Association of Microfinance Institutions in Timor-Leste

Financial Services Sector Assessment in Timor-Leste

and

Seminar/Workshop on "The Millennium Development Goals and The Eradication of Poverty – The Role of Microfinance in Timor-Leste"

FINAL REPORT

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Annexes

List of Acronyms and Abbreviations

AAP	Annual Action Plans
ACCU	Asian Credit Cooperative Union
ADB	Asian Development Bank
AMFITIL	Association of Microfinance Institutions of Timor-Leste
ASCs	Agriculture Service Centers
AusAid	Australian Agency for International Development
BDCs	Business Development Centers
BDS	Business Development Services
BPA	Banking and Payments Authority
BRI	Bank Rakyat Indonesia
CBOs	Cooperativa Baunila Organic (Primary Organic Vanilla Cooperative)
CCF	Christian Children's Fund
CCO	Cooperativa Café Organic (Primary Organic Coffee Cooperative)
CCT	Cooperativa Cafe Timor (Secondary Organic Coffee Cooperative)
CGAP	Consultative Group for Assistance to the Poorest
CGD	Caixa Geral de Depositos (formerly BNU)
CIDA	Canadian International Development Agency
CIIR	Catholic Institute for International Relations (Canada)
CRS	Catholic Relief Services
CUF	Credit Union Federation – also referred to as FHM
DAI	Development Associates Inc.
FHM	Fundasaun Hanai Malu (Union of Savings and Credit Cooperatives)
FONGTIL	Forum of NGOs in Timor-Leste
FPRET	Foundation for Poverty Reduction in East Timor (owner of IMfTL)
FSS	Financial Self-sufficiency ratio
GDP	Gross Domestic Product
GoTL	Government of Timor-Leste
GtZ	Gesellschaft für Technische Zusammenarbeit (Germany)
IMfTL	Instituicao de Microfinancas de Timor-Leste
INGO	International Non Governmental Organization
MBB MIX	Micro Banking Bulletin Market Information Exchange
MDE	Ministry of Development and Environment
MDG(s)	Millennium Development Goal(s)
MF	Microfinance
MFI	Microfinance Institution
MIS	Management Information System
MPF	Ministry of Planning and Finance
MR	Moris Rasik (microfinance institution)
MSME	Micro, Small, and Medium-scale Enterprises
NCBA	National Cooperative Business Association (USA)
NDP	National Development Plan
NGO	Non-Government Organization
OI	Opportunity International
OSS	Operational Self-sufficiency ratio
OTL	Oportunidade Timor Lorosa'e (microfinance institution)
PaR	Portfolio at Risk
PMT	Performance Monitoring Tool
SACCO	Savings and Credit Co-operative
SEP	Small Enterprises Project
SHG	Self Help Group
SIP	Sector Investment Program(s)
SME	Small and Medium-scale Enterprise
SoW	Scope of Work
TA	Technical Assistance/Assistant
TFET	Trust Fund for East Timor
TL	Timor-Leste
TLSS	Timor Living Standards Survey 2001
TRM	Tuba Rai Metin (microfinance institution)
TSP	Transitional Support Program
UNDP	United Nations Development Programme
UNMISET	United Nations Mission of Support for East Timor
UNOPS	United Nations Office for Project Services
UNTAET	United Nations Transitional Administration for East Timor
USAID	United States Agency for International Development
WB	World Bank

1. Executive Summary

Timor-Leste ranks 158 out of 177 in the UN Human Development Index (2004) as the poorest country in Asia. The GDP per capita is estimated at USD 434 in 2004. Some 40% of the population of 925,000 people lives on 1.5 dollars a day, 80% of them surviving on subsistence agriculture in the rural areas.

Since Independence in 2002, the Government of Timor-Leste has made good progress in downsizing the public sector and reducing the national budget financing gap to within available sources of funds. A comprehensive planning system guides the allocation of resources to priority sectors. During the past years, a series of laws have been promulgated to provide a more enabling environment for the private sector, which is promoted as the engine for economic growth and poverty reduction.

The estimated maximum market for financial services in Timor-Leste is small by international standards at 434,575 people. This market includes an estimated 275,300 economically active poor people (between 15-64 years of age), who can benefit from microfinance services. The estimated minimum market is thus comprised of 58,575 households, of which 46,860 reside in rural areas.

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

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

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

The quality of the portfolio deteriorates with the level of specialization from a Portfolio at Risk (30) of approximately 4% for commercial banks to 8.6% for MFIs, 22% for cooperatives and 35% for NGOs. Of all the providers, only two banks and one cooperative are profitable in 2004, but progress towards coverage of costs has increased to just below 50% among the MFIs since the end of 2003.

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

Significant progress has been accomplished over the past 1-2 years in terms of growth, performance improvements and outreach to the poorer segments of society, but the financial service sector still faces a number of internal and external constraints. While it may take longer to reach sustainability in Timor-Leste than in more well-endowed markets, these constraints are not insurmountable.

Excellent progress has been made with the establishment of AMFITIL as a platform for increased coordination, information sharing and visibility of the young microfinance industry. AMFITIL members have signed what is possibly the most detailed and stringent good-practice based Code of Conduct in the world of microfinance today, and a performance monitoring system is in place for quality assurance and self-regulation.

There are many challenges ahead and there is ample scope for improvement, and above all for expansion. The key to attaining sustainability for the suppliers is growth and retention of customers and asset quality. In the process, some consolidation through mergers and divestiture of less successful portfolios to stronger institutions should be expected and indeed encouraged.

To directly address the key constraints faced by the financial service providers, the development of a more vibrant financial service sector increasing its outreach to a larger segment of the East Timorese population could be supported in three ways:

- Institutional support for performance-based capacity building.
- Guarantees for commercial bank loans.
- Support for industry development among providers.

In this small market where information sharing and coordination is perplexingly limited, AMFITIL could potentially become a representative platform for all financial service providers. To fulfill its potential, the Association is in urgent need of full formalization through the development of bylaws, procedures and a business plan, election of a representative Board of Directors, and the establishment of a staffed secretariat.

Given the limited cash economy and level of rural market development, it is however, doubtful that the financial service providers can attain the required growth in isolation. Just like conventional banks cannot increase lending without bankable proposals, MFIs, cooperatives and NGOs cannot – or should not – lend to households that cannot earn sufficient income from their businesses to repay the loans and make a profit. Similarly, there is little reason for rural households to indebt themselves, if for example, they can acquire farm inputs for free. Access to financial services may be expected to contribute most effectively to poverty reduction when provided alongside – but not integrated with – basic social services, and in particular efforts to develop local markets. It seems timely for providers of financial and non-financial services to develop stronger strategic linkages, while specializing in providing the services they do best, based on a customer-focused, coordinated and business-oriented approach.

There are imminent opportunities to increase linkage banking and general coordination and collaboration within the financial service sector, as well as with other stakeholders in GoTL and among the donor agencies to develop a common and business-oriented approach to improve, adapt and expand the financial services to reach the under-served markets of poor households and micro-, small and medium-scale entrepreneurs (MSMEs), especially in the rural areas of Timor-Leste. Indeed, the coalescing of all development stakeholders around a more commercially oriented market development approach may well be a precondition for success in this small market.

Promotion and adherence to a market development approach would facilitate the ability of the self-employed to generate income and curb the level of distortion caused by subsidies and supply-led interventions. If the market for local products increases, the need for improving local productivity and hence the demand for business services, including finance, would also increase, thereby providing opportunities for financial service providers to grow and to support the increase and diversification of household incomes thus contributing to poverty reduction and economic growth.

2. Background and Introduction

The financial services sector in Timor-Leste has never been large, and even before the struggle for Independence in 1999, only 50% of the population had ever borrowed from any source. The total assets of the East Timorese banking sector as at June 2004 amounted to USD 135.6 million, but this represents an impressive growth of 97.8% since June 2003[1].

Before September 1999, the financial sector in Timor-Leste comprised 18 bank branches; 15 governmental and 3 private Indonesian banks, among them Bank Rakyat Indonesia (BRI) which operated 12 village bank units across the country. While deposits in this formal banking system in March 1999 reached USD 68.4 million, lending totaled only USD 18.2 million. Surveys suggest that only 11% of the population had ever borrowed from a bank. All the banks closed and repatriated their records, equipment and vehicles in the wake of the 1999 conflict. In the aftermath of the struggle, two foreign banks established offices in Dili providing primarily payments and forex services, but no lending for the domestic, rural market. In August 2003, the first Indonesian bank re-entered the market.

During the 1990s as elsewhere in Indonesia, credit unions were promoted as vehicles for government service delivery, and were heavily subsidized. The first credit cooperative was formed in 1990. In 1994, a Credit Union Federation (CUF) was formed, which had 27 member cooperatives in 1999 serving some 13% of the population according to surveys. While 17 remained members of CUF, only 4 credit cooperatives continued to operate after 1999. Today, only 3 of the 44 registered credit cooperatives have more than the 250 members generally thought to be the minimum for viable operations, and CUF has ceased to function as an effective apex organization.

Some 20% of the population relied on informal money lenders for their financial needs up to 1999, paying up to 20% per day in interest. Due to their losses, most money lenders stopped operating following the conflict (only 5% of a sample survey in 2001 reported to be accessing informal credit from money lenders), and today, money lenders seem to have all but disappeared from the financial scene in Timor-Leste.

UNTAET and donors recognized the market failure in the financial sector as justification for the use of public sector funds to finance private sector (banking) activity. Thus, donor funds from the Trust Fund for East Timor (TFET) were allocated to Caixa Geral de Depositos (CGD) for on-lending to small and medium-scale enterprises (SMEs) under the World Bank-managed Small Enterprises Project (SEP) in April 2000. The World Bank-managed Community Empowerment Project (CEP) commenced lending through local government structures to groups of rural micro entrepreneurs in 2001. Both projects lent at subsidized interest rates and encountered significant loss of capital through lack of repayments. Starting in December 2000, the ADB-managed Microfinance Development Project also funded by TFET focused on establishing the legal and operational basis for a specialized microfinance institution (MFI), the Instituicau the Microfinancas de Timor-Leste (IMfTL), which began lending to the rural poor in early 2002[2]. In addition, several bilateral donor agencies have funded small, localized micro credit projects implemented by national NGOs.

Simultaneously, several INGOs added micro credit or microfinance activities to their relief and humanitarian programs in Timor-Leste, providing capital and technical assistance to national NGOs for the provision of financial services. Eleven providers, including IMfTL, formed an informal Microfinance Working Group in 2003, which in 2004 was renamed to the Association of Microfinance Institutions in Timor-Leste (AMFITIL). In April 2004, AMFITIL members developed and signed a comprehensive Code of Conduct guiding their microfinance operations, and agreed to report quarterly on their outreach and portfolio performance to a central database, most members adhering fully to internationally recognized Good Microfinance Practices.

[1] Banking and Payments Authority (BPA) Annual Report 2003/04.
[2] Data from ADB: Timor-Leste 8th Progress Report, April 2004.

AMFITIL has not yet been formalized with a permanent secretariat, and members have taken turns filling the posts of President and hosting the secretariat on a voluntary basis. The strain on members trying to accomplish the arduous tasks of industry-building, public information dissemination and coordination in addition to the institutional development of their small and young MFIs is beginning to show. Not all AMFITIL members have performed equally well over the past years, mostly due to a lack of technical expertise, exposure and financial management skills. Equally, AMFITIL members have not had sufficient extra time for public information dissemination, and hence the existence and achievements of the Association are not as well- and widely known as could be hoped.

The level of coordination and common approaches to development among the many stakeholders of the Government of Timor-Leste (GoTL), donor agencies, NGOs and banks is perplexingly low for the small country. Several microfinance service providers, credit unions, commercial banks and NGOs have been providing financial services in Timor-Leste since Independence, but the range of products available, to whom and on which conditions, has not yet been comprehensively assessed. It was felt that such an assessment could provide the basis for a more coordinated approach to further support the financial services sector, and inform GoTL as well as potential donors of the gaps and constraints facing in particular the microfinance industry at present.

A window of opportunity for increased public awareness on the microfinance industry in Timor-Leste arose with the workshop on "Millennium Development Goals and the Eradication of Poverty – the Role of Micro Credit and Microfinance in Timor-Leste" co-organized by the Peace and Democracy Foundation and AMFITIL during December 8-9, 2004 to coincide with the visit to Timor-Leste of the founder and General Manager of the Grameen Bank in Bangladesh, Professor M. Yunus (see also Annex 7).

On behalf of the Association for Microfinance Institutions of Timor-Leste (AMFITIL), Catholic Relief Services (CRS), which currently holds the AMFITIL secretariat, thus applied to UNDP and USAID through its Small Grants Program managed by DAI to fund a financial services sector assessment in December 2004 to review:

- The access to and supply of financial services
- The stage of maturity of the microfinance sector, and
- The policy and legal framework governing financial services

The assessment was conducted during November 28 – December 20, 2004 by two independent consultants. Throughout the assignment, the Consultants were fortunate to meet with committed professionals, who shared their insights and assessments of the current situation and constraints, and took time from a busy schedule to attend meetings and provide information and feedback. The Consultants would like to extend their sincere appreciation for all the time and effort that was put into the assignment by all persons met and interviewed.

3. Approach and Methodology

The assignment consisted of two main components: an assessment of the financial services sector in Timor-Leste and assistance to AMFITIL to prepare and present the achievements of the microfinance industry in a multi-donor funded Seminar and Workshop on "Millennium Development Goals and The Eradication of Poverty" held during December 8-9, 2004 with Professor M. Yunus of Grameen Bank in Bangladesh as the key speaker and Guest of Honour (see Scope of Work for the assignment in Annex 1).

The Financial Services Sector Assessment utilized a financial systems approach, involving an assessment of the characteristics of the client market and the structure of demand for financial services; of the existing providers of financial services; of the financial and non-financial infrastructure for these retailers (such as training, TA, audit and fund provision); and of the enabling environment at macro-level, including policies, legislation and regulation pertaining to or affecting the finance sector.

A review of existing publications, reports and other materials was conducted to gain an overall understanding of the sector. The Team reviewed the laws related to finance, including the Banking Law, the Law on Commercial Societies and the Law on Cooperatives. Several policy papers and reports, including the National Development Plan (NDP) and annual reports from the BPA, WB, UNDP and ADB were also reviewed. At the level of the retail suppliers, the Team reviewed the annual reports, audited and current financial statements, market surveys, evaluations and impact assessments. Additional information on the finance market and its customers was obtained from impact research studies, donor-funded project reports, documents published by AMFITIL members and independent consultants.

Following structured interview guides developed by the Team, key stakeholders in the Ministry of Development and Environment, the Ministry of Planning and Finance, the BPA and donor agencies were interviewed. In addition, the Team met with management, staff and clients where possible, of commercial banks (ANZ, CGD and Bank Mandiri), the regulated non-bank financial institution IMfTL, the member MFIs and multi-purpose NGOs of AMFITIL, secondary and primary cooperatives, as well as projects of donors, international and national NGOs providing financial services, and compiled data on outreach and performance using detailed assessment questionnaires. The Team met with officials from UNDP and the USAID/DAI Small Grants program funding the assignment, and interacted regularly with the leadership and secretariat of AMFITIL. The work schedule of the Team is enclosed in Annex 2 and a detailed list of individuals met and interviewed is presented in Annex 3.

In response to the SoW, the Team assisted AMFITIL in preparing a presentation for the workshop held on 8 December including a Map of AMFITIL members' Outreach in Timor-Leste. In addition, the Team developed a presentation for the Seminar on 9 December in English and Bahasa Indonesia on the role of microfinance in poverty alleviation, the financial systems approach to inclusive financial services, and the status and experiences of microfinance in Timor-Leste as compared to Asian averages (see Annex 7). This presentation was developed based on an analysis of the quarterly performance monitoring data collected by the AMFITIL secretariat, so that progress since the commencement of performance monitoring in December 2003 was documented. The presentations were reviewed and revised in a meeting with AMFITIL members prior to the Workshop and Seminar.

During a brief meeting on December 20, AMFITIL members were offered an opportunity to discuss in more detail the performance monitoring system and the compilation of data using the Performance Monitoring Tool introduced by the Team in an assignment in April 2004, before the Consultants presented their key findings at a public meeting on 20 December in Dili.

A draft report was submitted to CRS on December 27 and circulated to all stakeholders in and around the financial services sector for review and comments. All comments received by 5 January 2005 have been incorporated into this Final Report.

This Report is divided into seven sections. Sections one through three present the executive summary, background, and methodology. Section four presents the political, economic, legislative and regulatory environment in Timor-Leste related to poverty and economic development, as well as findings related to the support infrastructure for the financial sector, and the donor community funding private sector development and financial service provision. Section five covers the findings of the Team related to clients and the market, while section six presents the findings with regard to current supply of financial services, including providers, outreach, performance, and key constraints. Section seven provides a series of opportunities to address the constraints identified for the financial services providers, government and donor agencies. Maps of the location and provisional outreach of key providers are provided in Annex 5, while Annex 6 presents an inventory of their products and services and the requirements for access.

This final report presents the findings and recommendations of the Consultants. The views and recommendations expressed in this report are those of the Consultants, and do not necessarily represent the views of Timor-Leste's financial sector stakeholders, nor of UNDP or USAID/DAI.

4. The Setting for Financial Services in Timor-Leste

4.1 Country Profile

Timor-Leste gained independence in 2002 after a prolonged conflict, which left a substantial part of the social and physical infrastructure of the country severely damaged. In the latest UN Human Development Index (2004), which combines measures of life expectancy, literacy and income to reflect human development, the country ranked 158 out of 177 countries, and as the poorest country in Asia[3]. The population of Timor-Leste is only 925,000 people, with approximately 50% below the age of 15 years.

The Government of Timor-Leste (GoTL) has made good progress over the past years in downsizing the public sector, reducing the medium-term financing gap by increasing domestic revenue and constraining expenditure growth, and building the key elements of a democratic political system, although many institutions are embryonic and the legal framework to facilitate private sector growth is still incomplete. The National Development Plan (NDP) lays out a 20-year vision and a five-year strategy with two key objectives: the promotion of rapid, equitable and sustainable economic growth and the reduction of poverty, and acknowledges the private sector as a key engine for growth. Timor-Leste, however, faces a multitude of challenges in achieving the objectives set out in the NDP.

After four years of transition, the economy of Timor-Leste remains a mixture of public and private activity. National accounts data suggest that private activities probably account for two thirds of non-oil GDP. Almost half of the private sector output is related to agriculture, a significant part of which is subsistence production for home consumption. Hotels, restaurants, transport and financial services account for another 25% of value added, with the balance made up by private construction and a small mining industry that supplies the construction sector[4]. As most consumable products are imported, the national trade deficit in 2003 was around 50% of GDP, with exports totaling USD 7 million against the total imports of USD 174 million[5].

Economic growth has slowed, with an estimated GDP per capita in 2003 of USD 430, down from USD 478 in 2002 as an expected consequence of the winding down of the UNMISET presence. In 2004, real GDP is expected to increase modestly by 1%, while inflation – the variation in prices in the basket of goods included in the Consumer Price Index established in 2003 – has decreased dramatically from 8.2% in 2002-03 to an estimated 3% in 2004[6]. Currently, around forty percent of the population is living at or below the national poverty line[7] of USD 1.5 per day in international dollars, adjusted using the Purchasing Power Parity[8].

The urban centers of Dili and Baucau are impacted most by the economic downturn as it has primarily affected the services and construction sectors. The challenge to creating sustainable jobs is compounded by a high unemployment rate estimated at 20%, rising to 43% among urban male youth; a high percentage of youth[9]; and a relatively low level of literacy, education and skill among the population[10].

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[3] UNDP: Country Fact Sheet, Human Development Report 2004 (http://hdr.undp.org)
[4] Ministry of Planning and Finance: Overview of the Sector Investment Programs, 1st Draft, August 2004.
[5] World Bank: Background paper for Timor-Leste and Development Partners Meeting, May 2004.
[6] Ibid.
[7] The minimum expenditure needed to purchase a food and non-food basket providing 2100 calories per person per day and an allowance for clothing and housing. The expenditure was adjusted for price differences between 5 regions of the country.
[8] The national poverty line of Timor-Leste was established in 2001 as the often quoted $0.51 per day or $ 15.44 per person per month, but using the accepted alternative calibration of the price per calorie to derive the Purchasing Power Parity adjusted exchange rates allowing for comparison across boarders, the line is actually $1.50. Timor-Leste Poverty in a New Nation: Analysis for Action, May 2003.
[9] UNICEF estimates that 66% of the population is below 25 years of age.
[10] 46% of the population older than 11 years has never attended school.

Eighty percent of households live in rural areas, the vast majority surviving on subsistence farming and trade. Informal micro- and small enterprises make up some 80-85% of the private sector, and studies estimate that 50-70% of GDP is produced in the informal economy[11]. With lower literacy rates and less access to formal sector jobs, women dominate the micro enterprise segment of the informal economy. The rapid population growth estimated at 3% per year combined with limited access to health care services, however, result in very high maternal and child morbidity and mortality rates, affecting the ability of women to contribute to income generation for the household. Subsistence farming is focused chiefly on the production of two basic food crops – rice and maize. Agricultural productivity is low, as it is primarily rain-fed, with little use and limited supply of improved inputs. The rural poor in particular are vulnerable to periodic food insecurity due to natural calamities. Beyond subsistence farming, a few higher-value products are being processed, in particular coffee, but also coconut, candlenut, fruits, and vegetables. In the service sector, there is active trade of basic commodities – both food and cash crops – in the districts and larger urban markets. A small number of medium-sized enterprises provide small-scale food processing, land preparation and local equipment repair and servicing.

At present, the value chain in Timor-Leste is relatively flat, with limited activity and/or presence of traders, processors, distributors and producers. The dramatic differences in microclimates, culture and language among the 13 districts of the country also affect the productive sectors, limiting the flow of information and collaboration in supply chains.

Expanding opportunities for – and the productivity of – the micro-, small and medium scale enterprises (MSMEs) is crucial to stimulating economic growth, both in the rural and urban areas. Appropriate market mechanisms, infrastructure and institutions need to be established to allow the private sector to depend less on donor funding and more on alternative income generating activities that are commercially viable. The challenge is to incrementally shift Timor-Leste's nascent private sector from its current subsistence farming and income generating activities to a more commercially-oriented and self-reliant, market-based economy. Among the many constraints faced by MSMEs, financing is usually given high priority, and appropriate, affordable and high-quality *financial* services are indeed an important part of the bouquet of services needed by MSMEs.

With the high level of poverty and with informal micro enterprises dominating the economy, microfinance has a particularly important role to play as part of an inclusive financial system availing market-responsive, effective and sustainable financial services to bolster the nascent private sector, and offering poor households a means to grow their micro businesses.

4.2 National Policies for Poverty Alleviation & Economic Development

4.2.1 The MDGs

In September 2000 the member states of the United Nations issued the Millennium Declaration committing themselves to eight goals and a series of sub-targets for broader and more inclusive human development, known as the Millennium Development Goals (MDGs) most of which are to be achieved by 2015. Each country is responsible for setting appropriate targets to attain the goals and for reporting on the progress towards achieving the goals.

Text Box 1: The MDGs

The Millennium Development Goals:

Goal 1	Eradicate extreme poverty and hunger
Goal 2	Achieve universal primary education
Goal 3	Promote gender equality and empower women
Goal 4	Reduce child mortality
Goal 5	Improve maternal health
Goal 6	Combat HIV/AIDS, malaria and other diseases
Goal 7	Ensure environmental sustainability
Goal 8	Develop a global partnership for development

Based on a comprehensive Poverty Assessment Project 2001-02, the Government of Timor-Leste launched its National Development Plan and the first National Human Development Report in

[11] UNDP & International Labour Organisation: "A Study of the Potential Contribution of the Micro and Small Enterprises (Informal) Sector to the Economic Development of Timor Loro Sa'e" by William J. House.

2002. The National Development Plan internalizes most of the MDGs in its overall and sectoral objectives. During 2003, the process of preparing a second National Human Development Report was commenced with a view to adapt the MDGs to the situation of Timor-Leste, evolving realistic targets and formulating strategies for their attainment.

4.2.2 The NDP and its Implementation

The National Development Plan 2002-2007 of the GoTL presents a comprehensive vision for 2020; identifies the key constraints to development, and establishes a phased development strategy of nation building and poverty reduction. The Poverty Reduction Strategy focuses on economic growth generated through the skills and efforts of the people as facilitated by the GoTL through:

- Productivity improvements in the agricultural sector;
- Increasing opportunities and productivity in the non-farm informal sector of which micro enterprises make up a substantial part, including support services such as the supply of micro credit;
- Enhancing the policy environment and attracting investments for the formal private sector to achieve growth and employment opportunities;
- Providing infrastructure; and
- Implementing pro-poor macro economic and public expenditure policies[12].

