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Report No: PAD4849

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED CREDIT

IN THE AMOUNT OF SDR 33.5 MILLION
(US$45 MILLION EQUIVALENT)

AND

A PROPOSED GLOBAL RISK FINANCING FACILITY GRANT
IN THE AMOUNT OF US$7.5 MILLION

FOR A

COMPETITIVENESS AND FINANCIAL INCLUSION PROJECT

June 2, 2022

Finance, Competitiveness and Innovation Global Practice
Eastern and Southern Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective April 30, 2022)

Currency Unit	=	Lesotho Maloti
US$1	=	SDR 0.74388157
Maloti 15.89	=	US$1

FISCAL YEAR
January 1 - December 31

Regional Vice President:	Hafez M. H. Ghanem
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ABBREVIATIONS AND ACRONYMS

AfCFTA	African Continental Free Trade Agreement
AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
ALEB	Association of Lesotho Employers and Business
ASYCUDA	Automated System for Customs Data
B2B	Business to Business
BDS	Business Development Services
BEDCO	Basotho Enterprise Development Corporation
C-PCG	COVID-19 Partial Credit Guarantee Scheme
CAFI	Competitiveness and Financial Inclusion
CBL	Central Bank of Lesotho
CMT	Cut and Trim
CPF	Country Partnership Framework
DFS	Digital Financial Services
DRF	Disaster Risk Finance
DTT	Department of Traffic and Transport
E&S	Environment and Social
EFA	Economic and Financial Analysis
ERR	Economic Rate of Return
ESF	Environmental and Social Framework
ESMF	Environmental and Social Management Framework
ESO	Entrepreneurship Support Organizations
ESRS	Environment and Social Review Summary
FI	Financial Intermediaries
FDI	Foreign Direct Investment
FM	Financial Management
FOB	Free on Board
FY	Fiscal Year
G2B	Government to Business
G2P	Government to Person
GBV	Gender Based Violence
GDP	Gross Domestic Product
GRiF	Global Risk Financing Facility
GRM	Grievance Redress Mechanism
GRS	Grievance Redress Service
GTEX	Global Textile and Clothing Program
GVCs	Global Value Chains
IBRD	International Bank for Reconstruction and Development
ICT	Information Communications Technology
IDA	International Development Association
IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
IPA	Investment Promotion Agency

ITC	International Trade Center
LAA	Land Administration Authority
LEAP	Lesotho Enterprise Assistance Project
LERIMA	Lesotho Electronic Registry in Interest in Movable Assets
LGMA	Lesotho Garment Manufacturers Association
LMIC	Lower Middle-Income Country
LMP	Land Management Plan
LNDC	Lesotho National Development Corporation
LPI	Logistics Performance Index
LRA	Lesotho Revenue Authority
LSC	Lesotho Startup Community
LTEA	Lesotho Textile Exporters Association
M&E	Monitoring and Evaluation
MCC	Maseru City Council
MFD	Mobilizing Finance for Development
MFI	Micro-finance Institutions
MOF	Ministry of Finance
MOHA	Ministry of Home Affairs
MPWT	Ministry of Public Works and Transport
MSBD	Ministry of Small Business Development, Cooperatives, and Marketing
MSME	Micro, Small and Medium enterprises
MTI	Ministry of Trade and Industry
NPF	New Procurement Framework
NPV	Net Present Value
NSDP II	Second National Strategic Development Plan
NUL	National University of Lesotho
OBFC	One-Stop Business Facilitation Centre
P2G	Person to Government
PCGF	Partial Credit Guarantee Fund
PCM	Private Capital Mobilized
PDO	Project Development Objective
PFMRAP	Public Financial Management Reform Action Plan
PIM	Project Implementation Manual
PMDU	Prime Minister’s Delivery Unit
PMU	Project Management Unit
PPD	Public-Private Dialogue
PPSD	Project Procurement Strategy for Development
PSCED	Private Sector Competitiveness and Economic Diversification Project
PSCED2	Second Private Sector Competitiveness and Economic Diversification Project
SACU	Southern African Customs Union
SADC	Southern African Development Community
SADP2	Second Smallholder Agriculture Development Project
SCD	Systematic Country Diagnostic
SCD-U	Systematic Country Diagnostic Update
SCORE	Sustaining Competitive and Responsible Enterprises
SEA	Sexual Exploitation and Abuse

SEP	Stakeholder Engagement Plan
SME	Small and Medium Enterprises
TFP	Total Factor Productivity
TICC	Tourism Information and Crafts Center
TOR	Terms of Reference
TVET	Technical and Vocational Education and Training
UNCTAD	United Nations Conference on Trade and Development
VC	Venture Capital
VFM	Value for Money
WBG	World Bank Group

TABLE OF CONTENTS

DATASHEET

BASIC INFORMATION

Country(ies)	Project Name	
Lesotho	Lesotho Competitiveness and Financial Inclusion Project	
Project ID	**Financing Instrument**	**Environmental and Social Risk Classification**
P175783	Investment Project Financing	Moderate

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach (MPA)	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Performance-Based Conditions (PBCs)	[ ] Small State(s)
[ ] Financial Intermediaries (FI)	[ ] Fragile within a non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made Disaster
[ ] Alternate Procurement Arrangements (APA)	[ ] Hands-on Enhanced Implementation Support (HEIS)

Expected Approval Date	Expected Closing Date
24-Jun-2022	31-Jul-2028

Bank/IFC Collaboration

No

Proposed Development Objective(s)

The project development objective is to increase access to business support services and financial products targeted at MSMEs and entrepreneurs, especially women and youth.

Components

Component Name	Cost (US$, millions)

Enhancing Financial Inclusion and Resilience of MSMEs	20.00
Scaling Support for Entrepreneurship and MSMEs	29.50
Project Management and Implementation Support	3.00

Organizations

Borrower:	Kingdom of Lesotho
Implementing Agency:	Ministry of Trade and Industry

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	52.50
Total Financing	52.50
of which IBRD/IDA	45.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	45.00
IDA Credit	45.00

Non-World Bank Group Financing

Trust Funds	7.50
Global Facility for Disaster Reduction and Recovery	7.50

IDA Resources (in US$, Millions)

	Credit Amount	Grant Amount	Guarantee Amount	Total Amount
Lesotho	45.00	0.00	0.00	45.00
National PBA	45.00	0.00	0.00	45.00

Total	**45.00**	**0.00**	**0.00**	**45.00**

Expected Disbursements (in US$, Millions)

WB Fiscal Year	2022	2023	2024	2025	2026	2027	2028
Annual	0.00	4.50	8.00	10.00	10.00	10.00	10.00
Cumulative	0.00	4.50	12.50	22.50	32.50	42.50	52.50

INSTITUTIONAL DATA

Practice Area (Lead)

Finance, Competitiveness and Innovation

Contributing Practice Areas

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	High
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	Moderate
10. Overall	Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [√] No

Does the project require any waivers of Bank policies?

[ ] Yes [√] No

Environmental and Social Standards Relevance Given its Context at the Time of Appraisal

E & S Standards	Relevance
Assessment and Management of Environmental and Social Risks and Impacts	Relevant
Stakeholder Engagement and Information Disclosure	Relevant
Labor and Working Conditions	Relevant
Resource Efficiency and Pollution Prevention and Management	Relevant
Community Health and Safety	Relevant
Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Not Currently Relevant
Cultural Heritage	Not Currently Relevant
Financial Intermediaries	Not Currently Relevant

NOTE: For further information regarding the World Bank's due diligence assessment of the Project's potential environmental and social risks and impacts, please refer to the Project's Appraisal Environmental and Social Review Summary (ESRS).

Legal Covenants

Sections and Description

In accordance with the Project Financing Agreement, by no later than one (1) month after the Effective Date, the Recipient shall: (a) adopt, in accordance with terms of reference acceptable to the Association, a manual, which contains Project arrangements and procedures for: (i) institutional coordination and day-to-day implementation of the Project; (ii) monitoring, evaluation, reporting and communication; (iii) criteria, procedures and responsibilities for Sub-project selection; (iv) eligibility criteria, allocation process, and restrictions on the use of funds for financing the Relief Grants, the ESO Grants and the LEAP Grants; (v) administration, procurement, financial management and accounting; and (vi) such other administrative, technical and organizational arrangements and procedures as shall be required for purposes of implementation of the Project ("Project Implementation Manual" or "PIM"); and (b) thereafter, carry out the Project in accordance with the PIM and not amend, abrogate, or waive said PIM or any part thereof without the prior written approval of the Association.

Sections and Description
In accordance with the Project Financing Agreement, for purpose of implementing Part 2.3(a) [Textiles Value Chain support] of the Project, and by no later than sixty (60) days after the Effective Date, the Recipient shall enter into, and thereafter maintain throughout the period of Project implementation, an output agreement with ILO, under terms and conditions approved by the Association (the "ILO Output Agreement"), whereby the Recipient shall: (a) hire the services of ILO to implement Part 2.3(a) of the Project in accordance with the provisions of the PIM, and the requirements of the ESS; (b) report regularly to the PMU on the progress achieved in the implementation of Project activities and any challenges, incidents and/or obstacles thereto; and (c) agree on the direct payment/advance of the proceeds of the Financing from the Association to ILO to facilitate the implementation of activities under Part 2.3(a) of the Project, as well as on the financial reporting and auditing requirements.

Conditions

Type	Financing source	Description
Disbursement	IBRD/IDA	No withdrawal shall be made for Capitalization of the Seed Financing Facility (SFF) under Subcomponent 2.1 unless the Recipient has submitted evidence showing that: (i) the hiring of the SFF Manager has been carried out under terms and conditions satisfactory to the Association; and (ii) the SFF has been established and made operational in a manner satisfactory to the Association.
Type	Financing source	Description
Disbursement	IBRD/IDA	No withdrawal shall be made for Horticulture Incubator Program (HIP) activities under Subcomponent 2.3 unless the Recipient has submitted evidence showing that the hiring of the HIP Manager has been carried out under terms and conditions satisfactory to the Association.
Type	Financing source	Description
Effectiveness	IBRD/IDA	The Financing Agreement shall not become effective until the Co-financing Agreement (Grant Agreement) has been executed and delivered and all conditions precedent to its effectiveness or to the

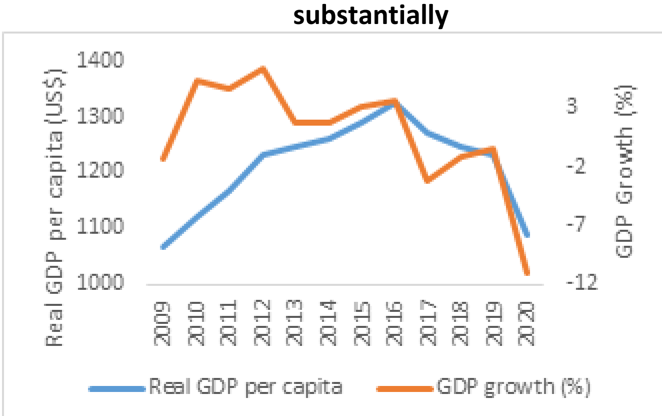
		right of the Recipient to make withdrawals under it (other than the effectiveness of this Agreement) have been fulfilled.
Type	Financing source	Description
Effectiveness	Trust Funds	The Co-financing Agreement (Grant Agreement) shall not become effective until evidence satisfactory to the Bank has been furnished to the Bank that the conditions specified have been satisfied: (a) the execution and delivery of the Co-financing Agreement on behalf of the Recipient have been duly authorized or ratified by all necessary governmental action; and (b) the financing agreement to the Project dated the same date as this Agreement, between the Recipient and the Bank, providing financing in support of the Project ("Financing Agreement"), has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Recipient to make withdrawals under it (other than the effectiveness of this Agreement) have been fulfilled.

I. STRATEGIC CONTEXT

A. Country Context

1. **Despite being a lower-middle income country, Lesotho persistently experiences high levels of unemployment, informality, inequality, and poverty, which have been further exacerbated by the COVID-19 pandemic.** Gross Domestic Product (GDP) growth declined from a peak of 6.3 percent in 2012 to -11.1 percent in 2020 (Figure 1). Lesotho's poor economic performance has been the result of compounding factors including declining revenues from the Southern African Customs Union (SACU)[1], recurrent climate related shocks that have drained fiscal resources[2], a high public sector wage bill that has inhibited spending on development objectives, and contraction of key economic sectors (manufacturing and tourism) due to the COVID-19 pandemic. Unemployment is at 22.5 percent[3], and while the poverty rate in Lesotho fell from 56.6 percent to 49.7 percent between 2002 and 2017, economic vulnerability persists with more than 75 percent of the population either poor or vulnerable to poverty, driven in large part by exposure to climatic shocks. Declines in remittances due to COVID-19 related border restrictions have further exacerbated poverty. Although income and other measures of inequality have fallen, Lesotho remains one of the most unequal countries in the world.[4] Overall, Lesotho's economic and social development is not commensurate with the country's lower-middle-income-status.[5]

Figure 1: GDP growth in Lesotho has slowed substantially



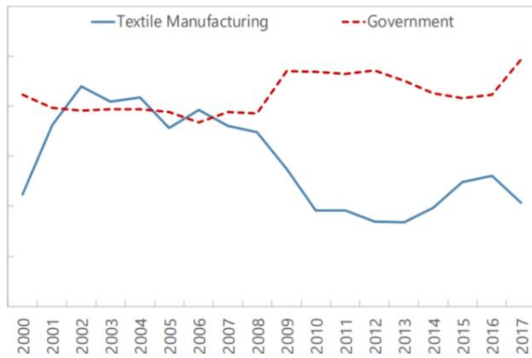
Source: World Development Indicators.

2. **The public sector has a disproportionate role in the economy, crowding out private participation and resulting in a weak and largely informal private sector.** The government has been the main driver of economic activity, with public

[1] SACU revenues fell from 30 percent of GDP in Lesotho's fiscal year (FY) ending March 2013 (FY 2012/13) to 17.7 percent of GDP in FY 2017/18 and are expected to decline further to 15.2 percent of GDP in FY 2019/20.
[2] The average annual cost of disaster response is estimated at US$19.3 million, or 1.6 percent of the total budget expenditure in the 2019/20 fiscal year.
[3] 22.5 percent unemployment (strict definition) or 38.3 percent (expanded definition) in 2019. World Bank Group. 2021. Lesotho Systematic Country Diagnostic Update: Bridging Implementation Gaps to Accelerate Development. https://openknowledge.worldbank.org/handle/10986/36910.
[4] World Bank. 2019. Lesotho Poverty Assessment.
[5] International Monetary Fund. 2019. Kingdom of Lesotho: 2019 Article IV Consultation. Volume 2019: Issue 113. https://doi.org/10.5089/9781498312370.002

spending accounting for 60 percent of GDP and with public sector investment levels averaging around 29 percent of GDP since 2010.[6] The public sector contribution to GDP now far exceeds that of the textile and apparel industry, which is the largest private sector industry in Lesotho (Figure 2).[7] Lesotho's public sector wage bill (as a percentage of GDP) is one of the highest in the world and public sector workers earn an average monthly salary that is approximately seven times higher than the minimum wage of a skilled worker in the textile sector.[8] The recent mid-term budget review projects the compensation of employees to account for 45.9 percent of total government expenditures for 2020/21.

Figure 2: Value Added by Industry (% of GDP), 2000-2017



Source: World Bank calculation using Lesotho Bureau of Statistics data.

3. **Lesotho's private sector is largely concentrated in two sectors – mining and textile/apparel manufacturing and economic diversification has proven challenging due to structural constraints.** These two sectors which account for 84 percent of all formal sector employment (Figure 3) and over two-thirds of all exports (Figure 4) are facing serious challenges. Textile and apparel exports have been declining due to productivity and labor market challenges and Kenya has overtaken Lesotho as the leading apparel exporter to the United States under the African Growth and Opportunity Act (AGOA). Total employment in the export manufacturing sector dropped from a peak of 43,500 in February 2020 to a low of 31,000 in April 2020 before rebounding to 39,000 in September 2020[9] with additional job losses reported in 2021 primarily because of the pandemic. Job losses in the sector have had an especially adverse impact on women who comprise 80 percent of the workforce but occupy lower-skilled jobs compared to men.[10] Growth and job creation prospects from the mining sector (primarily diamond exports) are limited.

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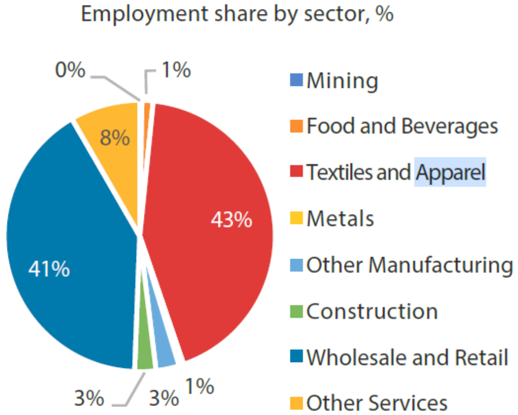
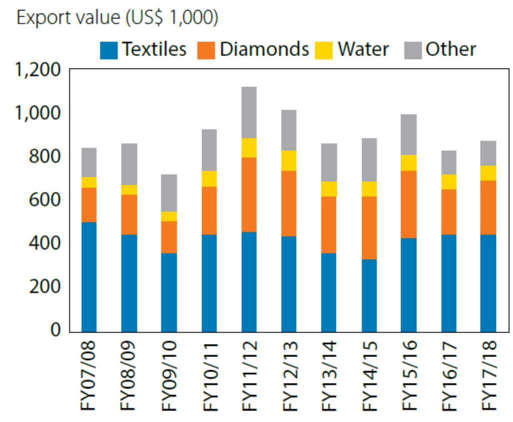
[6] World Bank. 2018. Kingdom of Lesotho Public Expenditure Review: Improving Expenditure Efficiency for Inclusive Development and Growth. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/30222 License: CC BY 3.0 IGO.
[7] The public sector employed about 43,597 people as of second quarter of 2020, and it is the second-largest employer after manufacturing, at 48,685 employees during the same period. Lesotho's population was 2,142,252 in 2020. (World Bank, forthcoming)
[8] World Bank. 2019. Lesotho Poverty Assessment.
[9] LNDC survey of 64 firms in eight industrial estates, November 2020; most of these factory workers are women. Lesotho National Development Corporation (2021). Impact of COVID-19 on Manufacturing Industry in Lesotho: Case study of LNDC Assisted Companies
[10] World Bank. 2018. Female Migration in Lesotho: Determinants and Opportunities. Policy Research Working Paper;No. 8307. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/29217 License: CC BY 3.0 IGO."

Figure 3: Employment in Lesotho is concentrated in mining and textiles and apparel (2018)



Source: World Bank (2018)[11]

Figure 4: Exports in Lesotho remain highly concentrated in textiles and diamonds



Source: World Bank (2018)

4. **Lesotho's growth could be fueled by increasing the competitiveness of the small and medium enterprise (SME) sector, scaling domestic startups, and expanding and capturing more value within high potential global value chains (GVCs).** A more dynamic SME sector can shift the balance of economic output and job creation to the private sector as highlighted in the National Trade Strategy (2021-25) with opportunities especially in the horticulture and export manufacturing value chains. To create jobs and attract investments, targeted efforts are needed to strengthen competitiveness of GVCs, improve production capabilities, improve access to reliable infrastructure, strengthen business and trade facilitation for export promotion, and improve the overall regulatory framework to create a competitive business environment.[12] Addressing the low productivity of the large informal sector (more than 80 percent of household businesses in Lesotho were not registered) is critical.

5. **Lesotho's business environment remains weak despite recent reforms, with political instability, tax rates and practices of the informal sector highlighted as the top three constraints**. The Second National Strategic Development Plan (NSDP II) (2019-2023) identified an "uncompetitive business environment" as one of the key binding constraints for private investments. Recent reforms include new legislation for business registration and licensing and secured lending as well as starting adoption of digital systems and procedures in trade facilitation, land administration, and construction permits, all supported under the World Bank's Second Private Sector Competitiveness and Economic Diversification Project (PSCED2) (P144933). Further support is needed for effective implementation of these reforms. Lesotho's ranking in the Global Competitiveness Index[13] dropped from 123 to 131 out of 141 countries from 2014 to 2019, and the Logistics Performance Index[14] ranking also dropped from 133 to 139. Political instability, tax rates, practices of the informal sector and access to finance are amongst the major constraints faced by firms.[15]

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[11] World Bank. 2018. Unlocking the potential of Lesotho's private sector: a focus on apparel, horticulture, and ICT (English). http://documents.worldbank.org/curated/en/832751537465818570/Unlocking-the-potential-of-Lesotho-s-private-sector-a-focus-on-apparel-horticulture-and-ICT
[12] World Bank (forthcoming). Export Competitiveness of the Textile and Apparel Sector in Lesotho,
[13] World Economic Forum. 2019. Global Competitiveness Report. https://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf
[14] World Bank. 2019. Logistics Performance Index Global Rankings. https://lpi.worldbank.org/international/global/2018.%202019
[15] World Bank Enterprise Survey, 2016

6. **Access to finance remains a challenge, particularly for small firms, due to limited financial intermediation and limited use of digital financial services (DFS).** Although the financial sector is liquid and profitable[16], domestic credit to the private sector is one of the lowest among the SACU countries and is half as much as other lower middle-income countries (LMICs). In 2019, Lesotho's domestic credit to the private sector was 21.5 percent of GDP, compared to 42 percent for all LMICs. The financial sector largely channels domestic savings outwards to South Africa rather than lending to the domestic private sector while the textile and apparel firms are largely financed through foreign channels. The pension fund for public employees owns sizable assets of which only around 3 percent is invested in Lesotho. There seems to be a mismatch between the financing needs of the mostly micro and small enterprises and the stringent requirements of the lenders including documentation, cash flow projections, risk assessment and the availability of collateral. These businesses resort to informal channels for financing given that microfinance institutions are not perceived as credible due to poor market practices in the past.

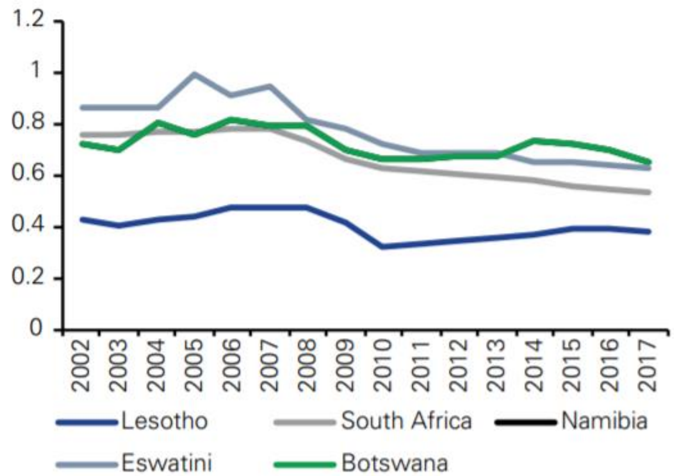
7. **Access to finance by women is particularly challenging, due to constraints on women's access to formal credit, low credit history, and high rejection rate of women loan applicants.[17]** Rural women in low-income categories are most vulnerable in this regard. As a result, women-owned businesses tend to start and stay small, with their lack of access to collateral resulting in overreliance on informal sources of finance and credit. For instance, as of 2021, only 27 percent of Basotho women have credit records.[18] The lack of women's credit history may partially be due to the very recent inclusion of more gender-informed credit reporting systems as well as a lack of market and user data for design of targeted policy interventions in Lesotho. This results in greater legal and regulatory barriers to women's access to financial inclusion.[19] To address this, the government of Lesotho has set a target of 30 percent of women recorded in the credit bureau by 2022.[20] To move beyond inclusion in credit records to improving overall creditworthiness, there is a need for reform in the mechanisms for evaluating women's bankability and creditworthiness. Mobile money is playing a critical role in driving financial inclusion in Lesotho, while microfinance has not met with much success.[21] It is estimated that 31 percent of women have mobile money accounts compared with 24 percent of men, and 40 percent of women made or received digital payments compared with 35 percent of men.[22] There is potential to enhance the impact of mobile banking especially for rural businesses.

8. **Increasing productivity growth by enhancing skills and digital technology adoption is critical for private sector development.** Total factor productivity (TFP) has been nearly stagnant and lags other countries in the region (Figure 5), characterized by negative labor productivity growth (-3.5 percent between 2013 and 2015) especially for small firms. Rural areas tend to have a higher share of low productivity jobs while urban areas tend to have a higher share of wage-earning jobs apart from jobs in the agriculture sector. Exporting businesses, particularly in the textile and apparel sector, are at risk of losing competitiveness without new investments in skills and technology, putting critical

[16] The three major banks are subsidiaries of South African banks and the fourth, the only domestic bank, is fully owned by the Government. All four banks are well capitalized, with an average Capital Adequacy Ratio (CAR) of 18 percent as of December 2018. Total assets of the four banks were about US$1.2 billion as of December 2018, equivalent to 48 percent of the country´s GDP.
[17] World Bank. 2018. Unlocking the potential of Lesotho's private sector: a focus on apparel, horticulture, and ICT (English). http://documents.worldbank.org/curated/en/832751537465818570/Unlocking-the-potential-of-Lesotho-s-private-sector-a-focus-on-apparel-horticulture-and-ICT
[18] Central Bank of Lesotho. 2021. Credit Information Sharing Quarterly Report: March 2021.
[19] Bill and Melinda Gates Foundation. 2019. Women's Digital Financial Inclusion In Africa
[20] Central Bank of Lesotho. 2021. Credit Information Sharing Quarterly Report: March 2021.
[21] Finmark Trust, Southern African Development Community Secretariat and United Nations Capital Development Fund. 2019. Measuring Progress: Financial Inclusion in Selected SADC Countries
[22] World Bank. 2018. Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution. Washington, DC: World Bank. https://openknowledge.worldbank.org/handle/10986/29510 License: CC BY 3.0 IGO."

jobs at risk.[23] Improved digital connectivity combined with improvements in digital skills and literacy, access to digital payments and other financial services, platforms such as digital identity schemes and support to digital entrepreneurs can lead to new businesses and jobs.

