

AFRICAN DEVELOPMENT FUND



PROJECT: ZUNTÁMON LUSOPHONE COMPACT INITIATIVE – PHASE I

COUNTRY: DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

APPRAISAL REPORT

September 2021

Preparation Team	Team Leader	J. NDAO	Chief Entrepreneurship and SME Development Officer	AHHD.0	8381
	Co-Team Leaders	J. DE LA PEZA	Senior Governance and Economic Management Officer	ECGF	4497
		M. R. NDIAYE	Senior Investment Officer	PIFD.1	4366
		E. NABENGE	Consultant Economist	COAO/LIST	6916
	Team Members	N. FERREIRA	Principal Business Development Officer	AHCG.1	4239
		C. LIMA NETO	Operations Assistant	LIST	N/A
		P. BAPTISTA	Principal Country Program Officer	COAO/LIST	6904
		F. MATEUS	Senior Country Economist	COAO/LIST	6906
		M. GOMES	Principal Advisory Services Officer	PINS.1	4423
		L. MIRITI	Chief Gender Officer	AHGC.1	2358
		G. LIMA	Senior Operations Officer	PERN.1	1739
		A. BILALE	Regional Procurement Coordinator	SNFI.3	8443
		J.B. RAKOTONIRINA	Procurement Officer	SNFI.3	6013
		S. VIEIRA	Senior Financial Management Specialist	FIFC.4	8449
		N. MUBIMA	Legal Consultant	PGCL.1	5097
		E. KAHUBIRE	Principal Social Safeguard Officer	SNSC	8339
	C.ADENIYI	Climate Change & Green Growth Consultant	PCEG.2		
	Sector Managers	T.J. MUZIRA		AHHD.0	4555
		M. KALIF		PIFD.1	2217
		E. ODIOGO		PAIF	1770
	Country Manager	P. TOIGO		COMZ	1299
Sector Directors	M. PHIRI		AHHD	4014	
	A. COULIBALY		ECGF	2536	
	S. NALLETAMBY		PIFD	2700	
	C. ANOHU		PAIF	2153	
Director General	L. MOKADDEM		RDGS	7301	

Peer Reviewers	Chief Financial Economist	MPYISI, E.	AHAI.1	8379
	Chief Investment Officer	KYOKUNDA, G.	PIFD.1	8352
	Senior Investment Officer	OBIANAGHA. K	PITD.4	4912
	Principal Investment Officer	AREA, A.	AFAWA	8478

AFRICAN DEVELOPMENT FUND



DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

ZUNTÁMON LUSOPHONE COMPACT INITIATIVE – PHASE I

RDGS/AHHD DEPARTMENTS

September 2021

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Currency Equivalents

(June 2021)

1 UA = 1.43 USD

1 UA = 29.40 STD

1 USD = 20.56 STD

1 EUR = 24.50 STD

1 UA = 1.20 EUR

Fiscal Year

January 1 – December 31

ACRONYMS AND ABBREVIATIONS

ADF	African Development Fund	LoC	Line of Credit
AFAP	Project Administration Agency	Fiduciary MSME	Micro, small and medium enterprise
APCI	Trade and Investment Promotion Agency	NPL	Non-Performing Loan
BCSTP	Central Bank of São Tomé and Príncipe	NDC	Nationally Determined Contribution
BDS	Business Development Services	NSO	Non Sovereign Operation
BISTP	International Bank of São Tomé and Príncipe	PALOP	African Countries of Portuguese Official Language
BMO	Business Member Organisation	PBO	Policy Based Operation
CRF	COVID-19 Response Facility	PSC	Project Steering Committee
CSP	Country Strategy Paper	PIU	Project Implementation Unit
DP	Development Partner	RMC	Regional Member Country
EA	Executing Agency	SEGA	Strategy for Economic Governance in
ESO	Enterprise Support Organisation	SME	Small and medium enterprise
ESW	Economic Sector Work	SO	Sovereign Operation
FDI	Foreign Direct Investment	STP	São Tomé and Príncipe
FFM	Flexible Financing Mechanism	TYS	Ten Year Strategy
GDP	Gross Domestic Product	UA	Unit of Account
GoSTP	Government of São Tomé and Príncipe	UNDP	United Nations Development Programme
GPN	General Procurement Notice		
ILO	International Labour Organization		
ITC	International Trade Center		
JfYA	Jobs for Youth in Africa		
LC	Lusophone Compact		

Grant Information

Client's information

GRANT RECIPIENT: DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

EXECUTING AGENCY: MINISTRY OF PLANNING, FINANCE, AND BLUE ECONOMY

Financing plan

Source	Amount (Million UA)	%	Instrument
ADF Grant	7.50	100	Grant
Government	0	0	NA
TOTAL COST	7.50	100	