To facilitate the planning and monitoring of progress towards the NDP, the GoTL has developed a Roadmap for the Implementation of the National Development Plan, which includes Stability Priorities (Feb 2003) structured around governance; employment creation in the private sector and agriculture; and service delivery for poverty reduction (primarily health and education).

Annual Action Plans (AAPs) are developed for each fiscal year, and progress is monitored through a Quarterly Reporting Matrix. The most urgent actions in the AAPs are collected in the planning matrix for the (currently Third) Transition Support Program (TSP) constituting the basis for the budget and balance of payment support provided by grants and technical assistance from 18 donor agencies[13].

With a view to refining the Roadmap and improving budgeting, GoTL is finalizing 15 Sector investment Programs (SIPs). Most of the draft SIPs have been tabled in the Council of Ministers, and are expected to be published by March 2005. The SIPs are reviewed in Sector Working Groups for the key economic sectors, which also negotiate budget allocations with donors. One of the SIPs outlines the GoTL strategy for support to Private Sector Development, including financial services, whereas another deals with Agriculture, Forestry and Fisheries.

4.2.3 Policies and Legislation for an Enabling Private Sector Environment

The central role of the private sector in national development is enshrined in the Constitution of Timor-Leste, which requires that the economy be based on market principles. The role of private activity as the engine of growth is also underscored in the National Development Plan and in the Road Map. In early 2004, GoTL adopted a private investment policy which brought greater focus and clarity to the operational economic leadership role expected of the private sector, both domestic and foreign, and spelled out the primarily enabling and regulatory role of GoTL.

The Government has embarked on a major effort to improve the enabling environment for domestic and international private investment in Timor-Leste. Chief among the pieces of legislation passed which support private sector development are the Land and Property Law, the Commercial Companies Law, the notary decree-law and the fisheries decree-law. A number of similar key laws

[12] GoTL: The National Development Plan, 2002.
[13] World Bank: Background Paper for the Timor-Leste and Development Partners Meeting, May 2004.

and decree-laws are in advanced stages of public consultation, including domestic and external investment laws, an insurance law, land and property lease decree-laws, and a bankruptcy decree-law. Many other key pieces of legislation are anticipated to help buttress private sector development, including an association law, a chamber of commerce law, an export promotion law, environment decree-laws, laws on intellectual property and competition, an accounting systems decree-law, and a social security law. A legislative framework on Cooperatives was also drafted in 2004.

The Private Sector Development Sector Investment Program (PSD SIP) sets out a detailed program aimed at creating a more conducive environment for the development of the private sector in Timor-Leste. It proposes measures to increase the level of domestic and foreign private investment, grouped into three broad categories. First is a series of activities aimed specifically at improving the enabling environment for the private sector by addressing current deficiencies. These include:

- Land and property regulatory development;
- Business regulatory environment development;
- Trade and industrial policy development;
- Financial sector policy and institutional development;
- Policies for labor and employment generation;
- Capacity building for policy-making and business regulation; and
- Policy analysis of the economic operations of formal and informal enterprises.

Secondly, these initiatives are proposed to be complemented by specific programs aimed at promoting domestic business activity and attracting additional foreign direct investment, which give particular attention to the following areas of business activity:

- Further development of agri-business, including increased production of specialty crops for export and import replacement;
- Development of forestry and fisheries products for domestic and export markets;
- Private participation through tendering in infrastructure, including power and water supply;
- Development of the onshore hydrocarbon potential, minerals and tourism industries;
- Capacity building for cooperatives, especially related to agricultural production and credit; and
- Fostering demand for local services and products and strengthening and developing supply.

Thirdly, the PSD SIP proposes continued donor support to the existing microfinance institutions with a view to ensure expanded access to microfinance as a complementary effort to improve income and employment prospects, especially for rural families. New initiatives proposed by GoTL in the Private Sector Development SIP focus on the development of credit cooperatives, which is perceived as a fast growing sector in promoting credit access to the rural population, as well as the development of the informal sector, where lack of credit is perceived to constitute a major impediment to development of micro-enterprise initiatives[14]. The SIP also explores the potential of creating a financial sector framework that enables commercial banks to operate in rural areas.

The SIP for agriculture, forestry and fisheries presents a multi-pronged strategy for promoting private business in this sector, and recognizes the role of financial service provision. One of the key elements in this SIP is improved access to rural credit for farmers and rural traders with particular emphasis on support to microfinance institutions and credit cooperatives. Both institutional types are seen as well suited to reach remote rural areas, and are considered in need of strengthening.

To complement the policies aimed at improving the enabling environment for private investment activities, GoTL is pursuing a strategy that includes more direct support to the development of the private sector, including improved linkages to markets and market information, extension services

[14] GoTL: Private Sector Development - Priorities and Proposed Sector Investment Program, September 2004.

to increase production of cash and food crops, studies of growth opportunities and niche markets, training, and support for businesses and cooperatives. These more direct interventions include:

- Promotion and development (through training and demonstration) of a entrepreneur spirit among the population;
- Training and support by the five Business Development Centers established for domestic investors; and support to external investors and exporters through an Agency for Investment and Export Promotion to be created;
- Capacity building for cooperatives through support via the Ministry of Development and Environment;
- Studies of, and subsequent support for the informal economy, including enhanced access to credit (microfinance expansion and financial sector framework and policies), training (domestic business promotion and vocational and technical training), knowledge about entrepreneurship (entrepreneurship development), and equipment (such as through leasing companies)[15].

The process of developing the SIPs, and the SIPs themselves, have provided GoTL and participating donor agencies and other stakeholders with a much improved overview of current initiatives and constraints in the sectors, and provide an excellent platform for better coordination and synergy in future.

4.2.4 Legislation and Regulations for the Financial System

The Banking and Payments Authority (BPA) created in November 2001 takes on most of the normal functions of an autonomous central bank under a Banking Regulation instituted by UNTAET in 2000. The Regulation authorizes the BPA to issue licenses, regulate and supervise the commercial banks and the Instituicao de Microfinancas de Timor-Leste (IMfTL) while managing the Dili Interbank Clearing House. A Quarterly Economic Bulletin is produced and circulated, and a very informative website has been launched[16]. BPA has recently opened a branch in Oecussi.

As Timor-Leste has adopted a foreign currency – the US dollar - as legal tender and as there is freedom of capital flows, the BPA is prevented from knowing and controlling the total volume of currency in circulation (for example cash payments for imports, transfers abroad and income of international personnel are not required to be declared), but developments in the formal financial system are closely monitored.

Minimum capital requirements for banks are set at USD 2 million (for Class C, increasing to USD 6 million for Class A banks) and supervision is carried out through analyses of required reporting, as well as on-site inspections. Instructions on the Chart of Accounts for Banks, Deposit Accounts (to combat money laundering) and Call Reports (to facilitate prudential regulation) have been issued.

For non-bank financial institutions, the BPA refers to the Law on Commercial Societies which was promulgated in 2003. Cooperatives are not supervised by the BPA, and BPA has expressed no interest in being charged with the supervision of NGO MFIs in future. As such, the BPA and AMFITIL are in agreement that prudential and formal regulation of the nascent microfinance industry would be premature and possibly counterproductive, while overly stretching the already limited supervision capacity of the BPA. Interestingly, the BPA has received 2-3 applications for banking licenses over the past year, but none have yet been approved.

Draft laws on insurance and bankruptcy are being finalized, and a combined credit and collateral registry is under development. Currently, the BPA is focusing on finalizing an anti-money laundering law and aligning operations with the new insurance law, recently approved by the Council of Ministers and now tabled to Parliament.

[15] Ibid.
[16] BPA Economic Bulletin October 2004 and BPA Annual Report 2003/04, June 2004. http://www.bctl.east-timor.org

4.3 The Role and Contribution of Microfinance

Microfinance services include micro credit, savings, money transfer, and insurance products. Over the past 20 years, microfinance has developed into a specialized method of providing these financial services at sustainable rates to the economically active poor households, who cannot access the commercial banks of the formal sector, be it for socio-cultural, systemic, geographical, or other reasons. This is also the case in Timor-Leste, where the microfinance providers serve 44% more borrowers than the commercial banks.

Target clients of the microfinance industry use and benefit from small savings and loans to *grow* rather than establish their micro-businesses. The key motivator for microfinance clients is access to (rather than price of) reliable and continuous financial services. The chief motivation for repaying a loan is the promise of future access to another loan and this is often re-enforced with social collateral such as group guarantees. This explains why microfinance can operate successfully in the informal sector without physical collateral, enforceable contracts, and commercial courts or enabling legislature. The laws of microfinance are embedded in good operating practices and re-enforced by social contracts.

Microfinance is not simply banking for the poor; it is a development approach with a social mission and a private sector-based financial bottom line that uses tested and continually adjusted sets of principles, practices and technologies. The key to successful microfinance lies in the ability of the provider to cost-effectively reach a critical mass of clients with systems of delivery, market responsiveness, risk management and control that can generate a profit to the institution. Typically, this profit is ploughed back to ensure the long-term survival of the institution, i.e. the continuous provision of services demanded by its clients. The two long-term goals of microfinance are thus *substantial outreach* and *sustainability*.

Financial services, especially credit, are being delivered around the world without sufficient knowledge of or attention to these good practices – but the short-term losses, and the longer-term unsustainable impact of such schemes ultimately harm the very clients that they were meant to benefit. The experience from past failures proves that direct provision of services by subsidized and non-profit bodies tends to result in limited outreach and unsustainable impact. This fact is, however, sometimes overlooked in the quest to combat poverty by availing cash to the poor through any available channel. Because money is a commodity well-known and managed by almost everyone, the technical skill and specialization necessary to provide this business service successfully is often not adequately recognized. In Timor-Leste, the World Bank-managed SEP and CEP projects provide examples of exactly these constraints.

Microfinance can be an effective and powerful instrument for poverty reduction, helping poor people to increase incomes, build assets, and reduce their vulnerability in times of economic stress. But it must be provided by institutions who strive to become effective business entities by developing a strategic vision for viability and the necessary professional skill and capacity. Often, promising microfinance institutions need support to address constraints during their first 2-5 years in order to secure their ability to provide market-responsive services in a viable manner.

4.4 The Support Infrastructure for the Finance Sector

The support infrastructure for the finance sector includes financiers (whole-sale lenders) and technical service providers (consultants, audit companies, IT companies, trainers etc.) as distinct from the providers of training and business development services to the micro-, small and medium scale enterprises themselves (the latter fall outside of the scope of this Assessment).

While the demand is high, there is a dearth of technical assistance and training providers for financial institutions in Timor-Leste. No providers could be found for financial services per se. Two audit companies operate in Dili, and while IT services are on offer, their level of skill rarely suffice

to service the MIS systems of financial institutions. Consequently, most financial service providers have their own network of in-house or regional expertise, which they can call on – often delaying trouble-shooting, and adding to operational costs.

The credit cooperatives have been supported up to 2003 by its now all but defunct Credit Union Federation (CUF or Fundasaun Hanai Malu), which used to offer inter-lending facilities among credit cooperatives, training to member cooperatives in collaboration with KLIBUR (see below), monitoring of member cooperatives, and study visits abroad.

KLIBUR Matan Dalan was established in 2001, supported by USAID, to act as a training facility primarily for the Cooperative Café Timor (CCT) network of coffee cooperatives. Its two training centers in Dili comprise 7 class rooms, 3 computer labs and a library, and are staffed by 24 permanent trainers, an additional 19 on call, and one international advisor. It is still heavily donor subsidized, and participant fees are not covering operational costs. It operates three lines of business:

1. The Institute of Business (IOB) providing:
   - Formal education to 300 students in 2004 in Financial Management, General management, Accounting, and Informatics management;
   - Regular courses for the public in English and Portuguese languages, computer literacy and accounting.
2. The Technical Assistance and Development Institute managing public radio broadcasting.
3. A section for Development of Cooperatives which provides:
   - Business training to Cooperativa Café Organic (CCOs);
   - Business training to Credit Cooperatives in collaboration with CUF.

KLIBUR has not publicized its services to a large extent, and may thus be relatively unknown outside of the cooperative movement. As the training center begins to consider income generation for sustainability, however, it may be an option for hosting, and perhaps delivering basic level financial management training, also to staff of non-cooperative financial service providers.

The Dili Distance Learning Centre established and funded by the World Bank is another potential service provider for the industry. Currently, the well equipped center offers language courses in English and Portuguese, but similar Distance Learning Centers elsewhere have provided video conferences on financial service delivery and microfinance. The Dili DLC is planning a combined training-of-trainers and participant training on microfinance in February 2005, and it would thus be an option for financial service providers to explore further as a future training partner.

The Timor Institute for Development Studies, TIDS (formerly the East Timor Study Group) in Dili has a group of primarily academic researchers attached, who have conducted social, political and economic research and studies. While TIDS has no specialization in financial services, the consultants linked to the center may be useful for market research, client surveys etc.

It is equally possible that some linkages, especially for NGOs and MFIs providing non-financial business development services (BDS) for their clients, could be developed with the four governmental Business Development Centers established in Dili, Baucau, Maliana and Oecussi respectively with support from World Bank under SEP II. Developing the supply and demand of BDS, however, normally involves engaging the private sector in the provision of business services, working with multiple providers in the market in order to stimulate competition, and not subsidizing transactions between providers of the service and the customers.

The market in Timor-Leste has seen encouraging bank linkages over the past year, with one bank lending to one MFI and providing bridging finance for the CCT to buy coffee from their farmers. None of the banks are opposed to appraising the applications from other MFIs, but all three would still require fixed assets collateral in order to lend. Excellent servicing of commercial loans, combined with more information on the structure and performance of the portfolio of MFIs, however, have led banks in other countries to accept a lien on superior portfolio as soft collateral

for loans. As GoTL is urging banks to lend to the rural poor, such tiered lending provides significant social benefits for participating banks, and there is thus every reason to pursue further linkage banking in future.

4.5 The Funders of Private Sector Development and Finance

Numerous donor agencies and international organizations are assisting Timor-Leste in all sectors of the economy, including 12 multi-lateral organizations (such as the UN-family, the European Union, World Bank, Asian Development Bank, WHO and the World Food Programme (WFP) in total having contributed USD 372.4 million since 2000) and at least 18 bi-lateral government agencies. Of these agencies, Portugal, Australia and Japan have provided the largest contributions since 2000 (USD 199.8; 189.3 and 179.4 million respectively), followed by USA (USD 99.6 million) as at June 2004[17].

During 2000-2003, most donor agencies focused on relief and reconstruction work, providing funds for the rebuilding of infrastructure and livelihoods. As a consequence, the level of subsidization of basic needs (food, clothing, building materials) and farm inputs (seed, seedlings, tools and equipment etc.) was very high, with WFP and the Food and Agriculture Organisation (FAO) being among the key implementers.

Over the past four years, the total GoTL-registered spending on policies and programs that directly supported the development of the private sector amounted to USD 22.6 million, with donors funding more than 90%. Interestingly, almost 80% of these funds have been provided for microfinance programs and support to the development of medium and small business development (see Table 2). In addition, a number of donors have provided substantial resources for the development of agriculture. Programs aimed at commercial crop development, post-harvest storage and processing, and support for the development of commercially-oriented farmer organizations amounted to about USD 16 million as registered by GoTL[18], and it is within this program portfolio in particular that subsidization of input-supply (seeds, seedlings, hand-tools and equipment etc.) has taken place.

Some smaller donor agencies have withdrawn from Timor-Leste, and most of the relief projects have been completed. In a number of sectors, there is now evidence of a much-needed switch in the donor-funded portfolio from emergency aid and relief to a longer-term and more private sector-friendly development focus.

Table 2: Private Sector SIP expenditures, FY1999/00 – 2002/03 (in USD)

Program	Funding Source		Total	
	CFET	Donors	Amount	%
Management and administration	49,000	-	49,000	0.2
Industrial policy & development	747,500	1,523,805	2,271,305	10.1
Trade policy and development	63,500	121,183	184,683	0.8
Land & Property policy/programs	552,000	478,862	1,030,862	4.6
Investment promotion	46,000	71,928	117,928	0.5
Labor market policy/programs		750,000	750,000	3.3
Financial sector development		*401,709*	*401,709*	*1.8*
Microfinance		*5,354,203*	*5,354,203*	*23.7*
SME development		*12,008,047*	*12,008,047*	*53.2*
Tourism policy/development	71,000	335,079	406,079	1.8
TOTAL	**1,529,000**	**21,044,816**	**22,573,816**	**100.0**

From 2000-2003, the World Bank initiated and supervised two projects that included the provision of subsidized credit (interest was 10% p.a. on a declining balance); the Community Empowerment and Local Governance Project (CEP I, II, III), and the Small Enterprise Project (SEP I and II). While the USD 1 million credit component under CEP was added on to the broader-scope project, aiming at lending relatively small amounts to rural borrowers organized in groups, the USD 4 million SEP credit component provided a wider range of individual loans (USD 500 – 50,000) for private business, disbursed primarily in or near district-level towns through Caixa Geral de Depositos (CGD).

[17] Registry of Development Aid, Ministry of Planning and Finance, July 2004.
[18] GoTL: Private Sector Development and Proposed Sector Investment Program, September 2004. Table 2 is quoted from Section VII, page 32.

Neither project fared well. The repayment rate of the SEP credit line for individual loans was around 60% and ended in 2003[19], the project having taking all risks, and thus leaving the bank without losses. The CEP credit component was implemented as a revolving fund alongside community sub-grants through local government structures using the World-Bank funded Kecamatan Development Project approach from Indonesia. Approximately 1,050 primarily uncollaterized loans were disbursed all over the country over the 3-year period at an average value of USD 1,200, mostly to small retail stores (kiosks) (54%), while 33% financed agriculture, livestock production and fisheries. The repayment rate across districts ranged from 28-31%. The reasons for this failure are many, but relate perhaps primarily to the weak and ill-enforced lending practices including the disassociation of credit risk from lending decisions; poor monitoring and repayment enforcement; and human capacity deficiencies. While CEP may well have succeeded in revitalizing a number of small and micro-enterprises existing before 1999, it did not meet any reasonable standard of sustainability, and cannot be said to have supported the emergence of a sound credit culture in rural Timor-Leste.

While CEP was not a financial sector project, it did have an obligation not to compromise the reestablishment of a sound financial services sector, which it arguably did not fulfil. As global experience demonstrates, credit is not an accessory that can be added on to any project with minimal preparation, but requires specialist input to be successful. It would be important for CEP to facilitate the linkage of any remaining credit beneficiaries, who have serviced their loans well, to more sustainable alternative providers of financial services[20].

Asian Development Bank has contributed USD 4 million to the financial services sector, supporting the rehabilitation of credit cooperatives and, chiefly, the establishment of IMfTL through the Microfinance Development Project ending in early 2005.

Like several other donor agencies, USAID has funded a 'Small Grants Program' implemented by Development Associates Inc. (DAI) which has contributed a total of some USD 18.75 million in-kind and cash grants within the sectors of democracy and good governance, economic growth and health services. To promote economic growth, a number of small grants has been provided to farmers' and fishing groups for in-kind procurement of hand-tools, fishing equipment and boats. A total of 17 grants at a value of USD 1.04 million have been provided to the microfinance industry for loan capital, operational costs and training, benefiting six NGO members of AMFITIL (three MFIs and two non-financially specialized NGOs) as well as 5 credit cooperatives, including Fini Soromutu in Dili. In addition, USAID funds the Cooperativa Café Timor project (see section 6.2.3).

UNOPS is implementing an agricultural development project in Ainaro and Manatutu in cooperation with the Ministry of Agriculture, Forestry and Fisheries (MAFF). As part of this effort, UNOPS has supported the formation of 15 Self Help Groups (9 in Manatutu and 6 in Ainaro), who are provided with seeds and farm implements in kind, while depositing savings with the groups. The project has been replicating the Self Help Group (SHG) model developed by MaiRata in Bangalore, India. UNOPS is planning to replicate the formation of SHGs and provide micro-credit in Oecussi as part of the new EU-funded Rural Development Project (see also Annex 4).

GtZ is implementing an agricultural productivity improvement (food security) project in Baucau and Viqueque, also in collaboration with MAFF. As participating farmers required investment capital for hand-tools and traders required working capital for input supply, the project put up the funds as interest-free loans. GtZ explained that they had been unable to identify financial service providers with suitable financial products to meet this demand in their project area. While there is definitely a shortage of agricultural lending products in the market, this case also exemplifies the low level of information and awareness of available financial products. It would perhaps not have been

[19] See Craig Wilson: Final Evaluation and ICR Report for the WB Small Enterprises Project (SEP I), Economic Analysis, March 2003.
[20] For a detailed review of the CEP credit component, see John D. Conroy: Timor-Leste: Independent review of the Credit Component of the Community Empowerment Project, Conflict Prevention and Reconstruction, March 2004.

impossible for a CGD or IMfTL, for example, to make special arrangements to meet the specific demands of the GtZ project.

Several other donors have supported microfinance schemes through national or international INGOs, including AusAid and CIDA.

Albeit on an apparently decreasing scale, farming, fishing and forestry materials and equipment as well as basic consumption items (foodstuff, enterprise development supplies and fixed assets) are still being provided in kind on a grant basis, i.e. free of charge for the recipients, through donor-funded projects. This appears to be especially common in agriculture, community development and rural development projects implemented by GoTL or INGOs like World Vision and CARE as well as in the 'small grants funds' that donors such as USAID, New Zealand, CIDA and United Kingdom have provided, primarily to NGOs. While these grants-based 'hand-outs' do not constitute financial services, and thus do not form a direct part of this Assessment, they are mentioned due to their distortional effects on the development of a sound private sector market, and the constraints and displacement they represent for financial service providers aiming for sustainability.

It was not possible for the Assessment Team to review the details and effects of all donor projects providing grant-funded inputs to the potential market for financial services, but as an *illustrative example* of the degree of displacement taking place in the market, the Assessment Team analyzed a sample of grants provided by funds from one donor-agency from January 2002 – August 2004 (See Table 3).

Table 3 Sample of USAID/DAI grant-funded projects, January 2002 – August 2004[21]

Input provided In-kind or cash	Value In USD	Beneficiaries	Location	Fin. Service providers in area	Fin. Product available in area (see Section 6.3)
Fish fingerlings Materials for pond construction	6,700	1 NGO 15 youths	Dili	CGD, IMfTL	Investment loans Small business loans
4 boats, 4 rumpong (fish aggregating device), nets	28,800 (7,200/coop)	MAFF 4 fishing coops	Manatutu Baucau	CCF CGD, OTL, CCF, TRM	Group loans Investment loans
Fruit tree seedlings Materials for nursery construction	91,500 (9,150/nursery)	1 INGO (WV) 10 community groups	Aileu	IMfTL, MR	Small business loans
Equipment/materials for carpentry workshop	81,800	1 NGO (Sct. Joseph) 50 youth/year	Baucau	CDG, CCF, TRM, OTL	Investment and working capital loans
Equipment/materials for fishing boat building factory	15,000 (3,000/coop)	1 NGO (OPTP) 5 fishing coops	Baucau	CDG, CCF, TRM, OTL	Investment loans Group loans
Equipment/materials for pottery workshop	170,300	1 INGO (WV) 13 women	Manatutu	CCF	None suitable
Equipment/materials for fish salting	8,500	1 NGO (Loron Leon), coops	Bobonaro	CDG, IMfTL, MR, CCF, F. Naroman	Investment loans Small business loans, group loans, Production loans
Materials for irrigation channel & water dam	32,300	1 NGO (Caritas) 50 families	Baucau	CDG, CCF, TRM, OTL	Investment loans
Hand-tractors, rice threshers	29,950	1 NGO (FAT) 5 farmers groups	Bobonaro	CDG, IMfTL, MR, CCF, F. Naroman	Consumption loans, crop loans, small business loans, Group loans, Production loans

[21] USAID/DAI Small Grants Program, Ex post Grants Assessments, August 2004. Legend: MAFF - Ministry of Agriculture, Forestry and Fisheries; WV - World Vision; OPTP - Organisasi Pemuda Teknik Profesional, FAT - Fundasaun Amizade de Timor.

It is important to note that many of these grant-funded inputs have yielded excellent results in terms of skills enhancement, increased agricultural productivity, returns on investments, and increased income for the beneficiaries. The point is that with increased awareness of and linkages to financial service providers, and with some product innovation, it might well be possible to debt finance these projects in future, linking the beneficiaries to more sustainable sources of credit and contributing to building a more inclusive financial system.