Figure 5: Lesotho's TFP growth lags other SACU countries, 2002-2017



Source: World Bank (2019)[24]

9. **While Lesotho has the highest rates of female participation in ownership of formal firms (39.1 percent) in sub-Saharan Africa, female-owned businesses in Lesotho tend to start and stay small and are concentrated in a few sectors.** The highest proportion of firms in Lesotho with majority female ownership (45 percent) are small while only 9 percent of large firms have a female majority. Most of the women entrepreneurs in Lesotho are livelihood or subsistence entrepreneurs, and very few are growth or opportunity entrepreneurs.[25] Despite limited data, consultations suggest that barriers faced by women entrepreneurs include access to credit, discrimination by financial institutions, high levels on unpaid care work resulting in lack of ability to engage in enterprise development, and limited access to business development, training, knowledge, and access to networks and markets (which are common to all entrepreneurs). The uptake of mobile banking and the implementation of the Land Act, 2010 (which granted new rights to women to own and inherit property) are creating new opportunities for women.[26]

10. **Lesotho is highly exposed to climatic and other economic shocks (Annex 2).** From 1980-2020 Lesotho was impacted by 22 shocks, 90 percent of which were climatic, and there is an expected increase in frequency of intense precipitation events leading to heightened risk of flooding, increased aridity, temperatures, and drought.[27] These climatic shocks will result in crop damage, hunger, wildfires and disease outbreaks which are expected to adversely affect 'working

[23] FinMark Trust. 2021. Measuring Progress: Financial Inclusion in Selected SADC Countries. Measuring_Progress_Financial_Inclusion_in_selected_SADC_countries_-_2019_Report.pdf (finmark.org.za)
[24] World Bank. 2019. Lesotho Poverty Assessment: Progress and Challenges in Reducing Poverty (English). Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/387071576240590486/Lesotho-Poverty-Assessment-Progress-and-Challenges-in-Reducing-Poverty
[25] A necessity or livelihood entrepreneur is someone who has pursued entrepreneurship to acquire productive employment and livelihood for themselves; a growth entrepreneur sets out to create and grow a business that will generate jobs.
[26] Lesotho Land Administration Authority (2010). Land Act 2010 (Act No. 8 of 2010)
[27] Climate Change Knowledge Portal: For Development Practitioners and Policy Makers

days', impacting businesses.[28] During the 2020-2021 period, Lesotho declared two state of emergencies for shocks (COVID-19 and heavy rains) that severely impacted businesses primarily due to damage to infrastructure disrupting trade logistics. The agricultural sector, including horticulture, is particularly exposed to climatic shocks. Horticultural crops are sensitive to climatic shocks because of their high-water demand and strict temperature requirements. In Lesotho, the vulnerability to temperature extremes, hail, and drought (expected to increase with climate change) are pertinent challenges to the sector, highlighting the importance of strengthening its climate resilience.

11. **MSMEs have been particularly hard hit by these compounding shocks, with no resilience-building mechanisms in place.** MSMEs were severely impacted by declining sales, closures, reduction in employment as well as supply chain and financial shocks while the suite of support measures fell below expectations in terms of impact given their ad-hoc and unbudgeted nature. Furthermore, they put pressure on fiscal space, as they were not pre-financed, as the country embarks on a path of fiscal consolidation and debt sustainability. This experience, and the fact that the government does not have a comprehensive disaster risk financing strategy, demonstrates that MSMEs are highly vulnerable to future climatic shocks.[29]

12. **Political volatility is impeding private sector development.** When Fitch Ratings maintained its negative outlook on Lesotho in August 2021, it noted "Recurring bouts of political volatility and infighting within the government amid an overall weak institutional capacity constrain the government's ability to adjust fiscal policy and push forward reforms, and exacerbate problems with public-finance management."[30] High levels of leadership turnover in key ministries, such as the Ministry of Small Business Development, Co-operatives, and Marketing (MSBD) and the Ministry of Trade and Industry (MTI) has contributed to delays and shortcomings in addressing constraints to private sector development through, "insufficient access of small and medium-sized enterprises to finance, lack of equitable and effective regulation and enforcement, and lack of capacity in Government to implement reforms."[31]

13. **Economic and institutional transformation for private sector led job creation and inclusive growth requires a multi-faceted approach to address the myriad constraints.** Shifting the growth model from a public sector dominated approach to a private sector-led one requires a suite of integrated interventions in improving the enabling environment for private investments through more effective implementation of policy and regulatory reforms, enhancing financial inclusion, strengthening the ecosystem for firms and entrepreneurs to enable them to participate more effectively in high potential regional and global value chains and enabling businesses to tap opportunities from digital transformation through expanding support for skills development and technology adoption.

B. Sectoral and Institutional Context

14. **Substantial progress was made on business environment reforms under the PSCED2 project, but additional investments are needed for effective implementation.** Government to business (G2B) systems for registering a business, renewing licenses, trading across borders, and making tax payments are in place. The Company Registry system at the One-Stop Business Facilitation Centre (OBFC), the online automated Construction Permit system at the Maseru City Council (MCC), the Lesotho Electronic Registry in Movable Assets (LERIMA), and the credit bureau at the

[28] EM-DAT: The Emergency Events Database – Université Catholique de Louvain (UCL) - CRED, D. Guha-Sapir, Brussels, Belgium. and UNHCR (2018). Lesotho Flash Update 01 – Hailstorms and Flash floods (period: March 1, 2018 –March 31, 2018).
[29] World Bank Covid Business Pulse Survey Dashboard. March 7, 2022.
[30] Fitch Rains. August 2, 2021. Fitch Affirms Lesotho at 'B'; Outlook Negative. *https://www.fitchratings.com/research/sovereigns/fitch-affirms-lesotho-at-b-outlook-negative-02-08-2021*
[31] African Development Bank. 2013. *Kingdom of Lesotho, Country Strategy Paper, 2013-2017*. Abidjan: African Development Bank.

Central Bank of Lesotho (CBL) are notable achievements. The upgrading of the Automated System for Customs Data (ASYCUDA) at the Lesotho Revenue Authority (LRA), an online business licensing system, and an integrated land information system linked to an online payment system at the Land Administration Authority (LAA) were other significant investments. These past investments in G2B systems and services in Lesotho proved critical during COVID, allowing people to continue to use business services without the need for in-person interaction. Additional investments are needed to deliver seamless and integrated business services through strengthening inter-agency coordination and high-level oversight, increasing the technical capacity for implementation, and broadening and streamlining the services provided by the OBFC as well as establishing a national payment gateway. Parallel efforts are needed to implement an Insolvency Act and the Business Licensing and Registration Act.

15. Regulations and systems to support access to finance for the private sector need to be strengthened. Lesotho has made significant improvements in providing access to credit, particularly credit reporting, under the PSCED2 project. Important legislation including the Security Interest in Movables Act have been adopted and efforts are underway to expand coverage to include businesses which will especially benefit women entrepreneurs who have lower levels of access to immovable property. Sustainability of some credit related systems needs improvement to ensure reliability, including the Credit Reporting System under the CBL. Interoperability across digital platforms would be highly beneficial for facilitating financing to the private sector. For example, having the National ID, the LRA, business registries, and banking systems able to talk to each other would improve the business environment, increase access to finance and even domestic revenue mobilization.

16. Reforms to Lesotho's investment framework and institutions are needed to attract investment into high-potential economic sectors. Lesotho does not have an Investment Promotion Bill or a designated Investment Promotion Agency (IPA) although an investment policy is being developed. The existing FDI regulatory framework does not provide for any fiscal, administrative (licenses, permits, approvals) or property and utility incentives (land, water, electricity, last mile infrastructure). Investments are subject to subjective treatment and based on unclear non-transparent criteria and ad-hoc legal agreements. The business licensing regulations restrict foreign investment in some important sectors such as commercial farming. The need for "a modern, competitive investment policy and legal regime", recognizing a critical lack of a structured legal, regulatory, and institutional framework on investment policy and promotion[32] is evident but is unlikely to be realized soon under prevailing political economy challenges.

17. The Second National Strategic Development Plan (NSDP II) (2019 – 2023) emphasizes the need for Lesotho to tap into its existing comparative advantages to broaden sources of growth and has identified horticulture, manufacturing and technology and innovation as high potential sectors. The main binding constraints inhibiting private sector investment in these priority sectors are access to finance, access to land, infrastructure (including access to utilities and energy), access to skills, poor health and the regulatory environment (**Error! Reference source not found.**) need to be addressed concurrently through a multi-faceted approach and leveraging synergies between various interventions across Government and development partner financed programs. The NSDP II estimates that addressing these constraints could unlock private sector investment and entrepreneurship and create more than 20,000 new jobs.

[32] World Bank. 2020. Lesotho Policy Notes. World Bank, Washington, DC. World Bank. https://openknowledge.worldbank.org/handle/10986/34434

Figure 6: Binding constraints inhibiting growth in four prioritized sectors in the NSDP II

Productive Sector	Severity of Constraints					
	Access to Finance	Access to Infrastructure	Access to Skills	Access to Land	Regulatory Environment	Poor Health
(1) Agriculture	High	Low	High	High	Medium	High
(2) Manufacturing	High	High	High	High	Medium	High
(3) Tourism and Creative Industries	High	High	Medium	High	Low	Low
(4) Technology and Innovation	Medium	Medium	Medium	High	High	Low

Source: Lesotho Second National Strategic Development Plan

18. **Additional investments are needed to build on the foundations laid under the PSCED2 project in supporting investments in high-potential economic sectors, including strengthening the tourism and horticulture value chains and supporting MSME growth.** Under PSCED2, in tourism, construction of the tourism information and crafts center (TICC) was completed, a star grading system was established, and a digital system was developed for the tourism promotion agency. In horticulture, three commercial fruit production farms were established, and the Agriculture Finance Department within the Lesotho Post Bank was established which disbursed more than 30 million maloti to more than 140 agribusinesses. Finally, the MSME sector was supported through the PSCED2 Lesotho Enterprise Assistance Program (LEAP) matching grants facility which assisted more than 12,000 businesses to access finance and improve their capabilities. Further investments in each of these sectors are needed to unlock their potential for growth and job creation.

19. **The current pilot commercial horticulture projects can be scaled and replicated through a targeted horticulture business incubation program.** The pilot farms established under the first and second Private Sector Competitiveness and Economic Diversification (PSCED) projects have successfully demonstrated the commercial potential to produce deciduous fruits and vegetables in Lesotho for both the domestic and export markets. There is significant interest from smallholder farmers to venture into commercial horticulture and several projects are currently being supported through the Second Smallholder Agriculture Development Project (SADP2) (P165228). While there is significant potential to attract large scale investments in commercial agriculture, these investments would require a competitive investment regime including the availability of land parcels of adequate size, a transparent and credible land ownership and leasing system and ancillary infrastructure investments. While these longer-term initiatives are being implemented, there are immediate opportunities to support new and emerging smallholder farmers to participate in the horticulture value chain through a systemic horticulture business incubation program delivered through a public-private partnership that supports selected high potential farmers through business development and technical support services, access to markets and access to finance.

20. **While the tourism sector has promising potential, recovery is likely to be slow given the global challenges facing the travel and hospitality industry.** Lesotho's tourism potential is under exploited and there is scope to increase private investments and create new jobs. The tourism sector's challenges include scarcity of skills, limited online presence, poor infrastructure, inadequate facilitation of visitors at borders, and limited experience with eco-tourism. Addressing these barriers could stimulate job creation once the regional and global tourism industry returns to a new normal through the pandemic. According to the UN World Tourism Organization, every tourism job creates approximately 1.5 additional jobs in related sectors.[33] Lesotho's tourism industry will continue to rely heavily on South African and neighboring markets and, while the industry gradually recovers, there is scope to strengthen the investment policy

[33] United Nations World Trade Organization. 2019. Tourism and Jobs: a better future for all. https://www.unwto.org/world-tourism-day-

regime to attract FDI in this sector, improve the availability and quality of skills required by the industry, and invest in required infrastructure to facilitate private investments.

21. **The export manufacturing sector, especially textile and apparel, has potential to attract new investments and create jobs.** The pandemic has exposed the underlying challenges that are stifling the export competitiveness of the export manufacturing sector, including liquidity (especially for the Basotho owned firms), ability to adopt digital solutions, improving labor conditions and resolving pay disputes and compliance with social and environment requirements of global supply chains. Dedicated efforts are required to build regional value chains (particularly intra-SADC), improve manufacturing capabilities and access to reliable infrastructure (especially water, energy, waste management, and factory space). There are opportunities to strengthen business and trade facilitation for export promotion, promote industrial clustering and integrated supply chains, and improve the overall regulatory framework to create a competitive business environment. Targeted public-private efforts to improve the competitiveness of the textile and apparel sector include: (i) strengthening the cut-make-trim (CMT) business; (ii) expanding value-added products in yarn and fabric; (iii) generating capabilities to trade through Delivery Duty Paid Basis; and (iv) promoting the training of middle management human resources and upgrading the overall workforce skills.[34]

22. **There is a nascent entrepreneurship ecosystem which can be nurtured to support young Basotho entrepreneurs.** Concerted action from key public and private sector actors is required to address the critical gaps, including in terms of gender equality, in the entrepreneurship ecosystem in five intersecting areas: (i) strengthening the policy and regulatory environment and institutional capacity and coordination, (ii) expanding access to early stage finance, (iii) building an entrepreneurial culture, developing skills, and a talent pipeline, (iv) helping entrepreneurs access new market opportunities, and (v) enhancing the capacity and quality of business support services. The existing support programs are all relatively recent, small in terms of investment size and beneficiaries, primarily concentrated in Maseru and (in their current form) of limited scope, impact and scalability as well as not fully leveraging the considerable resources that are available in the regional entrepreneurship ecosystem, especially in South Africa. The continuous mentoring, business counselling, and access to financing opportunities that are required by the startups for the initial years is conspicuously missing. Access to early-stage finance is extremely limited, particularly for women, and a critical gap as entrepreneurs do not have information about, or access to, existing financing opportunities in the region. There are untapped opportunities to leverage private funding to establish seed funding instruments with angel investors and the Basotho diaspora and to attract venture capital funds and foundations which are active in South Africa. However, the absence of a healthy pipeline of investible ventures is a key constraint for potential investors.

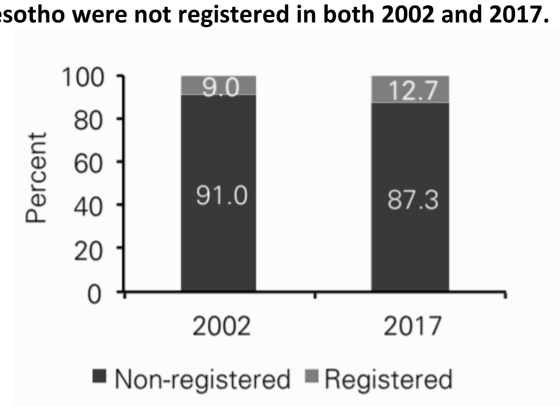
23. **Strengthening the capacity of MSMEs, particularly through support to digital transformation, is important to enable them to grow and be resilient.** Accelerating digital reforms and enhancing digital skills can unlock new business opportunities, enable business owners to reach new markets, and help MSMEs offer digital products. The World Bank Business Pulse Survey found that while firms are very keen to adopt digital technologies[35], government support is lacking. Putting in place a regulatory framework to facilitate digital transactions, promote fintech solutions, and support businesses to adopt digital tools and business models and leverage regional digital platforms can support the creation of new jobs in the digital sector. Complementary efforts are required to provide better quality and more affordable broadband access and enhance the availability of digital skills in partnership with the private sector. Digital businesses, including digital startups and SMEs that want to incorporate digital technologies, are hampered by poor

[34] World Bank (forthcoming). Scoping Study to identify markets and investment opportunities for textile and apparel in Lesotho
[35] World Bank. 2021. Africa's Pulse, No. 23, April 2021: An Analysis of Issues Shaping Africa’s Economic Future. Washington, DC. https://openknowledge.worldbank.org/handle/10986/35342

digital infrastructure outside of urban areas. Only 8 percent of businesses currently use mobile money for business to business (B2B) payments.[36]

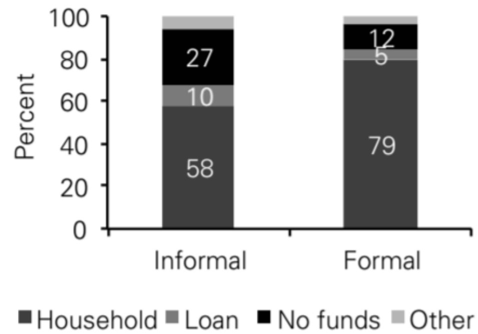
24. **Expanding access to MSME financing, particularly through digital financial services, would support the viability and growth of MSMEs.** Most MSMEs are micro, informal, and focused on survival rather than growth. There are an estimated 85,173 MSMEs in Lesotho, with an estimated collective monthly turnover of M192 million (approximately US$11 million). The MSME sector employs approximately 55,000 people in mostly low paying jobs. Eighty-three percent of them do not employ any workers and less than 3 percent employ 5 or more people.[37] These businesses are largely struggling to survive in a difficult business environment and lack financial and non-financial support including efficient infrastructure and impactful business development services to build capabilities and access new opportunities and markets. The rate of informality has not changed significantly over the last 20 years (Figure 7) with most businesses still not part of the formal financial sector and reliant on low levels of savings which limit their capacity to grow and create jobs (Figure 8).

Figure 7: More than 80 percent of household businesses in Lesotho were not registered in both 2002 and 2017.



Source: World Bank (2019)

Figure 8: Most businesses in Lesotho, whether informal or formal, do not access formal finance

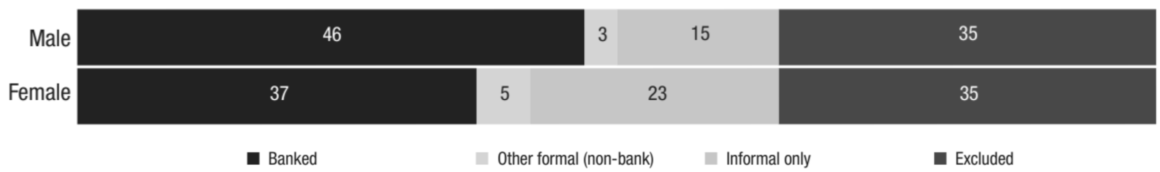


Source: World Bank (2019)

25. **MSMEs currently face multi-dimensional challenges accessing finance, particularly for women-led businesses**. Key findings from focus group discussions include very stringent requirements by banks, low efficacy of the current partial credit guarantee scheme, high co-financing requirements (MSMEs must put in 30-40 percent of total loan amount), costly digital transactions (6 percent fees for some systems), and limited support from the Lesotho National Development Corporation (LNDC) and the Basotho Enterprise Development Corporation (BEDCO). An important finding from the focus groups was that women had a particularly challenging time accessing financing for their MSMEs, even before the COVID-19 pandemic. Women stated that they were required to include their husband's name and income statements to access a loan and were less likely to be approved by a bank, particularly if they were unmarried, as they were perceived to be riskier borrowers. Evidence shows that this is a systemic challenge (Figure 9).

[36] FinScope Trust. 2016. Micro, small and medium enterprises (MSME) survey. https://finmark.org.za/system/documents/files/000/000/283/original/finscope-lesotho-pocket-guide_en.pdf?1609752854
[37] FinScope Trust. 2016. Micro, small and medium enterprises (MSME) survey. https://finmark.org.za/system/documents/files/000/000/283/original/finscope-lesotho-pocket-guide_en.pdf?1609752854

Figure 9: Lesotho MSME Financial Access (%)



Source: FinScope (2016)[38]

26. **Strengthening the resilience of MSMEs can limit damage to these businesses from the climatic and other economic shocks that periodically impact Lesotho's economy.** The COVID-19 and recent droughts and floods have shown how acutely MSMEs are affected by climatic shocks, highlighting the importance of developing resilience building mechanisms. The focus group sessions conducted during the pre-appraisal mission shed insight on the topic, with the majority of MSMEs noting the exposure of their business to climatic shocks. In addition, the team learned that MSMEs experienced challenges with receiving relief grants during the COVID-19 pandemic. Formal MSMEs cited the grant requirements to be onerous, particularly the mandated two years of bank statements. Even if MSMEs provided all required documentation, they only received a payment for one-month, rather than the intended three months due to lack of resources available. MSME owners noted that when impacted by the compounding shocks of COVID-19, drought, and floods, they were forced to retrench, reduce hours and/or reduce pay, force early retirement, shift their business model (leading to a more diversified business). Some had to abandon their buildings and/or close their operations. In the absence of resilience building investments, the expansion of the MSME sector will continue to be hampered by recurrent climatic shocks.

27. **Through targeted investments, the government can strengthen the resilience of both MSMEs and horticulture to climatic shocks.** While the Ministry of Finance (MOF) does maintain a contingency fund for unforeseen expenditures, these funds tend to be deployed early in the budget cycle (prior to the occurrence of climatic shocks) leaving no earmarked funds for MSMEs. Relatedly, existing digital finance service (DFS) infrastructure does not allow for efficient G2B payments in response to climatic shocks or for other purposes. Expanding the financing instruments (such as sovereign insurance or contingency funds) available to government to rapidly deploy financial support to MSMEs during climatic shocks is critical. Key DFS reforms to allow G2B payments include: (i) implementation of a national switch to allow non-bank service providers access to retail payment infrastructure and simplifying e-money and agent banking regulations to increase the usage of DFS; (ii) facilitate the entry of fintech in the market by removing regulatory barriers; and (iii) move to accept and use digital payments in government to person (G2P) and person to government (P2G) payments, including tax payments and social transfers. Promoting investments and entrepreneur capacity to implement climate smart horticulture business plans will be crucial to develop a vibrant horticulture industry moving forward.

Scope of the Project

28. **The proposed project has adopted a selective approach by targeting interventions that link closely to business expansion and resilience and job creation, specifically those related to supporting entrepreneurship, MSMEs, and high potential value chains.** The proposed interventions are targeted at increasing financial inclusion and resilience

[38] FinScope Trust. 2016. Micro, small and medium enterprises (MSME) survey. https://finmark.org.za/system/documents/files/000/000/283/original/finscope-lesotho-pocket-guide_en.pdf?1609752854

as well as strengthening the support for MSMEs and entrepreneurship along the high potential value chains. Under increasing financial inclusion and resilience, the proposed interventions focus on strengthening delivery of G2B services, increasing access to finance for MSMEs with a focus on ensuring inclusion of women owned MSMEs and enhancing resilience of the business sector from climate and other shocks. Support for MSMEs and entrepreneurship is focused on enhancing the scope and quality of business support services, access to early-stage finance and improving the overall competitiveness and climate resilience of horticulture and export manufacturing value chains. Drawing from the experience of the PSCED and PSCED2 projects, institutional, legal, and regulatory reforms pertaining to access to finance, investment policy and business environment reforms could be more effectively supported through a parallel accompanying technical assistance program such as under the current Jobs Platform. The project interventions proposed therefore target market and coordination failures through direct support to entrepreneurs and firms while leveraging private sector service delivery capacity to augment limited public sector capacity. Although the tourism value chain has not been explicitly targeted, entrepreneurs and existing MSMEs in the sector will be able to fully benefit from the project interventions.

29. **Leveraging analytical and advisory support under the Jobs Platform**. The proposed project draws extensively upon the analytical and advisory activities that were implemented under the World Bank's Southern Africa Jobs Platform.[39] The on-going support to the Lesotho Prime Minister's Delivery Unit (PMDU) is facilitating the Cabinet Sub-Committee on Business Environment Reforms and public-private dialogue on key value chains (tourism, export manufacturing and horticulture) as well as key themes such as business environment reforms, access to finance, and youth employment and entrepreneurship. The Jobs Platform supported a review of the draft Investment Policy, an assessment of the competitiveness of the textile and apparel sector, an assessment of business incubation services, participation of Lesotho in a regional Start-up Community and developing a business environment road map for Lesotho, all of which are directly relevant to the project design and implementation.

C. Relevance to Higher Level Objectives

30. The project contributes directly to High Level Objective (HLO) One and Three as well as aligning with the gender informed approach outlined in the upcoming Country Partnership Framework (CPF) (FY22-26). Under HLO 1, Increased Employment in the Private Sector, the project will contribute to CPF Objective One (Improved enabling environment for private investment and competitiveness) and CPF Objective Two (Increased opportunities and capabilities for MSMEs and entrepreneurs). Under HLO 3, Improved Climate Resilience, the project will contribute to CPF Objective Seven - Increased climate-sensitive spatial planning, service delivery, financial and infrastructure resilience, through strengthening the risk financing instruments under Component 1.3. The project seeks to reduce climate vulnerability by contributing to adaptation interventions that increase MSME's financial resilience to climatic shocks such as droughts and floods, with a focus on women owned MSMEs given their additional challenges accessing finance from banks. Under the gender informed approach of the CPF, the project has identified strategic entry points and actions towards addressing those priority gender gaps in Lesotho as set out in the World Bank Lesotho Gender Assessment 2022. The project aims to provide economic opportunities for women through support for women-owned startups and women-owned MSMEs to assist them in launching businesses, adopting new digital technologies, and improving managerial practices.

