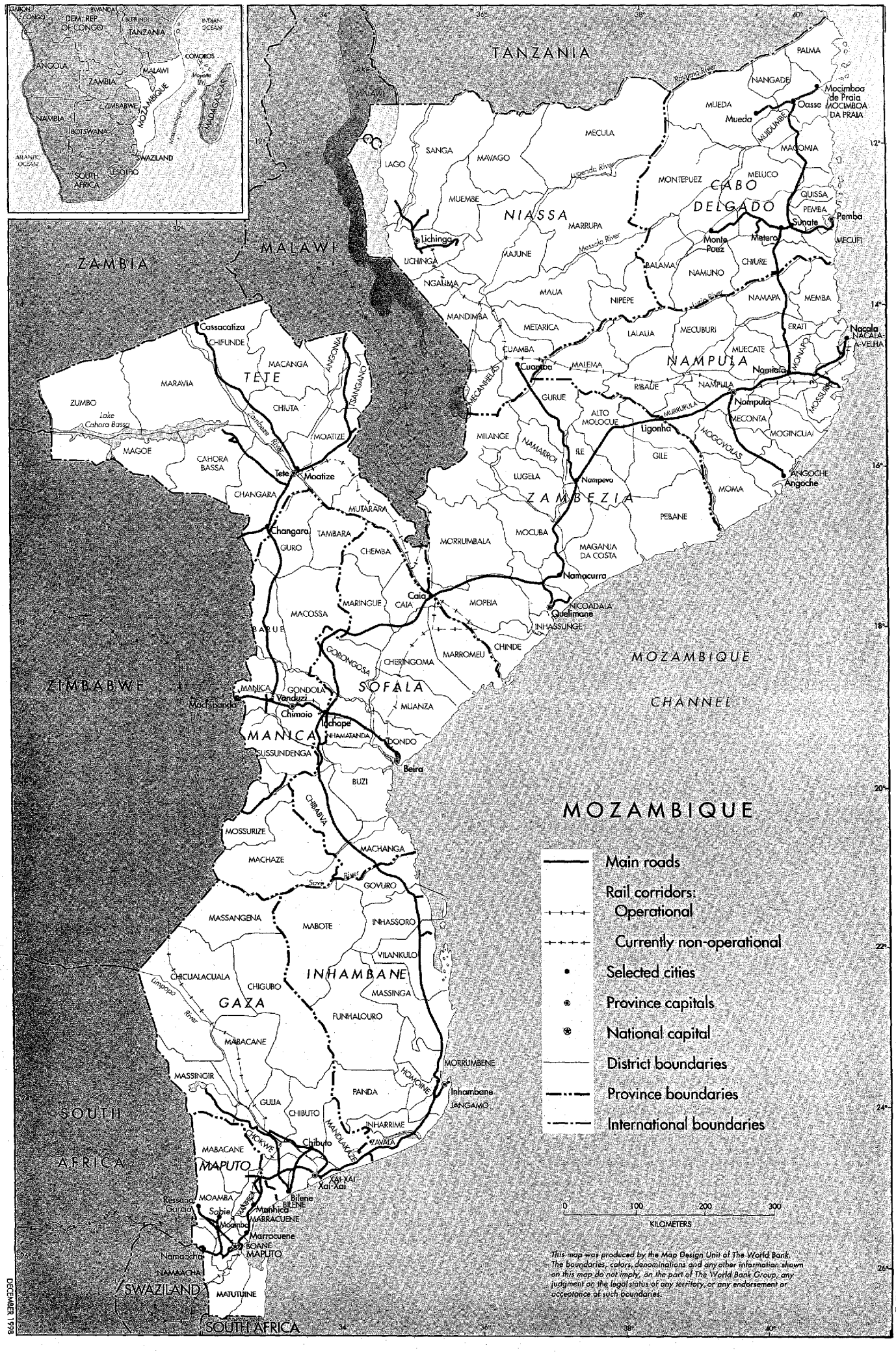


EXTERNAL DEBT and RESOURCE FLOWS

	1977	1987	1997	1998
(US$ millions)				
Total debt outstanding and disbursed /a	..	4,043	7,439	8,344
IBRD	..	0	0	0
IDA	..	87	1,162	1,335
Total debt service paid /a	..	42	119	159
IBRD	..	0	0	0
IDA	..	4	10	12
Composition of net resource flows				
Official grants	..	304	313	313
Official creditors /c	..	261	285	295
Private creditors	..	46	69	43
Foreign direct investment	..	6	64	213
Portfolio equity	..	..	..	..
World Bank program				
Commitments /d	..	111	100	36
Disbursements	..	48	148	131
Principal repayments	..	4	2	3
Net flows	..	45	147	128
Interest payments	..	0	8	9
Net transfers	..	44	139	119



a. After rescheduling in Naples terms. b. Excluding private debt. c. Excluding IMF and including debt relief on current payments.
d. Includes the US$ 150 million grant under the Economic Management Reform Operation provided as HIPC Initiative interim assistance.



DECEMBER 1998

IBRD 29996