A pragmatic approach is called for in order to achieve the medium-term goal of a commercially viable and inclusive private sector. The SIPs developed for the key economic sectors can go a long way in facilitating coordination and reducing duplication and displacement over the years to come. As a first step, the demand for input (equipment, raw materials etc.) registered by grant-funded projects could be presented to financial service providers for their consideration – at least a part of the input demand currently met by grants, especially to farmers' and fishing groups, may well be met by existing financial service providers.

Crucially, information sharing and coordination between input-supply and grant-provision projects on the one hand and financial service providers on the other needs to improve. Analyzing the current portfolio of ongoing or planned donor-funded projects, a number of opportunities for such closer linkages with the aim of gradually replacing grant-funded input with commercially sustainable service delivery appear. Annex 4 presents a non-prioritized and non-exclusive list of donor-funded projects, in which a closer linkage to financial service providers might be worth exploring.

Prior to implementation, especially of new or planned projects, donor agencies should also consider if the ultimate demand for input among the beneficiaries might more viably be met though an interim subsidy to a financial institution, enabling it to develop, test and roll-out a new product (for example farm equipment leasing, leasing of energy production equipment etc.), or to expand its current product line to a new area by opening a new branch. This may be particularly relevant for the emerging rural electrification sector, including micro-/mini-hydropower development, currently being appraised by EU and NORAD.

For the small 'market', the level of coordination, co-operation and coherence in approaches in general among donor agencies is surprisingly low. There seems to be little knowledge of or attention to lessons learned and generally accepted 'good practices' for private sector development in the international aid community, and the task of coordination placed on the shoulders of the over-stretched government seems larger than necessary. While it is clearly the responsibility and interest of the government to coordinate aid, a higher level of inter-donor coordination of approaches and agreement on principles would be helpful, especially in support to the private sector, to avoid supply-driven and substituted services displacing private sector providers.

5. The Demand for Financial Services

5.1 Size and Composition of the Market

The average per capita expenditure (consumption) in Timor-Leste in 2001 was $24.20 per month, with the richest 20% of the population spending an average of $55/month equal to 45% of the total per capita expenditure of the population, and the poorest 20% having $8/month at their disposal, spending only 7% of the total per capita expenditure. Economic inequality is thus significant.

Of the total population of Timor-Leste, 47% made up the economically active (15-64 years of age) labor force in 2001, lowest in the major urban centers of Dili and Baucau and highest in the rural central region. This corresponds to the reported 50% of the population being under the age of 15 years. Participation in the labor force in 2001 was markedly higher for men (81%) than women (40%).

Only 15% of the work force is receiving wages or salary. Those employed may, however, well be enjoying inflated wages caused by the large influx of international organizations over the past four years. World Bank estimated in 2002 that unskilled farm labor wages in the coffee industry were three times the rates offered in neighboring Indonesia. This obviously raises concerns over the job security of employees in the nascent private sector, as well as the opportunities for private sector growth and job creation.

Eighty five percent of the population is self-employed, the vast majority in agriculture. Non-poor rural households are more likely to have non-farm income sources than the poor, and earnings from these sources are higher than earnings from farming[22].

Extrapolated to today's figures, the total economically active population would comprise 434,575 people, which would be considered the total market for financial services, and of which the non-poor and the 15% wage earners could potentially access formal banking services. In this Assessment, however, we focus primarily on the financial services to the poor, who are usually excluded from accessing financial services from formal banks.

Until the data from the 2004 Census are analyzed, the Timor Living Standards Survey from late 2001 constitutes the most comprehensive analysis of poverty in Timor-Leste to date, and while the population has grown by some 11% since 2001[23], there is little to suggest that the level and characteristics of the poor has changed dramatically. Hence, the statistics from TLSS will be summarized below to characterize the market for financial services for the poor. In 2001, 39.7% of the population lived below the poverty line. Assuming the same percentage, this would mean a total of 367,000 people today.

The national poverty rate hides important variations across the country:

- Poverty increases from East to West in Timor-Leste. Oecussi, Bobonaro and Covalima in the West are home to 20% of the total population, but 25% of the poor. Baucau, Lautem and Viqueque in the East account for 25% of the total population, but less than 20% of the poor.
- Poverty increases with altitude – the central highlands are home to the highest number of poor.
- Poverty is higher in rural areas than in urban areas. While 80% of the population live in rural areas, so do 75% of the poor. The rural center of Timor-Leste is the poorest area, followed by the rural west and urban centers other than Dili and Baucau.

While higher poverty correlates with lower education level, lack of access to infrastructure, and farming as main source of subsistence, the 2001 TLSS did not find significant gender correlations. The crude data suggested a *lower* incidence of poverty among the 10% female headed households than among the 90% headed by males, especially in rural areas. However, this difference balanced out with size and composition of households: male headed households were generally one third larger than female headed ones, and had a higher child share. Contrary to many other countries, poverty in Timor-Leste seems to affect households headed by males and females in equal measure; only in urban centers are male headed households less poor. In rural families, the age composition within the household more than the gender of the household head appears to impact the level of poverty[24].

Income generation is a core factor for livelihood improvement, and the importance of microfinance as a means of income generation is confirmed by the structure of poverty in Timor-Leste: Households whose resources are at least in part gained from a *household business* (but not from wages), experienced substantially less poverty than households whose head only worked on their farm, as illustrated in Figure 4.

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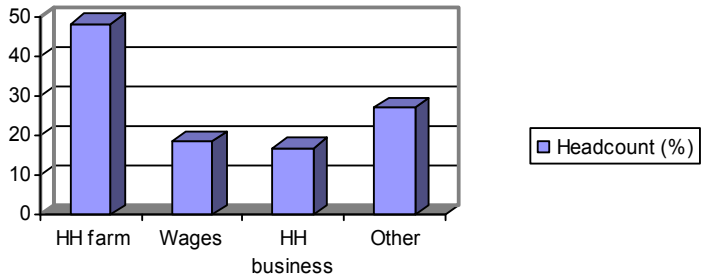
[22] Data from the Timor Livings Standards Survey 2001 as analyzed in Timor-Leste: Poverty in a New Nation, Analysis for Action, GoTL and Development Partners, May 2003.
[23] Poverty Assessment 2001 (Timor-Leste: Poverty in a New Nation, Analysis for Action) counted a population of 829,000 vs. Census published in 2004 counting a population of 925,000.
[24] Ibid. pp. 174-177 and 207.

Among households whose head (in the the economically active age group) is generating income from farming alone, poverty is most widespread (49% are poor), while poverty is lowest among households whose heads are either employed as civil servants and teachers or generate income as traders, especially in urban areas[25].

Figure 4: Poverty and Employment Status of the HH Head



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

While income will move poor families toward self-sufficiency, acquiring assets is the key to their achieving economic security. Assets act as insurance against economic uncertainty and as wealth accumulation to prepare for future expenses. It is also essential for access to conventional credit. Material assets in Timor-Leste comprise primarily of land and livestock.

Whereas 86% of the population reportedly lived in households with access to land in 2001, and 95% of the households cultivated their land, the size of land holdings was only 0.2 ha per person, and productivity was low – so low, in fact that those *without* land access, both in rural and urban areas, were less poor than those with land access. This correlates with the finding that the capability to rely on non-farm sources of income, such as a micro-business, is in general associated with low(er) poverty[26]. However, poverty decreases with larger land holdings, also in the rural areas.

Apart from land and housing, the most important asset of households in Timor-Leste is livestock. Ninety percent of rural and 71% of urban households keep livestock. Livestock holding in cities is associated with higher poverty, although the urban dwellers with livestock are still less poor than their rural peers. In rural areas, where dependency on farming activities is perhaps inevitable, holding of livestock is a sign of prosperity. But its importance for poverty reduction is its value. Rural poverty does not decline markedly until the value of livestock of a household exceeds $ 300. The poverty gap suggests that the key drivers to reduce poverty are activities outside of farming and livestock production[27].

Financial assets generally play a minor role in subsistence economies, but it is noteworthy that 46% of the population in 2001 had savings in cash or jewelry, averaging 140% of their monthly expenditures. The poverty gap suggests a close link between access to markets (major urban areas and the coffee market in rural center region) and the ability to build financial assets as well as a clear correlation between savings and wealth: Poverty dropped close to zero for per capita savings in excess of $150[28].

In conclusion, there are approximately 367,000 people living below the national poverty line of $15.44 per month in Timor-Leste today, the vast majority in large (average size 6.2 people in 2001, now 4.7 as per the 2004 Census), male headed households in the rural areas, surviving on subsistence agriculture, and having little education. Boosting human capital through education would reduce poverty.

Most of the 78,100 poor households that these people represent[29] have access to land, even if unregistered, and most farm the land. In addition to farming, some 10% operate non-farm household businesses, and are better off for it. The existence of infrastructure (especially

[25] Poverty in a New Nation, pp. 72-73.
[26] Ibid., p. 75.
[27] Ibid., p. 78.
[28] Ibid., p.81-82.
[29] As microfinance is normally serving only one member of the household, but benefiting the entire family, the market size is often given in number of households, which also adjusts for the young population of Timor-Leste.

sanitation and electricity – surprisingly access to roads has little payoff) reduces poverty, and irrigation, high-value crops (such as coffee rather than maize) and a local market presenting income generating opportunities from non-farm activities affects both farm and non-farm income generation positively[30].

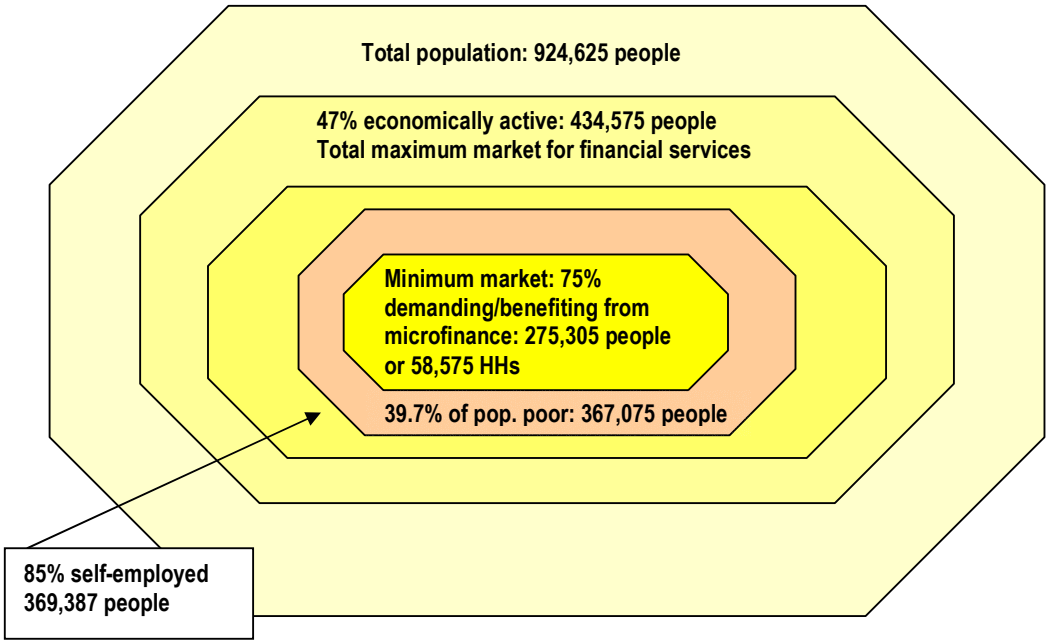


Figure 5: Estimated Market Size for Financial Services in Timor-Leste

Not all poor households can benefit from financial services; without an income generating household activity, credit in particular can over-indebt households, making them poorer. Adjusting for these factors by 25% due to the current low level of economic activity in rural Timor-Leste, we reach a total minimum market estimate of 58,575 poor households demanding and able to utilize microfinance services, of which 46,860 (80%) reside in rural areas.

6. The Supply of Financial Services

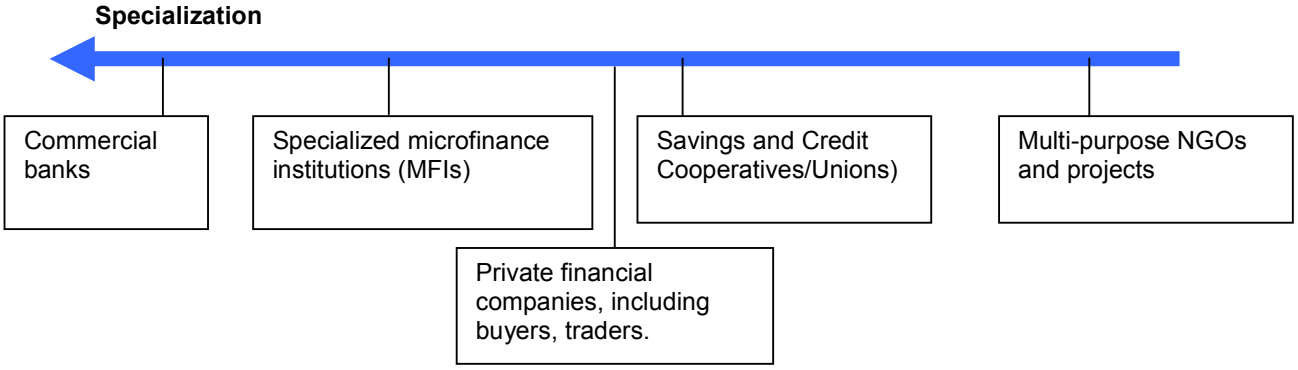
6.1. The Structure of the Supply Market

Financial services in Timor-Leste are provided by five types of institutions, forming a spectrum of professional specialization with the commercial banks at the head, as depicted in Figure 6. As in many developing countries, however, the most specialized institutions are not the largest suppliers in the market. For a detailed map of location of suppliers' branches and a sample of market penetration per district, see Annex 5.

The preferred market segment of the commercial banks are the largest enterprises and the most wealthy people, perceived as the 'safest', most bankable clients with the most collateral and thus the least likely defaulters. The poor households by contrast are considered too risky to bank. As in many other countries, this perception is at best moderated by fact in Timor-Leste.

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

Figure 6: Providers along the continuum of Specialization



For Timor-Leste in particular, the policy and legal frameworks usually governing financial service provision are evolving and incomplete, and the current inability of banks to rely on effective enforcement mechanisms for loan contracts, registration and liquidation of pledged collateral and recovery of debt increases the perceived risk of lending significantly. Donor support and relatively well performing portfolios, as well as the need of the commercial banks to extend their business (or close shop) in the very small East Timorese market has, however, contributed to a budding, albeit cautious, interest in the small enterprise and lower-income segment, as well as in the rural market.

The specialized microfinance institutions (MFIs) in Timor-Leste comprise one regulated microfinance institution, the Instituicao de Microfinancas de Timor-Leste (IMfTL) established with support from ADB through the TFET, and three local NGOs each supported by international NGOs and focusing exclusively on the provision of financial services to moderately – extremely poor households, primarily through credit to women, in urban and rural areas. All are core members of the Association of Microfinance Institutions in Timor-Leste, AMFITIL.

A Credit Union Federation (Fundasaun Hanai Malu) was formed in 1994 under Indonesian rule to support the 27 member cooperatives, which in 1999 had an estimated total membership of 7,350. Today CUF has 44 credit cooperatives registered, 7 of which have more than 100 members. Only 3 of these currently have a membership above the generally accepted minimum of 250 members required for sustainable operations[31]. These cooperatives provide savings and credit services to their membership, which generally include middle- to low-income wage earners, and small entrepreneurs in urban and peri-urban areas.

An estimated 200 NGOs support development in the broadest sense, primarily through donor-funded projects across Timor-Leste. A total of 69 International NGOs are registered in the NGO Forum (FONGTIL) as of November 2004[32], of which 14 report or are known to be supporting microfinance specifically or as part of several services provided through national NGO partners. Of these 14, only four are members of AMFITIL, while one INGO member of AMFITIL is not registered with FONGTIL. It was not possible in the short time available in country for the Assessment Team to contact all the INGOs reportedly providing financial services.

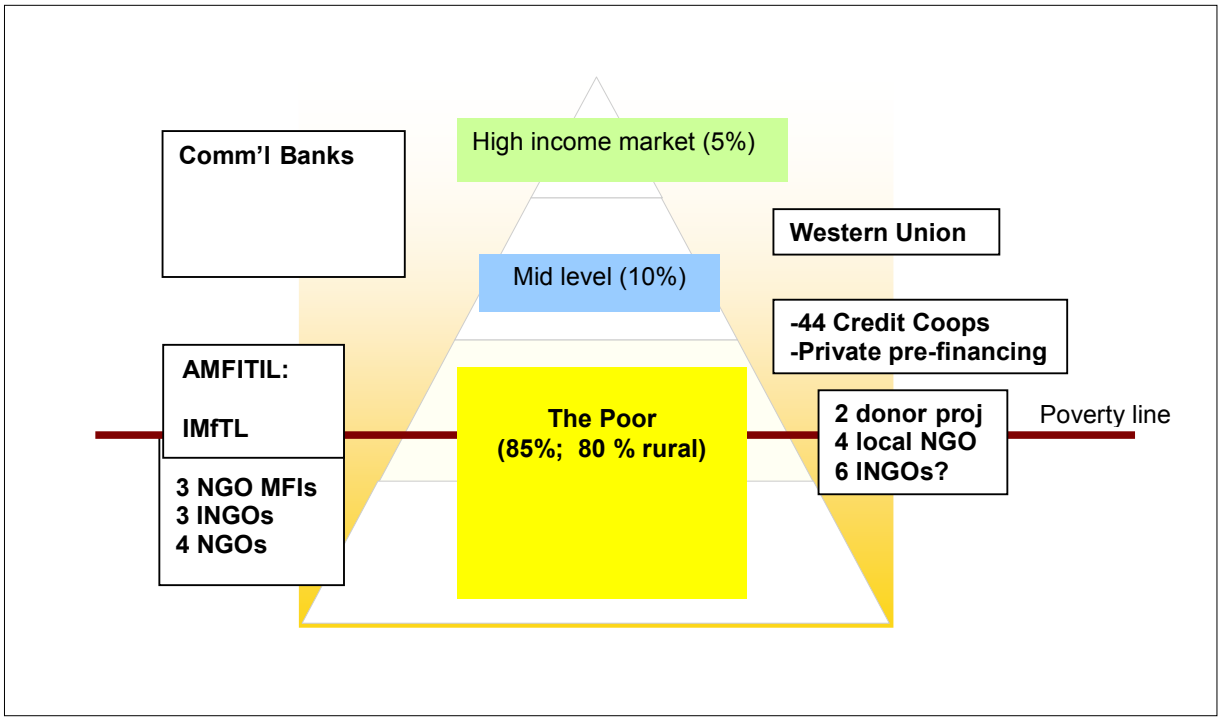
Four national, multi-purpose NGOs are members of AMFITIL, while an additional four national NGOs providing microfinance services were identified during the Assessment, one of which is registered with FONGTIL. They provide financial services to a limited number of very-extremely poor and disadvantaged households in urban and rural areas, often in combination with provision of social services.

In broad terms, the four main categories of financial service providers each cover their segment of the market, as depicted in Figure 7. However, none of the categories of providers are yet covering the entirety of their preferred market segments neither in terms of geographic outreach nor by

[31] Ministry of Development and Environment: Seccao do acompanhamento as Cooperatovas, 30 October 2004.
[32] East Timor NGO Forum: International NGO Register, November 2004.

numbers. Several geographic areas are severely under-served, including Oecussi, Lautem and Viqueque. As a positive trend, however, microfinance institutions have concentrated their efforts in the poorer districts of the West, and some financial service providers are planning to expand to the East over the coming years (see Annex 5). Competition among providers is increasing, especially in the urban centers. Along with the decrease in inflation, this has contributed to the fall of commercial lending rates among banks.

Figure 7: Core Market Segments of Suppliers by category.



6.2 The Key Suppliers – Outreach and Performance

6.2.1 Formal Financial Service Providers

From a banking network with 18 outlets, comprising five branches of Indonesian state banks, including 12 village banks units of the Bank Rakyat Indonesia; ten regional development banks and three private commercial banks prior to the referendum in 1999, the formal banking sector in Timor-Leste has shrunk to include three foreign-owned commercial banks offering an increasing range of financial services in Dili and Baucau, and one financial company providing cash transfer services.

The three commercial banks currently operating in Timor-Leste are:

- Caixa Geral de Depositos (CGD, formerly BNU) with headquarters in Portugal. It has two branches in Dili, one in Baucau and one in Glenu (Ermera), and plans to open a branch in Maliana, Bobonaro in 2005. CGD offers standard, as well as, low threshold savings accounts, collateralized investment loans and working capital for small-, medium and large businesses, and consumption loans of 2-3 years to salary earners at rates of 7-13% per annum (p.a.). Salaries of GoTL officials with CGD loans are directed through CGD, and CGD also offers remittances, Letter of Credit and foreign exchange.

- Bank Mandiri with headquarters in Indonesia opened a branch in Dili in August 2003. Competing for the medium to higher end market, Bank Mandiri is offering checking accounts,

standard savings and term deposits, and has received many loan applications, though lending is still limited to investment and working capital loans at rates around 11% p.a. Additional services include remittances at very competitive prices, foreign exchange including traveler's checks, and safe deposits boxes for rent. Bank Mandiri is currently assessing the market for smaller loans.

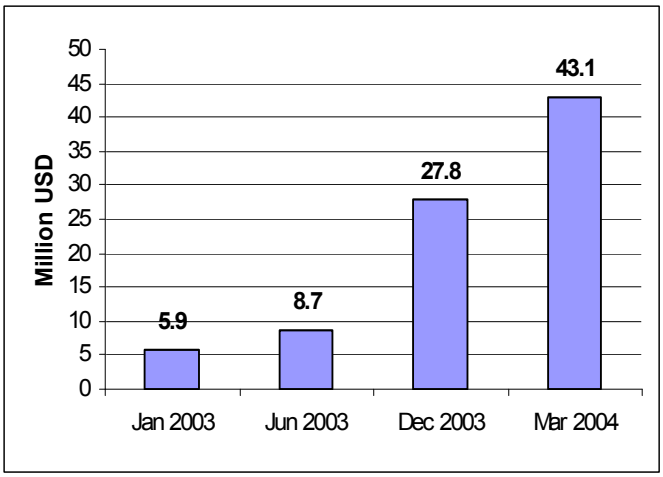
- ANZ with headquarters in Australia has one branch in Dili. ANZ offers rather expensive savings accounts (high fees) and has provided some collateralized working capital loans to medium and large businesses of maximum 5 years, and 3-year consumption loans to fixed income earners at rates of 14-16 % interest p.a. In addition, foreign exchange, EFTPOS facilities (ATM for foreign and local debit cards, which are also accepted by some 27 merchants in Dili) and remittances are done. ANZ will re-assess its business strategy in early 2005, considering an expansion of treasury services, lending and rural banking.

In addition, Western Union has established two outlets in Dili and Baucau catering primarily for private remittances at comparatively high costs. They report to have some 1,500 customers.

Bank business has soared since the beginning of fiscal year 2003/04. As at June 2003, the total deposits of the commercial banks and IMfTL (see below) was USD 58.5 million, of which the majority was invested abroad. Credit by the formal banks represented only 10.4 million or 17% of total deposits as at June 2003. The average interest rate was a high 15-17% due primarily to perceived high credit risk, and credit was provided primarily for housing and reconstruction (60% of loans representing 93% of loan value). While 7% of the total number of loans financed domestic trade (stores and kiosks), only one agricultural loan had been provided[33].

As at September 2004, bank deposits through some 32,500 accounts have reached USD 85.9 million, that's an increase of 68% in 15 months. CGD holds about 62% of deposit accounts at a value of 48% of total deposits, not least due to the banking for government staff, and Bank Mandiri holds 33% of accounts worth 22% of the total deposits. The 5% of accounts held by ANZ make up 30% of the total deposits in the system, as several international organizations and UNMISET bank with ANZ. Even more impressive is the six-fold increase in bank lending to private individuals and enterprises since June 2003. Commercial banks have an outstanding loan portfolio of about USD 65.9 million as at September 2004[34].

Figure 8: Outstanding Credit of Commercial Banks to Private Enterprises[35]



This expansion has no doubt been facilitated by the credit risk-free introduction to the smaller loan-size market segment that the SEP project provided to CGD, and their subsequent policy change to continue to serve this market. As at June 2004, credit was still primarily provided for housing and reconstruction (40% of loan value), but financing of domestic trade had increased to 15% of loan value, and transport and communication (taxis and microbuses) represented 10% of loan value. In all these sectors, however, the import component is high, so a lot of the financing actually ends up as profit for importers and manufacturers abroad.