31. The Systematic Country Diagnostic Update (SCD-U) (2021) highlighted the weak business environment as a key disincentive for private investment. The SCD-U prioritizes the need to shift from a public sector-driven to a private-

[39] World Bank. Jobs and Economic Transformation ASA (P171855)

sector driven, export-oriented and job-creating economic growth model. The SCD-U offers the following policy recommendations: (i) accelerating implementation of business reforms; (ii) establishing a modern, competitive investment policy and legal regime; (iii) accelerating the implementation of key legal and regulatory financial sector reforms, together with the rollout of digital financial services to expand inclusion; (iv) increasing agricultural productivity, value addition and commercialization to promote agribusiness development, MSMEs and food security; (v) building on past success to revitalize the manufacturing sector and ensuring the sector regains its competitiveness; (vi) attracting private investments in key value chains to create new jobs; and (vi) improving trade facilitation and trade policy. The proposed project is also aligned with IFC's strategy for Lesotho including the mobilizing finance for development (MFD) approach and focus on increasing private capital mobilized (PCM) through supporting public investments that are necessary to catalyze new private investments in key value chains.

II. PROJECT DESCRIPTION

A. Project Development Objective

PDO Statement

32. The project development objective is to increase access to business support services and financial products targeted at MSMEs and entrepreneurs, especially women and youth.

PDO Level Indicators

33. The proposed project supports results in two areas: (i) improving financial inclusion and resilience through improvements in G2B digital services, credit infrastructure and payment systems and government supported financial products that increase MSME creation, growth, and resilience to climatic and other shocks, and (ii) direct support for entrepreneurship and MSMEs to increase startup creation and growth and the capabilities of MSMEs to grow and participate in the high potential export value chains. Please refer to Section II.D for the Theory of Change. Please refer to Section II.E for how the project results complement ongoing or upcoming World Bank Group and development partner projects that support private sector development in Lesotho.

34. The following indicators will be used at PDO level:

- Number of firms benefiting from private sector initiatives (Of which are women owned, Of which are youth owned)
- Value of financing (seed funding, grants, partial credit guarantee, credit infrastructure improvements, resilience funding) accessed by enterprises through the program (Of which is financing accessed by enterprises that are women owned)
- Percentage of enterprises supported by the program with increased revenue in real terms (Of which are women owned)

Results targets as well as intermediate indicators are included in the results framework in Section VII.

B. Project Components

35. The project has three components that will support the Government's efforts to expand the private sector in Lesotho. The components focus on reforms and transformations in the following areas:

a) Enhancing financial inclusion and resilience of MSMEs (US$20 million)
b) Scaling support for entrepreneurship and MSMEs (US$29.5 million)
c) Project management and implementation support (US$3million)

Component 1: Enhancing Financial Inclusion and Resilience of MSMEs (US$20 million)

36. Component 1 will enhance financial inclusion through strengthening the delivery of efficient and reliable G2B digital services and improved access to financial services to facilitate the establishment and operation of new businesses and reduce the time and cost of regulatory compliance especially for MSMEs. It will also provide support for firms to be more resilient to shocks from climate, pandemic, and other natural disasters. The component will include activities that support (i) optimizing the outcomes of investments in G2B digital systems and processes made under the PSCED2 project, to strengthen inter-operability, efficiency, and impactful service delivery for businesses, particularly those receiving support under Component 2, (ii) improving financial access through upgrading the security and reliability of credit infrastructure and expanding access to digital financial services, and (iii) instruments to expand financial resilience for businesses especially MSMEs to cope with disasters and other shocks to the economy. The component will finance technical assistance, goods, training and capacity building programs, and recurrent expenditures, including operating costs objectives.

Subcomponent 1.1 – Enhancing Government to Business (G2B) Digital Services to more effectively serve MSMEs (US$6.5 million of which US$4.5 million IDA equivalent and US$2 million Global Risk Financing Facility (GRiF) Grant)[40]

37. **Subcomponent 1.1 will provide support to build on investments in G2B systems made under the PSCED2 project that serve MSMEs.** The systems' investments, technical assistance, training, and capacity development will improve the reliability and interoperability of key G2B systems, address regulatory and process bottlenecks, and strengthen interagency coordination and the delivery capacity of the relevant Government agencies for more efficient G2B services including increased digitization of government payments. The payments gateway, coupled with other G2B service improvements, will enhance the efficiency of government support to businesses, while also strengthening the business environment for MSMEs and entrepreneurs and reducing the cost of doing business. Investments in the G2B systems will consider the impact of climate change, seeking to minimize the impact of flash flooding events and / or wildfire (both more likely with climate change).

38. Activities under this subcomponent include:

- **System upgrades for business facilitation, trade facilitation, and land registration**: upgrades and business process reengineering to enhance the functionality, sustainability, and inter-operability of key G2B systems including business registration and licensing, construction permitting, land administration, trade facilitation (customs and national single window), and cross-border transport and transit operations. Costs to keep the

[40] The GRiF is as a Multi-Donor Trust Fund, housed at the World Bank, to help countries design and implement financial solutions to manage disasters and climate shocks.

current business registration system running during the transition period.

- **Design and implementation of an interoperability framework**: development of a G2B systems interoperability framework with institutional agreements and architecture for secure data exchange between agencies/G2B backbone systems (including OBFC's business licensing and registration, LRA tax and trade facilitation, LAA's property registry, and CBL's credit bureau and moveable assets registry (LERIMA).
- **Design and implementation of a payment gateway**: implementation of a government payment gateway, with incentives for merchant payments, to consolidate and enhance the effectiveness of digital G2B payment systems and related processes.

A detailed and costed action plan covering these activities will be discussed and agreed with the government, including inputs from private sector stakeholders, at the outset of implementation of this subcomponent.

39. **System upgrades for business facilitation, trade facilitation and land registration**: (i) The OBFC business registration system will be consolidated into the existing UNCTAD business licensing and business permitting system. The implementation would start with a prototype and would continue by phasing out of OBFC's current business registration system for companies, which will be maintained until the transition to the UNCTAD system is complete. The transition is expected to take less than two years. Each phase of this transition, which includes process review, data analysis, prototyping, implementation, and testing, will be done jointly by UNCTAD and OBFC staff. Each of the phases will include capacity building for the OBFC staff to ensure system transition is coordinated with OBFC's business processes. The new OBFC system will use the G2B Payment Gateway which will also be implemented under this subcomponent;(ii) The LRA's customs system, based on UNCTAD's ASYCUDA World system[41], will be upgraded including automation of important modules such as e-Certificate of Origin and Risk Based Selectivity and the connection of LRA's national single window with the G2B Payment Gateway; and (iii) The LAA land registry system will be upgraded to improve land survey, land registration, data integrity and data exchange with other downstream agencies. As part of the data exchange implementation, the MCC's construction permit system will also be upgraded. Both the Land Registry and the Construction Permit systems will also be integrated to the G2B Payment Gateway.

40. **Implementation of an interoperability framework**: The design and implementation of a G2B interoperability framework will be done in parallel to G2B systems enhancements and business process reengineering to integrate isolated systems. The framework scope would focus on the G2B backbone systems with more impact on business processes: financial and payment systems, CBL's credit bureau and moveable assets registry (LERIMA), and business regulatory agencies (OBFC's business licensing and registration, LRA tax and trade facilitation systems, LAA's property registry). Key elements of the framework will include a high level G2B information architecture that identifies data sources and data consumers, volume, and types of transactions for secure data interchange between business related systems. A governance structure for the G2B framework will be developed including the operation of an inter-agency steering committee, institutional arrangements (roles and responsibilities), and technical task forces to participate in different phases of the implementation.

41. **Implementation of a payment gateway**: This activity will enhance the effectiveness and security of G2B processes by consolidating G2B government payments into one payment gateway to be used by all G2B agencies which will allow businesses to make payments via cards, electronic transfers, and mobile money for all G2B processes. The agencies that will have access to the payment gateway include the OBFC, MCC, LAA and LRA to provide seamless online payment facilities for businesses.

[41] ASYCUDA World is a computerized customs management system that covers most foreign trade procedures. ASYCUDA software is developed in Geneva by UNCTAD

Subcomponent 1.2. Improving Access to Financial Services (US$3.0 million IDA equivalent)

42. **This subcomponent provides technical assistance and investments to improve access to financial services for MSMEs, particularly women owned MSMEs,** by (i) strengthening the credit infrastructure system that facilitates access to business financing,; (ii) promoting market innovation through the development of new financial products targeting women-owned businesses; and (iii) expanding the impact of the LNDC-managed risk sharing facility through the development of a portfolio guarantee including targeted efforts to support women-owned MSMEs.

43. **Strengthening the credit infrastructure system (US$1.0 million):** Technical assistance will be provided to the CBL to build on the credit infrastructure reforms supported under the PSCED2 to further enhance the credit reporting system and the movable asset registry. The credit reporting system will be strengthened by improving the quality and accuracy of data, expanding reporting through the inclusion of alternate data, broadening the coverage to include corporate data, and leveraging the existing platform for development of value-added services which seek to increase access to finance. The support will include the (i) development of a simplified data template to improve data submissions and completeness; (ii) amendment of the Credit Reporting Act to allow access by a credit bureau to alternative sources of data and data processing of corporate entities; (iii) development of a credit scoring system to enhance utility of credit reporting including the adaptation of tools and mechanisms that can adequately evaluate women's creditworthiness; and (iv) capacity building efforts to enhance CBL's supervisory capacity, utilization of the system by credit providers and consumers, and MSME awareness and understanding of the credit bureau. The project will also support the enhancement of capabilities and utilization of the moveable assets registry (LERIMA), through system optimization and integration with relevant databases. This support will include: (i) integration of data from the motor vehicle and company registries into LERIMA, and (ii) capacity building and awareness of financial institutions and MSMEs, with a focus on women owned MSMEs, to increase utilization of LERIMA. To ensure that these activities are advanced with due consideration for broader financial inclusion objectives in Lesotho, and adequately leverage synergies from other projects, technical assistance will also be provided to the MoF in support of national financial inclusion priorities.

44. **Promoting market innovation through the development of new financial products (US$1 million):** Recent legislative improvements, specifically the implementation of the Security Interest in Movable Property Act, 2020, provide a solid legal base for developing accounts receivable financing and other asset-based lending instruments. To promote market innovation, capacity building will be provided to financial institutions to bolster knowledge and understanding of the new legislation and support design and implementation of new products that take advantage of the legislation, including products which strengthen the climate resilience of MSMEs (e.g. savings accounts for MSMEs exposed to climatic shocks, insurance products which manage climate risk such as agriculture insurance, liquidity instruments / facilities which provide short term lines of credit to MSMEs exposed to climate shocks). Activities to support development of alternative and innovative credit products include: (i) capacity building to financial institutions for the development of asset-based lending; and (ii) capacity building to MSMEs, with a process that includes targeting women MSMEs, that are potential users of the lending products. Support will be provided to financial institutions and potential borrowers for scaling value chain financing for horticulture (to complement the support for horticulture incubation services under subcomponent 2.3). This technical assistance will build on the successful efforts under the PSCED2 to establish the Agriculture Finance Department within the Lesotho Post Bank which provides cash flow-based lending. Value chain financing leverages collateral inherent in the lending transaction being financed, for instance future receivables, to extend borrowing and consequently connects to efforts to advance the development of LERIMA. Activities to be supported include technical assistance to Post Bank for (i) development of a business case for agricultural value chain finance, including market assessment, climate risk assessment and financing methodology; (ii)

design and implementation of a management information system (MIS) to support value-chain financing; (iii) capacity building for internal staff and prospective farmers (to be conducted together with the horticulture incubation program); and (iv) methods to integrate climate mitigation and adaptation measures into business plans of MSMEs (e.g. drought resistant seeds, accumulation of savings to respond to climatic shocks, diversification of planting geographies to spread risk).

45. **Expanding the impact of the LNDC risk sharing facility (US$1 million):** To increase the impact of the LNDC risk sharing facility (L-PCG), support will be provided to strengthen institutional and operational features of the scheme and allow it to scale through the design and development of a portfolio guarantee. Under the portfolio approach, the guarantee will be applied to all loans meeting predefined eligibility criteria. This offers: (i) systemic coverage, as the guarantee will be provided to a large portfolio of eligible loans; (ii) reduced processing time, as compared to individual guarantee issuance; and (iii) elimination of adverse selection by PFIs, as all eligible loans are automatically included under the guaranteed portfolio. Technical assistance will be provided to (i) review and improve governance, institutional and operational features of the L-PCG; (ii) develop a business case and financial model for portfolio guarantee; (iii) design and implement the portfolio guarantee scheme including development of supporting documentation and systems – i.e. operational manual, risk management framework, monitoring and evaluation system; (iv) procure requisite hardware to support a robust MIS, and (v) capacity building for L-PCG staff, prospective PFIs, and MSMEs.

Subcomponent 1.3 - Strengthening the Resilience of MSMEs to Climatic Shocks (US$10.5 million of which US$5 million IDA equivalent and US$5.5 million GRiF Grant)

46. The activities under this sub-component will support the design, capitalization, and implementation of risk financing instruments with the objective of providing financial support to otherwise viable MSMEs during climatic shocks, enable them to maintain operations and strengthen their financial resilience. The sub-component will target the MSMEs that are most vulnerable to climatic shocks, particularly those that are women owned. While the focus of this sub-component is to strengthen the financial resilience of MSMEs to climatic shocks, in the event of a resurgence of COVID-19 or similar shock, resources to finance MSME support may be considered on an exceptional basis. It is estimated that around 20,000 MSMEs will be supported through this subcomponent.

47. The sub-component activities are designed to ensure the government can more independently finance and deliver financial assistance to otherwise viable MSMEs that are adversely affected by climatic shocks over the course of the project, reducing the reliance on budget reallocations or humanitarian funding. To achieve this, the subcomponent will allocate: (i) US$4 million for MSME financial resilience which will be disbursed as grants via the PMU to climatic shock affected, but otherwise viable, MSMEs. Eligibility criteria for disbursements will be detailed in the operations manual of the project and include eligible climatic shocks, the data upon which to assess the severity of climatic shocks, the disbursement process, target MSMEs, resources provided to each MSME depending on its size, etc.; (ii) US$6 million to finance the sovereign insurance which is expected to initially focus on drought and subsequently expanded to consider floods. Technical assistance will be provided to the MOF for the design and procurement of this sovereign insurance and payouts from the sovereign insurance will be disbursed into the Contingency Fund held by the MOF; and (iii) US$0.5 million of technical assistance to strengthen disaster risk finance capacity in the Government.

48. The activity will also support the strengthening of the existing national business registry through developing a database for informal MSMEs which will be initially managed by the PMU. Over its duration, the project will support the Government to integrate the database for informal MSMEs into the business registry. The project will finance data collection exercises to update the database which will include banking details, geographic location, and sector. The database combined with the G2B payment systems established under subcomponent 1.1 will enable rapid disbursement of resources to climatic shock affected MSMEs. This activity will build on the success of the recent COVID-19 relief grants provided to MSMEs, which leveraged mobile money channels to enable rapid, transparent, and efficient payments. A Disaster Risk Finance (DRF) Coordinator will be recruited as part of the PMU to coordinate the implementation of this subcomponent.

49. In parallel to the CAFI project, the World Bank will provide technical assistance under a GRiF financed advisory services and analytics (ASA) project to support the MOF with two key risk financing activities. First, to draft and adopt a National Disaster Risk Finance Strategy articulating the MOF's strategic priorities for financing disaster response. Second, to draft and adopt regulations for the Contingency Fund held at MOF (including fund governance, the disbursement and procurement processes, financial management of resources, and auditing and reporting requirements). Included in the regulations will be the establishment of an MSME Resilience Window. A sequenced implementation approach will be adopted, first focusing on supporting the MoF draft and adopt a National Disaster Risk Finance Strategy and regulations, after which focus will be placed on design and purchasing of sovereign insurance. Upon adoption of the regulations, the project will discuss with the Government options to provide resilience funding for MSMEs through the Contingency Fund.

Table 1. Summary of Component 1 Activities

Component	Activities	Proposed budget (US$)
Component 1	**Enhancing Financial Inclusion and Resilience of MSMEs**	**20.0 million**
Subcomponent 1.1. Enhancing G2B Digital Services to More Effectively Serve MSMEs	• Upgrades to enhance the functionality, sustainability, and inter-operability of key G2B systems including business registration and licensing, construction permitting, land administration, trade facilitation (customs and national single window), and cross-border transport and transit operations • Development of a G2B systems interoperability framework with institutional agreements and architecture for secure data exchange between agencies/G2B backbone systems (including OBFC's business licensing and registration, LRA tax and trade facilitation, LAA's property registry, and CBL's credit bureau and moveable assets registry (LERIMA)) • Implementation of a government payment gateway, with incentives for merchant payments, to consolidate and enhance the effectiveness of digital G2B payment systems and related processes • This sub-component will be co-financed with a GRiF grant.	4.5 million (IDA) and 2.0 million (GRiF)
Subcomponent 1.2. Improving Access to Financial Services	• Strengthen the credit infrastructure system that facilitates access to business financing including upgrades and capacity building to expand use of the credit reporting system and the LERIMA moveable assets registry • Promote market innovation through the development of new financial products including capacity building for financial institutions and MSMEs to utilize asset based lending and technical assistance to PostBank and prospective borrowers for value chain financing for commercial farmers and agribusinesses • Expand the impact of the LNDC risk sharing facility through the development of a portfolio guarantee by providing technical assistance to LNDC, PFIs, and MSMEs to revamp and utilize the facility • Technical assistance to the MoF on access to finance to ensure that these activities are advanced with due consideration for national financial inclusion objectives	3.0 million
Subcomponent 1.3. Strengthening the Resilience of MSMEs to Climatic Disasters and Shocks	• This sub-component will be co-financed with a GRiF grant. • Strengthen private sector resilience to climatic disasters and shocks: o Provide US$4.0 million for MSME financial resilience o Provide US$6.0 million for sovereign insurance to protect MSMEs from shocks o Work with the national business registry to establish a database for informal MSMEs eligible for financial support during climatic shocks o Provide technical assistance on the design and procurement of a sovereign insurance backstop, and co-financing of insurance premiums o TA on disaster risk financing including adoption of a National Disaster Risk Finance Policy	5.0 million (IDA) and 5.5 million (GRiF)

Component 2: Scaling Support for Entrepreneurship and MSMEs (US$29.5 million IDA equivalent)

50. Component 2 aims to strengthen the nascent entrepreneurial ecosystem and access to early-stage finance for startups and youth owned businesses, support the digitization of MSMEs, and facilitate private investment in high-potential value-chains including encourage upgrading of skills and adoption of sustainable production practices by businesses to enhance productivity and green growth. The component will include activities that support (i) establishing an Entrepreneurship Hub and Seed Financing Facility to increase the quality and scope of integrated startup business support services and increase access to early-stage financing; (ii) scaling the current Lesotho Enterprise Assistance

Program (LEAP) focusing on supporting MSMEs to adopt digital and green technologies and upgrade their capabilities; and (iii) facilitating investment into productive value chains that are linked to local MSMEs. The component will finance technical assistance, goods, training, recurring expenditures including operating costs, grants, and investments in a "seed financing facility."

Subcomponent 2.1. Establishing an Entrepreneurship Hub and Seed Financing Facility (US$12.5 million)

51. Subcomponent 2.1 will support the establishment of a sustainable entrepreneurship ecosystem. The entrepreneurship ecosystem will provide integrated support to startups and innovative SMEs based in Lesotho. Startups are defined as businesses with high-growth potential and intention. Innovative SMEs are defined as those SMEs with higher risk, higher potential products, or business models than typical SMEs. These types of entrepreneurial businesses will benefit from the specific types of business and financial support that the project will provide through the entrepreneurship ecosystem.

52. The subcomponent will finance a new specialized Entrepreneurship Hub and a seed financing facility (investment fund/accelerator) that will facilitate the development of a comprehensive entrepreneurship ecosystem. This will include the following specific activities: (i) establish a sustainable and privately managed Entrepreneurship Hub; (ii) upskill and certify 15 existing or newly established entrepreneurship support organizations (ESOs); (iii) create and manage an incubation support program that includes competitive funding to incubate up to 500 businesses; (iv) facilitate the integration of the Lesotho Startup Community within a wider regional entrepreneurship ecosystem; (v) create a program to facilitate Basotho Diaspora engagement with the Lesotho entrepreneurship ecosystem; (vi) facilitate the selection of an experienced private fund manager to establish and manage a seed financing facility and an associated acceleration program; and (vii) provide initial funding to create the seed financing facility that will invest in 50 startups over the period of the project.

53. **Establish a sustainable and privately managed Entrepreneurship Hub (US$2 million).** An Entrepreneurship Hub will be established within the new Tourism Information and Crafts Center (TICC) building that was constructed with financing from the PSCED2 project. The Entrepreneurship Hub will provide an attractive co-working, community building, events, and networking space for use by Lesotho's entrepreneurs and ESOs. The Hub will provide a central location with facilities and digital infrastructure and support services, including access to broadband internet services. Its mission will be to catalyze the development of the entrepreneurship ecosystem through entrepreneurship awareness, training, financial and capacity building support to ESOs, and other support programs. The Hub will be managed by a competitively selected private organization that will manage the space and run the ecosystem support activities discussed below. The Hub will have a particular emphasis on bringing youth, women, and other underrepresented populations into the entrepreneurship community and ecosystem. It will also work beyond Maseru including through partnerships with organizations in other regions as needed.

54. **A private sector operator will be selected to establish and manage the Entrepreneurship Hub space and run the hub's ecosystem building programs described below.** The operator would be selected, through a competitive selection process, based on relevant prior international experience as well as local knowledge. This will likely yield a mixed team of international and local experts or organizations, which would be ideal for establishing the local ecosystem and then connecting it internationally. The PMU would provide quality assurance and disburse funds to the operator based on agreed milestones. The governance and administrative arrangements and eligibility criteria for selecting the operator would be detailed in the Project Implementation Manual (PIM).

55. **Upskill and certify entrepreneurship support organizations (ESOs) (US$1.0 million).** The Entrepreneurship Hub will manage an ESO certification and training program to bring the quality of services of existing ESOs up to international standards as well as to encourage new ESOs to be created. The goal is to improve ESO performance and their ability to provide higher quality services to existing and aspiring entrepreneurs in the country, thus addressing the entrepreneurs' needs for skills upgrading (including soft skills), managerial capabilities, technology, and other needs. The project plans to certify up to 15 ESOs. Ten existing ESOs have been identified during project preparation and it is expected that additional ESOs will be established throughout the project implementation period. The program will have an active outreach to ESOs to encourage participation and solicit applications. A diagnostic, training, and competitively awarded technical assistance will help ESOs to assess their management and operations and improve their performance to achieve certification.

56. **Create and manage an incubation support program that includes competitive funding to incubate up to 500 SMEs/startups (US$5 million).** The Entrepreneurship Hub will run an incubation support program that includes periodic calls for proposals to finance ESO incubation programs. ESOs will only be eligible to participate in the calls for proposals after they have been certified. ESOs with successful proposals are expected to be provided with US$100,000 to run an incubation program for 10 SMEs/startups over a period of one year. Half of the funding would go directly as a grant to the SMEs/startups (i.e., US$5,000 per SME/startup), upon achievement of specific milestones. The other half of the funding would go to the ESO to cover management costs and compensate coaches and mentors to advise entrepreneurs on developing their concepts, business models, and business plans, and monitoring their progress. The main objective of the incubation programs would be to scale up the SMEs/startups from concept stage to an investable stage. SMEs/startups graduating from the incubation programs would constitute a deal flow for the seed financing facility. A specific process to towards sharing information with and supporting women led startups and SMEs will be shared with the ESOs to encourage programs that reach and meet the needs of women entrepreneurs. Five incubation cycles will run in parallel for a period of a year, with quarterly review meetings between the Entrepreneurship Hub managers and the ESO Project Teams. A new call for proposals for funding would be run every six months, allowing additional ESOs to compete for the funding and the successful existing ESOs to obtain more funding for their incubation programs. ESOs with women, youth, and climate related programs will be encouraged to apply for support. The incubation program would incubate up to 500 SMEs/startups based on the expected number of cycles.

57. **Facilitate the integration of the Lesotho Startup Community (LSC) within a wider regional entrepreneurship ecosystem (US$1.0 million).** The Entrepreneurship Hub would facilitate the establishment and operation of a Lesotho Startup Community as part of the regional Innovation Bridge Startup Community, supported by the World Bank under the Southern Africa Jobs Platform ASA. The LSC members would be introduced to the platform to strengthen collaboration, networking, and sharing of knowledge and experience, and implement training programs to enhance the capacity and impact of incubators, accelerators, and other entrepreneurship support organizations within the ecosystem. This activity would also facilitate exchange programs between startups in the LSC, the Southern African startup ecosystem, and the Basotho Diaspora. This would attract role models and partners to become actively involved in supporting Lesotho's entrepreneurship ecosystem. This might include, for example, a "Proud to be a Basotho Entrepreneur" campaign to attract entrepreneurs back to Lesotho or the facilitation of a Basotho Business Angels Network. A main objective would be putting the Lesotho entrepreneurship scene "on the map" to raise awareness of the Lesotho ecosystem with Basotho in the Diaspora and attract non-Basotho investors.