[33] Banking and Payments Authority: Annual report 2002/03
[34] TFET: Report of the Trustee to the Donor's Council Meeting May, 2004 and BPA Annual Report 2003/04.
[35] Banking and Payments Authority, Economic Bulletin, March 2004 cited in the PSD SIP, August 2004.

Agriculture is still a neglected investment sector, typically seen as very high risk. It is encouraging, however, that the average commercial lending rate has fallen over the period by some 3 percentage points to a prime rate of 11-12% as at June 2004[36].

While CGD is the undisputed lending market leader, holding 90% of the loan portfolio of the banking system, the average outstanding loan sizes differ significantly:

Table 9: Lending by Formal Financial Institutions

Institution	Loans outstanding Sept. 04 in USD	% Increase since 2003	Est. # borrowers	Average outstanding loan size in USD
CDG	59,614,000	423%	9,000	6,624
Bank Mandiri	5,683,680	0 in 2003	61	93,175
ANZ	566,000	n.a.	23	24,609
For comparison: IMfTL	581,713	-22%	2,623	221

At average outstanding loan sizes of USD 20,000 or higher, neither Bank Mandiri nor ANZ are reaching the lower segments of the market directly. But Bank Mandiri has provided a credit line to an MFI (Moris Rasik) as well as bridging finance to CCT – promising signs of increased banking linkages, and excellent means by which a commercial bank can support increased access to financial services by the poor, whom it cannot and does not wish to reach itself.

The lower average loan size of CGD indicates responsiveness to the lower-income urban population. Especially the relatively long-term consumption loans have become extremely popular judging from the long queues in front of the Dili branches, and the stacks of unprocessed applications inside. CGD has a current backlog of about five months on loan processing.

In terms of portfolio performance, the banks have in general had good experiences. While ANZ reports a 7% Portfolio at Risk on their small portfolio[37], CGD and Bank Mandiri report an average Portfolio at Risk of 1.9-2.5% for 2004, which is well within acceptable banking standards as confirmed by the BPA Annual Report 2003/04. There is perhaps reason to caution against a possible future backlash of non-performing loans, especially in CGD, given the dramatic portfolio growth, the 24 month loan term of the smaller consumption loans, and the limited options for legal intervention in cases of default. It may be prudent to provision conservatively over the next year.

None of the banks in Timor-Leste were breaking even in 2003, but the 2004 income statements look much more promising for CGD and Bank Mandiri. Both should be making a profit, which for Bank Mandiri is fast, considering they started only in August 2003.

In 2002/03, USAID provided funds for an elaborate feasibility study of the re-entry into Timor-Leste of Bank Rakyat Indonesia (BRI). BRI is the most profitable bank in Indonesia, recording a net profit of Rp. 1.182 trillion with a 46% return on equity in the first half of 2003[38]. The conclusion of the study was a clear recommendation to the Board of BRI for re-entry, marred by a less than commercial suggestion that grant funds would make the re-opening "much more feasible". It is noteworthy that Bank Mandiri undertook and funded its own feasibility study during the same period of time, and re-opened its branch in Dili before the BRI study was finalized. It is not fully evident that BRI would be an immediately beneficial addition to the supply of financial services in Timor-Leste at this time, but should BRI decide to re-enter, there is no reason for donor agencies to be distorting the market further by providing grant funding for the process.

With the ongoing withdrawal of UN and other personnel, the Dili banking market is unlikely to prove attractive to other international banks in the immediate future. Two-three financial companies have, however, recently applied to the BPA for a banking license.

[36] Banking and Payments Authority Annual Report 2003/04.
[37] Interview and correspondence with General Manager Mr. Peter Boutcher.
[38] "BRI IPO Fever" in Indonesia Investor Edition 12, November 2003.

6.2.2 Specialized Microfinance Providers

The Instituicao de Microfinancas de Timor-Leste (IMfTL) is the largest provider in this category. IMfTL was created under the ADB-managed Microfinance Development Project (MDP) funded by a USD 4 million TFET grant as a company limited by shares (maximum share capital is USD 3 million of which USD 2 million is paid up). It was established in December 2001 through UNTAET Executive Orders endorsed by the Council of Ministers, which created the IMfTL and the Foundation for Poverty Reduction in East Timor (FPRET) as its interim legal owner.

In May 2002, BPA issued a license for IMfTL to operate as a registered microfinance institution. IMfTL has a settlement account with BPA and is a member of the Timor-Leste inter-bank clearing system. Under the current license, it cannot hold more than USD 1 million in savings, and cannot call itself a bank, but is allowed to:

- take and intermediate deposits;
- extend credit (65% of the portfolio should be provided as micro-credit);
- provide payment and collection services, current and checking accounts, and safe keeping of valuables.

Its current governance structure is unusual in that the Board of Trustees of FPRET comprise ADB and other TFET donors (Australia, Portugal and EU as observer), GoTL and private members. At the conclusion of the MDP at the end of 2004, the charters of FPRET and IMfTL are being reviewed prior to divestiture of IMfTL to more appropriate shareholders. Following the review and revision of the ownership structure, IMfTL plans to apply to BPA for a full (category C) banking license.

IMfTL has three branches in Dili, Gleno (Ermera) and Maliana (Bobonaro) respectively. Since inception, the demand for deposits has been higher than expected and as at October 2004, IMfTL holds USD 870,183 in some 8,081 accounts. The vast majority of these deposits are small (average USD 130) passbook savings, while a small group of corporates and non-poor individuals keep their larger deposits (average account size USD 1,665) with IMfTL, probably due to the convenience of location outside Dili. This has contributed to IMfTL reaching its allowable ceiling for deposits quickly, and the current necessity to reject new, low-income depositors is the chief reason behind the urgency in submitting a bank license application to BPA.

A total of 2,685 borrowers of whom 30% are women, hold an outstanding portfolio of USD 623,952. The average loan size outstanding ranges from USD 273 for payroll loans to salary earners to USD 72 for female members of solidarity groups. Thus, while IMfTL remains responsive to the demands from non-priority market segments (for example non-poor salary earners, who perhaps make up a larger percentage of the total loan portfolio than expected for an MFI), it also serves the target market it was established to serve: the rural and urban poor and micro-entrepreneurs operating businesses in and around the branch locations.

In addition to IMfTL, three national NGO MFIs make up the category of specialized MF providers:

- Moris Rasik supported by CASHPOR Inc.
- Tuba Rai Metin (TRM) supported by Catholic Relief Services (CRS), and
- Opportunity Timor L'orosae (OTL) supported by Opportunity International.

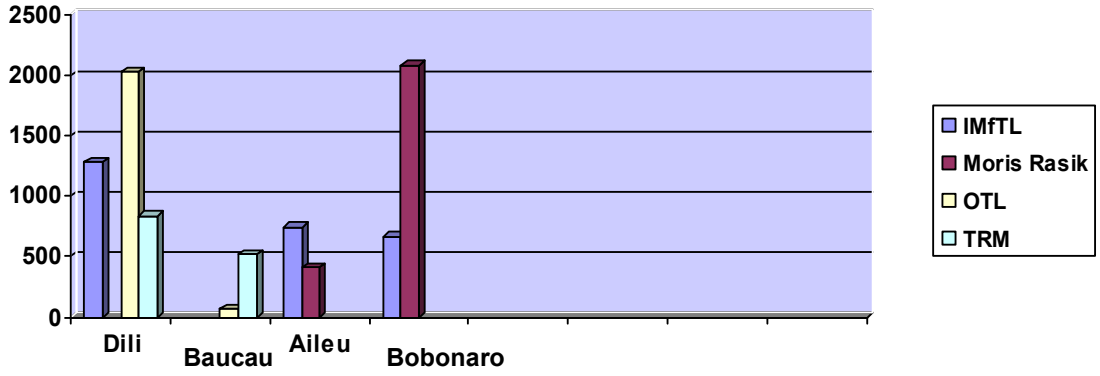
All three are members of AMFITIL, and are established specifically to provide sustainable financial services to poor households. Their market sub-segments differ slightly, but the primary focus is on the very-extremely poor households in rural settings.

Combined, the four MFIs serve a total of 18,926 depositors of whom 72% are women, and of whom 70% are also accessing credit, in ten Districts across Timor-Leste, with Moris Rasik being the most rural in outreach, followed by Tuba Rai Metin. With their 13,208 borrowers, they far out-

perform the formal banks in person outreach, but their combined loan portfolio amounting to USD 1,250,092 is only 2% of that of the banks, testifying to the provision of small loans. The average outstanding loan size per borrower in this category is USD 92 as at Sept. 2004, which is 21% of Timor-Leste's GDP per capita[39].

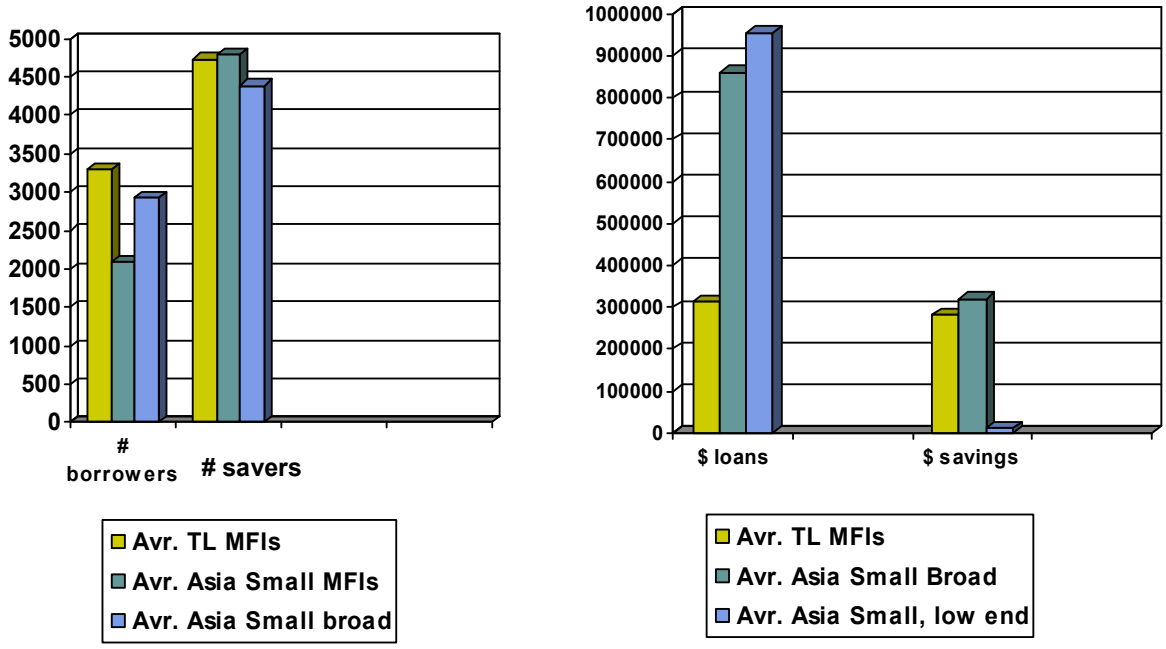
While some geographic market segmentation is apparent, the four specialized MFIs do compete increasingly in the more economically active districts in Timor-Leste:

Figure 10: Overlapping MFI outreach (no. borrowers) in selected Districts as at October 2004.



The specialized MFIs are doing very well on outreach and relatively well for the age of the institutions (average age 3.5 years) in terms of performance, when compared with the small, low-end MFIs in Asia reporting to the global CGAP Microfinance Information eXchange (The MIX) database[40], which would be the peer group of the specialized MFIs in Timor-Leste, as illustrated in Figure 11.

Figure 11: Comparative outreach and portfolio size of MFIs in Timor-Leste and Asian peer group



[39] Internationally, loans below 250% of the GDP per capita are recognized as micro-loans.
[40] The Microfinance Information eXchange has been collecting and compiling standardized performance data from 124 MFIs worldwide for 5 years. See www.themix.org. The Asian 'small low end' peer group comprises MFIs lending at average outstanding loan balances per borrower of less than 20% of GDP per capita or USD 150. Small 'broad' MFIs in Asia comprise those lending at average outstanding loan balances per borrower of 20-149% of GDP per capita.

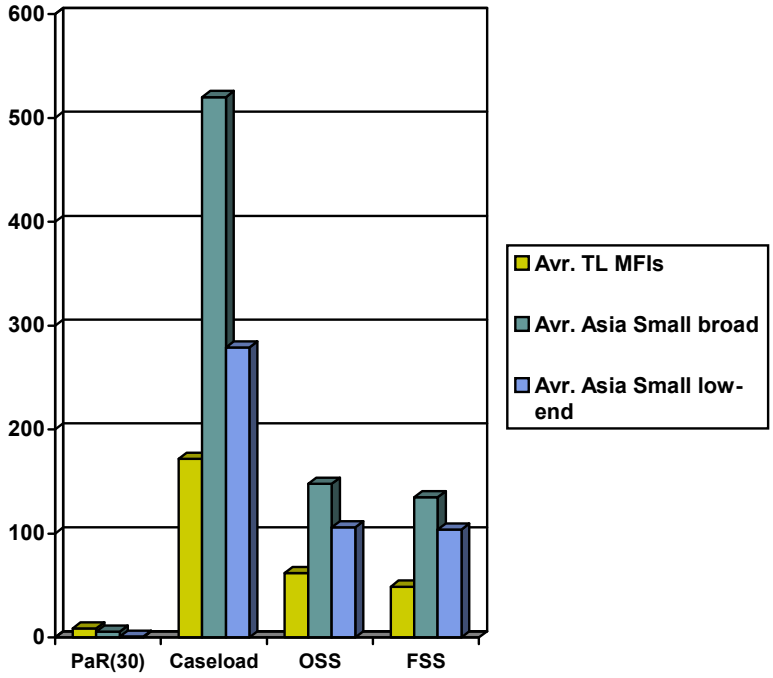
The portfolio quality as measured by the Portfolio at Risk (PaR30) ratio (value of outstanding loan balance with arrears > 30 days divided by value of outstanding loans) by end September 2004 is a combined average 8.69% among the group of MFIs in Timor-Leste, which is somewhat higher than the 5.6% registered by the regional peer group average, and higher than desirable. For MFIs, PaR30 should not be higher than 5%.

High productivity is key to successful microfinance provision, as the higher transaction costs of serving many customers in remote areas must be off-set by extreme efficiency in order for the MFI to become financially viable. In credit-led MFIs, productivity is often measured by the caseload (borrowers per credit officer). The average MFI caseload of 172 in Timor-Leste is still a ways away from the 279 average caseload of low-end Asian peers (see figure 12).

The same is true for the financial viability indicators of operational and financial self-sufficiency. Average operational self-sufficiency for the four MFIs (the % of operational costs covered by generated income) is 62.25%, while financial self-sufficiency (including adjustments for inflation and subsidies) is just below 50%.

Taking the market difficulties and the relative youth of the MFIs into account, these results are not discouraging, but do point to the need for growth, as well as to the need for operational subsidies for a while to come.

Figure 12: Comparative performance of TL



6.2.3 Savings and Credit Cooperatives

Production and service cooperatives, including credit unions, were actively developed and supported during the 1990's, with a Credit Union Federation (Fundasaun Hanai Malu) formed in 1994. CUF had 27 member cooperatives in 1999 with an estimated total membership of 7,350, when most ceased to operate effectively or indeed collapsed through loss of assets (uncollectible loans), financial resources, records and members. During 2001-2003, ADB supported an attempt to resuscitate the credit cooperatives and CUF, but the old credit cooperatives proved beyond rehabilitation facing insurmountable institutional and governance problems due to shortage of skills and simple lack of members for viable operations[41]. Since Independence, new credit cooperatives have been established under CUF, but while CUF has 44 member credit cooperatives registered today, 7 have more than 100 members, and only 3 of these currently have a membership above the generally accepted minimum of 250 members required for sustainable operations[42].

While systems and procedures are in place for the CUF to act as a second tier apex for credit unions, active execution of its role seems to await further external funding, and among the general public the past failures appear to have dampened the enthusiasm for reestablishing a cooperative

[41] Asian Development Bank: Fifth Progress Report on Timor-Leste, December 2002.
[42] Ministry of Development and Environment: Seccao do acompanhamento as Cooperatovas, 30 October 2004.

movement in Timor-Leste. Apart from the historical roots, it is not immediately evident why CUF is still linked to a GoTL department (the Ministry of Development and Environment). It may be more feasible to try to revive the cooperative apex structure outside of government.

The three savings and credit cooperatives that show potential for viability are Naroman in Atsabe, Ermera; Fitum Naroman in Laceil, Bobonaro; and Fini Soromutu in Dili, which has benefited from KLIBUR's training center as well as from informal oversight and advice from NCBA. Together, these three cooperatives report to have a total of 1,997 members (32% women) whose deposits totaling USD 848,478 are utilized as loan capital by the cooperatives in addition to the share capital of USD 40-110 paid up by members. A total of 780 members are reported as borrowers, of which there are 291 (37%) women. The total loans outstanding as at September 2004 is reported to be USD 328,028, at an average loan size of USD 421. Being markedly higher than the loans provided by MFIs, this gives a proxy indication of the relatively wealthier segment of the low income non-poor that join cooperatives.

All three credit cooperatives appear to have benefited from the standardized procedures, product designs and reporting formats delivered through CUF, as their share capital composition, savings and loan products are remarkably alike. Implementing the systems and procedures, however, is clearly a challenge, perhaps more so now that the ADB-support to the cooperative movement has ended. For example, the Assessment team was unable to confirm whether any of the three cooperatives had actually held their Annual General Assembly in 2004 and paid out dividends to members on their significant investments.

Portfolio at Risk was estimated by management to average an alarming 22%, a figure which should cause concern among members as to the recoverability of their investments. While Fini Soromutu seems to be the strongest credit cooperative in terms of financial management, general staff capacity to manage, record, and report portfolio performance is clearly very limited. Fini Soromuto appears profitable as at September 2004, but the Assessment Team was unable to verify the scarce data provided by the cooperatives, and even basic portfolio performance data was not readily available nor fully consistent in any of the three cooperatives.

Portfolio and financial management requirements and skills do not differ significantly between savings and credit cooperatives and MFIs. It may therefore be pertinent to invite the three best performing cooperatives to attend AMFITIL meetings and trainings, and perhaps join the Association to access support and information on good practices in financial services provision.

Outside of the realm of financial service provision, some 40 production and logistics cooperatives exist, the majority of them small in membership (less than 50 members). The most successful are the 16 Cooperativa Café Organic (CCO) coffee producers' cooperatives organized under the apex umbrella Cooperativa Café Timor, CCT, which acts as the processing and marketing body for the export of organic coffee from Timor-Leste.

The 16 CCOs in Ermera, Liquica, Aileo, Ainaro and Manufahi estimate the tonnage per harvest of coffee produced by their 25,000 members, and establish road sites for collection of coffee after harvest, for which they receive a small commission. In addition, CCT also manages 17 Cooperativa Baunila Organic (CBOs) of 829 vanilla-producers in all districts but Viqueque, Covalima and Oecussi.

As the secondary or apex cooperative structure, CCT sets the per-kg buying price for organic coffee cherries before each harvest, following negotiations with the National Cooperative Business Association (NCBA) headquartered in Jakarta, who pre-finances the buying of coffee by CCT. CCO farmer members are not obliged to sell to CCT, but so far CCT has been able to offer very good prices (this season USD 0.16/kg), and collects the coffee at farm gate/road site by truck. CCT runs two wet processing factories in the country, from where the coffee is trucked to Dili for drying, storage and dry processing before it is shipped out for export. Similarly, the vanilla is processed in Dili before export.

As an additional incentive to members, CCT runs nine rural health and maternity clinics in the six districts, and one commercial clinic in Dili. Making use of the significant fleet of trucks, CCT provides whole-sale basic goods transport service to 'cooperativa dos logistos', cooperative grocery stores run by 101 members.

To facilitate the training and skills development of CCOs and others, the KLIBUR training center in Dili provides business and vocational training courses for cooperative members as well as for the public. The credit cooperative Fini Soromutu is co-located with the KLIBUR training center, but runs as a completely separate organization, which does not receive funds from CCT or NCBA. Interestingly, five of the CCOs have recently requested support to establish savings and credit cooperatives as an additional service to their members.

The entire CCT operation is managed and overseen by NCBA who has five foreign advisors in Timor-Leste, and is funded by USAID through the Timor Economic Rehabilitation and Development Project (TERADP). Encouragingly, donor funds are no longer subsidizing the actual coffee production and processing, and CCT has been able to access domestic debt financing for the significant outlays during buying time. The health clinics have been fully subsidized by a USAID grant which expires in September 2005, and a system of service for fee is now being put in place, providing pre-paid accounts to CCO members, while charging cost-covering fees from the public.

6.2.4 Multi-purpose NGOs

In addition to the four specialized MFIs, a minimum of eight multi-purpose or non-financially specialized national NGOs are providing financial services to poor households supported by at least five international NGOs, but only four of these NGOs are so far members of AMFITIL. These include:

AMFITIL members:	*Area of Microfinance Operation:*
Christian Children's Fund	Dili, Liquica, Baucau, Covalima, Bobonaro, Manatutu
Hotflima	Dili, Covalima, Aileu
Timor Aid	Dili, Liquica
Halarae	Bobonaro

Other NGOs:	*Supported by:*	*Area of Microfinance Operation:*
HAFOTI	CIIR	Aileu, Baucau, Viqueque, Oecussi, Maliana
Loka Dalan	Oxfam Hong Kong	Liquica (Bazartete and Liquica)
Habitat for Humanity	Habitat for Humanity Int'l	Dili, Liquica, Aileu
LANAMONA	CARE, CIDA	Dili, Bobonaro

A further six international NGOs registered with FONGTIL report to be supporting microfinance, but the status of their activities could not be verified during the short Assessment. These INGOs include:

Name of Organization:	*Reported Area of Operation:*
Terre des Hommes, Netherlands	-
The Matsuba Fund, Japan.	Dili, Same, Los Palos (Iliomar)
Leigos Para O Desenvolvemento, Portugal	Dili (microfinance under study)
Intercooperacao e Desenvolvimento	Lautem, Bobonaro, Liquica
Concern Worldwide Timor-Leste	Lautem (Luro), Manufahi (Turiscai)
CHF International	-

The non-financially specialized NGOs have typically started by providing social or basic needs services to a specific target group of beneficiaries in a limited area sponsored by donor-funds, and have later added financial service provision to their projects in response to needs expressed by their beneficiaries.

As such, these NGOs – and their support structure of INGOs and donors - typically focus on the general impact on beneficiaries' livelihoods of their entire project intervention, and less on the portfolio quality and technical and financial sustainability of the microfinance services. They do, however, tend to reach the very poorest of the poor in their project areas.

Table 13: Core Clients and Methodologies of non-financially specialized NGOs

NGO	Core beneficiaries	Microfinance methodology
CCF through 1 branch and 6 local NGOs	Poor children through livelihood improvement of mothers/families	Self-Help Groups
Hotflima	Poor women in rural areas	Self-Help Groups
Timor Aid (Micro credit project)	Peri-urban widows, poor women and poor households	Solidarity Group lending
Halarae	Refugees/displaced families having returned to poverty	Solidarity Group lending
HAFOTI	Poor rural women	Savings and credit groups
Loka Dalan	Poor rural households/farmers	In-kind livestock revolving fund
LANAMONA	Poor rural women in water/ sanitation project areas	Self Help Groups
Habitat for Humanity	Urban slum dwellers	Savings and match loans for housing improvements

The non-financially specialized NGOs reach a total of 4,744 borrowers as at end September 2004, of whom 80% are women. Only three NGOs lend to both men and women. As several NGOs only provide credit, the total number of savers supported by these NGOs is 3,473, hereof 95% women.

There are, however, huge variations in the outreach as well as the quality of the portfolio of the NGOs as illustrated in Table 14.

Table 14: Outreach of non-financially specialized NGOs

NGO	#Savers	#Borrowers	$ savings	$ loans outst.	Avr. Loan size in $	Est. PaR
CCF	1,529	2,017	29,474	110,828	40-100	0.0%
Hotflima	1,375	1,375	60,240	107,595	68-160	2.5%
Halarae	0	387	0	3,785	30-60	100%
LANAMONA	333	70	10,371	2,530	50	32%
Loka Dalan	0	370	0	10,500	In kind	5%
Habitat	228	228	52,393	12,704	50-250	41% LaR*
HAFOTI	8	127	220	9,358	150	15%
Timor Aid	0	117	0	9,958	85	100%
Total	**3,473**	**4,744**	**152,698**	**380,852**		**≈ 35%**

* LaR is Loans at Risk, a measurement of the number of loans with arrears as a % of total no. of loans.

Having benefited from exposure and training through AMFITIL, the AMFITIL-members display a higher level of understanding and skill, and report on at least some of the performance monitoring indicators established by AMFITIL. The staff of non-member NGOs have typically not been exposed to microfinance Good Practices, or trained specifically for microfinance provision, and as a consequence the skill levels for portfolio and financial monitoring, management, recording and reporting are generally low.

It is perhaps unsurprising, therefore, that the estimated Portfolio at Risk across this segment of suppliers is 35%, covering a range from 0% on group repayments of CCF to 100% of the failed portfolios of Halarae and Timor Aid. None of the non-financially specialized NGOs, with the notable exception of Hotflima, were able to provide the data for or calculate any financial viability ratios for their microfinance activity at the time of the Assessment.

CCF started a new project in February 2004 to support Self-Help Groups through their branch in Baucau and six additional Affiliated Community Organizations (ACOs), including Graca in Covalima, Hamutuk and Balibo Ba Oin in Bobonaro, Moris Foun in Manatutu, Goreti in Liquica and

Fo Diak in Dili. While Halarae is preparing to divest its portfolio to CUF and will not continue in microfinance, LANAMONA has developed a proposal for supporting their groups to form savings and credit cooperatives in future. Loka Dalan will continue its in-kind livestock revolving fund, providing sheep or pigs at a value of USD 700 for each of their groups with the condition that an animal is returned for the benefit of other groups.

6.3 Range of Products and Services

6.3.1 Loan Products

The suppliers in Timor-Leste offer a relatively well developed range of loan products, which should suit most segments of the market. They include (see Annex 6 for details):

Collateralized Loans:

- Investment and Working capital loans from USD 10,000 – 100,000 or above at 7-15% p.a. over 6-36 months
- Agricultural (crop production) loans at USD 100/ha at 22.5% effective p.a. over 3-12 months
- SME loans at USD 3,500-10,000 at 7-15% p.a. effective over 6-36 months
- Small Business loans of USD 100-3,000 at 18-56% effective p.a. over 3-18 months
- Consumption loans in the range of USD 400-2,000 at 15-56% effective p.a. over 6-36 months

Uncollateralized Loans:

- Consumption loans in the range of USD 100-500 at 15-56% effective p.a. over 6-60 months
- Microenterprise/livelihood loans at USD 50 – 400 at 19-56% effective p.a. over 4-12 months
- Group loans at USD 500-4,000 at 18-29% effective p.a. over 6-12 months

Despite the agrarian economy in Timor-Leste, the supply is particularly thin when it comes to financing of agricultural production. Only one supplier has a crop production loan, and while the investment, consumption and small business loans on offer, in principle, should be able to include the financing of agricultural equipment (such as hand tractors or mills), no supplier has developed a particular product for this segment of the market, which is traditionally regarded as high-risk.

Confirming this lack, as well as the low level of information available on products, GtZ was unable to find a financial intermediary willing to lend capital to farmers requiring hand-tools (USD 500-2,500) and to traders requiring working capital for input supply. The GtZ project therefore availed the capital itself, providing 3-year loans at zero interest to 4 medium-scale traders (average loan size USD 20,000), as well as 2-year leasing-type loans to farmers for farm equipment. Farmers must provide an upfront down-payment, and the equipment remains in GtZ ownership until 80% of the loan is paid back. The working capital loans to the traders has enabled an interesting on-lending of micro-loans as pre-financing from the traders to farmers at an average of USD 100, which a total of 215 farmers repay in paddy or cash (mostly paddy). GtZ is actively looking for a financial institution to take over the management of the portfolio of USD 113,567 in Baucau.

To an extent, the high level of subsidized input supply or credit for the same is a result of the limited outreach of the financial services providers, as CEP and GtZ will attest to. Especially in rural Timor-Leste, it is not (yet) possible to identify a financial service provider in the vicinity of every project area that is capable of supplying appropriate debt financing products on the scale that may be demanded. On the other hand, continued subsidization will hamper the growth of the small financial sector, as customers will of course prefer the short-term benefit of 'free' services (see section 4.5).

There is still scope for innovation and development, but for customers, the immediate constraints may be related more to the limited outreach of financial services providers (location of branches) and the eligibility requirements (collateral, transaction costs and loan processing time) than to the actual availability of appropriate products. Thus, for the suppliers the immediate issue is expansion of outreach perhaps more than product innovation.

Clients of microfinance suppliers complain of initial loan sizes being too small (USD 50), and it may admittedly be difficult to grow a business with a USD 50 loan given the inflated cost and price structure in Timor-Leste. The cyclical nature of most microfinance methodologies, however, will allow clients to access larger loans, if the initial loans are repaid on time. In addition, many microfinance clients are unhappy with the weekly repayments. There is evidence to suggest, however, that clients who complain – or leave a program giving the weekly installments as the reason – are those whose businesses are unsuccessful and do not generate enough profit[43]. A more dynamic market for their produce or services would in these cases be a more relevant solution than a different repayment structure.

6.3.2 Savings Products

The supply of savings products in Timor-Leste is well developed. Whereas the interest earned on deposits is generally low, and negative in real terms if inflation is taken into account, access to savings services is hampered more by the limited outreach and coverage of suppliers than by the actual availability of products.

Savings products in the market include (see Annex 6 for details):

- Time deposits (fixed for 1, 3, 6, and 12 months) at 0.7-1.15% p.a.
- Current/savings accounts (some with check books) at 0.25 – 0.75% p.a.
- Small deposit savings accounts with free or very low opening balances at 0.50-0.75% p.a.
- Voluntary savings w/ cooperatives and MFIs at 1% to a high of 6% p.a.

Of particular note is the small deposit accounts introduced by the commercial bank CGD. For accounts opened in the name of a person younger than 30 years of age, the opening balance is only USD 5 and the minimum deposit only USD 1, while these requirements increase slightly to USD 10 and USD 2 respectively, if the account holder is an adult. Such a lowering of the threshold for access is usually only seen in competitive markets, and CGD must be commended for offering this opportunity for low-income people to save in a regulated institution.

The innovative savings-led housing improvement scheme run by Habitat for Humanity is set to expand. It is interesting to note that urban slum dwellers, usually among the poorest of the poor (Habitat's eligibility criteria include a monthly income of USD 30-150) are able to save significant amounts of cash with the project, which are then returned to clients as lump sums with a smaller top-up loan, which they invest in improving their housing.

Most MFIs and cooperatives require compulsory savings as a partial guarantee for the otherwise uncollateralized loans, and some MFIs intermediate these savings. As loans outstanding normally exceed the deposits kept, however, the risk associated with this practice is low.

A few of the MFIs, and possibly the cooperatives that accept voluntary savings from their members also intermediate these funds. While the systemic risk stemming from this practice is limited, there is nevertheless always a risk of liquidity crisis, should the MFI experience a 'run' on its savings. AMFITIL members have signed on to prudent management of deposits in their Code of Conduct.

Text Box 15: excerpt from AMFITIL Code of Conduct

AMFITIL Code of Conduct:

"Deposits (savings) belong to the depositor and sufficient liquidity will be maintained [..] to ensure that demands for withdrawals of such deposits can be met at all times. Non-regulated MFWG (AMFITIL) members intermediating savings as loans will ensure that:

- Savings are collected only from members who are also borrowers or who are about to become borrowers of the MFP;
- Clear and comprehensive governance and management structures, policies and procedures are in place to minimise the moral hazard risk to the depositors;
- For credit-led MFPs, a Deposit Reserve Ratio (current assets/deposits) at or greater than 100% will be maintained at all times".

[43] Yohanes Usboko and David Gibbons: A Study on Exits and Inactive Clients from Moris Rasik Microfinance, July 2004.

The market leader in terms of interest on voluntary deposits is the MFI Moris Rasik at 6% p.a. This rate was set at the start of operations without full clarity of the cost and pricing structure in the market, and it is obviously always difficult to reduce an interest rate that customers has become used to.

While all three leading credit cooperatives report attractive interest rates on their members' savings, it is not entirely documented that interest is actually paid out to members every year.

6.3.3 Other Financial Services

In the small and relatively young East Timorese market, it is not surprising that there are few other financial services available than loans and savings. The commercial banks offer the entire range of financial products, including Letters of Credit, forex, money transfers and debit cards etc. Western Union provides cash transfers, as does IMfTL for domestic transfers.

The prices for cash transfers vary somewhat in the market, and have become one of the niche products offered competitively by IMfTL and Bank Mandiri as depicted in Table 16.

Table 16: Prices for Money Transfers

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

6.4 Key Constraints

While the number of suppliers of financial services in Timor-Leste is sufficient to serve the small market, the suppliers have not yet reached a scale that ensures access by all the people who demand financial services and could benefit from them to improve their livelihood and expand their businesses. As at September 2004, financial service providers are lending to a mere 10% of the estimated minimum market of 275,300 people, while 21% of the market has access to savings (see Annex 5).

In the longer run, some consolidation in the industry should be expected, and indeed encouraged for the strongest and most promising suppliers to grow to a sustainable scale. This could come about by the smaller and less successful schemes currently run by the less technically specialized providers merging and/or divesting their portfolio to the stronger institutions. In the short run, however, growth is the key to ensure a lasting impact, both for the institutions providing the services, and for their customers.

It is not evident that the financial service providers can attain the growth necessary to ensure their long-term sustainability in isolation. Just like conventional banks cannot lend without bankable proposals, MFIs, cooperatives and NGOs cannot – or should not – lend to households that cannot earn sufficient income from their businesses to repay the loans and make a profit. Even if they receive a loan, the repayment difficulties will most likely discourage them from taking another loan, and this could be the reason for the high drop-out rates across the MFIs – especially if commodities are being offered for free in their vicinity.

The financial service providers in Timor-Leste face a number of internal constraints pertaining to their institutional capacity as well as external constraints related to the market and the environment in which they work.

6.4.1 Internal, institutional Constraints

All of the financial service providers currently active in Timor-Leste are by international standards small and display weaknesses in financial, managerial and strategic management capabilities. With the small resident population of whom some 66% are under 25 years of age; a history of employment in low-level positions during the Indonesian occupation and thus low levels of skill and experience; a very basic educational system; and a significant brain-drain to the Diaspora and the resident international organizations (UN, INGOs) that remunerate at double the public sector salaries, it is not surprising that Timor-Leste faces a serious human resource dilemma: While unemployment is high and job creation therefore a key concern of government, the labor price levels are inflated and the level of training and skill of the available work force is extremely low. In addition, there are very few opportunities for high-quality training in Timor-Leste.

Many work places, including financial institutions, thus have foreigners in managerial positions and national staff in well-paid lower positions, undergoing intensive (and expensive) on-the-job training while not yet having reached the desired level of productivity. This capacity gap contributes to higher transaction costs, which in turn affects the level of efficiency and sustainability.

Almost all of the financial service providers have been and are relying very heavily on donor funds or international technical assistance. Despite this high level of technical assistance, most financial institution staff has not yet achieved the level of capacity that would enable them to steer a successful financial service provider ahead. Particularly within the group of non-financially specialized NGOs, the level of technical skill and knowledge about good practices appears insufficient, also among the INGOs and donors funding this support. As a result, the operational technical expertise made available has not always been of sufficient quality, or has not reached front line staff. Microfinance schemes have not in all cases been receiving adequate or appropriate support, as several failed portfolios demonstrate.

The financial statements of all cooperatives and non-specialized NGOs demonstrate this gap in operational capacity. At least half do not record, report or consolidate even a basic balance sheet or income statement, and do not (and are possibly not required to) report the most basic performance indicators. It would be important to ensure that financial statements are required, and that operations and projections are adjusted for in-kind subsidies as capacity is built in this area[44]. While several financial service providers also offer business development training and support to their clients, none appear to price these non-financial services. Clients are not charged for the services, and they are not costed in the financial statements. Financial statements, when existing, are therefore likely to over-estimate performance.

Funding of operations and capital for on-lending is perceived by some stakeholders to be a clear constraint. With the exception of 1-2 of the specialized MFIs, however, capital for on-lending is not an actual immediate need if the end result is to be a well-functioning, professional microfinance industry. The actual need (absorption capacity) of the MFIs with real capital constraints over the next 1-3 years is limited (in the range of USD 150,000), which may well be accessed locally. The risk of availing more capital to weak managerial structures with little understanding of operational requirements for growth cannot be understated.

The perceived need for loan (and grant) funds stems in part from the generally low priority that sustainability has been given among the non-financially specialized NGOs. Donors and the parent NGOs of several of these microfinance schemes have been providing grant funding with little performance monitoring and/or little focus on sustainability for several years, and several of the local government structures and NGOs now engaged in microfinance started as general delivery mechanisms of donor funds to Timor-Leste, and thus without a clear vision of (or indeed requirement for) ever having to become sustainable. Several NGOs continue to receive mixed messages (promises of more grant funding, priority of poverty reduction goals) from donors and to

[44] AMFITIL has a set of standardized portfolio data and financial statement formats developed during a workshop in April 2004.

some degree GoTL, which does not facilitate the needed transformation to more business-oriented operations – or the alternative option of focusing on non-financial service provision, where experience and skill-levels may be stronger.

By contrast, all the specialized MFIs are striving for sustainability, and there is full recognition in AMFITIL that growth and sustainability must now be given priority. The level of effort required to attain these goals, especially given the limited skill levels available in Timor-Leste, is equally understood, and the quarterly performance monitoring system established provides an excellent starting point for self-regulation among the financial service providers that are not regulated by BPA.

6.4.2 External Constraints

The small market is dispersed across the sparsely populated country. The cost of reaching people by setting up outlets within reasonable distance of people's residences is higher than in neighboring countries due to the inflated cost structure of transport etc. The limited infrastructure outside of the main city centers compounds the problem, and security is still a concern in several areas. These constraints are increasing with the poverty level of the target clientele of suppliers – conventional banks will normally remain within the perimeters of urban areas awaiting customers, while MFIs will proceed deep into the country-side to reach the economically active poor.

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

Literacy rates are still very low in Timor-Leste (43%), and in most households, women are responsible for caring for the sick. Women of childbearing age also undergo frequent pregnancies and are usually anaemic; and a very high proportion of children are severely malnourished. Rates of maternal and child mortality in Timor-Leste are the highest in Asia. Thus, family and health issues limit the availability of time and energy for productive business activities.

Despite the many unmet demands in the rural communities, carving out new business opportunities and market niches requires innovation and skill. The immediate choice among off-farm livelihood activities in many rural areas is often running a kiosk selling dry goods, trading in a limited number of basic goods or animals at weekly markets, making and selling food products (buns, fried bananas, ground coffee), weaving Tais (local cloth), etc. Not all poor people have the skills and/or the time to make a success of these activities. Competition is stiff, margins are low and returns are limited, especially when many clients invest their loans in similar activities in limited local markets[45]. As is the case for any business effort, the difficulty of investing micro-loans profitably is compounded by general economic slumps and by droughts and floods and other external shocks.

The historical legacy of external patronage and pervasive subsidization of real costs of services, inadvertently perpetuated with the influx of donor funds after Independence, has left the population disempowered. This disempowerment is reflected in inflated demands for and subsequent disenchantment with government support; unrealistic expectations of support 'due' by merit of past hardship, and to a certain extent disengagement in self-reliant – and self-financed - development.

[45] As corroborated by the findings of a study on drop-outs from one of the Timor-Leste MFIs. Y. Usboko and D. Gibbons: A Study on Exits and Inactive Clients from Moris Rasik Microfinance, July 2004.

The combination of difficult markets for income generating businesses and a certain expectation of external 'rescue' may be contributing to the high levels of drop-outs that many MFIs are experiencing at present.

These external constraints, while noted, do not present insurmountable hindrances to successful delivery of financial services. Operational costs will be higher than in more well-endowed environments, but methodologies can be adjusted to better accommodate the market. It may take microfinance in Timor-Leste significant time to reach sustainability, but it is not an impossible task.

6.4.3 Coordination of development efforts and support

Chief among the constraints is perhaps the low level of coordination of development efforts in the country; not in terms of planning matrices of what is being done, but in terms of an overall agreement and adherence by all stakeholders to a commercially oriented market development approach focused on the needs of the client, which would increase the ability of households to generate income; curb the level of distortion in the market caused by grant-funding; and thus improve the business also of financial service providers.

In the course of the preparation of the SIPs, it became even more apparent that coordination is amiss in Timor-Leste's development planning. Responsibility for policy-making and regulation pertaining to the private sector alone is dispersed among at least 11 different agencies of government, including:

- Ministry of Development and Environment
- Secretary of State of Commerce and Industry
- Secretary of State of Labor and Solidarity
- Secretary of State of Natural and Mineral Resources
- Timor Sea Office
- Ministry of Planning and Finance (including Customs)
- Ministry of Agriculture, Forestry and Fisheries
- Ministry of Foreign Affairs and Cooperation
- Ministry of Justice
- Ministry of Transport, Communications and Public Works
- Banking and Payments Authority

A related issue is the fragmentation or absence of coherent information about the total amount of resources being budgeted in support of private sector initiatives by GoTL. The Government is currently spending about $1 million a year on various private sector initiatives, but no formal mechanisms currently take an integrated view of support for the private sector. There is a strong case for improved coordination of policies and programs. The Ministry of Development and Environment, along with the Secretary of State of Commerce and Industry, have increasingly been charged with responsibility for the cross-sectoral issues related to private sector development (PSD). A PSD Ministerial Committee was recently created to address identified shortcomings, but it has yet to demonstrate that it can act as an effective mechanism for strengthening coordination and policy-making. A working group for the development of the PSD SIP has been created involving senior government officials and advisors, together with a diverse group of stakeholders. This group aims to create ownership of the PSD plans and raise coordination of activities in the sector among stakeholders.

Equally, a number of economic sectors, especially those where TFET has not been active, are characterized by large numbers of relatively small donor interventions, with little evidence of effective coordination among donors or with the responsible government agencies. In a number of cases, progress in building sectoral policies and programs has been hampered by differing approaches being taken by various donors[46]. While the total amount of direct donor support for private sector related activities over the past four years exceeds USD 40 million, the Registry of External Assistance (REA) of the Ministry of Planning and Finance is the sole record of total donor

[46] GoTL: Private Sector Development – Priorities and Proposed Sector investment Program, August 2004.

contributions to the sector. It is hoped that the current plans to strengthen the REA and the adoption of the SIPs can help to extend coordination to ensure common approaches adopted by all donors and uniform policies and procedures for support in each sector.

7. Opportunities for the Future

7.1 Opportunities for Financial Institutions

The provision of financial services in a 'depressed' economic setting like Timor-Leste calls for high levels of market responsiveness, responsibility and prudence on the part of providers to carefully assess product range, loan access and loan size against the customers' business capacity and opportunities for investment to avoid over-indebtedness.

Loan sizes should start at sufficient but small levels, and increase only with the ability of the customers to gainfully invest larger amounts. Repayment installments and frequencies should be tailored to the cash flow of the business activities, and savings should be emphasized as a means for poor households to cushion themselves against external shocks. Care must be taken not to overload customers with unnecessary transaction costs (transport, unproductive time in queues and meetings, excessive paperwork, and availability for funders' sometimes excessive requests to 'visit the beneficiaries' etc.). At the same time, a 'zero tolerance' for late repayments must be enforced.

In a certain sense, the smallness of the financial industry is therefore an opportunity in itself. There is scope and time to build capacity, consolidate industry achievements and ensure that fund inflows for on-lending as credit to the poor will not lead to poor households being overburdened with debt as they would access available credit for non-productive (consumption) needs, and end up poorer than before. A mere quantitative increase in the availability of credit will not in itself provide the desired poverty reduction impact in Timor-Leste nor foster a vibrant financial services sector, as the CEP and SEP projects have demonstrated.

There is dedicated management and staff in financial service provision in Timor-Leste. All three banks are currently reviewing and/or planning to expand their operations, and the specialized MFIs are actively pursuing growth strategies with a fair commitment by their international NGO partners to remain involved in Timor-Leste. The four MFIs demonstrate capacity to absorb both skills and funds. There are, however, a couple of the NGO schemes which are likely, and ought, to discontinue microfinance operations.

The global experience of microfinance clearly demonstrates that financial services are most effectively delivered by specialized providers committed to long-term sustainability and thus not as integrated development efforts that mix "free" (grant-based) services with credit. However, access to financial services in Timor-Leste may be expected to contribute more effectively to poverty reduction when provided *alongside* basic social services and efforts to develop local markets. With the huge number of committed projects, donors and NGOs in the country, there are ample opportunities for strategic linkages between providers of all the different services needed by poor households to improve their livelihood. But it is time to specialize and segment the service provision market, based on the principle of "all doing what they do best" rather than "everyone doing everything".

Ultimately, the value of any service is determined by the intended customers' (beneficiaries') willingness to pay for it, be the payment in kind (time, effort) or cash. Financial services, when provided sustainably, demand responsibility on the part of the customer, and can thus support the re-empowerment process among clients. Microfinance as a sustainable development approach focused on providing appropriate financial services to the poor is particularly well suited for this purpose, as it typically introduces the services through empowering group mobilization. Groups thus formed provide an excellent platform for access by poor households to the complementary

social and business development services that can be delivered by equally specialized non-financial service providers.

To further stimulate the re-empowerment process among clients, it may be feasible to explore some unconventional avenues unique to East Timorese culture: while weakened with colonization (Portugal) and occupation (Indonesia) and temporarily disrupted in 1999, East Timorese communities seem to remember and be in the process of re-establishing an ancient socio-cultural leadership and wealth management structure, which includes elements of group savings, community mobilization, penalties for non-compliance to agreed practices, deities to be respected, and a clear hierarchy at clan/family, village and sub-regional (Dom) levels. These could be tapped into by modern financial service providers. Possibly with lesser authority, the Catholic Church could also be a channel for the dissemination to a large audience of 'good practice' messages, especially related to self-reliance, and usage and repayment of loans.

Rather than seeing the environment as a constraint, the structure of this environment can inform the adaptation of products and services; delivery mechanisms and institutional strengthening among the financial service providers in coordination with providers of other services. This requires promotion of a consistent commercial approach and orientation, and an appreciation and understanding of actual and perceived risks at all levels. Such a coordinated and integrated overall approach centering on the needs of the customer could guide the specialization of service providers, including providers of financial services, to support enterprise development for broad-based economic growth and poverty reduction.

For the specialized MFIs, a change of ownership structure from NGOs to companies limited by guarantee (or by shares at a later stage), for example, should be considered as an important aspect of their future development towards maturity as financial service providers. While a company structure has financial implications (taxation etc.), it enables MFIs to be distinguished from (charitable) NGOs with no legally identifiable ownership structure, and would facilitate their access to commercial credit for on-lending. With the Law on Commercial Societies promulgated, this option can now be explored further.

Excellent strides have been made with the establishment of AMFITIL as a platform for increased coordination, information sharing and increased visibility. It would be pertinent to invite all financial service providers that agree to the Code of Conduct and can demonstrate a minimum level of performance to become members. The performance monitoring system adopted should be strengthened and enforced, and the public information dissemination and dialogue with government and donors should be continued. AMFITIL is eminently well positioned to take on these tasks, but it would require further formalization of the Association. The next steps in this process should include the adoption of bylaws, procedures and a work plan; the election of a representative Board or Directors; and the establishment of a staffed secretariat independent from any member.

7.2 Opportunities for Government Policy Makers

The key GoTL stakeholders to support a more enabling environment for the financial services sector appear to include at least the following:

- The Ministry of Planning and Finance, Department for Planning and External Assistance (coordinates SIPs, AAPs, donors and thus should be informed about constraints in the sector)
- The Ministry of Development and Environment (The traditional contact point for AMFITIL, also coordinating support to cooperatives)
- The Office of the Senior Minister for Foreign Affairs and Cooperation (Extensive international contacts and funder of several NGOs providing financial services)
- The Banking and Payments Authority (regulates the banks and IMfTL)

The coalescing of all development stakeholders, including GoTL, the donor community, INGOs, and NGOs around a more client-focused, coordinated and business-oriented approach to enterprise and market development in general, and the delivery of business development and financial services in particular, is a precondition to success in this small market. If the market for selected local products increases, the need for improving the local productivity would grow, and hence the demand for business services, including finance, would also increase, providing the opportunity for financial service providers to grow. With the incomes of micro-, small and medium scale entrepreneurs (MSMEs) increasing and diversifying, private sector contributions to economic growth will be supported.

The laws promulgated and the laws on bankruptcy and regulations pertaining to insurance and taxation that are currently in process, are crucial to increased commercial lending. Their absence is not an immediate constraint to microfinance operations. It would, however, be important to consult financial service suppliers in the process of finalizing the laws, so that specific constraints to their practical implementation may be addressed before the final promulgation of the legislation.