58. **Facilitate the selection of an experienced private seed fund manager to establish and manage a seed financing facility and an associated acceleration program (US$0.5 million).** An overall objective of subcomponent 2.1 is to initiate an investment culture in Lesotho's Entrepreneurship ecosystem. The activities of the Entrepreneurship Hub

described above are intended to create a vibrant entrepreneurship ecosystem with 15 ESOs certified, and 500 newly incubated entrepreneurs/startups/SMEs, some of which will be ready for follow-on investment. This will create the environment necessary to attract a qualified fund manager to manage a seed financing facility and acceleration program in Lesotho. This activity will provide financing to attract a fund manager for these programs and finance setup costs for the fund and the acceleration program. The fund manager should have a proven track record of managing similar programs and will be selected under an open and transparent international competitive bidding process and based on clearly defined outputs and outcomes. Financing would be provided for a review of the investment environment for venture capital (VC) activity, an outreach and communications campaign to attract interested fund managers, and initial setup costs (e.g., legal costs, fund modeling, pre-launch management costs) for the seed financing facility and accelerator. The fund and accelerator are expected to be established during the first year of project implementation, with investment and acceleration activity taking place over the final four years of project implementation.

59. **Provide initial funding to capitalize the seed financing facility, that will invest in 50 startups over the period of the project (US$3.0 million).** This activity will provide US$3 million to capitalize the seed financing facility. The funding will be provided as a grant to be used as permanent capital on terms that would be negotiated with the prospective fund managers during implementation (e.g., on a first loss basis or on a rolling fund basis). However, a minimum requirement will be for the selected fund management company to raise a minimum of US$ 1 million in matching capital to bring the minimum fund size to US$4 million. The fund will be spent / invested over the final 4 years of the project period as follows: US$2.5 million for direct investment into 50 startups/SMEs with ($50,000 investment in each); US$0.5 million as follow-on investment in up to 5 startups/SMEs; and US$1 million as management fees (3 percent during the investment period and 2 percent during the divestment period). The investment into the 50 startups/SMEs is expected to be provided as follows: US$25,000 equity investment to be used for the operations/growth of the startup/SME and US$25,000 grant for the costs of the acceleration program to be managed by the fund manager for the benefit of the 50 startups/SMEs. The final amounts and arrangements for the investments and acceleration program would be negotiated with the prospective fund managers. However, the guaranteed revenue for the fund management and acceleration company under this setup is planned so that it is attractive to early-stage fund managers in the region that would be establishing the first such seed financing facility in Lesotho. To address gender gaps that women-owned startups/SMEs face, the seed fund will ensure a minimum of 20 percent of investments support women-owned SMEs and start-ups. Similarly, the seed fund will ensure a minimum of 20 percent of investments go to SMEs/startups that have built climate change adaptation and mitigation considerations into their business model.

Subcomponent 2.2. Scaling Up the Lesotho Enterprise Assistance Program (LEAP) for MSMEs (US$5 million)

60. This subcomponent will support an enhancement of the existing Lesotho Enterprise Assistance Program (LEAP). LEAP is a matching grants facility established under the World Bank's PSCED2 to support MSMEs. The main eligible use of LEAP financing under PSCED2 was the purchase of business development services (BDS). The LEAP program under CAFI will allow for a wider range of eligible expenditures that support MSMEs to improve their productivity or growth, as well as strengthen their resilience to climatic shocks. Supported MSMEs will be eligible to finance any investments that target improved productivity or business expansion including BDS, purchases of technology (equipment, machinery, software), training and skills development, strengthening disaster risk management and / or capacity (drought resistant seeds for agribusiness SMEs, flood protection, capacity development on creating climate smart business plans, etc.) or other relevant expenditures. The program will sharpen its focus on climate smart MSMEs with strong potential for growth and productivity improvements by including related criteria (such as the inclusion of

climate smart in business models) in its review process. The program will also enhance its efforts to target MSMEs investing in digitization (digital tools, processes, and systems for business operations or participation on digital platforms), environmentally and socially sustainable operations, with focus on resilience to disasters and other economic shocks. Specific outreach will be made to target MSMEs led by women and youth, as well as those that are exposed to climatic shocks. LEAP will refer MSMEs with a high potential to scale to the managers of the seed financing facility financed under subcomponent 2.1, so those businesses can be considered for appropriate follow-on financing. This window of the LEAP program is expected to utilize US$2 million of funding to finance around 200 MSMEs over the project implementation period as listed in Table 2.

Table 2. LEAP Window 1: Estimated Financing for MSMEs by Firm Size

Firm Size	Average Grant Size	# of Total Grants	Total Funding
Micro	US$250	200	US$50,000
Small	US$1000	75	US$75,000
Medium	US$20,000	75	US$1,875,000
Total		350	US$2,000,000

Further details will be documented in the LEAP operational manual, including caps on the size of grants, matching amounts required, eligibility criteria, proposal review procedures, and disbursement arrangements.

61. An additional LEAP window will be created to support skills development programs developed and delivered by public or private training providers in partnership with the private sector. This responds to demand by firms in exporting sectors for skills that are unmet in the market. These skills include technical, supervisory, climate risk and management skills. For example, few textile firms promote Basotho to managerial or supervisory positions, citing a lack of skills. The tourism and hospitality industry also cites lack of necessary skills in the market, and when severe climatic shocks (such as the 2015/2016 el nino drought) occurred, their revenues declined. Other industries with potential for growth, particularly within the digital economy, are limited by technical, managerial, and entrepreneurial skills. Such skills are not being provided adequately through existing education options (TVET or university). This LEAP window will try to create a demand-driven set of training programs by requiring the private sector to be involved in the development of any programs it finances. Businesses and industry associations within high potential value chains that receive support under subcomponent 2.3 will be encouraged to design skills programs that can be financed under this LEAP window. Innovative delivery mechanisms using digital platforms or programming designed for women, youth, or other priority groups will be encouraged. Similarly, innovative ways to attract the private sector to participate will be encouraged such as the use of vouchers distributed through associations and businesses for employees or recruits receiving training. Training programs will target improving environmental and climate sustainability, such as through improved water usage and energy efficiency, as well as improving resilience to climate change through financial literacy training on the role of savings and insurance in managing the financial impacts of shocks, and the use of credit to invest in adaptation measures (e.g. flood defenses, terracing, storm drains, drought resistant seeds, etc.). This window of the LEAP program is expected to utilize US$2.5 million of funding to finance around 10 skills development programs that train 1,000 people over the project implementation period as listed in Table 3.

Table 3. LEAP Window 2: Estimated Financing for Skills Programs

# of Skills Programs Financed	Average Grant Provided	# of Trainees	Total Project Funding Disbursed
10	US$250,000	100	US$2,500,000

Further details will be documented in the LEAP operational manual including eligible providers, program requirements, co-financing, or other resources to be provided by the training providers, priority sectors or types of trainees, etc. The skills window will be initiated after the LEAP matching grants program enhancements are completed to simplify implementation.

62. Under PSCED2, administration of the LEAP program was financed by IDA with grant financing mostly provided by government counterpart funds. One of the challenges with LEAP under PSCED2 was slow disbursement of funds that were provided by the government. This discouraged applications to the program in comparison to the periods of time when grants financing was provided by IDA and readily available to disburse. Under CAFI, IDA funds will therefore be used for both program administration and grants financing. Program administration is expected to require US$0.5 million over the implementation period.

63. Finally, this sub-component will also support the expansion of the LEAP management and delivery capacity by bringing in experienced private sector service providers to augment the delivery capacity of the PMU.

Sub-component 2.3. Expanding SME Participation in High Potential Value Chains (US$12 million)

64. **This sub-component consists of technical assistance, training, and capacity building support for two activities that target, respectively: (i) strengthening the competitiveness of the textile and apparel GVC and (ii) expanding smallholder horticulture production through a Horticulture Incubation Program.** The support for the textile and apparel GVC is expected to accelerate the recovery of firms from the impacts of the pandemic, revitalize investments in Lesotho taking advantage of new opportunities emerging from the global reorganization of GVCs and expand business opportunities for (especially Basotho owned) SMEs through penetration of new markets, and enhancement of firm level productivity and employment conditions. The Horticulture Incubation Program will aim to expand participation of Basotho farmers in the commercial horticulture value chain, increasing the number of commercial horticulture farms and expanding production for both domestic and export markets. This program will build on the experience of the three demonstration farms that are currently being supported under the PSCED2 project.

65. **Strengthening competitiveness of the textile and apparel GVC (US$6.0 million).** This technical assistance program will be designed and delivered by the International Labor Organization (ILO) in partnership with the International Trade Center (ITC). The program will combine elements of the ILO's Sustaining Competitive and Responsible Enterprises (SCORE) program and the International Trade Center (ITC) Global Textile and Clothing (GTEX) program as well as the Better Work program which was previously implemented in Lesotho. The program is expected to benefit at least 50 textile and apparel firms and impact over 30,000 Basotho workers (80 percent of whom will be women). The firm level productivity interventions will focus on continuous improvement projects in (i) improved workplace collaboration; (ii) total quality management; (iii) resource efficiency and cleaner production; (iv) occupational safety and health; and (v) better work force management including skills development for Basotho supervisory and middle management staff. This will include a focus on improving conditions of work for workers themselves, particularly women workers by ensuring transparent and accountable systems in place for maintaining the minimum working conditions, informed by Lesotho's international commitments on labor, with a focus on assessing compliance with the ILO Maternity Protection Convention. The program will also develop the capacity of national business support structures including the Association of Lesotho Employers and Businesses (ALEB), the LNDC, the Lesotho Textile Exporters Association (LTEA), the Lesotho Garment Manufacturers Association (LGMA) and the MTI on improving overall working conditions and promoting competitiveness. Close partnerships and coordination will be established with the international garment buyers and retailers present in Lesotho through the ILO and ITC networks. The GTEX program will focus specifically on the Basotho-owned SMEs to improve pre-production capabilities to respond to an increasing demand of international buyers to provide services beyond cut and trim (CMT) to Free on Board (FOB). The technical support will include material sourcing, product development, and, to a certain extent, design development capabilities. Corresponding areas of interventions could include increasing export marketing and branding capabilities as well as facilitating market linkages into new potential markets including under the AfCFTA.

66. The expected intermediate outcomes of the support to the textile and apparel GVC would include reduced workforce turnover and absenteeism, incidences of Gender Based Violence, product rework and defect rates, workplace accidents and increased production line productivity and cost savings. The outcome indicators at the end of the program will include increased employment, exports, and investments.

67. Expansion of smallholder horticulture production through a horticulture incubation program (US$6.0 million). Building on the achievements of the current PSCED2 project support for horticulture production, support under this program will finance goods, works, equipment, operating costs, technical assistance, and capacity building to expand horticulture production for export using climate smart horticulture techniques. A competitively selected, experienced service provider will be selected to design and deliver a climate smart horticulture incubation program to support new and emerging commercial farms established by existing smallholder farmers and collectives. The service provider will also be expected to manage and operate a Horticulture Incubator Center which will be established at a vacant facility at Mahobong that is owned by the National University of Lesotho (NUL). The Horticulture Incubation program will help support and develop competitive smallholder commercial horticulture farms and agribusiness SMEs and, while doing so, develop new business models that are resilient to climatic shocks, can operate profitably and contribute to job creation and farm livelihood diversification and shift the mindset of horticulture farmers to be climate smart. Building on the experience gained from the three existing demonstration farms, the Horticulture Incubation program will help select and adopt technologies appropriate for specific horticulture crops, identify and motivate emerging farmers and entrepreneurs including farmers companies, and reduce entry barriers and strengthen linkages of these farms and SMEs to regional value chains through facilitating access to markets, finance, networks, and technical resources especially (but not exclusively) from South Africa. Selection criteria for the service provider will include experience in climate smart horticulture (including stress tolerant horticulture, conservation agriculture, small-scale irrigation and water harvesting, hail nets, flood protection, improved homestead gardening, and sustainable processing technologies), recognizing that promoting climate smart horticulture will require a concerted effort to sensitize and change the mindset of farmers.

68. The provisioning of physical space and resources at the Horticulture Incubator Center will include facilities in which the clients can conduct operations, office space, meeting facilities, and certain required farming resources including access to the existing demonstration farms. The selection of farmers/agribusiness SMEs into the incubation program will be based on an open selection process and carefully established criteria including access to adequate land (soil suitability and farming acreage), access to irrigation infrastructure (financed through the World Bank's SADP2 project or the Millennium Challenge Corporation compact), motivation and demonstrated commitment of the farmers/entrepreneurs, availability of financial and other in-kind resources, the integration of climate risk management and resilience into their farms and willingness to commit to at least a three-year incubation program. Farmers/SMEs that benefit from the International Finance Corporation's potential agribusiness investments in Lesotho will be encouraged to apply. Several cohorts of farmers/agribusiness SMEs will be selected to participate in a first phase pre-incubation program that provides training, office space and access to basic inputs such as seeds/seedlings and other farm inputs. Farmers/SMEs that graduate from the pre-incubation program and meet established criteria will be eligible to be part of a second phase full incubation program that provides more tailored training and technical support/extension services to scale their businesses, strengthen climate risk management and access to commercial financing opportunities. It is expected that around 100 farmers/agribusiness SMEs will be selected for the pre-incubation program of which between 10-15 farms/agribusiness SMEs are expected to qualify for the full incubation program. The program will also support capacity and skills development for R&D and extension services through a proposed partnership between Stellenbosch University and the NUL. The government has secured US$0.95 million of parallel financing from the India, Brazil, South Africa fund to support the development of the horticulture sector. This funding will be used to co-finance programs managed by the Horticulture Incubator Center.

Table 4. Summary of Component 2 Activities

Component	Activity	Proposed budget (US$)
Component 2	**Scaling Support for Entrepreneurship and MSMEs**	**29.5 million**
Subcomponent 2.1. Establishing an Entrepreneurship Hub and Seed Financing Facility	• Support to establish a sustainable Entrepreneurship Hub within the new Tourism Information and Crafts Center building including: ○ Upskilling and certification of entrepreneurship support organizations (ESOs) ○ Competitive funding for ESO run incubation programs that incubate up to 500 innovative SMEs/startups ○ Facilitation for the integration of the Lesotho Startup Community (LSC) within a wider regional entrepreneurship ecosystem and build links to the Basotho Diaspora • Seed Financing Facility to provide funding for startups/innovative SMEs including investments of US$50,000 for 50 startups with entry into an acceleration program run by the fund management company; follow on investment for 5 startups that demonstrate traction.	12.5 million
Subcomponent 2.2 Scaling the Lesotho Enterprise Assistance Program (LEAP) for MSMEs	• Matching grants to MSMEs for productivity improvements or business expansion. This is an evolution of the current Lesotho Enterprise Assistance Program (LEAP). • Grants for skills development programs developed jointly by the private sector and public or private training providers. Programs would target for technical, supervisory and management skills in export sector or other high potential sectors including digital. Innovative delivery mechanisms such as digital platforms would be encouraged. • Program administration costs including LEAP staff, consultancy contracts to augment LEAP management, program evaluation, and related costs.	5 million
Subcomponent 2.3 Expanding SME Participation in High Potential Value Chains	• For textile and apparel GVC, TA program will consist of a multi-year, integrated ILO Sustaining Competitive and Responsible Enterprises (SCORE) program and the International Trade Center (ITC) Global Textile and Clothing (GTEX) program, tailored for Basotho firms, and delivered jointly by both organizations. • Expansion of smallholder horticulture production through a Horticulture Incubation program. Support under this program will finance goods, works, equipment, operating costs, technical assistance, and capacity building to setup a Horticulture Incubator for small farms and agribusiness SMEs and expand horticulture production for export.	12 million

Component 3. Project Management and Implementation Support (US$3.0 million IDA equivalent)

69. **This component will provide support for the management and implementation of project-associated activities.** Activities to be financed include salaries of project management unit (PMU) staff/consultants in areas of project management, project coordination, fiduciary specialists (e.g., procurement, financial management), monitoring and

evaluation (M&E) specialist, a dedicated environment and social (E&S) specialist, project communication, and citizen engagement. This component will also cover modest office equipment and independent audits and learning/training for the PMU and beneficiary agencies, through the official closing date of the project. It is expected that all consultant terms of reference (TORs) will clearly stipulate knowledge transfer and hands on training to ministry staff. Special attention will be devoted to promoting equal participation of women in all decision-making bodies under the project and contributing to tackling barriers in recruitment, retention, and promotion.

70. **The project would also finance data collection on the SME and entrepreneurship sector to be carried out by the MTI M&E unit, working with BEDCO, and with the support of the PMU.** The data will be analyzed and shared with all stakeholders in the project including the government beneficiary agencies (listed in section III.A), the entrepreneurship hub and fund, the ESOs, and others. The purpose is to provide these stakeholders with data to inform their program design decisions, which is largely missing in current program design.

71. **This component will also support capacity building of the PMDU (Prime Minister's Delivery Unit) under the Cabinet Subcommittee on Trade and Investment), given the importance of the PMDU to delivering on the goals of the NSDP II and the related objectives of this project.** Two consultants, financed by the project, will act as core members of the PMDU and provide capacity building to government staff employed at the PMDU. The support would be limited to two years which is the timeframe the PMDU is expected to be active. One of the critical roles of the PMDU, as part of its mandate from the Cabinet subcommittee on Trade and Investment, will be to track and monitor significant private investments and address investment bottlenecks. This will enhance the effectiveness of the activities under subcomponent 2.3 on value chain development. The PMDU will also ensure implementation progress on the G2B systems supported under subcomponent 1.1, given their relevance to a stronger overall business environment which is a high priority of the PMDU. This approach balances the benefits of strengthening and working with the PMDU without creating reliance on the PMDU for the objectives of the project. A strengthened PMDU may be more likely to continue through political changes.

72. **The component will provide support for continuation of the public-private dialogue (PPD) platform initiated by the PMDU.** This PPD platform has provided an opportunity for the private sector to engage with the government during the COVID-19 pandemic about impacts on SMEs, private firms, and industries. This has been well received by the private sector and provided important inputs for government's economic plans. The project would finance the costs for a regular (e.g., monthly, or quarterly) series of engagements throughout the project duration. The private sector's views of the effectiveness of the PPD would be measured in the project's results framework as part of the project's commitment to citizen engagement.

Table 5. Summary Project Financing Table

Component	Sub-Component	IDA Financing (US$ millions)	GRiF Co-Financing (US$ millions)
1. Enhancing Financial Inclusion and Resilience of MSMEs	1.1 Enhancing G2B Digital Services to More Effectively Serve MSMEs	4.5	2.0
	1.2 Improving Access to Financial Services	3.0	
	1.3 Strengthening the Resilience of MSMEs to Climatic Disasters and Shocks	5.0	5.5
2. Scaling Support for Entrepreneurship and MSMEs	2.1 Establishing an Entrepreneurship Hub and Seed Financing Facility	12.5	
	2.2 Scaling the Lesotho Enterprise Assistance Program (LEAP) for MSMEs	5.0	
	2.3 Expanding SME Participation in High Potential Value Chains	12.0	
3. Project Management and Implementation Support		3.0	
TOTAL		**45.0**	**7.5**

Cross Cutting Considerations

73. **Mobilizing Finance for Development (MFD) and Private Capital Mobilized (PCM).** The project supports the MFD approach in the following ways. Subcomponent 1.2 will support the PCG which will unlock private credit from banks to participating MSMEs. Subcomponent 1.3 seeks to leverage the capital of international reinsurers and local insurers through transferring sovereign risk of climatic shocks to the private market. (Box 1 explains how this is treated under the Multilateral Development Bank Task Force Reference Guide 2018). Subcomponent 2.1 intends to attract private investors in startups using the public funding in the seed investment facility. Targeting the public funding at the project preparation phase offers potential to unlock significant private investment. Subcomponent 2.3 is designed to attract new private investment in high-potential value chains that supports SME participation, through the targeted use of public funding. Project preparation in a complex investment climate, such as that found in Lesotho, is a significant cost hurdle for private investors with potential investment projects.

Box 1 - Subcomponent 1.3 is expected to enable US$30 million of private capital

Subcomponent 1.3 will transfer sovereign climatic risk to the insurance market and mobilize the capital of private (re)insurance companies (local and international) on the total sum insured, thereby reducing the financing that the Government of Lesotho would have needed to allocate to address climatic shocks out of scarce budgetary resources.

The 2018 methodology considers insurance as PCM for situations whereby a multilateral development bank (MDB) transfers its credit risk associated with loans or guarantees to an insurance company (unfunded risk transfer). With CAFI, IDA is facilitating a risk transfer rather than transferring its own risk, and the total sum insured, estimated at US$30 million during the life of the project, is what insurers will be liable for should a severe climatic shock happen. The project approach is well aligned with the thrusts of the Development Committee Paper "From Billions to Trillions"[42]) which states "MDBs can provide new and expanded channels to address risk and uncertainty, and thus mobilize resources and co-investment from both existing and nontraditional sources of capital such as pension funds, sovereign wealth funds, and insurance companies". The paper recognizes "weather insurance for farmers" as a development finance solution.

According to the 2018 methodology, there are three conditions to qualify as PCM under the unfunded risk transfer:

1. ***The risk transfer is in respect of the specific set of assets which the MDB is financing from its commitments**: The project is providing contingent financing for MSMEs since the sovereign insurance will enable the MOF to provide relief resources to shock affected but otherwise viable MSMEs to enable them to keep their businesses open during severe shocks.*
2. ***The timing of the commitment of the third-party insurer and the MDB's financing commitment are within twelve months of each other**. The task team will strive to work with the Government to design and place an initial insurance product within the first 12 months of the project.*
3. ***The MDB reduces its reported commitments by the same amount as the coverage of the risk transfer**. This Project does not meet this criterion. The Project is using the most efficient route to transfer risk and mobilize private finance from insurers, thus complying with the spirit of this condition. If IDA were to strictly follow the letter of this condition, IDA would need to i) issue a CAT DDO type of instrument as contingent funding in case of drought and then ii) sell the instrument or a portion of it to an insurer. Since IDA credit interest rates are very low in line with its development mandate, IDA would have to sell the instrument at a loss to pass it to a market counterpart. Furthermore, the dialog with the Government of Lesotho on a CAT DDO has been tabled for now after the occurrence of Covid-19. Therefore, the approach taken by the project to support the Government of Lesotho purchase sovereign insurance using IDA resources is a significantly more efficient way to transfer this risk to the private insurance market.*

As shown above, the Project does not meet all three criteria under the MDB PCM methodology, but it is fully aligned with the spirit of the methodology. It will therefore track the capital at risk from insurance companies as Private Capital Enabled (PCE).

C. Project Beneficiaries

74. The project's direct beneficiaries include 20,000 MSMEs under component 1 and 600 MSMEs and 600 workers under component 2. This includes:

- Entrepreneurs and SMEs that receive financing and business support services, including particularly women-owned and youth-owned businesses.

[42] From billions to trillions: MDB contributions to financing for development (English). Washington, D.C. World Bank Group. http://documents.worldbank.org/curated/en/602761467999349576/From-billions-to-trillions-MDB-contributions-to-financing-for-development

- Entrepreneurship hubs that receive capacity building support.
- Farmers and agribusiness SMEs that are integrated into the horticulture value chain.
- People that are provided skills that make them more employable or more valuable to existing employers through skills development programs.

Table 6: Component 1 and 2 Beneficiaries

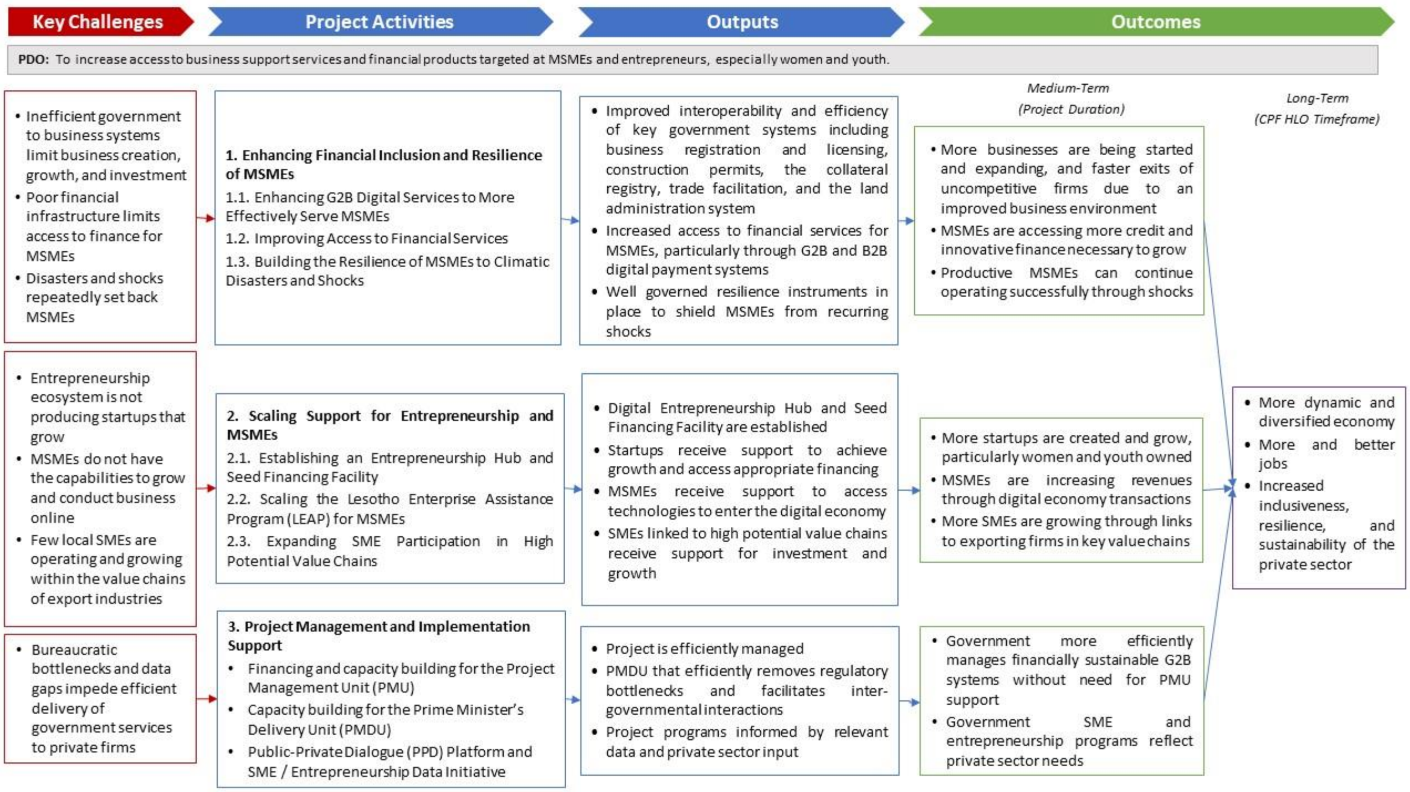
	Resilience Payments (MSMEs)	Seed Financing (Startups)	LEAP (Micro businesses)	LEAP (Small businesses)	LEAP (Medium businesses)	Value chain (Textile Workers)	Value chain (Horticulture SMEs/Farms)
Number of beneficiaries	20,000	50	200	75	75	600	200

D. Results Chain

75. Figure 10 shows the theory of change developed for the project. Outputs are what is expected to be produced directly because of project activities. These outputs contribute to the medium-term outcomes that are tied closely to the PDO. These in turn contribute to the long-term outcomes which are defined in the CPF and planned to be achieved in a 10-to-15-year timeframe.