The interest or "rush" apparent in 2002/03 to legislate or regulate the nascent microfinance segment of the financial system is premature and poses a risk to sound industry development. Performance-based self-regulation as performed by AMFITIL within a governmental policy framework which recognizes the important role microfinance can play in the economy, would be a preferred scenario.

The SIP on private sector development confirms GoTL's understanding of the role of the financial sector in supporting private sector growth, and recognizes to a large degree the important role that sustainable and professionally managed financial intermediaries can play in the overall strategy to reduce poverty and enable economic growth. It would be important to invite AMFITIL as a representative body for the microfinance institutions to the Working Group established for the finalization and implementation of the PSD SIP.

The government/donor- sponsored Business Development Centers in Dili, Baucau, Maliana and Oecussi, and the agricultural service centers established by the Ministry of Agriculture, Forestry and Fisheries (MAFF) can prove effective in the short term, but worldwide experience has shown that long-term sustainability remains the greatest challenge for such governmental BDS provision, as is also recognized in the SIP. Most of the current training programs offered are reportedly suffering from a lack of understanding of the actual skills needed by the labor market. In addition, the lack of basic numeracy and literacy skills particularly among rural micro- and small scale entrepreneurs negatively affects their access to, and use of, information and training to improve their ability to adequately price produce, and be included into the supply chain. The GoTL, in their coordinating role, should therefore continue to monitor the sustainability of these centers and ensure that they do not undermine the development of private sector service providers.

The bi-annual Dialogue Fora planned to start in 2005 between the GoTL and private sector stakeholders are a welcome direct link. Too often, however, governments and donors demand a very high degree of participation by private sector entities in "policy dialogues", which for the most part are deemed cost-ineffective by the commercial operators. Policy level dialogue should focus on:

a) assisting MSMEs in clarifying and articulating constraints that need attention at the policy level;
b) facilitating the entry (and sometimes "translation") into the policy arena of these concerns, constraints and demands, such as using 'intermediaries' like the currently funded experts seconded to government, AMFITIL and other business associations;
c) facilitating the processing by the government of these issues; and
d) ensuring the delivery of specific feedback (sometimes after "translation") from the policy level to the operational level at which the MSMEs operate.

As a representative of the private sector financial service providers, AMFITIL should be invited to attend the Entrepreneurs Forum.

7.3 Opportunities for Donor Agencies

The key donor agencies for support to institutional development and enhanced coordination in the financial services sector appear to include the following:

- Asian Development Bank (on the Board of IMfTL)
- USAID (key funding agency for microfinance and CCT in Timor-Leste)
- World Bank (supporting macroeconomic development and SEP II, chairs Donor Consortium)
- UNDP (has pledged USD 300,000 for microfinance in 2005)
- GtZ (implements a food security project with a finance component)

The proposed PSD Sector Investment Program calls for an increase in spending to about USD 28 million during the four year period ending with fiscal year 2006/07. The proposed CFET budget allocations of USD 3.3 million would account for 14%. Some USD 8 million of donor support is already committed under ongoing TFET and other programs that support microfinance and SME development. GoTL is thus proposing new funding of USD 17 million[47].

At the policy level, many donors are supporting GoTL in a less than well-coordinated fashion, and the processing of a multitude of well-meant inputs on legislation and project support is tasking for the under-resourced government. In the immediate future, therefore, better inter-donor coordination and dialogue with representative fora of private sector stakeholders, like AMFITIL and the planned Entrepreneur Forum should be prioritized.

While there are many coordination fora in which donors participate in Timor-Leste, most tend to focus on the compilation of data rather than on building consensus around good practice funding. To facilitate conducive private sector development, given the high level of grant-based donor funds in the country, the formation and operation of an informal MSME Development donor working group as either a stand-alone group or as a sub-committee of the existing donor/government consortium could be considered in addition to the working groups established with GoTL. Such a Group should act as a forum for 'donor-internal' discussions, clarifications and alignment of approaches and strategies to enable a higher level of coherence in the dialogue with GoTL and implementing agencies.

An active donor group focusing on private sector development would be responsible for pro-actively coordinating donor policies and programming through:

- Forging coherence and compliance with good practices especially on the issue of subsidies;
- Monitoring donor investment and impact;
- Maintaining an ongoing dialogue with government and service providers over policy formulation and rollout; and
- "Policing" donor actions to assure that they become consistent with the development of sustainable business service markets.

The latter is critical if a level playing field is to be maintained.

To directly address the key constraints faced by the financial service providers, the development of a more vibrant financial service sector increasing its outreach to a larger segment of the East Timorese population could be supported in three ways:

- Institutional support for performance-based capacity building
- Guarantees for commercial bank loans
- Support for industry development among providers

[47] GoTL: Private Sector Development – Priorities and proposed Sector Investment Program, August 2004.

7.3.1 Institutional Support

All financial service providers agree that capacity building in the broad sense is their current biggest need. Management and staff training by TA specialized in financial service provision at the operational level is a predominant demand, and there is also a desire to see clients trained. Capacity building – like business services in general – is not only training, but also includes technical assistance, development of operational policies, procedures and systems, institutional strengthening (management and organization), market research, product development and basic equipment for the younger MFIs.

Capacity-building could include regular, conceptual and practical training at gradually increasing levels of complexity in a more structured environment as well as demand-based, on-the-job technical assistance. The 'generic' training could be undertaken jointly with staff from different institutions participating in each course to enhance awareness of market developments. Such a training process lends itself well to be coordinated by an Association such as AMFITIL (see below). Training should be sequenced and defined based on training needs assessments and demand, but probably starting with business planning, financial projections and delinquency management.

As there are no financial service training providers or consultants in Timor-Leste at present, and due to the language barrier, CGAP-trained private sector service providers such as PERIBANDO (GtZ Indonesia) and Prudentia Microfin could be contracted from Indonesia to deliver standardized (micro)finance trainings and training-of-trainers in Bahasa Indonesia. With back-stopping from the CGAP hub EDA in New Delhi and Punla Sa Tao in Philippines for example, customized training materials could be developed and translated locally. The Centre for Microfinance in Kathmandu, Nepal is another source of available trainers and (English) training materials, especially geared towards lower-level staff with less financial management background working in conditions similar to Timor-Leste.

It would be important to engage potential future training providers from Timor-Leste in the process with the view that TA could be sourced locally at a later stage. One potential commercial provider to explore is the Dili-based accounting firm Johnson and Martins. The KLIBUR business training center and the Dili Distance Learning center could also be approached.

On-site follow-up by qualified TA/consultants would be important, and equally it would be important to avail financial institutions of contacts and exposure to allow each institution to source specific TA for specific problems encountered. TA appears to be needed for areas such as business and strategic planning, development and revisions of policies, manuals, systems (credit management, savings management, internal controls, financial management and reporting), and product development as well as for debt collection, divestiture, mergers and exit strategies for unsuccessful microfinance schemes etc.

Training and TA in Timor-Leste could be complemented by exposure visits or 'apprentice stays' (pending language capabilities) to similar environments, where the financial services industry is more mature, for example Nepal, rural Philippines (Panabo), and Indonesia (BRI and Danamon Savings and Credit).

All capacity building should underpin the drive towards more business-oriented operations. Therefore, capacity building should be costed at market rates, and the institutions charged accordingly. It is, however, well recognized that very few of the current providers (except perhaps Bank Mandiri and CGD) have the funds to afford market-rate capacity building. The MFIs are caught in the common 'Catch 22': to reach a scale where they can become profitable enough to allocate funds for training, they need capacity building which they cannot yet afford.

Therefore, an interim funding mechanism could be established to which financial service providers could apply for funds for capacity building. AMFITIL and other apexes should be able to apply on equal terms with individual financial service providers. Applications should include a justification of

need, as well as proposed performance indicators and targets for the expected results of the support. The mechanism should cater for capacity building in the broad sense of institutional development, including funds to procure basic equipment (safes, motorcycles, filing cabinets, computers, generators), systems (MIS for example), etc. Only for very young institutions should recurrent operational costs (salaries, rent) be considered for funding. In general terms, institutions should be able to cover these costs from their income. Institutions should contribute in-kind or cash to the total costs (including opportunity costs) of capacity building, and funding should decrease as sustainability levels rise. Lack of achievement against negotiated performance targets should exclude institutions from subsequent funding.

As most financial service providers are not yet sustainable, and therefore must rely on donor funding for a while to come, enhanced performance monitoring by funders of both current and future grants would promote the attention to business achievements. Performance monitoring indicators should focus on growth, risk management and sustainability. Indicators and specific, verifiable and time-bound (*not* cumulative) targets for each indicator should be negotiated prior to any funding. Rather than, or at least in addition to "head-count" indicators of number of clients reached or number of staff trained for example, the indicators should measure quality improvements in services and operations as a result of the grants, and could include the following:

Asset quality measurements:
- Portfolio at Risk
- Risk coverage/write-off ratios
- Client retention rate
- Number of clients taking 2nd and larger loans

Efficiency and productivity measurements:
- Loan officer case load
- Cost per borrower
- Operating expense ratio

Financial management improvement measures:
- Written policies and procedures, such as business plans, default and write-off policies
- Loan tracking system producing reliable data
- Financial statements and MIS producing reliable data
- Liquidity ratio

Profitability measurements:
- Operational and Financial Self-Sufficiency ratios
- Portfolio yield/revenue generated
- Net interest margin

7.3.2 Bank Guarantees

To the extent that loan capital is an immediate constraint to growth and the financial service providers have a respectable operational basis for managing such growth, capital for on-lending should be provided as loans rather than grants, but there is very little experience with corporate borrowing among the current MFIs, and no MFI presents financial statements that would attract a fully commercial lender—i.e. no MFI is profitable, nor will they be for a while yet (2-5 years). In order to reach a sustainable level, they will, however, have to grow their portfolio, and hence external loan capital will be required – the common Catch 22.

While there is encouraging evidence of increasing linkage banking, with one commercial bank lending to an MFI, several other MFIs may need capital for on-lending in the coming 1-3 years, and will not necessarily have sufficient fixed assets for collateral. Until the commercial banks become more familiar with the operations of MFIs, they may require some under-writing in the form of fixed deposit cash or non-cash guarantees against losses from such credit lines or loans.

A linkage banking guarantee mechanism could be provided to under-write commercial loans to MFIs. Guarantees should, however, not leave commercial lenders completely free of credit risk,

but the credit risk can be shared, with the under-writing decreasing over time. Guarantees should be provided at a (reasonable) cost to the MFI, and be based on performance targets measured by verifiable indicators.

Preferably the mechanism should include TA that could facilitate linkages and negotiations on terms and conditions between the banks and interested MFI; and assist in the revision as needed of the documentation for the product; while acting as a third party Guarantor of the MFI, signing a tri-partite agreement, and taking (loan book) collateral from the MFI as security for the guarantee.

7.3.3 Enhanced Coordination through AMFITIL

Each financial service provider in Timor-Leste is striving to improve their operations with relatively disparate support from head quarters, INGO partners and donors, and the potential for cost-effective synergy in overcoming constraints is not fully exploited. There is a need to bring the financial service providers together to improve coordination and streamlining; facilitate lateral learning and advocacy; and enhance equitable access to mutually beneficial capacity building services in a more cost-effective manner.

The chief reason for this need is the small market, the similarities in capacity constraints, and the need to professionalize service delivery for future growth. But there is also a perplexing lack of general awareness about financial service provision, outreach and quality in Timor-Leste, and an urgent need for more public information and 'education' about the industry, its achievements and constraints, which in turn could facilitate a higher level of coordination and coherence in policy making and funding.

AMFITIL is registered as a local NGO on Articles of Association akin to national MFI associations elsewhere, and has currently 11 members, including all of the specialized MFIs. In addition, members have signed what is probably the most specific and detailed Good Practice-based Code of Conduct in the microfinance world today. Members have agreed on a minimal performance monitoring system, and most members are reporting quarterly performance ratios to the secretariat.

The leadership of the Association is elected, and secretarial functions are rotating on a voluntary basis among the very busy members. This is proving a bottleneck for the Association to perform its tasks for processing the performance monitoring of members into a feedback mechanism providing members a measurement of their progress against peer group averages; for the public information dissemination; and for the dialogue with GoTL, donors etc.

To strengthen AMFITIL and promote its development into Association acting as a legitimate representative platform for good-practice based microfinance – and perhaps for financial service provision in general - in Timor-Leste, it needs an elected Board of Directors and a permanently staffed secretariat housed separately from any member. A physical secretariat of the Association would signal professionalization and increase visibility, while providing a "focal point" for contacts, linkages, resources and information on and about the industry.

Tasks of such a secretariat should be determined and prioritized by the members in an annual business plan with specific targets to be developed and adopted at a constituting Annual General Assembly, which should also elect a Board of Directors, who could subsequently recruit the staff for the secretariat.

In conclusion, the financial services sector in Timor-Leste is small, but significant progress has been accomplished over the past 1-2 years in terms of growth, performance improvements and outreach to the poorer segments of society. There are many challenges ahead and there is ample scope for improvement and above all for expansion of the portfolios, without which none of the providers will be able to become and stay profitable.

There are imminent opportunities to increase linkage banking and general coordination and collaboration within the financial service sector, as well as with other stakeholders in GoTL and among the donor agencies, to develop a common and business-oriented approach to improve, adapt and expand the financial services to reach the under-served markets of poor households and micro-, small and medium-scale entrepreneurs, especially in the rural areas of Timor-Leste.

Annex 1

Scope of Work
Lead Consultant

Conducting a Financial Services Sector Assessment and Participation in a Workshop on "Millennium Development Goals and The Eradication of Poverty – The Role of Microfinance in Timor-Leste"

Purpose*:*

The purpose of the consultancy is to conduct an assessment of the financial services sector with particular focus on the microfinance providers, and evaluate its current and potential effect on economic development and poverty alleviation in Timor-Leste. The assessment team will focus on identification of the range of financial services available, who has access to them, what are the key constraints and opportunities to providing microfinance, who are the key stakeholder that can ensure and enabling environment for microfinance services, with a focus to defining interventions to optimally enhance the development of the microfinance sector. The information captured from the assessment should provide decision-makers and service providers with information that will enable them to prioritize and develop strategies and interventions to support and implement activities focused on strengthening the economy through improved financial services.

Background:

East Timor gained its independence in May 2002 as one of the world's poorest countries with GDP per capita at $US 478---and 41% of the population living below the national poverty line of $0.55 per person per day.[1] Since independence, growth rates and per capita incomes have declined due to a contracting economy and weak prospects for local and foreign investment. The Asian Development Bank reports that one of the major factors contributing to the country's slow moving economy is the lack of access to capital, which has affected the ability to rebuild businesses.[2] Seventy five percent of the population is rural and 80% of rural communities rely on subsistence agriculture. In addition, many families rely on self-employment activities in the informal sector, and do so without access to working capital or other financial services to cope with economic difficulties. The poor are vulnerable to economic instability and food insecurity, and those most affected are often women and women heads of households. With lower literacy rates and less access to formal sector jobs, women dominate the informal sector with their microenterprises that they often rely on as means to improve their household economy.

There is recognition that creating new employment opportunities and higher incomes are the highest priorities for East Timor. The future of employment and pro-poor growth in East Timor will depend on development of a viable business sector including development of micro and small businesses. This can be achieved through a combination of various private and public sector initiatives that improve financial systems for the poor. The persistence of poverty and the proliferation of self-employment activities points to the need for an economic development intervention, such as microfinance, and the provision of financial services to address the needs of the poor is a nascent industry in East Timor. Though several microfinance service providers, credit unions, cooperatives, commercial banks and INGO programs have been providing financial services since independence, and a few individual institutions have undergone an assessment of their own institution's operations, a comprehensive assessment of the financial services sector has yet to be conducted to confirm the range and access of financial services available to the poor for investment in economic activity.

[1] United Nations Development Programme. December 2002. *East Timor Human Development Report.*
[2] Microfinance Development Project/East Timor, A TFET-Funded project of the East Timor Transitional Administration, managed by the Asian Development Bank, November 2000.

The need for effective and sustainable microfinance services in East Timor is significant given the extent of poverty and the destruction of the financial infrastructure as a result of the long struggle for independence. In order to develop a responsive and inclusive financial services industry, it is vital that the decision-makers and providers are identified and come together for dialogue and information sharing. In addition, a comprehensive financial sector assessment will synthesize the information necessary to enable decision-makers and financial service providers to make decisions and develop interventions to ensure that the financial services sector will not only flourish in East Timor but will also be inclusive of poor and vulnerable groups. The results of the workshop and assessment should identify key opportunities and constraints of providing financial services to the poor, as well as identifying the range of services that are available and accessible. Moreover, it's crucial that key stakeholders are identified who can dialogue with the new government on the benefits of a thriving microfinance sector to ensure the continuation of sound economic legislation and policies affecting the microfinance industry. Therefore, this assessment will provide timely information to analyze the context, the experiences to date, and identify key stakeholders who will be able to provide much needed financial services to the poor with the goal of accelerating economic growth as articulated in the East Timor National Development Plan.

Scope of the Assessment:

1. Assess the **access and supply of financial services** available looking at:
   a) mapping of geographic and institutional coverage of financial services, and the range of services offered (with particular attention to agriculture equipment loans).
   b) development of an inventory of financial services sector operation in Timor-Leste that includes MFIs, Cooperatives, Credit Unions, commercial banks, development banks, NGOs, wholesale institutions and the range and types of services they offer.
   c) access to their services available to the wider community members particularly women, vulnerable groups and farmer groups.
   d) their contributions toward poverty alleviation and economic development in Timor-Leste.

2. Identify the **stage of maturity of the microfinance sector** looking at:
   a) analysis on how microfinance fits within the broader financial services sector of TL.
   b) analysis of the outreach (breadth and depth) of existing Microfinance Institutions/Providers
   c) effectiveness and efficiency of Microfinance Institutions/Providers services delivered.
   d) challenges and opportunities that influences the development of the Microfinance sector.
   e) analysis of the existing and potential demand of microfinance services within the country.
   f) analysis of the role of the microfinance sector within the GOTL's strategy to alleviate poverty.

3. Analyze the **national and legal framework** governing microfinance services looking at:
   a) existing challenges and opportunities that enable or hinder various institutions/agencies to effectively and efficiently deliver their microfinance services.
   b) an overview of current policies/regulation/legislation/strategy affecting microfinance services.
   c) analysis of stakeholders that should be involved in future development of a national Microfinance policy and/or regulation.

4. Assess the **role of other key players** involved in the development of the microfinance sector including Donors, Government, INGOs, AMFITIL, Commercial Banks, and Development Banks looking at:
   a) their present attitudes and constraints towards supporting the microfinance sector
   b) analysis of areas where future collaboration can take place.

Outputs:

1) December 8-9 Workshop on "Millennium Development Goals and The Eradication of Poverty – The Role of Microfinance in Timor-Leste":

8 December: The day involves roundtable discussions and is designed to give microfinance practitioners and community representatives an opportunity to discuss the various technical issues around the workshop's theme directly with Dr. Yunus the Guest Speaker. As part of the assessment, the consultants will meet prior to the workshop with AMFITIL members to prepare for the workshop and then participate in the day's events.

9 December: The day will involve presentations, panel and group discussions with all stakeholders involved in providing financial services in East Timor. The consultants from the assessment team will also participate and make a presentation that will focus on:

- Microfinance as a Tool for Eradicating Poverty
- A Financial Systems Approach to Address the Needs of the Poor: How MF should be geared to support financial systems that are inclusive of the poor and vulnerable groups
- Microfinance "Best Practices" for Various Stakeholders
- Experience of Microfinance in Asia: Benchmarks for Comparison
- Current Experience of Microfinance Sectors in Timor Leste

2) Research on Financial Services Sector in Timor-Leste

The principal activity in the consultancy is to conduct a comprehensive assessment of the financial services sector and analysis of the role of microfinance in addressing poverty alleviation and economic development in Timor-Leste. The assessment will focus on identification of the range of financial services available (including farmer access to credit for agriculture inputs and equipment), who needs and has access to them, what are the key constraints and opportunities to providing them, who are the key stakeholders that can ensure an enabling environment for financial services, how microfinance services in particular can impact poverty alleviation, and identify interventions to optimally enhance the development of the microfinance sector.

Prior to and after the workshop the consultants will conduct research through a comprehensive review of existing documentation, national policy and legislation. This will be followed by visits and meetings to the various stakeholders and providers both in Dili and in the districts. Finally, there will also be interviews and focus group discussions with current and potential clients of the financial services sector. Special attention will be paid to women, vulnerable groups and farmers.

3) Debriefing Workshop on Financial Services Sector in Timor-Leste:
The results will be presented at a debriefing workshop to discuss the findings with the key stakeholders and providers in the microfinance sector on December 20th, 2004 in Dili.

4) Final Report on Financial Services Sector in Timor-Leste:
Following the workshop, the consultants will prepare a draft report in one electronic copy in English (no longer than 25 pages plus annexes) and submit no later than 27 December 2004. Any comments received before January 05 2005 in addition to those received on 20 December 2004 will be incorporated into a Final report to be submitted in one electronic copy in English latest by 10 January 2004. The final report will contain, among other information, a detailed review of lending institutions including Microfinance providers (type and range of services, coverage, outreach), the existing and potential demand of the financial services sector, the constraints and opportunities of the financial services sector development, the special regulatory framework and who are the stakeholders to influence this environment, and the potential of future Microfinance suppliers within the country.

Methodology of the Assessment:

1. Study prior and ongoing assessment to the financial services sector and produce an overall presentation of financial services operation within the country. Obtain initial briefings from the UNDP, AMFITIL, USAID, DAI on the objectives, scope of the assessment and clarification on any issues as required. Modify the T.O.R. based on mutual agreement if necessary.
2. Review the relevant background documents including existing assessments, reports, and current legislation relevant to the financial services sector in Timor-Leste.
3. Consult various AMFITIL members, other Microfinance providers, Government Institutions, Development Agencies including UN Agencies, Donor Agencies, NGOs, Development and Commercial Banks, Cooperatives, Credit Unions, etc.
4. Visit selected districts, microfinance programs/projects and community organizations.
5. Organize participatory focus group discussions to examine the relevant issues, including current and potential clients of financial services for the poor.
6. Draft the report and make presentation of conclusions, findings and recommendations.
7. Finalize the report with the comments and inputs from various stakeholders and development partners.

Location of Consultancy: The consultancy will take place in East Timor-- in Dili and districts-- from 3 December to 21 December 2004. Writing of final report work can be finalized at the home base of the lead consultant.

Timing and Duration:
The consultancy would commence on 3 December 2004 and conclude 10 January 2005. The length will be 19 consecutive working days in-country, inclusive of weekends and 2 days in-home country. The total number of working days in the consultancy is 21 days. Final Report should be submitted no later than 10 January 2005.

Working Relationships:
The lead consultant will be assisted in the accomplishment of the activities and outputs by a second consultant and will collaborate with this person on the design and development and on the report writing. The CRS MF Program Manager and AMFITIL Secretary, Marcella Willis, will act as the consultant's liaison in East Timor, and will assist the consultant with administration and logistics during the consultancy. The consultant will collaborate with Catholic Relief Services and the Association of Microfinance Institutions in Timor-Leste (AMFITIL) in developing and finalizing this assessment. Catholic Relief Services is the main contact coordinating with the co-funders USAID/DAI and UNDP. The AMFITIL will provide in-kind contribution.

Annex 3

List of Persons Met and Interviewed

Government of Timor-Leste:

Dr. Jose Ramos-Horta, Senior Minister of Foreign Affairs and Cooperation
(also Founder of Peace and Democracy Foundation and Timor Aid)
Mr. Abel da Costa Freitas Ximenes, Vice Minister of Development & Environment
Mr. Caetano de Sousa Guterres, Chief of Cabinet (Also Founder of HOTFLIMA)
Mr. Cosme F. B. da Silva, Director, Devt. Support Div., Ministry of Development and Environment
Mr. Bonafacio Correia , Chief, Section for Informal Sector and Self-employment
(also Chairperson of Federation of Credit Unions of East Timor)
Mr. Ramon Oliveros, Advisor, Planning & Ext. Assistance, Ministry of Planning and Finance

Ms. Maria Jose Sarmento , Dep. General Manager, Banking & Payments Authority

Commercial Banks:

Mr. Teofilo Fonseca, Dep. General Manager, Caixa Geral de Depositos
Mr. Ken Widjajanto, General Manager, PT Bank Mandiri
Mr. Peter Porter, General Manager, ANZ Bank

Finance Companies:
Ms. Eugenia Matos da Costa , Pacific Holdings Ltd. (Western Union)

MFIs:

Ms. Marcella Willis, Microfinance Program Manager, Catholic Relief Services
Mr. Sergio M. Espirito Santo, General Manager, Institucau de Microfinancas de Timor-Leste
Ms. Helen Todd, Executive Director, Moris Rasik
Mr. A. Hasan Bullah, Program Manager, Moris Rasik
Ms. Maria da Costa, Center Leader, Moris Rasik Aileu Branch
Ms. Luzmarie de Villa, Finance Manager, Opportunity International
Mr. Jose Adriano Gusmao, Director, Tuba Rai Metin (also President of AMFITIL)
Mr. Adalgiza Freitas Marques Marcal , Baucau Branch Manager, Tuba Rai Metin
Ms. Ana Florinda, Group Leader, Tuba Rai Metin Baucau branch group
Ms. Justinha Da Costa, Group Leader, Tuba Rai Metin Baucau branch group

Cooperatives:

Mr. David Boyce, NCBA Enterprise Development Adviser, Cooperativa Café Timor
Mr. Oscar Hernandez, NCBA Financial Advisor, CCT
Mr. Cecilio Alfes, Manager, CCT
Mr. Pedro Ximenes, Managing Director, KLIBUR
Mr. Joao Vilanova, Training officer, KLIBUR
Mr. Nicilau de Vasconselos, Senior Directos, Cooperativa Credito Fini Soru Mutu (CCFSM)
Mr. Angelino Monteiro, Credit Officer, Naroman Credit Cooperative
Mr. Jose Henrique Maia, Credit Officer, Fitun Naroman Credit Cooperative

I/NGOs:

Ms. Jessica Pearl, Country Director, Catholic Relief Services (CRS)
Mr. Alfonso de Oliviera, Manager Agriculture, CRS
Ms. Jill Umbach, Country Director, CARE International Timor-Leste

Ms. Maria Aurora dos Reis, National Director, Christian Children;'s Fund East Timor (CCF)
Mr. Nick Gnanathurai, Microfinance Advisor, CCF
Ms. Fransisca Maia, Self Help Group Leader, CCF Baucau
Ms. Aurea da Costa Guterres, Director, HOTFLIMA
Mr. Paulo da Costa Amaral, Director, Fundacao Halarae
Mr. Alex Nunes, Program Coordinator, Fundacao Halarae
Ms. Maria do Ceu Federer, Chief Executive Officer, Timor Aid
Ms. Maya Bruck, Program Manager, Timor Aid
Mr. Domingos da Costa, Micro Credit Manager, Timor Aid
Mr. Ildefonso Guterres, Project Manager, HAFOTI
Mr. Abilio A.F. Belo, Operations Manager, Habitat for Humanity
Mr. Luis Barebuti, Manager, LANAMONA
Mr. Antonio Geronimo, Manager, Loka Dalan
Mr. Agapito dos Reis, Manager, Graca
Mr. Estanis Martins, Director, Peace and Democracy Foundation

Donor Agencies and Projects:

Ms. Elizabeth Huebens, Resident Representative, World Bank
Mr. Charles Andrews, Resident Representative, Asian Development Bank (ADB)
Mr. Eugenio A. Demigillo Jr., Advisor, ADB Microfinance Development Project
Mr. Naoki Takyo, Asst. Resident Representative, UNDP
Mr. Antonio Vitor, Programme Analyst, PRCD Unit, UNDP
Mr. Charles Bonhomme, Head of Cooperation Office, Embassy of France
Mr. Peter Ellis Counsellor Development Cooperation, AusAid
Mr. Günther Kohl, Team Leader, GtZ
Ms. Brigitte S.-Podborny, Institutional Development Adviser, GtZ
Mr. Nicholas Hobgood, Chief of Party, USAID/DAI East Timor
Ms. Kate Heuisler, Asst. Chief of Party, USAID/DAI East Timor
Mr. Osario Correia, Assistant Manager, USAID DAI Small Grants Program
Mr. Joao Boavida, Managing Director, AustCare
Mr. Damian Mate, Technical Advisor, UN HABITAT

Others:

Professor Muhammad Yunus, Managing Director, Grameen Bank, Bangladesh
Ms. Lamiya Morshed, Director for Development, Grameen Trust
Mr. Michael O'Dea, Adviser, International Development Corporation Pty Ltd.
Mr. Barry Thomas, External Advisor, Peace and Democracy Foundation

Annex 4

List of Ongoing and Planned Donor-Funded Projects with opportunities for linkages to financial service providers to (gradually) replace direct subsidization of input[1]

Project sub-sector and Name	Donor Agency	Donor funds committed in USD	Project End Date
Agriculture and Rural Development			
Rural Development Program I	AusAid	3.5 million	30 Sept 2005
Rural Development Project* (Oecussi Community Activation)	EU UNOPS	3.5 million 0.3 million	30 Jun 2008
Agricultural Rehabilitation Project III	EU WB	7.9 million 3.0 million	30 Dec 2005
Household Poultry Project	UNDP	1.4 million	01 Dec 2006
Coffee Industry Support (CCT)	USAID	17.9 million	30 Sept 2005
Coffee Grower Support, Maubisse	JICA	0.4 million	31 Mar 2006
Food Security, Baucau/Viqueque	GtZ/MAFF	2.6 million	31 Oct 2005
Diversification of Food Supply	JICA	0.4 million	31 July 2006
Rural electrification	EU	Planning stage	
Micro-/mini hydropower	Norway	Planning stage	
Community Development			
Community Water and Sanitation	AusAid	2.7 million	30 Jun 2005
Community Stabilization*	EU/IOM	3.5 million	30 Jun 2008
Water and Sanitation	UNICEF	1.0 million	31 Dec 2005
Ainaro/Manatutu Community Activation	Japan/UNOPS	4.5 million	31 Oct 2008
CEP III	WB/TFET		
Water and Sanitation	UNICEF	1.0 million	31 Dec 2005
Community Fund/Small Grants programs	USAID/DAI, New Zealand, CIDA, UK	Est. 2.0 million	Ongoing
Income Generation/Special Groups			
Support to micro enterprises	ADB	0.2 million	30 Jun 2006
Integrated Employment Generation	ILO	0.2 million	01 Aug 2005
Livelihoods Project	WFP/Concern	0.9 million	31 Dec 2005
RESPECT	UNDP, Japan	3.9 million	01 Mar 2006
Employment Generation	Spain	0.3 million	01 Aug 2005
STAGE	UNDP, CIDA, ILO	1.0 million	01 Mar 2008
Protection/Assistance for Returnees	UNHCR	0.3 million	01 Aug 2005

* Possibly the same project registered by different donor agencies.

[1] Data from the Ministry of Planning and Finance: Registry of External Assistance, July 2004, and thus subject to the estimations, omissions and changes normally found in such registries. This list is illustrative, non-prioritized and non-exclusive, and the level of possible direct input supply subsidization in the projects mentioned has not been verified. The list is included as a guideline for contacts to establish linkages with financial service providers to discuss opportunities for a gradual transfer of possible grant-funded input supply to more sustainable, debt financed input provision to MSMEs.

Annex 5

Mapping of Financial Service Providers In Timor-Leste

A mapping of financial services providers based on geographic outreach (location of branches across the country) was carried out and is presented below (Maps 1-4).

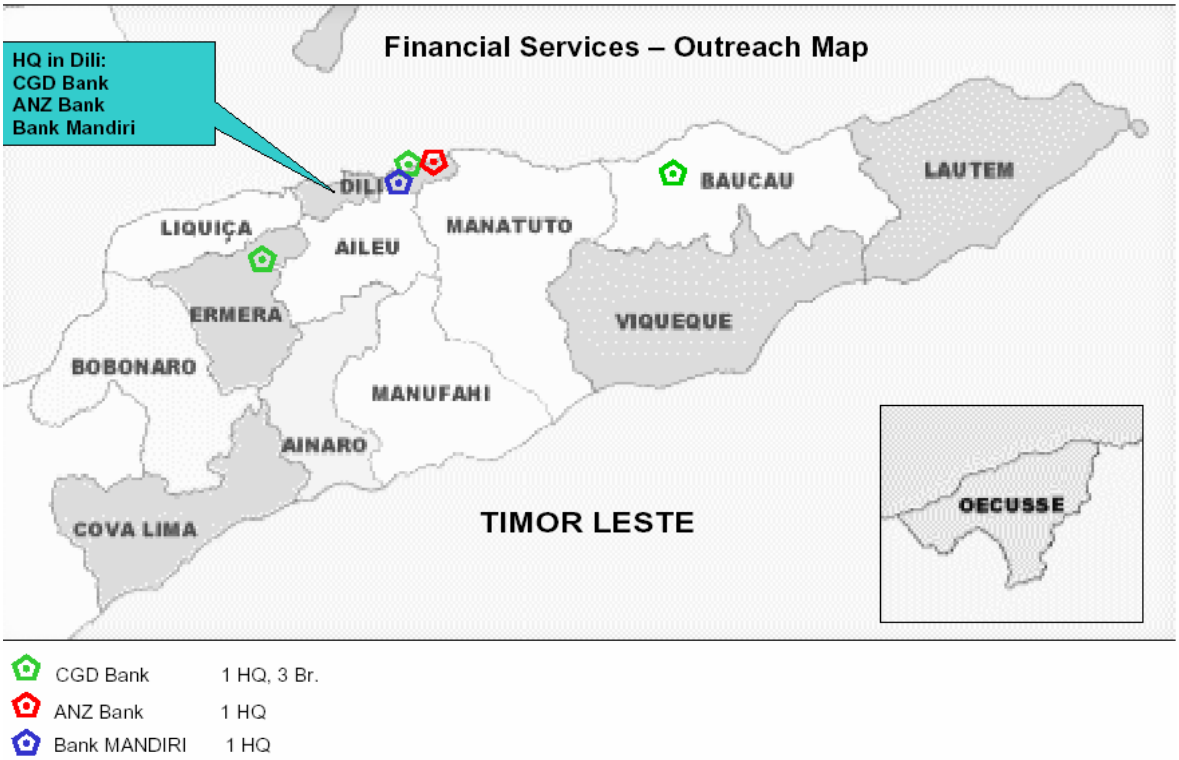
The Assessment Team also started mapping the market penetration by district. In the short time available for the Assessment, it was not possible to get outreach data by sub-districts from all providers, and the map could thus not be completed.

It is presented here (Map 5) with the raw data received as at 05 January 2005 (Table 5a), and it is hoped that AMFITIL will be able to complete the Map by adding outreach data from all banks, MFIs and NGOs by sub-districts, so that a more complete picture of service coverage can be developed and updated regularly. This would enable stakeholders to:

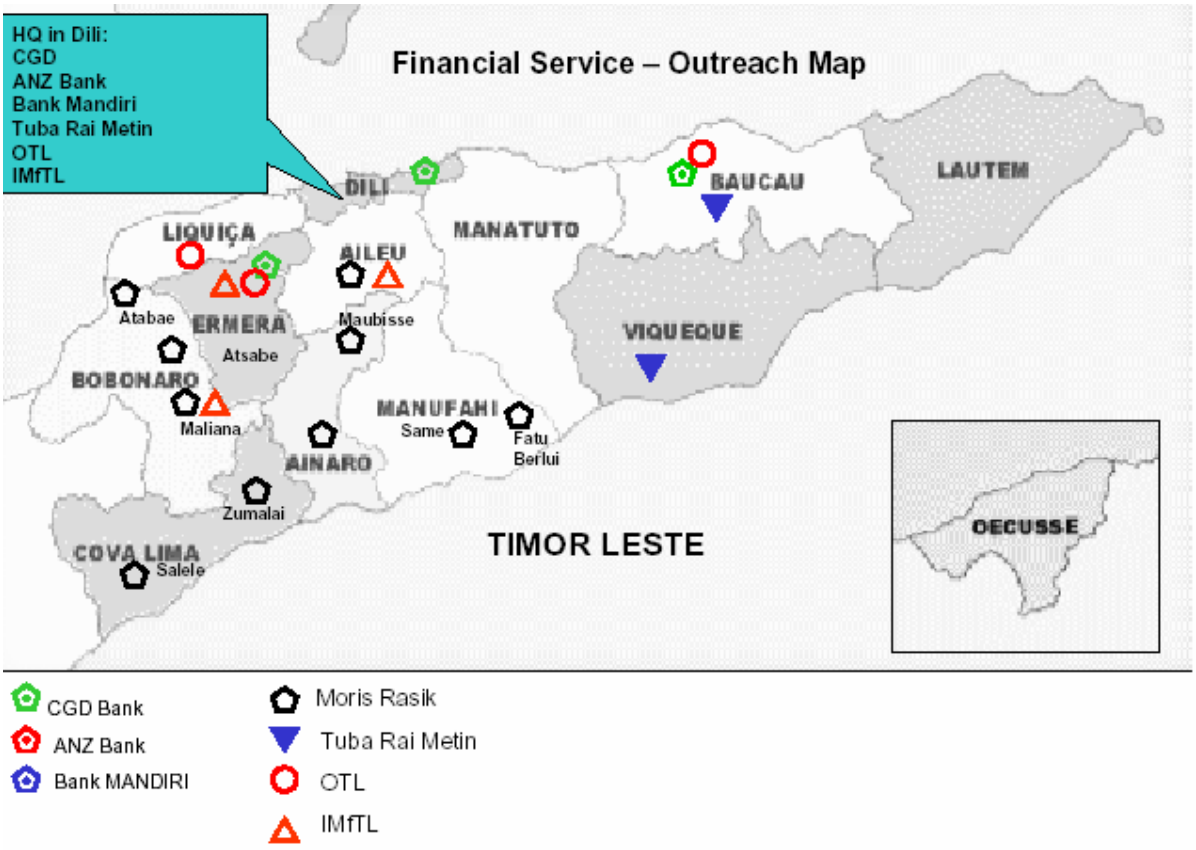
- Review progress on outreach
- Remain alert to possible risk of multiple borrowing among clients in sub-districts served by more than one provider
- Coordinate planned expansion to new areas with a view to focus on currently under- or un-served sub-districts

For a summary overview of outreach and performance for all financial service providers as reported to the Assessment Team, please see Table 5b.

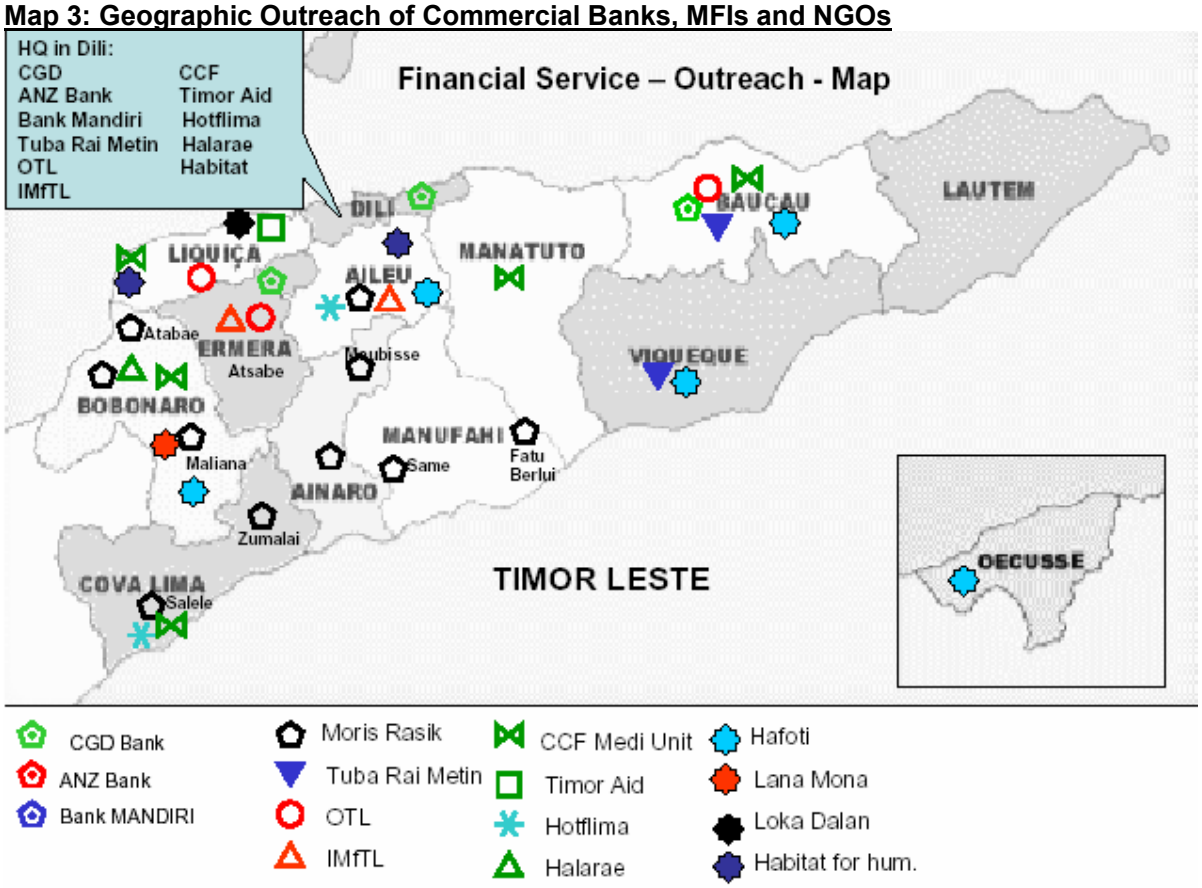
Map 1: Geographic Outreach of Commercial Banks



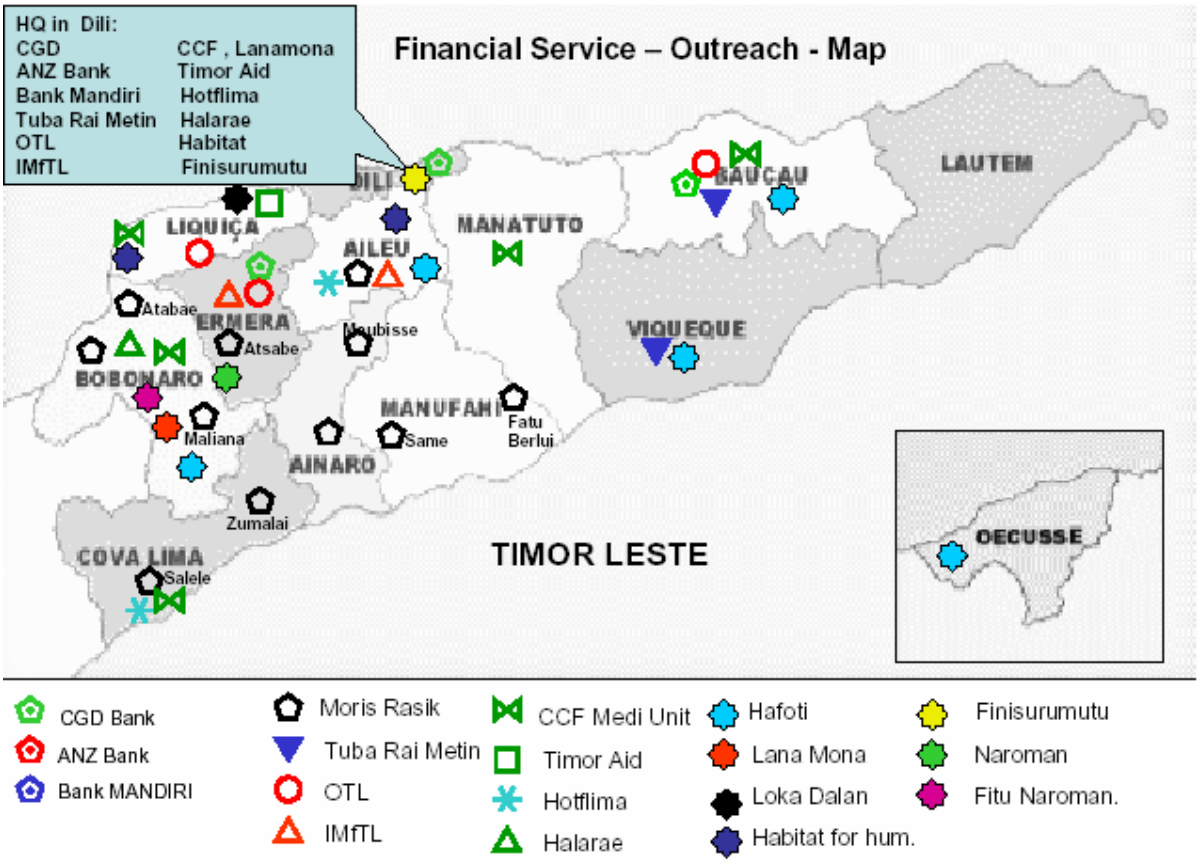
Map 2: Geographic Outreach of Commercial Banks and Specialized MFIs



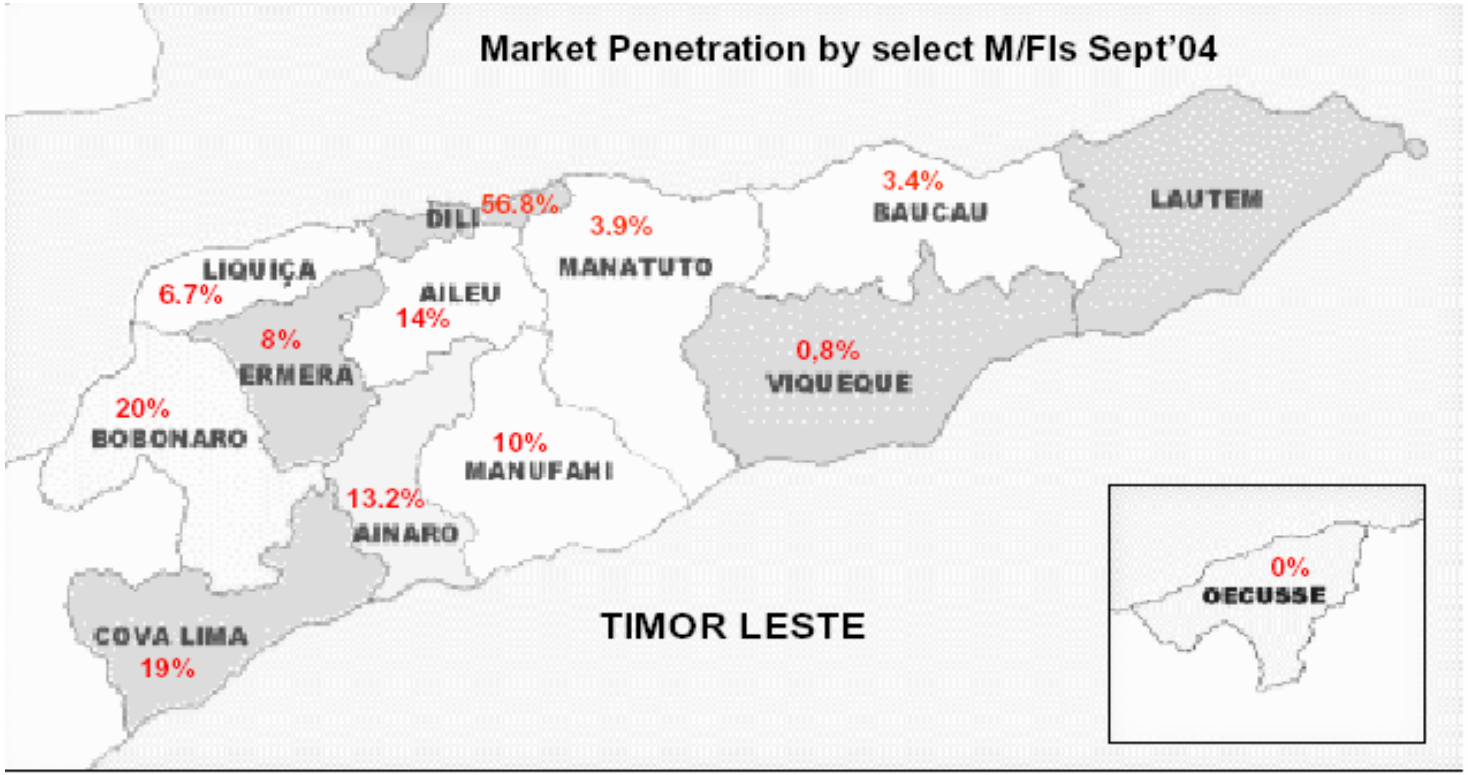
Map 3: Geographic Outreach of Commercial Banks, MFIs and NGOs