76. Key challenges addressed by Component 1 include inefficiencies in the G2B systems that support business activity, poor financial infrastructure that limits access to finance for MSMEs, and repeated climatic and other shocks that negatively impact the business activity of MSMEs. Component 1 activities that address these challenges will lead to improvements in G2B systems, increased financial services for MSMEs, and instruments to provide resilience to shocks for MSMEs. This contributes to business creation and expansion, increased financing for businesses, and more productive MSMEs resilient to shocks. Key challenges addressed by Component 2 include a nascent entrepreneurship ecosystem, limited capabilities of MSMEs to grow and engage in digital business, and limited presence of local SMEs in Lesotho's high potential value chains. Component 2 activities that address these challenges will lead to the establishment of an entrepreneurship hub and seed fund that support startups with financing and business advice, MSMEs more capable to conduct digital business, and SMEs operating within high potential value chains. This contributes to startup creation and growth particularly for women and youth owned startups, MSMEs with increasing revenues including through increased digital business, and MSMEs growing through links to high potential value chains. Key challenges addressed by Component 3 include government bottlenecks and data gaps that create inefficiencies in delivering G2B services to the private sector. Component 3 activities that address these challenges will lead to more efficient G2B services supported by the project, a PMDU that leads private sector reforms and engagement between the public and private sectors, and improved data to inform design and delivery of private sector support programs. This contributes to sustainability of efficient G2B services and SME and entrepreneurship programs that better reflect the needs of the private sector. In the long term, these results contribute to more dynamic and diverse economy, more and better job creation, and an inclusive and resilient private sector.

Figure 10: Project Theory of Change



E. Rationale for Bank Involvement and Role of Partners

77. **The World Bank brings substantial value added in supporting this project, based on its experience with previous private sector projects in Lesotho and its global expertise in financial inclusion and private sector development.** This project builds on the lessons learned and progress made by two previous World Bank private sector competitiveness projects in Lesotho – the PSCED and PSCED2 projects. The new CAFI project will draw on lessons from and synergies with financial sector development, disaster risk financing, entrepreneurship and MSMEs and value chains. The World Bank has implemented projects on these topics in several African countries and small or landlocked countries that bring useful experience. For example, building an entrepreneurship ecosystem within a small market requires specific approaches, for which the World Bank can draw on prior experiences. Similarly, the World Bank can draw on disaster risk financing approaches from similar small market countries. The World Bank's analytical services to the government on financial inclusion and private sector development will also inform the proposed project. The World Bank will prepare diagnostic, operational, and evaluative research during project implementation that will further influence how the project can utilize the financial sector and private sector to create jobs and support growth.

78. **The proposed project complements existing development partner support.** Other institutions, including the Millennium Challenge Corporation, United Nations Development Program (UNDP), African Development Bank (AFDB), International Fund for Agriculture Development (IFAD), US Trade and Investment Hub, and the European Union, among others, are working to support financial inclusion and private sector development. Some programs were recently completed, such as the UNDP's Scaling Inclusion through Mobile Money in 2019 and Enhancing Youth Empowerment for Sustainable Development Project in 2020; others are ongoing, including the African Development Bank's Economic Diversification Support Project, ILO's Better Work program and IFAD's Wool and Mohair Promotion

Project; and others are currently undergoing preparation, such as the Millennium Challenge Corporation's Business Environment and Technical Assistance (BETA) project and Market-Driven Irrigated Horticulture Project. Implementation of the project will be done in coordination with these complementary programs and engagement with the World Bank's development partners to maximize synergies and strengthen outcomes of shared objectives.

F. Lessons Learned and Reflected in the Project Design

79. **The design of the project is informed by World Bank experience supporting private sector development and analytical work on high-growth firms, entrepreneurship, and SMEs. These include the following:**
    - The project design incorporates lessons learned from similar World Bank-funded projects on access to finance and entrepreneurship, such as the Ghana Economic Transformation Project (P166539), the Benin Vocational Education and Entrepreneurship for Jobs Project (P175768), the Kenya Industry and Entrepreneurship Project (P161317), the Palestine Innovative Private Sector Development (P164412), the Morocco Innovative Startups and SMEs Project (P127482), the Jordan Innovative Startups Fund Project (P161905), and the Egypt Catalyzing Entrepreneurship for Job Creation (P162835) project, as well as projects on entrepreneurship supported by the World Bank's infoDev global partnership program.
    - Analytical work includes the High-Growth Firms report[43] and the COVID-19 Response for Firms Note[44], as well as country specific reports including Unlocking Lesotho's Private Sector (2018)[45] and the Lesotho Digital Economy Diagnostic (2020).[46]

    Some of these lessons learned are summarized below:

    - Support for growth-oriented startups and SMEs should be provided by private sector minded providers even when funding comes from public resources. These intermediaries are generally either privately-owned or publicly owned but privately managed.
    - Publicly funded entrepreneurship programs should ensure that strong talent and high-performance culture is developed within ecosystem intermediaries. Unlocking funding based on successful performance can incentivize intermediaries to develop and implement high-quality programs.
    - Financing alone is insufficient to boost the growth of startups and firms, and a comprehensive package of financial and nonfinancial services-including mentoring, training, business advisory services, and networking-is necessary to sustain the growth.
    - Digital platforms can offer an opportunity for MSMEs that have not been online to reach new and wider markets.
    - Regulatory and institutional reforms to the business environment are important complements to firm-level interventions to achieve results beyond the direct beneficiaries.

80. **The design of the proposed project draws upon lessons and experience from previous and ongoing World Bank-supported projects and analytical work in Lesotho,** including:

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[43] World Bank. 2019. High-Growth Firms: Facts, Fiction, and Policy Options for Emerging Economies. Washington, DC: World Bank. https://openknowledge.worldbank.org/handle/10986/30800
[44] World Bank. October 14, 2020. World Bank COVID-19 Response. https://www.worldbank.org/en/news/factsheet/2020/10/14/world-bank-covid-19-response
[45] World Bank. 2018. Unlocking the potential of Lesotho's private sector: a focus on apparel, horticulture, and ICT (English). http://documents.worldbank.org/curated/en/832751537465818570/Unlocking-the-potential-of-Lesotho-s-private-sector-a-focus-on-apparel-horticulture-and-ICT
[46] World Bank. 2020. Lesotho Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/33881

- **Embed SCD interventions in the project:** The 2015 Systematic Country Diagnostic (SCD) emphasized the need to shift from a public sector-driven to a private sector-driven, export-oriented, and job-creating economic growth model. One of the three identified pathways to the WBG's twin goals was promoting a competitive and export-oriented private sector by establishing incentives to support an outward-looking orientation. In 2021, the World Bank Group published an updated SCD entitled "Bridging Implementation Gaps to Accelerate Development, which noted that progress on this pathway was slow and that the private sector remained weak and small. It further noted that the overall doing business environment deteriorated; exports lacked diversification and concentrated on very few sectors; just over half of all businesses were excluded from the financial sector; labor productivity had declined over time, and few jobs had been created. To address these challenges, the new SCD suggests the following interventions, which have all been embedded into this project: (i) accelerating implementation of business reforms; (ii) establishing a modern, competitive investment policy and legal regime; (iii) accelerating the implementation of key legal and regulatory financial sector reforms, together with the rollout of digital financial services to expand inclusion; (iv) increasing agricultural productivity, value addition and commercialization to promote agribusiness development, MSMEs and food security; (v) building on past success to revitalize the manufacturing sector and ensuring the sector regains its competitiveness; (vi) attracting private investments in key value chains to create new jobs; and (vii) improving trade facilitation and trade policy.
- **Accompany TA on business environment reforms.** The PSCED and PSCED2 projects suggest that while legal and regulatory reforms are important, within the political economy context of Lesotho, these are likely to be more efficient and effectively delivered through accompany ASA rather than through the operation. The project has therefore minimized the number of legal and regulatory reforms in the project and removed any project activities that rely on such reforms.
- **Focus on growth-oriented SMEs.** The WBG Operational Guidance document on strengthening World Bank SME support interventions was published in 2020. It emphasizes that supporting survival MSMEs may counter the overall jobs and economic transformation agenda. Low productivity SMEs can be an obstacle to growth for high-potential businesses, promote inefficient allocation of limited resources, and impede sustainable creation of more and better jobs. Thus, supporting high-potential SMEs that have the scope to create jobs is critical to supporting the overarching goal of reducing unemployment.
- **Capacity building is critical for implementation.** The original PDO for the PSCED2 was to "contribute to the development of selected non-textile sectors resulting in increased private sector investment, firm growth and job creation." During the restructuring in March 2017, it was proposed to revise the PDO to "to improve the business environment for firms, strengthen select government institutions, and further diversify the economy." The revised PDO focused on strengthening the capacity of select government institutions, in parallel to other activities. Learning from this, a core part of the CAFI project is providing technical assistance and capacity building to government departments, to mitigate implementation challenges and strengthen outcomes.
- **Interoperability of existing systems is key to increasing utilization.** Under the previous project, complexities arose from having multiple business systems, poorly streamlined processes, and limited investments in public access sites. The PSCED2 restructuring report highlights the importance of streamlining business processes. To address this, the CAFI project seeks to build interoperability between systems, including the construction permitting system, the electronic payments system at the OBFC, the collateral registry, and the credit bureau.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

81. **The project will be implemented by the same Project Management Unit (PMU) that is currently implementing the PSCED2 project under MTI.** The PSCED2 PMU has a strong performance track record of over 15 years and has established strong project implementation capacity as well as working relationships with key agencies and Ministries across the Government. The PSCED2 project will conclude on June 30, 2022, allowing the PMU to be available and ready for CAFI project implementation from the outset of the project. The PMU will be responsible for all fiduciary aspects of the project including FM and procurement activities.

82. The PMU will also act as a capacity building partner for the PMDU. This brings some additional responsibility for the PMU but also provides the PMU with access to the highest levels of government if implementation challenges arise. This should be beneficial to successful implementation of the project. The PMU also currently acts as the implementing agency for the AfDB's private sector development project. This has facilitated strong coordination between the Bank and AfDB's complementary projects and that coordination can be expected to continue under the new project while the AfDB project is reaching closure.

83. The PMU has established strong working relationships through the current project with the relevant Ministries and agencies which is expected to continue through this project and the PMU will continue to provide capacity building support to the agencies as needed. The project will endeavor to transfer implementation responsibilities to the beneficiary agencies to the extent possible to build sustainability. The key project beneficiary entities are listed below.

Table 7. Beneficiary Agencies

Sub-Component	**Beneficiary Agencies**
1.1 Enhancing G2B Digital Services to More Effectively Serve MSMEs	OBFC, DTT, MPWT
1.2 Improving Access to Financial Services	MOF, LRA, CBL
1.3 Improving the Resilience of the Private Sector to Climatic Disasters and Shocks	MTI, MOF, LRA, CBL
2.1 Establishing a Digital Entrepreneurship Hub and Seed Financing Facility	MSBD, BEDCO
2.2 Scaling Up the LEAP Program for MSMEs	MSBD, BEDCO
2.3 Expanding SME Participation in High Potential Value Chains	LNDC, Labor Commissioner, NUL
3. Project Management and Implementation Support	MTI, PMDU

DTT = Department of Traffic and Transport
MPWT = Ministry of Public Works and Transport

84. An overview of implementation arrangements for each subcomponent is included below. Full implementation details are provided in Annex 1.

85. **Subcomponent 1.1:** The activities under this subcomponent will be procured by the PMU, on behalf of the beneficiary agencies, with supervision jointly managed by the PMU and beneficiary agencies. Transition of the business registration system into the UNCTAD business licensing and business permitting system will be carried out by UNCTAD's implementation team, working with the OBFC, which hosts these systems. The PMU will launch a competitive procurement for an international consulting firm to develop the G2B interoperability framework.

86. **Subcomponent 1.2:** The main beneficiary agency for the credit infrastructure activity is the CBL, under which the credit reporting system and the movable asset registry are housed. The MOF, MTI, and MOHA are critical for the advancement of envisaged work under this subcomponent, particularly given the system integration and inter-ministerial coordination required to strengthen the credit infrastructure system. The CBL will work jointly with the PMU to identify and supervise the contractors that will work with beneficiary agencies on the various activities including diagnostics, assessments, and piloting of approaches and systems. The new product development activity leverages advancements made on the movable asset registry in the development of value chain financing, for which Post Bank will be the primary implementing partner.

87. Under the risk sharing facility (PCG) activity, the MOF, MTI, and LNDC are the three critical agencies required to advance envisaged work. LNDC is the key implementing partner and will be responsible for the development and implementation of the portfolio guarantee. A technical working group will be constituted with representatives from the two ministries, as well technical staff from LNDC, to provide input and make key decisions with respect to this activity.

88. **Subcomponent 1.3:** A DRF coordinator will be hired into the PMU to manage the implementation of the MSME resilience subcomponent. The DRF coordinator will be financed using GRiF resources. Their primary reporting line will be to the Project Manager/PMU. They will also have a dashed reporting line to MTI and the Budget Controller of the MOF, given the parallel capacity building that will be done through the ASA. The establishment of an inter-agency DRF technical committee - including for example officials from the MOF, MSBD, MTI and Disaster Management Authority. The committee will validate the disbursement report. The report will then be sent to the head of the PMU for approval and release of funds the MSME resilience account to affected MSMEs.

89. **Subcomponent 2.1.** The PMU will hire experts to support them to run a fair and transparent international selection of two partners. The first is an operating agency to run the Entrepreneurship Hub and the ecosystem development activities and the second is a fund management partner that will run the seed financing facility and associated acceleration program. Once the Entrepreneurship Hub operating agency has been selected the PMU will have two roles: (i) monitoring and supervising the operating agency and (ii) disbursing the grants to the ESOs and the startups/innovative SMEs incubated under the ESO programs.

90. **Subcomponent 2.2.** The LEAP program is currently managed by a small (3 person) team within the PSCED2 PMU. The placement of the LEAP management at the PMU is designed to ensure that selection of supported MSMEs is objective and merit-based and allows for close implementation support by the World Bank. This arrangement will continue under the CAFI project at least for the initial years of implementation. Over time, consideration will be given to migrating the LEAP management to another organization. This could be an international consulting company, a mission-aligned organization such as the entrepreneurship hub or seed financing fund manager, or a public agency such as BEDCO or LNDC. Such a migration might support sustainability beyond the project implementation period but might also reduce the oversight by the World Bank and PMU. As such, the migration will be considered only after the LEAP program has established a track record of strong implementation under the CAFI project.

91. The current 3-person LEAP management team will be expanded by 1-2 additional staff given the additional window and greater program funding being added under CAFI. Specifically, 1-2 additional grants officer(s) will be hired. Regular monitoring and evaluation (M&E), financial management, and procurement for the LEAP program will continue to be carried out by the PMU staff assigned these roles. Supplemental M&E activities will be carried out by consultants hired

by the LEAP team as necessary. To foster continual improvements in the LEAP program, the project will support a mid-term evaluation of the impacts of LEAP grants under both windows, carried out by an independent M&E contractor.

92. **Subcomponent 2.3:** The support to the textile and apparel sector will be designed and delivered by a joint ILO-ITC team of technical experts and consultants (drawing upon their experience in other countries such as Egypt, Tunisia, and Madagascar as well as the global Better Work program) and will be managed by a competitively selected Chief Technical Officer. The Chief Technical Officer and nationally recruited project officers will report to the Project Coordinator and the program will be implemented under the oversight of a Technical Steering Committee chaired by the Principal Secretary of MTI and which includes the LNDC, Labor Commissioner, LTEA, LGMA and ALEB. The government will enter into a Cooperation Agreement with the ILO/ITC that includes the scope of work, deliverables, outputs and outcomes, monitoring, evaluation, and reporting as well as financial arrangements (based on similar agreements with other UN agencies in the past) and acceptable to the World Bank.

93. The horticulture incubation program will be implemented by a competitively selected private service provider who will also manage and operate the horticulture incubator center at Mahobong. The program will be managed by a project lead who will report to the project coordinator. The National University of Lesotho will enter into a lease agreement with MTI for the facility which will be upgraded into a functioning incubator center and managed by the service provider. The procurement for the upgrading of the facility will be managed by the PMU with input from the service provider. The capacity building and skills development program will be delivered through an agreement between Stellenbosch University and the National University of Lesotho.

94. **Sequencing of Implementation.** Implementation of activities will be sequenced as (i) some activities are dependent on other activities that will begin at the outset of implementation, and (ii) sequencing will allow the PMU to concentrate on key activities at the outset of implementation. Table 8 below describes the planned sequencing of the project activities.

Table 8. Sequencing of Implementation

Subcomponent	Implementation Beginning Immediately	Implementation Beginning Later (Various Starting Points)
1.1 Enhancing G2B Digital Services to More Effectively Serve MSMEs	• OBFC's business registration and licensing upgrade and consolidation into UNCTAD's platform. • G2B interoperability framework • Government payment gateway	• G2B systems upgrades (follows completion of the interoperability framework)
1.2 Improving Access to Financial Services	• Credit infrastructure system strengthening • LNDC risk sharing facility TA program	• Market innovation through the development of new financial products (asset-backed lending and agriculture value chain financing)
1.3 Strengthening the Resilience of MSMEs to Climatic Disasters and Shocks	• National Disaster Risk Finance Policy TA • Work with the national business registry to establish a database for informal MSMEs eligible for financial support during climatic shocks	• Provide US$4 million for MSME financial resilience fund (follows the DRF Policy development) • Technical assistance on the design and procurement of a sovereign insurance backstop

Subcomponent	Implementation Beginning Immediately	Implementation Beginning Later (Various Starting Points)
2.1 Establishing an Entrepreneurship Hub and Seed Financing Facility	• Entrepreneurship Hub and programs (ESO strengthening, incubation programs, ecosystem building)	• Seed Financing Facility (follows pipeline development by the Hub programs)
2.2 Scaling the Lesotho Enterprise Assistance Program (LEAP) for MSMEs	• LEAP MSME Matching grants program revisions and funding	• LEAP Industry-Driven Skills Program Window
2.3 Expanding SME Participation in High Potential Value Chains	• First phase of training for around 100 farmers/MSMEs under the horticulture incubation program • Design of the textile and apparel GVC TA program and training/ capacity building of stakeholders and selection of participating firms	• Second phase of in-depth business incubation support for a selected cohort of farms and establishment of the Horticulture Incubation Center • Implementation of the audits, training, and capacity building programs

B. Results Monitoring and Evaluation Arrangements

95. **The project will design, implement, and institutionalize a robust monitoring and evaluation system to collect timely data, analyze progress and results, and utilize the findings to make programmatic decisions and course-corrections.** Monitoring of the project's results indicators will be carried out by the M&E unit of MTI with support from the PMU, utilizing information from the project's beneficiary agencies. The MTI M&E team and PMU will work with these agencies to develop streamlined information flow mechanisms from different stakeholders (such as the ESOs supported by the Entrepreneurship Hub, the LEAP program managers, the horticulture incubation program, etc.). The MTI M&E team and PMU will develop and maintain a system to aggregate data across the programs to generate both the internal key performance indicators and results framework indicators. To ensure effective implementation and M&E management, several actions will be needed to strengthen the Government's capacity to ensure reliable and high-quality M&E. First, the project will support PMU efforts to enhance its current information system so that it can gather data on performance of institutions including tracer studies, ESO providers' assessment, surveys of the beneficiaries. It will also support TA to the implementing agencies to design the M&E system for the project and to develop operational monitoring systems at the program level. Project implementation will be monitored regularly through bi-annual supervision missions. Process evaluations will be conducted every year to detect bottlenecks and identify good practices and inform possible adaptation. Lessons learned from relevant assessments will be used for course correction during project implementation.

96. **Evaluation of project activities.** The project will explore and use various evaluative approaches to assess the project's relevance, effectiveness, impact, efficiency, and sustainability. The project will conduct baseline, midline and end line evaluations to track progress by triangulating both quantitative data and qualitative information. This will be further complemented by the monitoring data collected regularly by the MTI M&E team and PMU. The project will also identify opportunities to conduct impact evaluations in partnership with the Gender Innovation Lab, particularly to understand how project interventions contribute to the gender-sensitive outcomes. Similarly, the project will also explore the use of formative evaluations of key project activities (such as the entrepreneurship training programs, LEAP, access to finance, and upgrading G2B systems) to identify strengths, weaknesses, and opportunities to

strengthen interventions, improve targeting and coverage, and enhance implementation strategies. Tracer studies, ESO providers' assessment, and surveys of the beneficiaries will also be conducted to inform the effectiveness and efficiency of project activities.

C. Sustainability

97. The project is supporting broad reforms on financial inclusion and the private sector. Such efforts are meant to strengthen access to finance, create jobs and support export-led growth. Sustainability will be supported through three main avenues: system level interventions, infrastructure development, and skills development/capacity building.

- **System-level interventions will promote structural reform.** System-level interventions include investments to enhance the interoperability of government IT systems that facilitate private sector activity; implementation of a government payment gateway to support G2B digital payments; investments to strengthen credit infrastructure; establishment of an MSME resilience account for rapid disbursements and procurement of sovereign insurance (which will be co-financed on a sliding basis, so the cost is increasingly transferred to the budget over the life of the project).
- **Establishment of infrastructure**: The project will support the establishment of a sustainable entrepreneurship hub, seed financing facility, infrastructure for the horticulture incubator program. This infrastructure will exceed the life of the project, enabling activities to continue.
- **Technical assistance will build skills amongst the workforce and government capacity.** Technical assistance will be provided to the Government to address deficiencies and build interoperability and strengthen disaster risk financing. For the workforce, skills development initiatives will build technical, supervisory and management capacity in high potential sectors and capacity of MSMEs and entrepreneurs. Building capacity at the government level will enable line ministries and agencies to continue project activities after the completion of the project. Skills development is intended to equip the workforce with the skills required at the labor market, thereby enabling them to find employment.

IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis

98. The project is expected to offer a range of social and economic benefits to support the creation and growth of firms in Lesotho, along with overall growth of the economy, by addressing key constraints and bottlenecks for local businesses. The project is also expected to support efficiency and productivity improvements within government agencies and offices that serve MSMEs through digital capacity building, along with improving access to finance and resiliency support available to these firms. Additionally, the project will provide support to establish a sustainable Entrepreneurship Hub and a Seed Financing Facility, provide matching grants to enable productivity improvements and skills development programs, and targeted support to SMEs in high-potential value chains. These interventions will help improve the competitiveness of local businesses, thus increasing profits, contributing to increased fiscal revenues, and supporting the growth of high-potential sectors and exports. This support to businesses will additionally help to contribute to the creation of more and better jobs.

99. As part of preparation for the project, the World Bank task team conducted an economic and financial analysis (EFA) to determine the value of the anticipated benefits relative to the costs associated with the project. The total project

Net Present Value (NPV) is estimated at US$11.1 million at a 15 percent discount rate,[47] and the Economic Rate of Return (ERR) at 24 percent based on the total project investments. The economic analysis of this project is based on increased revenues for SME beneficiaries under Components 1 and 2 through the activities and investments under this project.

100. Component 1: Since subcomponents 1.1 and 1.2 focus on technical assistance to improve government services for MSMEs, these activities have been excluded from the analysis as their impact is difficult to quantify; however, Annex 2 includes a discussion on the literature supporting such investments. For subcomponent 1.3, the NPV is estimated at US$856 thousand using a 15 percent discount rate, with an ERR of 18 percent, based on a 44 percent reduction in MSME revenues estimated as a result of climate shocks.

101. Component 2: The Component 2 NPV is estimated at US$10.3 million using a 15 percent discount rate, with an ERR of 26 percent. Beneficiaries are expected to show a lower failure rate and higher revenue growth rates due to the investments of the Project.

B. Fiduciary

(i) Financial Management

102. The PMU within the MTI will be accountable for the project financial management arrangements, (including budgeting, accounting, payments, internal controls, transaction processing, quarterly and annual financial reporting). This responsibility will be entrusted on the Financial Manager of the PMU. The project will use the existing accounting system, called TOMPRO to record and account on the project funds.

103. Budgets will be prepared based on approved work plans and procurements plans. In accordance with the World Bank's financial reporting requirements, the project will be required to prepare and submit to the World Bank Unaudited Interim Financial Reports not later than 45 days after the end of each financial quarter.

104. Disbursements under the project will be done in accordance with the rules and procedures as set out in the World Bank's disbursement handbook. Component 1.1 and 1.3 of the project will be financed through IDA and TF funds, but financing the same activity. To this end a pooled Designated Account will be maintained by the project. The Designated Account will be opened with the Central Bank of Lesotho. The FM systems for the PMU are assessed as adequate for the project to use IFRs for disbursement and financial reporting. Advance in the Designated Account will be based on expenditure projections for six months and will be supported by the forecast prepared as part of the IFRs.

105. The annual project financial statements, including the auditor's opinion and a management letter, will be submitted to the Bank not later than six months after the end of the fiscal year. The annual audit will be carried out by the Office of the Auditor General of Lesotho.

106. The overall conclusion of the financial management assessment is that the project's financial management has an overall risk-rating of **Moderate**. The ongoing FM arrangements are working adequately. The project is not financing

[47] The EFA model utilized a 15 percent discount rate as the estimated risk-adjusted opportunity cost of capital. Additional NPV estimates at other discount rates have also been provided as a measure of the sensitivity of our analysis.

complex activities; it will finance consultancies, small works, PMU, and grant management that the PMU has been satisfactory performing with the previous project.

107. The Recipient will carry out procurement for the project in accordance with the World Bank's "Procurement Regulations for IPF Borrowers" (Procurement Regulations) dated July 2016 and revised in November 2017, in August 2018 and November 2020 under the "New Procurement Framework (NPF), and the "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants", dated July 1, 2016, and other provisions stipulated in the Financing Agreements.

108. Procurement activities shall be carried out by the PMU on behalf of the beneficiary agencies. All procuring entities as well as bidders and service providers, i.e., suppliers, contractors and consultants shall observe the highest standard of ethics during the procurement and execution of contracts financed under the project in accordance with paragraph 3.32 and Annex IV of the Procurement Regulations.

(ii) Procurement

109. **General Procurement arrangement:** The CAFI project is an Investment Project Financing (IPF) and procurement for the proposed project will be carried out in accordance with the World Bank's Procurement Regulations for Investment Project Financing Recipients - Procurement in Investment Project Financing Goods, Works, Non-Consulting and Consulting Services, Fourth Edition, November 2020. The Project will also be subject to the Guidelines on Preventing and Combatting Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants' dated July 1, 2016. The procurement planning, execution and contract management processes will be tracked through the Systematic Tracking of Exchange in Procurement (STEP) System.

110. **Government National Procurement System:** The Lesotho Procurement Regulations of 2007, revised in 2018 have been assessed and the results indicate that the Country's Regulations are generally consistent with international good practices, although some weaknesses were identified, which should be mitigated through adequate measures to insure and enhance: (a) there is adequate advertising in national media; (b) procurement is generally open to eligible firms from any country; (c) contract documents have an appropriate allocation of responsibilities, risks, and liabilities; (d) publication of contract award; (e) the national regulations do not preclude the World Bank from its rights to review and audit procurement documentation and activities under the financing; (f) implementation of an effective complaints review mechanism; (g) maintenance of records of the procurement process and (h) the request for bids/request for proposals document shall require that bidders/proposers submitting bids/proposals present a signed acceptance at the time of bidding, to be incorporated in any resulting contracts, confirming application of, and compliance with, the World Bank's Anti-Corruption Guidelines, including without limitation, the World Bank's right to sanction and the World Bank's inspection and audit rights. With incorporation of these qualifications/ provisions, the Lesotho Procurement Regulations will be acceptable to be used under those procurements using open national approach not subject to the World Bank's Prior Review as to be agreed with the World Bank in the Procurement Plan to be approved in STEP.

111. **Project Procurement Strategy for Development (PPSD**): MTI developed a Project Procurement Strategy for Development (PPSD) that informs (i) determination of optimal procurement approaches and (ii) the development of the fit for purpose Procurement Plan for the first 18 months of project implementation. The PPSD includes identification of major contracts under the project, detailed market information, procurement approach options, and procurement risks analysis for the packages envisaged under the project. The PPSD and the Procurement Plan maybe be updated during project implementation to reflect any substantial changes in procurement approaches and methods to meet the actual project needs.

112. **Procurement Risk Assessment:** The procurement risk assessment has taken into considerations the Strengths, Weaknesses, Opportunities and Treats of the operational context of the implementing agency. The project will be implemented by the same PMU that is currently implementing the World Bank financed PSCED2 project under MTI. The PSCED2 PMU has good performance track record of many years and has established project implementation capacity as well as working relationships with key agencies and Ministries across the Government. The PSCED2 project will end in June 2022 allowing the PMU to be available and ready for CAFI project implementation from the outset of the project. The PMU will be responsible for all fiduciary aspects of the project including FM and procurement activities. The MTI and its PMU, having prior experience of working on PSCED and PSCED2 projects, are expected to implement the project smoothly. However, the fact that there will be many project beneficiaries under each component and subcomponent may make coordination a challenge and could be considered as a risk. Based on the existing procurement capacity under the MTI, the overall organizational structure for implementing the project, and the interaction between the project's staff responsible for procurement duties and management of the Ministry, risk is assessed as **Moderate**. This rating has also considered the fact that the current project (PSCED2) does not have any IPF component involving complex or high value contracts. It is also expected that all the procurement activities envisaged under the new project (CAFI) will be simple and small value contracts. Taking all these circumstances, though this section will be further refined after detailed procurement capacity assessment of MTI is conducted, the major capacity limitations or risks identified at the moment are: (i) coordination challenge as implementation of components and subcomponents involve many beneficiaries, (ii) Implementation capacity gap within the different beneficiaries, and (iii) lack of practices on good contracts implementation management.

113. **Procurement Risk Mitigation measures**: The MTI will have overall responsibility of procurement under the project. Based on the above preliminary procurement implementation risk identification, the mitigation measures may include: (i) provision of reorientation/training to the PMU on World Bank's procurement procedures and contract management, including use of STEP platform; (ii) putting in place simple, but efficient, procurement and contract management mechanism (tracking system);(iii) Develop PIM/PPSD that would assist the practitioners on procurement routines and (iv) strengthen the PMU based on the need of the new project. More frequent World Bank's implementation support missions with the objectives of providing closer support and monitoring the performance of PMU and its Procurement team's performance would add value.

114. **Operating costs.** These items will be procured using the borrower's national procurement and administrative procedures acceptable to the World Bank, including selection and payment to project implementation support personnel. Operating costs may include project related communications and travel costs, conference costs, maintenance costs, repair costs, honorariums, and similar operating costs that may be reimbursed through SoEs.

115. **Fiduciary oversight by the World Bank.** The World Bank shall prior review contracts according to the prior review thresholds set in the PPSD/Procurement Plan. All contracts not covered under prior review by the World Bank will be subject to post review during implementation support missions, including missions by consultants hired by the World Bank or through supreme audit institutions as part of the financial audit. The World Bank may, at any time, conduct independent procurement reviews of all the contracts financed under the credit.

116. **Record keeping:** All records pertaining to award of tenders, including bid notification, register pertaining to sale and receipt of bids, bid opening minutes, bid evaluation reports and all correspondence pertaining to bid evaluation,

communication sent to/with the World Bank in the process, bid securities, and approval of invitation/evaluation of bids by the management would be retained by the Procurement Unit and also uploaded in the STEP for Post ante review and Independent procurement audit, as necessary.

C. Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

D. Environmental and Social

117. The overall environmental and social risk rating for the project is Moderate. The social risk rating is Moderate. Most of the proposed activities represent provision of technical assistance (TA), as well as minor repair works within existing structures in well demarcated and fenced areas owned by the Lesotho National Development Corporation (LNDC) and MTI. Downstream impacts of the technical assistance activities are considered positive by potentially reducing the environmental impacts of manufacturing firms associated with ESS2 related occupational health and safety, ESS3 related environmental pollution, and ESS4 related community health and safety. The repairs, servicing and end-of-life disposal of ICT equipment may result in ESS3 related environmental risks resulting from electronic wastes (e-wastes), hazardous waste and solid wastes if not managed appropriately. The equipment required, the associated cycle of replacement or upgrades, existing e-waste, hazardous and solid waste management measures in project implementing entities, regulatory framework, and in-country capacities to manage end of life disposal of electronic equipment and parts were analyzed during project preparation. To ensure the management of e-waste and other hazardous waste, the Environmental and Social Management Framework includes a Waste Management Plan (WMP). The WMP includes simple technical guidelines on how to manage the disposal of ICT equipment (end-of-life and during repairs). The ESMF was disclosed both in-country and on the World Bank website on March 28, 2022. The potential use of pesticides and fertilizers in commercial agriculture will potentially result in ESS3 related environmental pollution (including the degradation of surface water and groundwater). The project will set up a Horticulture Incubator Center which will be established at an already existing facility at Mahobong that is owned by the National University of Lesotho. This will involve minor civil works including rehabilitation of already buildings. Rehabilitation works would potentially lead to ESS3 related noise and air pollution, generation of waste, loss of plant cover, ESS2 and ESS4 related increase in occupational and community health and safety risks. The risks and impacts will be managed through the preparation and implementation of sub-project specific ESMPs. The potential risks and impacts associated with the project activities are considered to be predictable and temporary and/or reversible; low in magnitude; site-specific, without likelihood of impacts beyond the actual footprint of the Project. No adverse impacts on biodiversity and habitats are expected.

118. Potential social risks are: (i) possible exclusion of vulnerable and disadvantaged groups from fully participating/benefiting from the project; (ii) challenges that may arise in conducting genuine stakeholder engagement, particularly involving beneficiary MSMEs and informal business entities; and (iii) relatively limited capacity of MTI in handling ESF requirements, including in relation to requirements on establishing and maintaining a functioning project-level GRM. These potential risks are addressed through project ESMF which also include Labor Management Procedures and GBV/SH/SEA Prevention and Response Action Plan, all proportionate to the risks. GBV risks are associated with the working conditions of female employees in the textile and apparel industry (which will be addressed through the support provided under Sub-component 2.3 of the project). The ESMF was prepared and disclosed on March 28, 2022. A Stakeholder Engagement Plan has been prepared and addresses the above risks. During preparation, the project conducted several consultations with various stakeholders, and ESF instruments were prepared considering feedback from stakeholders. Given the importance of outreach in both mitigating the risks as well as ensuring successful project implementation, Component 3 of the project will, among others, finance various stakeholder engagement activities which will be designed to take place throughout project implementation. The project may also face social and environmental challenges related to transmission of communicable diseases e.g., COVID-19 that could arise from people gathering for capacity building workshops and training activities. Despite these potential risks, the project activities are expected to have positive developmental and social outcomes related to business support services and financial products targeted at MSMEs and entrepreneurs, including vulnerable groups such as women and unemployed youth. The Project will not involve capitalization/access to finance on-lending to MSMEs/PFIs, and there will be no Financial Intermediaries under the Project at this stage. Thus, ESS9 is deemed not relevant, and there are no associated downstream social and environmental risks that could have resulted from sub-projects. The environmental and social risk ratings will be reviewed periodically throughout the project life cycle to ensure that it continues to stay current with project implementation progress.

119. Climate. The project seeks to reduce climate vulnerability by contributing to adaptation interventions that increase MSMEs' financial resilience to climatic shocks such as droughts and floods through activities under multiple subcomponents. Investments under subcomponent 1.1 will be made to minimize their exposure to climatic shocks. Subcomponent 1.3, totaling US$10.5 million, focuses on climate adaptation by strengthening the private sector's resilience to climatic shocks. The average annual cost of disaster response to the government budget prior to the pandemic is estimated at US$19.3 million. Most shocks (all but the COVID-19 pandemic) have been climatic shocks, notably droughts and floods. This subcomponent will support the government with the establishment of an MSME resilience account within the PMU to support MSMEs during climatic shocks, rather than rely on less reliable and less timely mechanisms such as budget reallocations, borrowing, or humanitarian aid. Climate resilience will be mainstreamed through the LEAP program under subcomponent 2.2. Finally, subcomponent 2.3 will strengthen the climate resilience of the horticulture sector in Lesotho through its demonstration farms and training on climate resilience techniques.

120. Gender Tag. Project activities will be designed to reduce gaps between men and women operating in the private sector in Lesotho and promoting women's economic empowerment. For example, the design of G2B systems supported by the project will consider gender-based constraints; support for startup/MSME development and financing will target women entrepreneurs and business owners; and skills development programs will pilot gender-specific skills development programs. One specific gender gap addressed by the project is the lower coverage rate for women-owned businesses by the credit bureau. Improvements will be measured by the indicator "Percentage of women-owned enterprises recorded as being creditworthy in the credit bureau". The baseline is 27 percent and the end target of the project is 40 percent, which would indicate important improvement in the opportunity for women-owned businesses to access credit.

121. Citizen engagement: Project preparation included consultations with the key private sector organizations and intended project beneficiaries through in-person consultations and digital platforms. The team organized a series of webinars (and in person sessions wherever feasible) with the representatives of the high potential value chains, entrepreneurship support organizations, and organizations representing MSMEs. The PPD platform under Component 3 supports continuous engagement during project implementation between the government and the private sector, so that the project's stakeholders are engaged throughout implementation. The citizen engagement indicator utilized is "Percent of enterprises engaged with the public private dialogue platform that assess the platform as improving government responsiveness to private sector concerns". The Component 2 design provide for further feedback mechanisms for project beneficiaries as well as mechanisms to ensure that the feedback is reflected in the project implementation arrangements.

122. Grievance Redress Mechanism (GRM). A GRM will be established for the project and maintained throughout project implementation for project beneficiaries, citizens, and stakeholders. The GRM will be used for beneficiaries and stakeholders of all project components. Responsibility for management and resolution of complaints will lie with those at the beneficiary agencies at various levels who will work with community members and representatives of vulnerable groups (women, youth, and others to be identified through ongoing implementation of environmental and social standards). The project's social specialist in the PMU will be responsible to ensure the GRM is operational, including logging and tracking all complaints received and their timely resolution. Staffing and operational procedures are further elaborated in the Stakeholder Engagement Plan (SEP) and will be detailed in the POM. The GRM will incorporate specific provisions to allow safe and ethical registration, documentation, and management of complaints including Gender Based Violence/Sexual Exploitation and Abuse (GBV/SEA) complaints. A specific reporting mechanism of GBV response protocol will be established.

V. GRIEVANCE REDRESS SERVICES

123. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

VI. KEY RISKS

124. The overall risk of the project is substantial. This is due to the anticipated risks in political and governance, macroeconomic, technical design, and institutional capacity for implementation and sustainability. Mitigation measures for each of these risks are described below. Each high and substantial risk will be reviewed throughout implementation to ensure the most suitable risk mitigation measures are being utilized.

125. Political and Governance risk is rated High. Lesotho is characterized by an unstable political environment which contributes to challenges in implementation of important policies and regulations. Over the past decade, Lesotho's key governance indicators have been generally better than the lower middle-income country and SSA averages, but have been declining over time, particularly around political stability, and government effectiveness. The governing coalition remains fragile with considerable possibility of repeated political changes during project implementation. To mitigate this risk, the project has been designed to minimize activities that rely on policy or regulatory changes that are difficult or unpredictable to advance in a situation of political instability and low government effectiveness.

126. **Macroeconomic risk is rated Substantial.** Lesotho is currently classified as having a moderate risk of external debt distress, impacted by the global recession triggered by the COVID-19 pandemic. Repeated disasters have increased budget pressures leaving the government with a limited ability to respond to shocks. To address this, Lesotho is in discussions with the IMF on a program that may bring some stability along with fiscal and other restrictions. The disaster risk financing strategy proposed in the project is part of a strategy for managing macroeconomic risk. The resilience instruments in the project are specifically intended to create a sustainable way to shield MSMEs from the impact of shocks that does not depend on the government's current fiscal situation.

127. **Technical Design of the Project risk is rated Substantial.** Project interventions are modeled on known interventions from other World Bank projects. However, some of the interventions have technical risk due to the unique context of Lesotho including a small country economy dependent on two primary export markets. For instance, the ability to attract new investors is challenging to determine in a small economy especially in a post pandemic global trade and investment scenario. To mitigate this risk, the technical design of the project has minimized elements that require the government to build political consensus and follow through on longstanding reforms especially on investment policy and business environment. Project implementation arrangements leverage private sector technical and delivery capacity, rather than rely on government implementation, wherever possible and aim for long term sustainability of the programs and instruments.

128. **Institutional Capacity for Implementation and Sustainability risk is rated Substantial**. Despite strong implementation of the PSCED2 project, the PMU already has dual responsibilities as it is also implementing an AfDB-financed private sector project (which, however, is closing in December 2022). The PMU may still have responsibility for implementing and closing the PSCED2 project, such as making final disbursements, while it takes on the responsibilities for project implementation. The PMU has also been asked to support the development of the PMDU which brings additional responsibilities and there is a need to enhance the technical capacity of the PMU. To mitigate this, efforts will be made using resources under the current project to boost the capacity of the PMU team, including adding two deputy project managers, dedicated E&S and M&E staff, and additional procurement staff, given the size of the program. Efforts will be made to strengthen ownership of project implementation by key ministries as much as possible.

VII. RESULTS FRAMEWORK AND MONITORING

Results Framework
COUNTRY: Lesotho
Lesotho Competitiveness and Financial Inclusion Project

Project Development Objectives(s)

The project development objective is to increase access to business support services and financial products targeted at MSMEs and entrepreneurs, especially women and youth.

Project Development Objective Indicators

Indicator Name	PBC	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
Increase access to business support services and financial products								
Firms benefiting from private sector initiatives (CRI, Number)		0.00	100.00	200.00	300.00	400.00	450.00	500.00
Of which are women owned (Percentage)		20.00	20.00	25.00	30.00	40.00	45.00	50.00
Of which are youth owned (Percentage)		20.00	20.00	20.00	25.00	25.00	25.00	25.00
Value of financing (seed funding, grants, partial credit guarantee, credit infrastructure improvements, resilience funding) accessed by enterprises through the		0.00	1,000,000.00	3,000,000.00	6,000,000.00	12,000,000.00	14,000,000.00	16,000,000.00

Indicator Name	PBC	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
program (Amount(USD))								
Of which is financing accessed by enterprises that are women-owned (Percentage)		20.00	20.00	25.00	30.00	40.00	40.00	40.00
Percentage of enterprises supported by the program with increased revenue in real terms (Percentage)		20.00	20.00	30.00	40.00	50.00	50.00	60.00
Of which are women owned (Percentage)		25.00	25.00	30.00	35.00	40.00	45.00	50.00

Intermediate Results Indicators by Components

Indicator Name	PBC	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
Enhancing Financial Inclusion and Resilience of MSMEs								
Percent change in the number of enterprises accessing supported G2B systems (Percentage)		20.00	20.00	25.00	30.00	35.00	40.00	45.00
Percentage of women-owned enterprises recorded as being creditworthy.in the credit bureau (Percentage)		27.00	30.00	33.00	36.00	39.00	40.00	40.00
Number of additional		0.00	25.00	50.00	100.00	150.00	200.00	250.00

Indicator Name	PBC	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
enterprises covered by the partial credit guarantee (PCG) scheme (Number)								
Number of MSMEs registered for coverage in MSME Resilience Fund database (Number)		0.00	1,000.00	4,000.00	8,000.00	12,000.00	14,000.00	15,000.00
Value of potential payouts to MSMEs from private capital mobilized for climate resilience (Amount(USD))		0.00	0.00	0.00	6,000,000.00	6,000,000.00	12,000,000.00	12,000,000.00
Scaling Support for Entrepreneurship and MSMEs								
Percentage of enterprises supported by the entrepreneurship and SME programs with increased employment (Percentage)		25.00	25.00	30.00	35.00	40.00	45.00	50.00
Number of startups and innovative SMEs supported through entrepreneurship hub support programs (Number)		0.00	100.00	200.00	300.00	400.00	450.00	500.00
Of Which are Women-Owned (Number)		0.00	20.00	50.00	90.00	140.00	180.00	225.00
Number of enterprises accessing early-stage finance (Number)		0.00	5.00	15.00	25.00	35.00	45.00	50.00
Number of entrepreneurship hub and LEAP program supported enterprises that adopted new digital technologies		0.00	25.00	75.00	150.00	200.00	250.00	300.00

Indicator Name	PBC	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
(Number)								
Number of LEAP fund supported enterprises with 25% or greater increase in revenues one year after grant support (Number)		0.00	50.00	100.00	150.00	200.00	225.00	250.00
Number of supported enterprises in targeted value chains with increased value of exports (Number)		0.00	10.00	20.00	30.00	40.00	45.00	50.00
Project Management and Implementation Support								
Percent of enterprises engaged with the public private dialogue platform that assess the platform as improving government responsiveness to private sector concerns (Percentage)		60.00	65.00	70.00	75.00	80.00	80.00	80.00

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Firms benefiting from private sector initiatives		Annual	Beneficiary organizations ' data (ESOs,	PMU will collect the data from beneficiary agencies	PMU

			Horticulture Incubator, Textiles Program Operator) - the indicator will only include firms that benefit directly from project financed activities.		
Of which are women owned	This disaggregate captures the share of women-owned enterprises out of all the enterprises.	Annual	Beneficiary organizations' data (ESOs, Horticulture Incubator, Textiles Program Operator)	PMU collects data from beneficiary organizations	PMU
Of which are youth owned	This disaggregate captures the share of youth-owned enterprises out of all the enterprises, with youth referring to the official country designated age group (between 15-35 years of age).	Annual	Beneficiary organizations' data (ESOs, Horticulture Incubator, Textiles Program Operator)	PMU collects data from beneficiary organizations	PMU

Value of financing (seed funding, grants, partial credit guarantee, credit infrastructure improvements, resilience funding) accessed by enterprises through the program	This indicator measures the value of financial support received as a result of project activities, in USD. This aggregates the total financing disbursed by the program through the seed funding, grants, and contingency funds, as well as accessed by firms as a result of project support under the partial credit guarantee and credit infrastructure improvements, by the project end date.	Annual	Beneficiary organizations ' data	PMU will collect from beneficiary organizations (financial institutions participating in the PCG, LEAP unit, seed financing facility, MoF Contingency Fund unit)	PMU
Of which is financing accessed by enterprises that are women-owned	This disaggregate captures the share of women-owned enterprises out of all the enterprises accessing financing. This is estimated by calculating the ratio of women owned enterprises to all enterprises.	Annual	Beneficiary organization' s data	PMU to collect data from beneficiary organizations	PMU
Percentage of enterprises supported by the program with increased revenue in real terms	This indicator measures the ratio of enterprises that reported a positive (greater than 0%) year-over-year increase in revenue after a year of engagement with	Annual	Beneficiary organizations ' data	PMU to collect data from beneficiary organizations	PMU

	the program and after compensating for inflation. The indicator does not capture revenue increases of those enterprises that participated in low-touchpoint activities of the program, such as participation in one-time events or activities, such as attending entrepreneurs hub events, one-time networking activities, and so on.				
Of which are women owned	This disaggregate captures the share of women-owned enterprises out of all the enterprises with increased revenue.	Annual	Beneficiary organization's data	PMU to collect data from beneficiary organizations	PMU

Monitoring & Evaluation Plan: Intermediate Results Indicators					
Indicator Name	**Definition/Description**	**Frequency**	**Datasource**	**Methodology for Data Collection**	**Responsibility for Data Collection**
Percent change in the number of enterprises accessing supported G2B systems	The indicator measures the change in the utilization of G2B systems upgraded with the support from the program. The change will be tracked against the baseline	Annual	G2B systems usage data	PMU to collect data from the agencies managing the G2B systems	PMU

	value of number of active users before upgradation of the system.				
Percentage of women-owned enterprises recorded as being creditworthy.in the credit bureau	The indicator measures the proportion of women-owned enterprises supported by the program who have been recorded in the Central Bank of Lesotho's credit bureau as being creditworthy.	Annual	Central Bank credit bureau data	PMU collects data from the CBL credit bureau	PMU
Number of additional enterprises covered by the partial credit guarantee (PCG) scheme	The indicator measures how many enterprises are covered by the partial credit guarantee schemes with the support from the project.	Annual	FIs that utilize the PCG	PMU to collect data from LNDC which will collect data from participating FIs	PMU
Number of MSMEs registered for coverage in MSME Resilience Fund database	This indicator measures the number of MSMEs that have been registered for coverage by the MSME Resilience Fund	Annual	Resilience fund MSME database	PMU to collect from MSME Resilience Fund unit	PMU
Value of potential payouts to MSMEs from private capital mobilized for climate resilience	Value of potential insurance payouts to MSMEs from the resilience insurance plan	Annual	Insurance provider	PMU collects the data from the insurance provider	PMU
Percentage of enterprises supported by the entrepreneurship and SME programs with increased employment	This indicator measures the ratio of enterprises that reported a positive (greater than 0%) year-over-year increase in full time equivalent (FTE)	Annual	Beneficiary organization's data	PMU to collect data from beneficiary organizations	PMU

	employment after a year of engagement with the entrepreneurship and SME programs. The indicator does not capture employment increases of those enterprises that participated in low-touchpoint activities of the program, such as participation in one-time events or activities, such as attending entrepreneurs hub events, one-time networking activities, and so on.				
Number of startups and innovative SMEs supported through entrepreneurship hub support programs	The indicator measures the total number of unique enterprises that receiving any form of technical or financial support from the program activities, including through programs run by the Hub ESOs.	Annual	Entrepreneurship Hub data	PMU collects data from the Entrepreneurship Hub which collects the data from ESOs that the hub supports	PMU
Of Which are Women-Owned	This disaggregate captures the share that are women-owned	Annual	Entrepreneurship Hub data	PMU collects data from the Entrepreneurship Hub which collects the data from ESOs that the hub supports	PMU