Map 4: Geographic Outreach of Commercial Banks, MFIs, NGOs and Credit Coop's



Map 5: Market Penetration by District of Select Financial Service Providers



District	Tot.Pop	# HHs	Clients	District	Tot.Pop	# HHs	Clients	District	Tot.Pop	# HHs	Clients
Aileu	36,889	8,177	1,156	Covalima	55,941	10,546	1,999	Lautem	57,453	13,382	
Ainaro	53,629	12,128	1,600	Dili	167,777	30,400	17,293	Manufahi	44,235	8,704	887
Bobonaro	82,385	18,575	3,740	Ermera	103,169	21,028	1,685	Manatuto	38,580	8,797	347
Baucau	104,571	23,815	806	Liquica	55,058	11,099	752	Viqueque	66,434	15,276	122
								Oequsse	58,521	13,016	

Raw Data for market Penetration Map (incomplete as not all M/FIs could report)

Table 5a: Financial Services Outreach Mapping 31 October 2004 – Provisional

District	Subdistrict	Total pop.	# women	# Households	Fin. Service provider	# savers	% of HHs
Aileo		**36,889**	**17,840**	**8,177**		**1,156**	**14%**
	Aileo	17236	8480	3642	MR IMfTL*	413 743	31.7%
	Remexio	9252	4509	1844			
	Lequidoe	6041	2879	1387			
	Laulara	4270	1972	1304			
Ainaro		**53,629**	**26,665**	**12,128**		**1,600**	**13.2%**
	Ainaro	13,667	6,796	2,902	MR	771	26.5%
	Hatu-Belico	10,796	5,343	2,333	MR via Maubisse		
	Maubisse	20,172	10,075	4,816	MR	629	13%
	Hatu-Udo	8,994	4,451	2,077	MR from Same	200	9.6%
Bobonaro		**82,385**	**41,430**	**18,575**		**3,740**	**20%**
	Atabae	9,533	4,737	2,098	MR CCF* via BBO	687 142	39.5%
	Balibo	13,602	6,735	3,224	MR from Maliana CCF* via BBO	230 74	9.4%
	Bobonaro	22,021	11,280	5,044	MR F.Naroman	632 411	20.6%
	Cailaco	8,405	4,196	1,987			
	Lolotoe	7,021	3,594	1,520			
	Maliana	21,783	10,888	4,702	MR IMfTL* CCF via Hamutuk ***CGD 2005***	533 663 368	33.3%
Baucau		**104,571**	**52,088**	**23,815**		**806**	**3.4%**
	Baguia	9,426	4,840	2,260			
	Baucau	40,878	20,063	8,566	CGD OTL* CCF* TRM*	 65 109 262	5%
	Laga	16,073	8,063	4,048	TRM*	63	1.6%
	Quelicai	15,918	8,125	3,973	TRM*	62	1.6%
	Vemase	8,127	3,992	1,834			
	Venilale	14,149	7,005	3,134	TRM* CCF* via Baucau	128 117	7.8%
Covalima		**55,941**	**27,923**	**10,546**		**1,999**	**19%**
	Fatululic	1,893	984	336			
	Fatumean	3,384	1,672	698			
	Fohorem	4,261	2,089	804			
	Maucatar	6,018	3,008	1,107	CCF* via Graca	157	14%
	Suai	22,240	11,095	4,025	CCF* via Graca MR from Salele	307	7.6%
	Tilomar	6,222	3,068	1,189	MR (Salele) CCF* via Graca	503 102	50.8%
	Zumalai	11,923	6,007	2,357	MR	930	39.5%
Dili		**167,777**	**79,404**	**30,400**	CDG B. Mandiri ANZ IMfTL* OTL* F.Soromutu	 11,000 1,500 1,279 2,025 511	**56.6%**
	Vera Cruz	33,463	15,866	5,803	TRM*	192	3.3%
	Nain Feto	22,800	10,751	3,895	TRM*	42	1%
	Metinaro	3,757	1,882	772	TRM*	167	21.6%
	Atauro	7,857	3,974	1,696			

District	Subdistrict	Total pop.	# women	# households	Fin. Service Provider	# savers	% of HHs
Dili contd.							
	DomAleixo	58,459	27,335	11,014	TRM* CCF* via Fo Diak	360 142	4.6%
	CristoRei	41,441	19,596	7,220	TRM*	75	1%
Ermera		**103,169**	**51,209**	**21,028**		**1,685**	**8%**
	Railaco	8,881	4,321	1,632			
	Ermera	28,217	14,022	5,546	OTL* IMfTL* CDG	610	11%
	Letefoho	20,030	9,878	4,361			
	Atsabe	15,849	7,997	3,437	Naroman	1,075	31%
	Hatolia	30,192	14,991	6,052			
Liquica		**55,058**	**27,272**	**11,099**		**752**	**6.7%**
	Bazartete	19,663	9,872	3,871			
	Liquica	18,780	9,120	3,583	OTL* CCF* via Goreti	600 102	19.6%
	Maubara	16,617	8,280	3,645	MR from Atabae CCF* via Goreti	50	1.4%
Lautem		**57,453**	**29,279**	**13,382**			
	Lospalos	27,625	14,066	6,045	***OTL 2005*** ***TRM 2006***		
	Lautem	13,002	6,576	3,345	***CCF 2005***		
	Iliomar	6,598	3,497	1,606			
	Luro	6,936	3,435	1,596			
	Tutuala	3,292	1,705	790			
Manufahi		**44,235**	**21,671**	**8,704**		**887**	**10%**
	Same	25,031	12,267	5,088	MR	576	11.3%
	Alas	6,463	3,201	1,287	MR via F'berliu		
	Fatuberliu	6,324	3,096	1,226	MR	311	25%
	Turiscai	6,417	3,107	1,103			
Manatuto		**38,580**	**19,217**	**8,797**		**347**	**3.9%**
	Manatuto	11,128	5,409	2,644	CCF* via Moris Foun	302	11.4%
	Laleia	3,188	1,604	914	CCF* via M Foun	30	3.3%
	Laclo	6,338	3,165	1,481			
	Soibada	2,926	1,481	543			
	Barique	4,903	2,356	1,108			
	Laclubar	10,097	5,202	2,107	CCF* via M Foun	15	0.7%
Oecussi		**58,521**	**29,402**	**13,016**			
	P.Makassar	29,113	14,431	6,666			
	Nitibe	10,985	5,504	2,588			
	Oesilo	10,892	5,563	2,609			
	Passabe	7,531	3,904	1,153			
Viqueque		**66,434**	**33,485**	**15,276**		**122**	**0.8%**
	Uatucarbau	6,427	3,307	1,483			
	Ossu	16,539	8,435	3,991			
	Watulari	16,582	8,530	3,761			
	Viqueque	21,348	10,555	4,730	TRM*	122	2.6%
	Lacluta	5,538	2,658	1,311			

* = # borrowers used, as no. members/savers not disaggregated by district/sub-district.
[*name year*] = planned outreach

Table 5b: Summary of Outreach and Performance of Financial Service Providers as reporting December 2004

Service Provider	# Borrowers	$ loans outstanding	# Savers	$ savings	Par(30)	Caseload	OSS %	FSS %	As at:
Banks									
CGD	9,000	59,614,000	20,000	40,876,000	2.50%	600	237%	204.40%	Sep-04
Bank Mandiri	61	5,683,680	11,000	19,111,180	1.90%	12	127%	105.37%	Sep-04
ANZ	23	566,000	1,500	25,987,000	7%	8	n/c	95%	Sep-04
Subtotal, Banks	9,084	65,863,680	32,500	85,974,180	3.80%	206	182%	135%	
AMFITIL member MFIs									
IMfTL	2,685	623,952	8,081	870,183	8.00%	174	85.00%	46.00%	Oct-04
MR	5,947	381,000	6,415	150,698	4.37%	145	47.00%	42.00%	Oct-04
OTL	3,052	182,014	3,052	89,920	18.58%	149	75.39%	71.60%	Sep-04
CRS/TRM	1,524	63,126	1,378	12,344	3.82%	218	41.60%	35.41%	Sep-04
Subtotal, MFIs	13,208	1,250,092	18,926	1,123,145	8.69%	172	62.25%	48.75%	
Credit Cooperatives									
Fini Soromutu	344	291,028	511	158,478	15.00%	86	195.00%	187.00%	Sep-04
Naroman	400	12,000	1,075	80,000	25.00%	80	n/c	n/c	Sep-04
Fitun Naroman	36	25,000	411	610,000	25.00%	12	n/c	n/c	Sep-04
Subtotal Coop's	780	328,028	1,997	848,478	21.67%	59			
NGOs – AMFITIL members									
CCF (MEDI)	2,017	110,828	1,529	29,474	0.0%	254	n/c	n/c	Sep-04
Hotflima	1,375	107,595	1,375	60,240	2.50%	229	33.00%	8.30%	Sep-04
TimorAid	117	9,985	0	0	100.00%	93	n/c	n/c	Sep-04
Halarae	387	3,785	0	0	100.00%	129	20.10%	12.80%	Jun-04
Multi-purpose NGOs and donor projects									
HAFOTI	127	9,358	8	220	15.00%	25	n/c	n/c	Sep-04
Lana Mona	70	2,530	333	10,371	32.26%	111	n/c	n/c	Sep-04
Loka Dalan	370	10,500	0	0	5.00%	93	n/c	n/c	Sep-04
Habitat	228	12,704	228	52,393	41.25%	25	n/c	n/c	Sep-04
GtZ – direct lending	53	113,567	0	0	15.00%	15	n/c	n/c	Aug-04
Subtotal NGOs/projects	4,744	380,852	3,473	152,698	34.55%	108	26.55%	10.55%	
TOTAL:	27,816	67,822,652	56,896	88,098,501					
AVERAGE:	1,464	3,569,613	3,793	5,873,233	17.18%	136	95.68%	80.79%	

Annex 6

Inventory of Financial Services

The range of financial products and services available in Timor-Leste is in itself rather comprehensive. The constraints for customers is thus related more to the limited geographical presence of the financial service providers (see annex 5), as well as to the meeting the requirements for access to the services available.

Overview of available services by provider:

Commercial Banks:

Caixa Geral de Depositos :

- Domestic and international bank services (Remittance, L/C and Foreign Exchange)
- Deposits (Saving Accounts, Time Deposits and Demand Deposits)
- Small saver's Deposit account
- Loans for investment, consumption and housing

PT Bank Mandiri:

- Domestic and international bank services (Remittance, L/C and Foreign Exchange)
- Deposits (Saving Accounts, Time Deposits and Demand Deposits)
- Working capital and Investment loans

ANZ Bank

- Domestic and international bank services (Remittance, L/C and Foreign Exchange)
- Deposits (Savings accounts, Time Deposits and Demand Deposits)
- Loans for investments and consumption
- EFTPOS facilities (27 merchants accept ANZ's local debit card and international credit cards, which are also serviced from Automated Teller Machines (ATMs))

Private Financing Companies:

Pacific Holding Ltd, Western Union

- International Money transfer

MFIs:

Instituicao de Microfinancas de Timor-Leste (IMfTL)

- Domestic money transfer services
- Deposits (savings and current accounts, time deposits)
- Loans for small businesses, crop production, consumption (payroll), micro-enterprises, market vendors (daily repayment) and group guaranteed micro-loans

Moris Rasik (MR)

- Voluntary savings
- Group guaranteed loans
- Individual collateralized loans

Opportunidade de Timor Lorosa'e (OTL)

- Compulsory savings
- Rural and Urban group guaranteed loans

Tuba Rei Metin (TRM)

- Compulsory savings (deposit guarantee)
- Group guaranteed loans

Credit Cooperatives:

Fini Soromutu

- Loans for production (businesses); consumption and emergencies
- Compulsory savings (with dividend)
- Voluntary savings (with interest)

Naroman

- Loans for production (businesses); consumption and emergencies
- Compulsory savings (with dividend)
- Voluntary savings (with interest)

Fitun Naroman

- Loans for production (businesses) and consumption
- Compulsory savings (with dividend)

Non-financially specialized NGOs:

CCF MEDI Unit through 1 branch and Affiliated Community Organizations (ACOs):

- Group savings
- Group loan

HOTFLIMA

- Group savings
- Group loans

HALARAE

- Micro loans for kiosks
- Rural business loans

TIMOR AID

- Individual loans for urban and rural economically active poor

HAFOTI

- Group and individual loans
- Voluntary savings

LANAMONA

- Group savings
- Group loans

Loka Dalan

- Livestock revolving fund

Habitat for Humanity

- Savings for housing improvements
- Top-up loans for housing improvements

Overview of Loan products in the market – by Loan Size

Loan size	Supplier	Requirements	Loan term In months	Expect to pay (APR*):	Expect to wait:
Investment and Working Capital loans (land, property, housing, business equipment)					
$ 10,000- 100,000 and above	CGD B. Mandiri ANZ	Collateral (fixed/movable); Business registration & license, TIN no.; Business plan; Balance sheet & P/L; Volume of sales; Cash flow projections; Bonafide management; On-site inspection; Other accounts w/ supplier; Monthly repayments.	12-36 12-36 6-12	7-15% p.a. 11% p.a. 15% p.a. + 1,5% flat fee	5 months 4-6 w After Feb/05

Agricultural loans (for farming, implements, equipment)					
$ 10-20,000	GtZ	Join GtZ project in Baucau. Work as trader, buying from farmers of project. Monthly repayments	36 m	0%	1 month
$ 2,500-5,000	GtZ	Join GtZ project in Baucau. Invest in farm equipment and increase yield. Monthly repayments and upfront down payment	24 m	0%	2 months
$ 100/ha max.	IMfTL Crop loan	Land certificate; Business license for min. 6m; Business proposal; Reference letter, ID; Balloon repayment.	3-12 m	22.5% + 5% fee	2 weeks

Consumption loans (education, vehicles, house improvements, repairs…)					
$ 500 – 2,000	CGD	Collateral (fixed/movable); Business registration & license, TIN no.; Business plan; Balance sheet & P/L; Cash flow projections; Other accounts w/ supplier; Monthly repayments.	12-36	7-15% p.a. + 1,5% flat fee	5 months
Salary x 10 Max. $ 2000	IMfTL	Employer's recommendation, copy of payroll, ID	12-24m	22.5% p.a. + 5% fee	2 weeks
$ 400 – 2,000	F. Soromutu	Coop membership & training; $110 share + compuls. savings; Application; Registration card, ID.	6-15 m	56% p.a. + 1% fee. 2% penalty fee if late.	8 weeks
$ 100-500	Naroman	Coop membership & training; $41 share + compuls. savings; Application; Registration card, ID.	6 m	19-37% p.a. + 1% fee.	8 weeks
$ 200	F. Naroman	Coop membership & training; $120 share + compuls. savings; Application; Registration card, ID.	6 m	56% p.a. + 1% fee	4 weeks
$ 10 – 350	Habitat	Urban slum dwellers only; Group membership & training; Save min. 1/3 of loan up front. Invest in housing improvements.	12-60m	19% p.a. on top-up loan	4 weeks

Loan size	Supplier	Requirements	Loan term In months	Expect to pay (APR*):	Expect to wait:
Small and Medium Enterprise loans (working capital, equipment, construction)					
$ 3,500-10,000	CGD B. Mandiri ANZ	As for Investment above	As above	As above	As above
$ 500 – 3,000	F. Soromutu	Coop membership & training; $110 share + compuls. savings; Business proposal; Registration card, ID.	18 m	56% p.a. + 1% fee. 2% penalty if payment late	8 weeks
$ 500 – 1000	Naroman	Coop membership & training; $41 share + compulsory savings. Business proposal; Registration card, ID	6 m	56% p.a. + 1 % fee	8 weeks
$ 500 – 2,000	IMfTL small business	Business Registration no.; Business license for 6 months; Reference letter, ID, TIN no.; Business plan; Financial statements/projections; Monthly repayments.	6-12m	18% p.a. + 5% fee	2 weeks
$ 400	F. Naroman	Coop membership & training; $120 share + compuls. savings; Business proposal; Registration card, ID.	12 m	56% p.a. + 1% fee	4 weeks
$ 100-2,000	Moris Rasik	Membership; Previous loans well serviced; Collateral (fixed/movable); Business plan and ID; Land certificate, if available Weekly repayments	6-18m	28.5% p.a. + 1% fee	2 weeks
$ 100-300	IMfTL market vendors	Business certificate for 6 months, TIN, ID Business address Daily/weekly repayments	3-12 m	22.5% + 5% fee	2 weeks
Micro-enterprise/livelihood loans (household business)					
$ 50-80	IMfTL Micro loan	Group membership; Land certificate, ID; Weekly repayments.	4 m	22.5% p.a. + 5% fee	4 weeks
$ 50-250	Tuba Rei Metin (TRM)	Group membership & training; Business proposal, ID; Weekly repayments; 10% Compulsory savings as deposit guarantee.	4-6 m	74.6% p.a. for initial 2 loans, 37.8% for subsequent loans.	8 weeks for initial loans, 3 weeks for subsequent loans.
$ 50 – 400	Moris Rasik (MR)	Group membership; Group approval of proposal; Weekly repayments; Min. 10% savings.	6.25m	38% p.a. + 1 % fee	1 week
$ 50 – 125	OTL Rural loan	Group membership & training; Business active for 6 months; Weekly repayments; Compulsory savings.	6.26 m	56% p.a. + 3% fee. 1% returned of on-time repayment	4 weeks
$ 125 – 325	OTL Urban loans	Group membership & training; Business active for 6 months; Weekly repayments; Compulsory savings.	6.25 m	56% p.a. + 3% fee. 1% returned if on-time repayment	4 weeks
$ 150	HAFOTI	Group membership; Business plan	12 m	19% p.a.	12 weeks

Group loans					
$600-$2,000	CCF	Group membership; Savings w/ group; Business plan approved by group.	8 m	Baucau: 29% p.a. Through ACOs: 18% p.a.	8 weeks
$ 1,500-4000	Hotflima	Group membership & training; Savings w/ group; Business plan approved by group.	6-10 m	18-29% p.a	8 weeks
$ 500	HAFOTI	Group membership; Savings w/ group; Business plan approved by group	12 m	19% p.a.	12 weeks

*** APR Defined:**
"Microfinance has adopted the term "effective" interest rate to mean the "effective" cost of borrowing, from a client's point of view. This would include all "out of pocket" costs to the borrower in obtaining credit, including interest, commissions, fees, maintenance of value, a charge for inflation, as well as a charge for forced savings (less any guaranteed interest the MFI credits to their client's account). The term given to the cost of a loan in the United States of America is APR, meaning "Annual Percentage Rate". In addition to moving the microfinance industry into greater transparency, the goal is to also encourage the adoption of consistent terms from the banking/finance world into microfinance." (http://www.mficonsulting.com/apr/catalog.html).

While the effective interest rate may seem high, MFIs provide considerable services to deliver the very small loans, often including initial client training and business assessment, processing and delivery of loans and collections of frequent loan repayments in remote areas and/or by direct delivery.

Overview of Savings products in the market

Account type	Supplier	Requirements	Opening/min bal.	Min. deposit	Fee	Interest
Small	CGD	0-30 years	$5	$ 1		0.75%p.a.
		< 30 years	$10	$2		0.75%p.a.
Time depo	CGD	Fix for 1,3,6, 12 m	$ 200			1.15%p.a
Current	B. Mandiri		$500		$2	0.25% p.a
Saving	"		$20-50		$1	0.50%p.a
Time depo	"	Fix for period	$500			0.70%p.a
Current	ANZ		$40		$2/month	0.25%p.m
Public	IMfTL		$10	$0.50	-	0.50%p.a
Group	IMfTL	Groups depo	$0.50	$0.50		0.50%p.a
Voluntary	F.Soromutu	Membership				1%p.a
Voluntary	Naroman	Membership	$500			1% p.a
Voluntary	MR	Membership				6% p.a.

Annex 7a

Presentations at Workshops during Assignment

Background to the Workshop

The Workshop entitled "The Millennium Development Goals and the Eradication of Poverty – The Role of Micro credit and Microfinance in Timor-Leste" hosted by the Peace and Democracy Foundation in collaboration with UNDP, Timor Aid and AMFITIL was held during December 7-9, 2004 to coincide with the visit to Timor-Leste of the founder of Grameen Bank in Bangladesh, Professor Muhammad Yunus and Lamiya Morshed, the Director of Grameen Trust, invited by Senior Minister of Foreign Affairs and Cooperation, Dr. Jose Ramos-Horta.

Dr. Ramos-Horta is the Founder and President of the Peace and Democracy Foundation, which was established with funds from the Nobel Peace Prize awarded to Dr. Ramos-Horta. The Foundation has funded the "Jose Ramos-Horta Micro credit Project" implemented by the national NGO Timor Aid (see Section 6.2.4). Based on Timor Aid's experiences, one objective of the visit by Professor Yunus and Ms. Morshed was to discuss the option of establishing a Grameen Bank replication in Timor-Leste to provide professional micro credit.

Recognizing the Workshop as an excellent opportunity for enhanced awareness raising and information sharing in and around the nascent microfinance industry, AMFITIL contacted the Peace and Democracy Foundation to establish common ground and facilitate further exchange of experiences and learning through joint detailing of the Workshop program.

The Structure of the Workshop

During Professor Yunus' and Lamiya Morshed's visit to Timor-Leste, they had several meetings with government officials and Timor Aid's Micro credit Project.

On December 8, 2004, two informal work sessions were held. The morning session was facilitated and attended by AMFITIL members, and discussed the current status of the microfinance industry in Timor-Leste based on an excellent presentation by the AMFITIL President (see Annex 6b and 6c). The afternoon session was facilitated by Timor Aid, and attended by representatives from women's groups and community development NGOs, who thus had an opportunity to learn more about the existing microfinance industry.

On December 9, 2004 a formal conference attended by government, donor agencies, NGOs and AMFITIL members was held, facilitated by the Peace and Democracy Foundation, which included key note speeches from government and Professor Yunus, and a panel discussion attended by several AMFITIL members, government and a commercial bank. AMFITIL capitalized on the opportunity of the planned visit to Timor-Leste of the Assessment Team by asking the Team to present an external view of the status and performance of the industry in Timor-Leste.

On December 10, 2004 before their departure, Professor Yunus and Ms. Morshed agreed to visit a center of Moris Rasik outside of Dili. Moris Rasik is a Grameen replication and a member of the CASHPOR network.

Scope of Work for the Consultants in relation to the Workshop

AMFITIL members met with the Consultants on 6 December to prepare for the Workshop. An Outreach Map for AMFITIL members was prepared and printed for the Workshop participants (available from AMFITIL Secretariat).

The Assessment Team assisted the AMFITIL secretariat hosted by CRS in preparing the presentation on AMFITIL's membership, achievements and key issues on microfinance in Timor-

Leste for the morning work session with Professor Yunus on 8 December. The presentation was comprehensive and excellently presented in both Tetun and English (See annex 6b and 6c). The ensuing discussion focused on issues including:

- Constraints in the small market
- Experience of Grameen bank in working with the poorest of the poor
- Interest rate setting and cross-subsidization
- Whole-sale lending to MFIs via an apex structure funded by government endowment funds
- Regulation and supervision for micro credit programs taking deposits

It was interesting to note that Professor Yunus suggested an apex structure for micro credit be established in Timor-Leste for whole-sale lending to MFIs, funded e.g. though a government endowment fund, which could provide capital even at subsidized rates. It was not clear how this fund would be capitalized.

Equally interesting was Professor Yunus' advocacy for urgent pro-poor regulation of the nascent microfinance industry in Timor-Leste through a Micro Credit Bank Law based on the regulation guidelines developed by Grameen Bank, i.e. as a separate legislation de-linking the provision of microfinance from the overall financial system to avoid MFIs 'becoming conventional banks that do not serve the poor'. While intermediation of deposits to a limited extent and only for members is done by NGO MFIs in Timor-Leste, AMFITIL and BPA have so far agreed that regulation would be premature, and outside of the current capacity of the BPA.

For the Conference on 9 December, the Consultants were asked to present an 'international perspective and an external assessment' of the microfinance industry in Timor-Leste. This presentation, in English and Bahasa Indonesia, is included in Annex 6d and 6e.

At the subsequent discussion, Professor Yunus noted the goal set by the Micro Credit Summit in 1997 that 100 million poor families should be served by the Year of Microfinance 2005. He noted that by end of 2003, some 55 million families were served, while this figure was set to increase to 75 million by end of 2004, and he encouraged Timor-Leste to set a target of reaching 50% of the poorest of the poor by the end of 2005.

He emphasizes the need for monitoring and measurement of progress, which was an encouragement to AMFITIL members that are already reporting quarterly to a joint database.

At the end of the Conference Dr. Ramos-Horta informed that he would nominate Professor Yunus for the Nobel Peace Prize in 2005.