Number of enterprises accessing early-stage finance	The indicator captures the total number of enterprises that have successfully received investment financing (not grants) from the seed facility. It counts the unique number of enterprises that received any amount of finance disbursed.	Annual	Seed Facility Data	PMU collects data from the Seed Facility.	PMU
Number of entrepreneurship hub and LEAP program supported enterprises that adopted new digital technologies	The indicator measures the number of unique enterprises that are supported by the entrepreneurship hub or LEAP program, have received technical support in gaining knowledge about or procuring new digital technologies, and have reported adopting one of more digital technologies through the training. To be considered "adopted," the digital technology must be embedded into the business process and practice.	Annual	Entrepreneurship Hub and LEAP Program data	PMU collects data from the Entrepreneurship Hub and LEAP Program	PMU
Number of LEAP fund supported enterprises with 25% or greater increase in revenues one year after grant support	Measures the number of LEAP fund supported enterprises that have a significant increase in	Annual	LEAP unit	PMU collects the data from the LEAP unit	PMU

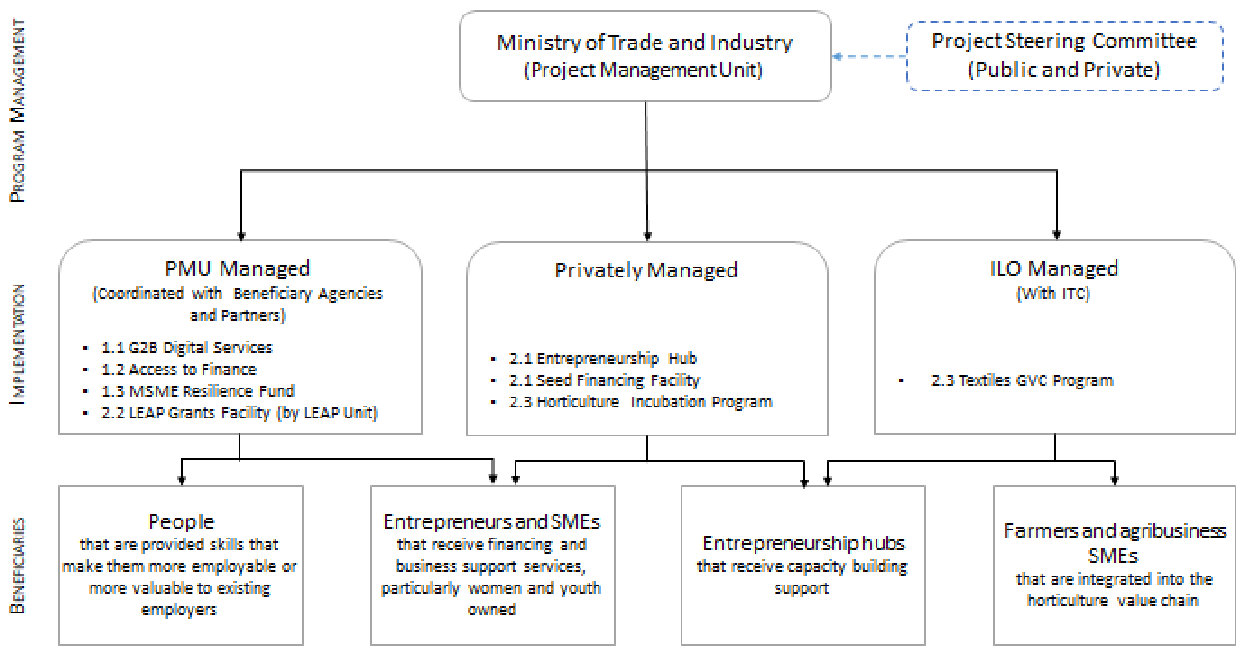
	revenues (greater than 25%) one year after receiving LEAP grants (out of an expected 350 grants provided)				
Number of supported enterprises in targeted value chains with increased value of exports	Measures how many enterprises in targeted value chains supported by subcomponent 2.3 have an increase value of exports after receiving support	Annual	Implementing partners for subcomponent 2.3 (Horticulture Incubator, Textiles program operator)	PMU collects from implementing partners	PMU
Percent of enterprises engaged with the public private dialogue platform that assess the platform as improving government responsiveness to private sector concerns	The indicator measures how enterprises view the responsiveness of government to their engagement through the public private dialogue (PPD) platform.	Annual	Survey of enterprises that participate in the PPD	PMU to collect data from the enterprises participating in the PPD	PMU

ANNEX 1: Implementation Arrangements and Support Plan

PROJECT INSTITUTIONAL AND IMPLEMENTATION ARRANGEMENTS

1. MTI is the implementing agency for all project subcomponents, working through a PMU which will have responsibility for day-to-day planning, management, and supervision of project activities. The PMU of the current PSCED2 project will also be the PMU of this project and there is expected to be seamless continuity in the transition to the new project after approval. The PMU will work together with various public and private agencies and organizations to implement the activities and it has established project implementation capacity since the first PSCED project. Implementation arrangements are illustrated in Figure 1.1.

Figure 1.1. Implementation Arrangements



2. **Subcomponent 1.1: G2B services. (Implementation) -** Subcomponent 1.1 activities will be procured by the PMU, on behalf of the beneficiary agencies, with supervision jointly managed by the PMU and beneficiary agencies.

3. Transition of the business registration system into the UNCTAD business licensing and business permitting system will be carried out by UNCTAD's implementation team, working with the OBFC, which hosts these systems. Upgrades to the construction permitting, land administration, trade facilitation (customs and national single window), and cross-border transport and transit operations systems, and upgrades apart from the transition to the business registration, licensing, and permitting systems, will be carried out by a consulting firm or firms, working closely with the OBCF, MCC, LAA and LRA, which host those systems.

4. The trade logistic modules for e-Certificate of Origin and Risk Based Selectivity will complement LRA's ASYCUDA system for Trade Logistics. The ASYCUDA system is also supported by UNCTAD which can assist on the development

of additional modules. LAA is supported by LandFolio and ESRI South Africa which will also provide support for further enhancements to the system.

5. Government will have a competitive procurement for an international consulting firm to develop the G2B interoperability framework. The consulting firm will have as deliverable documenting the existing G2B systems and they data exchange needs. They will also prepare the information architecture and governance which will guide the implementation of the inter-agency transactions. After the framework is developed, its governance and technical teams will decide hosting and security requirements, technical tools and techniques to be used on its implementation.

6. The G2B payment gateway will be developed by a firm selected under competitive procurement. The firm will be hired to work with G2B agencies to integrate the payment gateway with existing online processes. All payment transactions will be documented and subsequently implemented using a unique payment gateway.

7. **Subcomponent 1.2: Access to finance. (Implementation) -** The main beneficiary agency for the credit infrastructure activity is the CBL, under which the credit reporting system and the movable asset registry are housed. The MOF, MTI, and MOHA are critical for the advancement of envisaged work under this subcomponent, particularly given the system integration and inter-ministerial coordination required to strengthen the credit infrastructure system. The CBL will work jointly with the PMU to identify and supervise the contractors that will work with the beneficiary agencies on the various activities including diagnostics, assessments, and piloting of approaches and systems.

8. Under the risk sharing facility component, the MOF and DSBD are the two critical agencies required to advance envisaged work. The envisaged PCG strategy will require input and coordination between these two ministries. Further the determination with regards to the strategic advancement of a single public sector risk sharing facility will require a joint decision. A technical working group will be constituted with representatives from MOF and DSBD respectively to advance this component. The working group will also comprise representatives from the two guarantee schemes, LNDC-PCG and PCGF.

9. **Subcomponent 1.3: Establishment of an MSME resilience account within the PMU and strengthen delivery mechanism to beneficiaries. (Implementation) - A** DRF coordinator will be hired into the PMU to manage the implementation of the MSME resilience subcomponent. The DRF coordinator will be financed using GRiF resources. Their primary reporting line will be to the PMU director. They will also have a dashed reporting line to the Budget Controller of the MOF, given the parallel capacity building that will be done through an ASA. The MSME resilience funds will be held within the designated account at MTI, managed by the PMU. This account will disburse resources upon occurrence of eligibly shocks to affected MSMEs. Initially perils covered will include climatic perils (drought, flooding, heavy snowfall, hail) and pandemics, with a view to expanding to additional perils as operational experience is gained. This will strengthen the government's ability to finance high frequency, low severity climatic shocks to MSMEs and reduce reliance on budget reallocations or humanitarian funding. The project will provide technical assistance to the Disaster Management Authority (DMA) to strengthen their capacity to declare states of disaster and sub-national states of disaster. The latter is particularly important to strengthen the financial resilience of MSMEs to more localized shocks, such as flooding or hail. Declaring sub-national states of disaster is within their power, but this has not been exercised often. Capacity building will be done through knowledge-sharing and south-south knowledge exchanges.

10. **Subcomponent 1.3: Co-financing premiums for the sovereign insurance backstop. (Implementation):** The project will support the design and procurement of a sovereign insurance backstop mechanism to the MSME resilience

account within the PMU. The sovereign insurance backstop will activate for severe shocks, to reduce budget volatility and strengthen the governments' financing for shock response. Insurance payouts will be channeled into the account within the PMU, providing the Government with additional liquidity in the event of severe shocks. This additional liquidity will reduce the need to reallocate budget to finance shock response, as well as enable the Government to prepare and launch a more robust shock response. It is likely that the insurance product developed will be parametric, based on remote sensing and / or weather station data given data is poor in Lesotho and the insurance industry is nascent. The parametric insurance will initially focus on drought, given it is the most costly and detrimental to development peril in Lesotho. As with any parametric insurance product, basis risk is a key concern. Thus a value for money (VFM, see next paragraph) analysis will be conducted on a sovereign insurance product, with recommendations on how to strengthen the efficacy of the product.

11. **Subcomponent 1.3: Strengthen risk finance capacity in Government. (Implementation):** Strengthening capacity on the implementation of the MSME resilience account, adoption risk transfer instruments, and scaling up delivery mechanisms is critical for effective implementation. Capacity development will focus on supporting the MOF draft and adopt a National Disaster Risk Finance Policy. Capacity development activities are expected to include: (i) organizing a capacity development series to strengthen understanding of the benefits to financial protection and a risk layering strategy for different line ministries; (ii) convening a knowledge sharing event to explore international best practices on the development and implementation of risk instruments (iii) working in collaboration with risk carriers, such as the African Risk Capacity, strengthen capacity on risk transfer options, including the sovereign insurance backstop; and (iv) organizing a seminar on strengthening financial literacy, expanding financial inclusion, and scaling up digital payments, particularly G2B payments, for vulnerable populations, particularly women-owned MSMEs. The project will also support the expansion of and digitizing the list of informal MSMEs, and actively seek to maximize the number of women owned MSMEs in this database, in coordination with the business registry. The acute need to expand this database was evident during the Government's implementation of the Covid-19 Relief Fund, as there were significant delays when the Government sought to provide relief payments to MSMEs. The project will also support component 1.1, strengthening of Government to Business (G2B) payments, to ensure disbursements from the MSME resilience account in the PMSU reaches beneficiaries rapidly, with focus on vulnerable women owned MSMEs. Connecting pre-arranged funding to national delivery mechanisms is important to ensuring a timely response during shocks. Scaling up digital financial services and enabling the entry of fintech firms can play an important role in enabling expedited G2B payments. The G2B payment system will build on the success of the recent COVID-19 relief grants. This system proved a very effective delivery mechanism to MSMEs, however it was set up quickly and was not overly robust (used spreadsheets, prone to errors).

12. **Parallel ASA to strengthen capacity of MOF:** In parallel to the CAFI project, the FCI team will utilize an ASA to strengthen the capacity of MOF to develop and implement long-term risk financing instruments that will activate after the completion of the project. First, the ASA will support MOF to strengthen its existing Continency Fund through the adoption of regulations. The Contingency Fund in the MOF is established under the Public Financial Management and Accountability Act (2011) in Lesotho. The World Bank will support the MOF draft and adopt the regulations. The regulations will provide a robust governance process for implementing the Contingency Fund including fund governance, the disbursement and procurement processes, financial management of resources and auditing and reporting requirements. The regulations will also establish a private sector resilience window under the fund. This window will disburse resources upon occurrence of eligibly shocks to affected MSMEs. Initially perils covered will include climatic perils (drought, flooding, heavy snowfall, hail) and pandemics, with a view to expanding to additional perils as operational experience is gained.

13. Once the CAFI project is completed, the MSME resilience funds would shift from the PMU to the MSME Resilience Window within MOF's Contingency Fund. The sovereign insurance that will be procured through this project will then provide surge financing into the Contingency Fund. This will strengthen sustainability of the disaster risk financing instruments after the completion of the project. The ASA would also finance a 'risk finance operations manual' to strengthen the transparency and accountability of disbursements from the Contingency Fund. The risk finance operations manual will be published, and cover at a minimum the following details:

  a. Clear triggers to enable rapid disbursements from the Contingency Fund. As this instrument is designed to manage the impact of lower-level shocks, soft triggers will be used to trigger disbursements, in combination with hard triggers used for the sovereign insurance backstop.
  b. A list of eligible beneficiaries for a given shock event. Justification for inclusion of beneficiary MSMEs must be made against clear criteria. This could include aspects such as geographical location or sector within which the MSME operates.
  c. The information which is required in a 'Disbursement Report' which will be prepared by the DRF coordinator to justify a disbursement of funds from the Contingency Fund. This report will explain the shock event, its impact on MSMEs and the proposed response with costing. This report will be reviewed by a technical committee (next point).
  d. The establishment of an inter-agency DRF technical committee - including for example officials from the MOF, MSBD, MTI and Disaster Management Authority. The committee will validate the disbursement report. The report will then be sent to the Budget Controller and the Principal Secretary of the Ministry of Finance for approval and release of funds from the Contingency Fund. From there, the MOF will disburse funds from the Contingency Fund to affected MSMEs.
  e. Exact details on the flow of funds from the Ministry of Finance to shock affected MSMEs.
  f. The risk financing mechanisms will be implemented in close coordination with the DMA ensuring close alignment of the disaster risk financing instruments with ongoing disaster risk mitigation, reduction and adaptation activities of the Government.

14. **Subcomponent 2.1: Entrepreneurship Ecosystem. (Implementation):** Subcomponent 2.1 implementation will be managed by the PMU. The PMU will hire experts to support them to run a fair and transparent international selection of two partners:
  i. an operating agency to run the Entrepreneurship Hub and the ecosystem development activities.
  ii. a fund management partner that will run the seed financing facility and associated acceleration program.

15. Once the Entrepreneurship Hub operating agency has been selected the PMU will have two roles: (i) monitoring and supervising the operating agency and (ii) disbursing the grants to the ESOs and the startups/innovative SMEs incubated under the ESO programs.

16. Six months into the program, once the first batch of ESOs has been certified and the call for application to fund the ESO incubation programs is underway, the PMU will hire a firm to prepare the call for fund managers to manage the seed financing facility and accelerator program. This call would summarize the investment environment and the governance model for the fund. The firm would then run a communication campaign to attract the seed-investment fund managers. This activity will take approximately 6 months. The program will have a steering board comprising public and private sector representatives in equal numbers.

17. Once the fund management company is selected, it will take approximately 6 months to get legal agreement for the seed financing facility to begin operating. The facility should be ready to invest within 21 to 24 months from the start of the project. Institutional bodies, such as LNDC, BEDCO and potentially CBL, may be part of the steering board of the seed financing facility. However, the investment committee (IC) will be selected by the fund managers and should include 2 or more independent experts.

18. The following figures 1.2 and 1.3 describe the implementation timelines over the first two years of the project:

Figure 1.2: Implementation timeline for first two years of the project

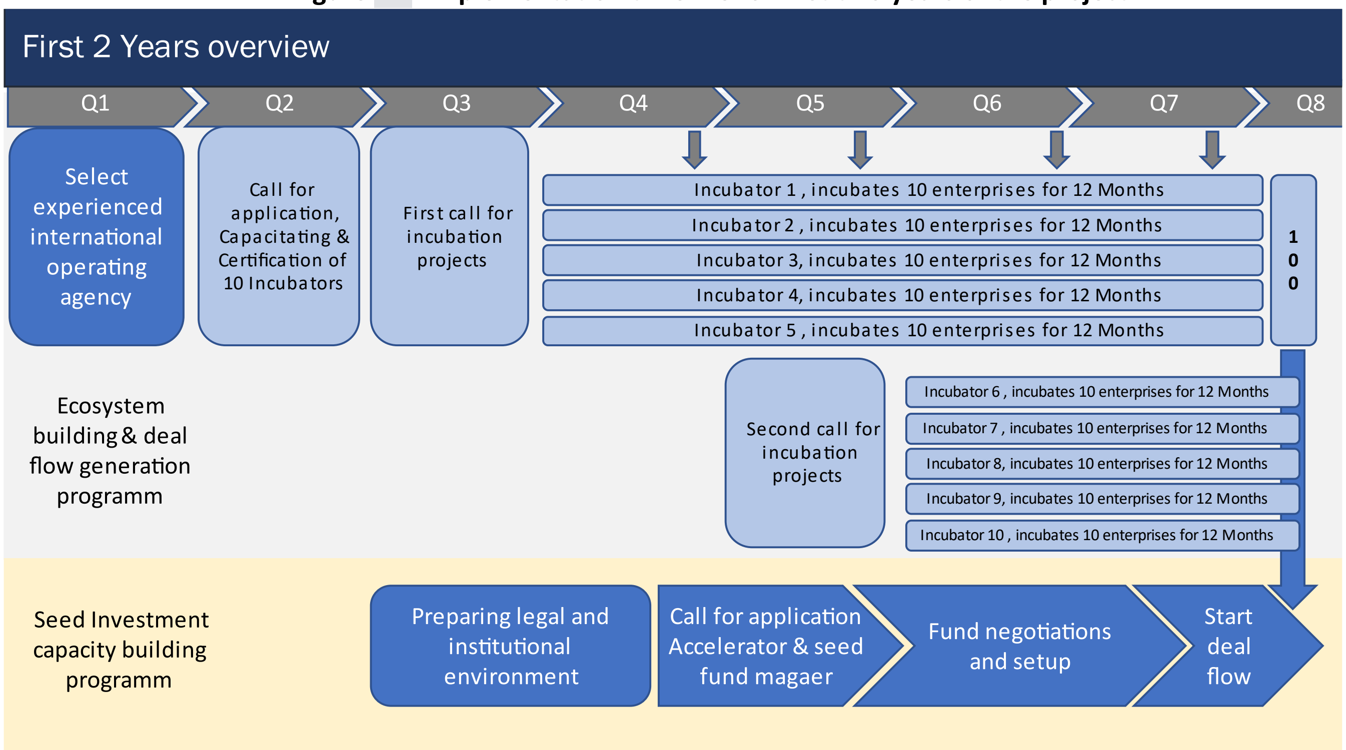
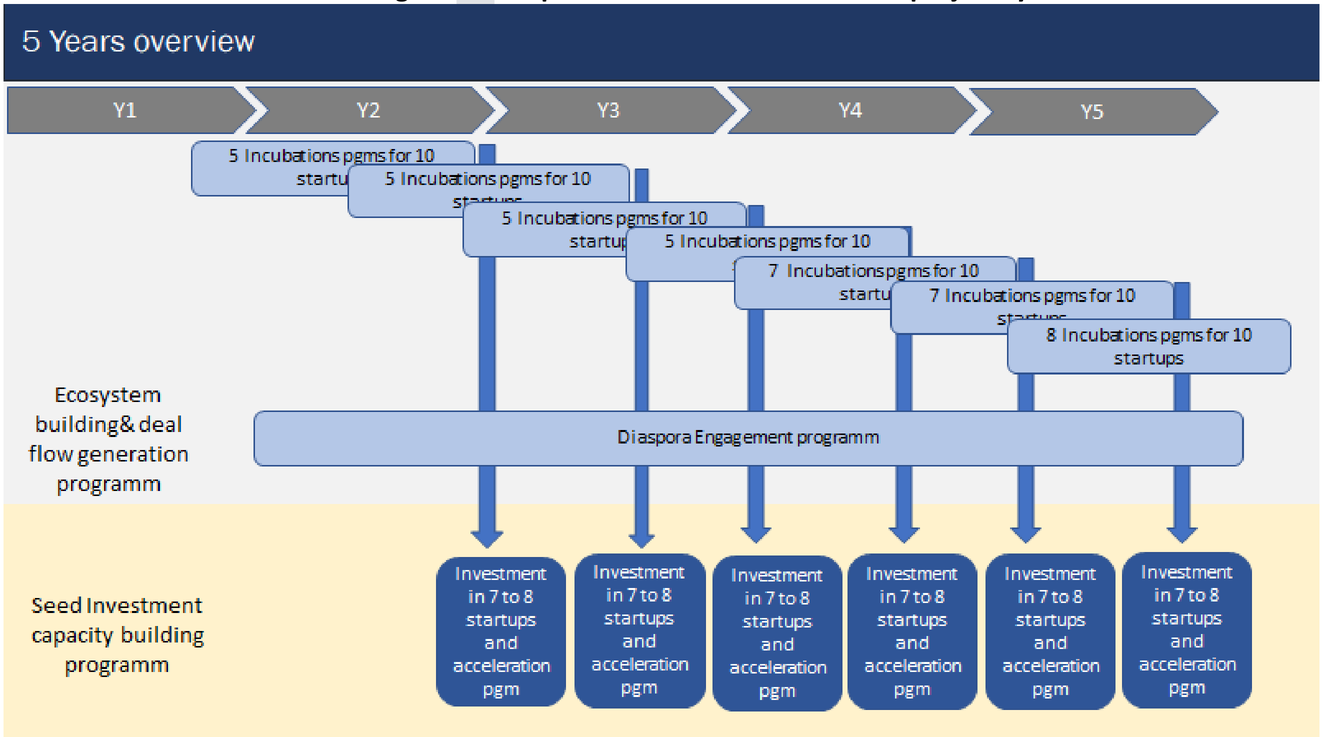


Figure 1.3: Implementation timeline for the project cycle



19. Subcomponent 2.2: Scaling the Lesotho Enterprise Assistance Program (LEAP) for MSMEs. (Implementation) - The LEAP program is currently managed by a small (3 person) team within the PSCED2 PMU. The placement of the LEAP management at the PMU is designed to ensure that selection of supported MSMEs is objective and merit-based and allows for close implementation support by the World Bank. This arrangement will continue under the CAFI project at least for the initial years of implementation. Over time, consideration will be given to migrating the LEAP management to another organization. This could be an international consulting company, a mission-aligned organization such as the entrepreneurship hub or seed financing fund manager, or a public agency such as BEDCO or LNDC. Such a migration might support sustainability beyond the project implementation period but might also reduce the oversight by the World Bank and PMU. As such, the migration will be considered only after the LEAP program has established a track record of strong implementation under the CAFI project.

20. The current 3-person LEAP management team will be expanded by 1-2 additional staff given the additional window and greater program funding being added under CAFI. Specifically, 1-2 additional grants officer(s) will be hired. Regular monitoring and evaluation (M&E), financial management, and procurement for the LEAP program will continue to be carried out by the PMU staff assigned these roles. Supplemental M&E activities will be carried out by consultants hired by the LEAP team as necessary. In particular, to foster continual improvements in the LEAP program, the project will support a mid-term evaluation of the impacts of LEAP grants under both windows, carried out by an independent M&E contractor.

21. Details of the two LEAP windows will be documented in a LEAP operational manual that will be subject to approval by the World Bank. This will include eligibility criteria, approval and review processes, eligible use of grant funds, grant size limits, procedures on disbursement of funds, M&E arrangements, recipient reporting requirements, and similar details.

22. External participation in the LEAP program governance will be considered to improve the transparency and impact of the program. First, a LEAP steering committee with relevant public and private stakeholders will be considered. The steering committee would periodically review and adjust the strategic direction of the LEAP program. Second, independent evaluators for grant applications will be considered. These could be drawn from organizations that have an interest in developing Lesotho's private sector but no direct ties to the LEAP applicants, such as entrepreneurship hubs, technical experts, or management consultancies.

23. **Subcomponent 2.3: Support for the textile and apparel GVC. (Implementation) -** The program will be designed and delivered by a joint ILO-ITC team of technical experts and consultants (drawing upon their experience in other countries such as Egypt, Tunisia, and Madagascar as well as the global Better Work program) and will be managed by a competitively selected Chief Technical Officer. The Chief Technical Officer and nationally recruited project officers will report to the Project Coordinator and the program will be implemented under the oversight of a Technical Steering Committee chaired by the Principal Secretary of MTI and which includes the LNDC, Labor Commissioner, LTEA, LGMA and ALEB. The participating firms will be selected through an open application process and several calls for applications to identify cohorts will be launched. The eligible firms need to enter into a performance agreement with the Project to ensure compliance with implementation arrangements and timelines for activities, data sharing and reporting requirements.

24. **Subcomponent 2.3: Expansion of smallholder horticulture production through the Horticulture Incubation program.** The Horticulture Incubation program will be established as a public-private partnership between the Government and an experienced private service provider/operator who will be selected through an appropriate international competitive process. The private service provider /operator will design and operate the incubation program as well as manage and operate the Horticulture Incubator Center based on agreed output and outcome indicators. The operator/manager will report to the Project Coordinator.

25. The provisioning of physical space and resources by the incubator includes facilities in which the clients can conduct operations, office space, meeting facilities and certain required farming resources including access to the existing demonstration farms. The selection of farmers/agribusiness SMEs into the incubation program will be based on an open selection process and carefully established criteria including access to adequate land (soil suitability and farming acreage), access to irrigation infrastructure (financed through the SADP2 or the Millennium Challenge Corporation program), motivation and demonstrated commitment of the farmers/entrepreneurs, availability of financial and other in-kind resources and willingness to commit to at least a three-year incubation program. Several cohorts of farmers/agribusiness SMEs will be selected to participate in a **pre-incubation program** that provides training, office space and access to basic inputs such as seeds/seedlings and other farm inputs. Farmers/SMEs that graduate from the pre-incubation program and meet established criteria will be eligible to be part of a **full incubation program** that provides more tailored training and technical support/extension services to scale their businesses and access to commercial financing opportunities. It is expected that around 100 farmers/agribusiness SMEs will be selected for the pre-incubation program of which between 10-15 farms/agribusiness SMEs are expected to qualify for the full incubation program.

FINANCIAL MANAGEMENT

26. The financial management assessment was carried out in accordance with the World Bank's Operational Policy and the Financial Management Manual issued by the Financial Management Board. The objective of the assessment was to determine whether the project implementing unit PMU within MTI have acceptable financial management arrangements, which will ensure: (1) that the project funds are used only for the intended purposes in an efficient and economical way, (2) the preparation of accurate, reliable and timely periodic financial reports, and (3) safeguard of the assets. The overall conclusion of the financial management assessment is that the project's financial management has an overall risk-rating of **Moderate** and the financial management arrangements satisfy the World Bank's minimum requirements under the Bank's policy and procedures on financial management.

27. While the discipline of Public Financial Management (PFM) has seen development in the last few years, there is still a general lack of effective systems, capacity, and experience. Work has started on the development of a new legal framework, methodologies and systems for budget, budget execution, accounting, reporting and oversight, but actual capacity at the moments remains largely weak. The ability of the Government to attract and retain qualified FM staff remains under pressure and the Bank assisted projects have therefore traditionally relied on the outside advisors (finance, procurement, and technical) to assist projects in their implementation efforts.

28. To address the weakness in critical PFM issues, the government is implementing a Public Financial Management Reform Action Plan (PFMRAP), with the support of the World Bank, EU, AfDB, and IMF. This program seeks to strengthen fiscal management institutions, accountability, and oversight for improved service delivery.

29. For the project, the implication currently is that full utilization of the government PFM system is not yet possible. Elements that will be relied upon is the independent audit by the Office of the Auditor General.

Risk assessment and mitigation

30. Table 1.1 below summarizes the results of the risk assessment and the mitigation measures.

Table 1.1: Financial Management Risk Assessment and Mitigation

Description of Risk	Risk Mitigation Measures incorporated in Project Implementation	Condition of Effectiveness (Yes/No)	Residual Risk/ (Risk) rating
INHERENT RISKS			
Country Level			
There are still notable challenges in the PFM reforms, namely, the rollout of the IFMIS and implementation of the PFMRAP.	The Government has acknowledged these challenges and action plans have been identified with the support of the donors to work on these challenges.	No	S
Entity Level			
Should new different personnel be recruited, they will possess limited experience in the financial management aspects of bank-funded projects.	Skills transfer and Institutional memory will be managed.	N	M
Project Level			
The project is handling some policy reform issues that take longer to be finalized.		No	M
Overall Inherent Risk	**Residual Risk: M**		
CONTROL RISK			
Budgeting			
The budgeting process may not be comprehensive and realistic to provide an adequate basis for performance monitoring	Budgets will be prepared based on approved procurement plans. Monthly and quarterly reports will be produced to report and monitor variances.	No	M
Accounting and financial reporting			
There is no identified risk. The project will use the existing Tompro accounting system and it has proven adequate for the current project.			L
Internal control			
There is a risk that adherence to approved policies and procedures may be negatively affected by non-adherence to thereof.	The project will use the current project implementation manual and will be updated based on lessons and experiences from the past project.	No	M
Funds flow			
No identified risk		No	L
Auditing			

Description of Risk	Risk Mitigation Measures incorporated in Project Implementation	Condition of Effectiveness (Yes/No)	Residual Risk/ (Risk) rating
No identified risk The project has been submitting acceptable audit reports on time.		No	L
Overall Control Risk	**M**		
Overall Risk	**M**		

H – High S – Substantial M – Moderate L – Low

31. **Strengths**: Existing financial management arrangements processes are adequate. The current project has been receiving unqualified audit opinions with immaterial findings in the management letter. The overall financial management ratings in the ISRs have been consistently Satisfactory.

32. **Weakness**: There is no identifiable weakness unless the project may change the entire current personnel. Then the institutional memory will be eroded.

FM strategy and approach for implementation support

33. The day-to-day operations of the project will be overseen by a PMU that will be headed by a qualified project manager. In addition, the PMU will include a Financial Manager who will oversee the FM aspects of the project. The financial management arrangements are described below.

34. **Budgeting arrangements:** The PMU will prepare an annual budget for the project based on approved annual work plans, and the Financial Manager will be responsible for producing variance analysis reports comparing planned to actual expenditures on monthly and quarterly bases. The periodic variance analysis will enable the timely identification of deviations from the budget. These reports will be part of the interim unaudited financial reports (IFRs) that will be submitted to the Bank on quarterly basis. The Financial Manager will coordinate the budgeting process in conjunction with the Project Manager.

35. **Accounting arrangements:** The project will use the existing computerized accounting software called TOMPRO for project financial management and the production of accounts. The accounting software is capable of transaction processing, production of project annual financial statements, IFRs, and other reports as required for the effective management and monitoring of the project. The project is using the cash basis of accounting as prescribed under the Cash Basis Standard issued by the International Public Sector Accounting Standards Board. The accounting procedures are spelt out in the Project Implementation Manual.

Internal auditing, internal controls and staffing arrangements

36. **Internal Auditing*:*** Due to the need to uphold good governance principles, the project will be included in the annual internal audit plans. The internal audit cited budget constraints as one of the possible limitations in covering the project. To mitigate the risk, an additional budget will be made available under operating costs to support the internal audit coverage.

37. **Internal Control Systems:** The PMU will use the Project Implementation Manual from the ongoing project, and it will be updated to accommodate new activities under the new phase. The manual will be updated and approved by negotiations.

38. **Staffing arrangements**: The Finance Manager will take the ultimate responsibility for the financial management function. She will be supported by a Finance Officer. The staffing arrangement will be continually reviewed during the project implementation, and if the need arises for additional capacity in the PMU, additional staffing will be considered.

DISBURSEMENT AND FUND FLOWS

39. **Banking arrangements**: The PMU (through the Minister of Finance) will open a pooled Designated Account denominated in United States Dollars at the Central Bank to receive the funds from IDA and TF. A project account denominated in Maloti will be opened and used to make local payments. This local account will be reimbursed with funds from US dollar account, although minimum balance needs to be kept in this account.

40. **Funds flow arrangements**: Upon effectiveness of the financing agreement and submission of a withdrawal application, the Bank will disburse an initial amount equivalent to six months expenditure into the Designated Account. Subsequent disbursements will be made on the basis of the approved projected expenditures for six months, which will form part of the IFRs.

41. The project will also have the option of using: (i) the Direct Payment disbursement method, involving direct payments from the credit account on behalf of the Government and to the suppliers of goods and services that have a value above a set threshold; and (ii) the Reimbursement disbursement method, whereby the Government makes payments for eligible expenditures and submits withdrawal application for reimbursement.

42. The disbursement details will be spelled out in the project's Disbursement Letter.

Financial reporting arrangements

43. The PMU will prepare quarterly un-audited IFRs for the project in form and content satisfactory to the Bank, which will be submitted to the Bank within 45 days after the end of the quarter to which they relate. The IFRs submitted to the Bank will contain the following statements:
    - Statement of Sources and Uses of Funds;
    - Statement of Uses of Funds by Project Activity/Component;
    - Designated Account (DA) Activity Statement;
    - Bank Statements for both the Designated and Project Account;
    - Summary Statement of DA Expenditures for Contracts subject to Prior Review; and
    - Summary Statement of DA Expenditures not subject to Prior Review.

44. The annual financial statements will be prepared using International Public Sector Accounting Standards. These statements shall be submitted to the Bank within 6 months after the end of the financial year. The accounts/financial statements will comprise of:

a. **A Statement of Sources and Uses of Funds/Cash Receipts and Payments**, which recognizes all cash receipts, cash payments and cash balances controlled by the entity; and separately identifies payments by third parties on behalf of the entity.

b. **The Accounting Policies Adopted and Explanatory Notes**. The explanatory notes should be presented in a systematic manner with items on the Statement of Cash Receipts and Payments being cross referenced to any related information in the notes; and

c. **A Management Assertion** that Bank funds have been expended in accordance with the intended purposes as specified in the relevant World Bank legal agreement.

Auditing arrangements

45. The project financial statements will be audited by the Office of the Auditor General in accordance with International Standards on Auditing, and the audit report together with the management letter and management responses will be submitted to the Bank within six months after the financial year-end.

46. The external auditor will be required to express a single opinion on the project financial statements. In addition, a detailed management letter containing the auditor's assessment of the internal controls, accounting system and compliance with financial covenants in the financing agreement, suggestions for improvement, and management's response to the auditor's management letter will be prepared and submitted to management for follow-up actions.

Audit Report	**Due Date**
Project audited financial statements and management letter	Within six months after the end of the financial year i.e., 30 September

Financial Management Action Plan

47. The following actions need to be taken to enhance the financial management arrangements for the project:

Action	**Date due by**	**Responsible**
Update Project Implementation Manual	By negotiations	PMU

Financial Management Implementation Support Plan

48. Based on the outcome of the FM risk assessment, the following implementation support plan (Table 1.2) is proposed. The objective of the implementation support plan is to ensure the project maintains a satisfactory financial management system throughout the project's life.

Table 1.2: Financial Management Implementation Support Plan

FM Activity	**Frequency**
Desk reviews	
Interim financial reports review	Quarterly
Audit report review of the program	Annually
Review of other relevant information	Continuous as they become available
On site visits	

Review of overall operation of the FM system	Annual
Monitoring of actions taken on issues highlighted in audit reports, management letters, and other reports	As needed

Conclusion of the assessment

49. The conclusion of the assessment is that, subject to implementation of the action plan shown above, the financial management arrangements are acceptable to the Bank. The overall residual risk rating is Moderate hence the project will have an on-field supervision at least once a year.

50. The financial management arrangements were validated by the current Finance and Project Managers in the PMU.

PROCUREMENT

51. The Project Procurement risk rating based on PRAMS is **Moderate**.

Selection of Goods, Works, and Non-Consulting Services: Methods and Prior Review Threshold

Table 1.3: Selection Methods and Thresholds for Goods, Works, and Non-Consulting Services

Approved Selection Methods**	Thresholds for Method (US$ equivalent)
Open International (Goods, IT Systems and Non-Consulting Services)	Equal to or more than US$1 million
Open National (Goods, IT Systems and Non-Consulting Services) – Open Tender or as stipulated	< US$1 million
RFQ (Goods, IT Systems and Non-Consulting Services)	Less or equal to US$100,000
Open International (Works)	Equal to or more than US$7 million
Open National (Works)	Less than US$7 million
RFQ (works)	Less or equal to US$200,000
Framework Agreements (Goods, Works & Consulting Services)	In accordance with Para 6.57 to 6.59 and 7.33 Annex XV: Frameworks Agreements of Procurement Regulations, and with prior agreement in Procurement plan with the World Bank.
Direct Contracting	No threshold; meet requirements of World Bank's Procurement Regulations

52. In addition to the above, there are other selection arrangements available in the World Bank Procurement Regulations, Fourth Edition, dated November 2020 which upon Bank prior clearance can be incorporated for use under the project.

53. Prior Review (Goods, Works, and Non-Consulting Services): The details of the Procurement review / oversight are defined in the Annex II of the Regulations for Borrowers. The following would be subject to Prior review of the Bank regardless of the Method of selection

54. The details of the Procurement review / oversight are defined in the Annex II of the Regulations for borrowers. Table 1.4 lists the prior review thresholds of the World Bank regardless of the Method of selection:

Table 1.4. Prior Review Thresholds for Works and Goods, IT Systems, and Non-consulting Services

Type of procurement	World Bank's Prior review threshold[48] *
Works	All procurements estimated to cost USD 15 million or more
Goods, IT Systems, and Non-consulting Services	All procurements estimated to cost USD 4 million or more

*These thresholds are for the purposes of the initial procurement plan for the first 18 months. The thresholds may be increased or decreased based on re-assessment of risks assessment. All contracts not subject to prior review will be post-reviewed (once annually, sampling minimum of 15% post review contracts).

I. For contracts subject to prior review, the Borrower shall seek the Bank's no objection before agreeing to:

a. an extension of the stipulated time for execution of a contract that has an impact on the planned completion of the project.

b. any material modification of the scope of the Works, Goods, Non-consulting services or Consulting Services, or other significant changes to the terms and conditions of the contract.

c. any variation order or contract amendment (except in cases of extreme urgency), including due to extension of time, that singly or combined with all previous variation orders or amendments, increases the original contract amount by more than 15 percent; or

d. the proposed termination of the contract.

The Borrower / Implementing Agency shall provide a copy of all amendments to the contract to the Bank for its records.

II. Prequalification

Not Applicable

Domestic Preference. The provision of domestic preference shall not be applied in the evaluation of bids in accordance with Annex VI of the Regulations**.**

III. Reference to Standard Procurement Documents

For all open international market approaches, World Bank's Standard Procurement Documents (SPD) are to be used. The latest versions of the SPD are available in the World Bank website.

IV. Any Other Special Procurement Arrangements

When approaching the national market, as agreed in the Procurement Plan, the National Open Tender procedure may be used. The specific qualifications requirements, for use of national open competitive procurement, is set out in Section V, para 5.3 of the Procurement Regulations and shall be applied.

Other national procurement arrangements (other than national open competitive procurement), that may be applied by the Borrower (such as limited/restricted competitive bidding, request for quotations/shopping, direct contracting), shall be consistent with the Bank's Core Procurement Principles and ensure that the Bank's Anti-Corruption Guidelines and Sanctions Framework and contractual remedies set out in its Legal Agreement apply.

As National Standard Procurement Documents are not yet developed following PPAD 2015, the Bank's Standard RFB Goods and RFP Consulting Services dated July 2016 or the latest version available in the World Bank website Procurement section will be used as a base and incorporating suitable modifications and the same would be agreed with the Bank subject to national competition.

Selection of Consultants: Methods and Prior Review Threshold

55. **Selection methods of procurement of Consultants' Services (Firms):** The Approved Selection Methods as reflected in the Section VII of the procurement regulations are listed in Table 1.5.

Table 1.5. Selection Methods and Thresholds for Consultants (Firms)

Method of Procurement	**Thresholds for Methods**
Quality and Cost Based Selection (QCBS)	As per requirements of para 7.3 of the Regulations (for any value, but usually for assignments average complexity and value US$300K or above)
Quality Based Selection (QBS)	As per requirements of para 7.8 to 7.10 of the Regulations (for any value, but activities of highly specialized and high downstream impact);
Selection based on a Fixed Budget (FBS)	As per requirements of para 7.4 and 7.5 of the Regulations
Selection Based on Least Cost Basis (LCS)	As per requirements of para 7.6 and 7.7 of the Regulations

Selection based on Consultant's Qualification (CQS)	As per requirements of para 7.11 and 7.12 of the Regulations Contracts estimated to cost equivalent of USD 300,000 or less per contract
Framework Agreements	All procurement that meets the requirements as per Para 6.57 to 6.59 of Procurement Regulations, and with prior agreement in PP with the Bank.
Direct Contracting	Must meet the requirements of Para 7.13 to 7.15 of the Regulations, and with prior agreement in PP with the Bank.

The short list may consist of all National consultants in case the estimated cost is less than USD 100,000 and US$300,000 for Engineering & construction supervision Consultants.

56. **Procurement methods for Selection of Individual Consultants (IC):** The Approved Selection Methods for IC as reflected in the Section VII of the procurement regulations are shown in Table 1.6.

Table 1.6. Selection Methods and Thresholds for Individual Consultants

Method of Procurement	**Thresholds for Methods**
Open Competitive Selection	As per requirements of para 7.36 and 7.37 of the Regulations (default for any value, usually higher values)
Limited Competitive Selection	As per requirements of para 7.38 of the Regulations
Direct Selection	Must meet the requirements of Para 7.39 of the Regulations, and with prior agreement in PP with the Bank

***Shall meet the requirements as stated in Regulations**

Terms of Reference (ToR) for all consultancy contracts shall be furnished to the Bank for its prior review and No Objection.

57. **Prior Review (Consultants):** The details of the Procurement Review / Oversight are defined in the Annex II of the Regulations for Borrowers. Table 1.7 lists prior review thresholds of the Bank for consultants regardless of the Method of selection:

Table 1.7. Prior Review Thresholds for Consultants (Firms and Individuals)

Type of procurement	**Bank's Prior review threshold***
Consultant Firm	All procurements estimated to cost USD 2 million or more
Consultant Individual	All procurement estimated to cost USD 400,000 or more

* These thresholds are for the purposes of the initial procurement plan for the first 18 months. The thresholds may be increased or decreased based on re-assessment of risks assessment. All contracts not subject to prior review will be post-reviewed.

STRATEGY AND APPROACH FOR IMPLEMENTATION SUPPORT AND PLAN AND RESOURCE REQUIREMENTS

58. The World Bank will conduct regular six-month implementation support missions to ensure efficient implementation of the project. Frequent engagement with the PMU will occur virtually to address any issues or challenges in a timely manner. This builds on the approach to implementation support that worked successfully under the PSCED2.

59. The project will be implemented by the same PMU that is currently implementing the PSCED2 project under MTI. The PSCED2 PMU has a strong performance track record of over 15 years and has established strong project implementation capacity as well as working relationships with key agencies and Ministries across the Government. The PSCED2 project will conclude on June 30, 2022, allowing the PMU to be available and ready for CAFI project implementation from the outset of the project. The PMU will be responsible for all fiduciary aspects of the project including FM and procurement activities. The PMU is fully financed from the Component 3 budget.

60. The PMU will also act as a capacity building partner for the PMDU. This brings some additional responsibility for the PMU but also provides the PMU with access to the highest levels of government if implementation challenges arise. This should be beneficial to successful implementation of the project. The PMU also currently acts as the implementing agency for the AfDB's private sector development project. This has facilitated strong coordination between the Bank and AfDB's complementary projects and that coordination can be expected to continue under the new project while the AfDB project is reaching closure.

61. The PMU has established strong working relationships through the current project with the relevant Ministries and agencies which is expected to continue through this project and the PMU will continue to provide capacity building support to the agencies as needed. The project will endeavor to transfer implementation responsibilities to the beneficiary agencies to the extent possible to build sustainability. The key project beneficiary entities are listed below.

Table 1.8. Beneficiary Agencies

Sub-Component	**Beneficiary Agencies**
1.1 Enhancing G2B Digital Services to More Effectively Serve MSMEs	OBFC, DTT, MPWT
1.2 Improving Access to Financial Services	MOF, LRA, CBL
1.3 Improving the Resilience of the Private Sector to Climatic Disasters and Shocks	MTI, MOF, LRA, CBL
2.1 Establishing a Digital Entrepreneurship Hub and Seed Financing Facility	MSBD, BEDCO
2.2 Scaling Up the LEAP Program for MSMEs	MSBD, BEDCO
2.3 Expanding SME Participation in High Potential Value Chains	LNDC, Labor Commissioner, NUL
3. Project Management and Implementation Support	MTI, PMDU

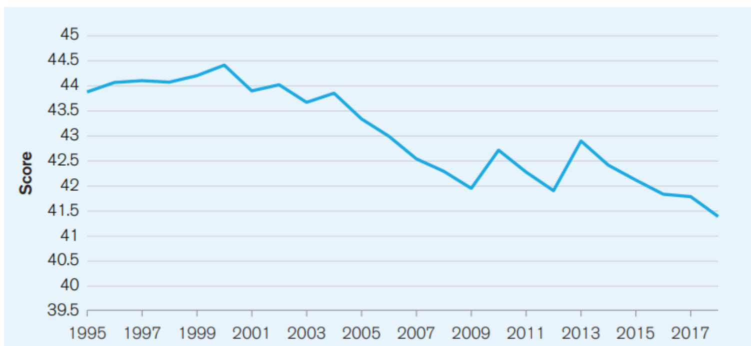
DTT = Department of Traffic and Transport
MPWT = Ministry of Public Works and Transport

ANNEX 2: Climate Risk in Lesotho

1. **Lesotho is highly exposed to climatic and other economic shocks.** According to Lesotho's National Adaptation Programme of Action, due to its geographical position and geophysical features that are primarily characterized by mountainous terrain, coupled with its poor economic situation, Lesotho is in a critical state of vulnerability to climate change. From 1980-2020 Lesotho was impacted by 22 shocks, 90 percent of which were climatic, and there is an expected increase in frequency of intense precipitation events leading to heightened risk of flooding, increased aridity, temperatures, and drought.[49] Lesotho is deemed highly vulnerable and ranked 127 out of the 181 countries on the 2020 ND-GAIN Index, which calculates a country's vulnerability to climate change. The more vulnerable a country is the lower their score on the ND-GAIN Index. Lesotho's score declined from 43.9 to 41.4 between 1995 and 2018, indicating increasing vulnerability (Figure 2.1). According to data from EM-Dat and the Think Hazard databases, Lesotho has high risk exposure to droughts, river flooding and wildfires. Since 2019, Lesotho has experienced all three natural disasters, with national states of disaster declared for drought in 2019 and floods in 2021.

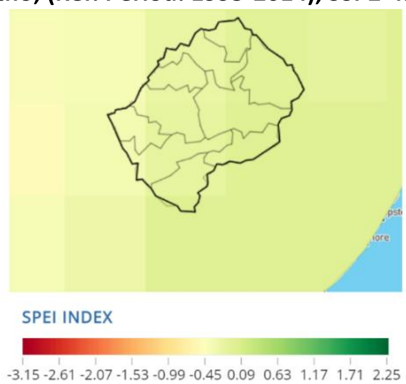
2. In the last six years, Lesotho has been adversely affected by both droughts and floods When looking at the annual SPEI drought index, in all scenarios of future climate mitigation[50], the drought index will worsen (Figure 2.2).

Figure 2.1: ND-GAIN Index for Lesotho, 1995-2018



[49] Climate Change Knowledge Portal, World Bank.
[50] A world of sustainability-focused growth and equality (SSP1); a "middle of the road" world where trends broadly follow their historical patterns (SSP2); a fragmented world of "resurgent nationalism" (SSP3); a world of ever-increasing inequality (SSP4); and a world of rapid and unconstrained growth in economic output and energy use (SSP5).

Figure 2.2: Projected Climatology/ of Annual SPEI Drought Index for 2040-2059 (Annual) Lesotho; (Ref. Period: 1995-2014), SSP2-4.5



3. **These shocks undermine the country's goal of turning the private sector into an engine of growth**. Climatic shocks will result in crop damage, hunger, wildfires and disease outbreaks which are expected to adversely affect 'working days', impacting businesses.[51] The agricultural sector is predominantly rain-fed, leaving it acutely exposed to these shocks. During the 2020-2021 period, Lesotho declared two states of emergencies for shocks (COVID-19 and heavy rains) that severely impacted businesses primarily due to damage to infrastructure disrupting trade logistics. Additionally, the horticulture sector is adversely affected by temperature changes, especially extreme heat, which ca damage plants and adversely affect the health of livestock. Crops have specific temperature windows for optimal growth and yield. Lesotho's maximum temperatures are expected to increase throughout the year.[52]

4. **Strengthening Lesotho's adaptive capacity to climate change is a core part of its Second Nationally Determined Contributions (NDC), which was finalized in 2017.** Lesotho is focused on implementing adaption mechanisms to improve and diversify livelihoods in view of current and future climate risks. Climate change strategies are integrated in the country's development strategies in support of plans to eliminate poverty and eradicate inequality. Aligned with Lesotho's NDC, by setting aside public funds, governments can strengthen their climate adaptation mechanisms and provide timely support to MSMEs when a shock occurs. While the Ministry of Finance (MOF) does maintain a contingency fund for unforeseen expenditures, these funds tend to be deployed early in the budget cycle (prior to the occurrence of climatic shocks) leaving no earmarked funds for MSMEs.

5. **Strengthening the financial resilience of MSMEs is also critical to managing the physical risks that emanate from climate change.** The physical risks of climate change pose a threat to Lesotho's financial sector due to vulnerability to an increase in non-performing loans. When looking at domestic credit to the private sector, or the financial resources provided to the private sector by financial corporations, Lesotho sits at 21.5 percent – a sharp increase from 5.2 percent in 2004. Financial support to MSMEs can ensure they have the liquidity needed to withstand shocks and reduce the financial sector's exposure to climatic shocks.[53]

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[51] EM-DAT: The Emergency Events Database – Universite catholique de Louvain (UCL) - CRED, D. Guha-Sapir, Brussels, Belgium. and UNHCR (2018). Lesotho Flash Update 01 – Hailstorms and Flash floods (period: March 1 2018–March 31 2018).
[52] Lesotho Climate Risk Country Profile, World Bank
[53] Analysis by the European Central Bank shows that the average default probability of the credit portfolios of the 10% of Euro area banks that are most vulnerable to climate change could rise 30% by 2050.