Important Financial Information

Grant Currency	UA
Commitment Charge/Fee	NA
Service Charge	NA
Tenor	NA
Grace Period	NA
FIRR, NPV (base case)	5%
EIRR, NPV (base case)	15%

Timeframe - Main Milestones (expected)

Concept Note Approval	April 2021
Appraisal	May-June 2021
Project Approval	September 2021
Effectiveness	December 2021
Completion	September 2025
Closing Date	December 2025

PROJECT SUMMARY

1. Project Overview: The Zuntámon Lusophone Compact Initiative Phase I Project (“Zuntámon”, “the Initiative”, and/or “the Project”) aims to improve the business environment, capacity, and access to markets and finance for SMEs, and therefore their contribution to the economy and job creation. The Project estimated at UA 7.50 million and fully funded by the ADF will focus on both islands of São Tomé and Príncipe. The Project is expected to improve access to markets and contracts for 60 growth-oriented SMEs by providing technical and business development training and access to finance that will lead to an average 10% growth in business sales by 2025. To facilitate tailored access to finance for small and medium enterprises (SMEs) under the Initiative, a government-anchored flexible financing mechanism will be designed and rolled out, which will take a blended finance approach and will be further capitalized with resources mobilized from investors across various profiles, including development finance institutions, commercial and concessional investors. In order to attract and gain additional investors’ confidence and ensure the sustainability of the financing mechanism, fundamental commercial justice system and conducive business environment challenges will be addressed through: (i) support in the establishment and operationalization of an arbitration center for commercial disputes; (ii) modernization of the legal framework for commercial disputes; (iii) streamlining business registration, licensing and MSME tax regime to incentivize formalization of businesses; and (iv) strengthening business environment reform coordination. The Project will focus its interventions on commodities and services where women and youth are economically active, such as tourism, and that have growth potential through export, namely: cocoa, coconut, horticulture products, and fish. The focus on the aforementioned commodities and services is in line with the Government of STP’s COVID-19 post-pandemic economic recovery strategies, which place great emphasis on supporting affected businesses and bolstering the recovery in key industries such as agriculture, fisheries, tourism, and hospitality. The Zuntámon Initiative is therefore a solution that seeks to unblock certain country-specific bottlenecks to private sector-led growth, while contributing towards a more resilient economy. Ultimate beneficiaries are therefore SMEs, especially women and youth-led businesses (30% of target, respectively). Other institutions include actors mandated to support investors and SMEs, such as the Trade and Investment Promotion Agency (APCI), Business Membership Organisations (BMOs)/ Enterprise Support Organisations (ESOs), financial institutions and the Central Bank of São Tomé and Príncipe (BCSTP). Project activities will be carried out through the following four components: 1) Fostering an enabling environment for SMEs, investors, and financial institutions; 2) Strengthening SMEs and SME support partners and facilitating investments to unlock value-chains; 3) Establishing facilities and financing to provide quality and affordable access to finance for SMEs; and 4) Project management. The project is expected to be implemented over four years (2022-2025), and will lay a foundation for the mobilization of additional resources of up to USD 30 million in Phase II of the Initiative from a broad range of investors, including an investment from the Bank’s non-sovereign operation (NSO) window.

2. Needs Assessment: São Tomé and Príncipe (STP) is a small island state faced with several challenges. Its economy is characterized by a narrow production base due to limited resources and capacity, as well as limited market access domestically to serve demand of the population and that of the tourism and hospitality sectors, within the region and internationally. The country’s private sector is nascent and has an estimated 9,602 Micro, Small & Medium Enterprises (MSMEs) with limited access to finance and business development services, amid high risks associated with a significant level of Non-Performing Loans (NPLs) in its banking sector amounting to 29.6% as of December 2020; further exacerbating low lender and investment confidence. Historically, the Government’s efforts to support the private sector have not been matched by a commensurate level of external investment. The COVID-19 pandemic has hit STP’s economy hard with direct repercussions on the economy’s growth, employment, debt, businesses, and value chains. The country’s real GDP growth in 2020 was registered at 3% in contrast to earlier projections, mostly as a result of increased external funding to reinforce public expenditure in response to the impact of the pandemic. On the other hand, inflation had peaked at an average of 10% in light of the pandemic and closing the year at 9.4%, mostly attributed to structural constraints in the primary sector, particularly, the supply of vegetables and fish. Growth in 2021 is however expected to slow down to 2% in 2021 mostly anchored on the delayed tourist flows due to extended travel restrictions, as well as

decreased external funds. Most informal businesses in São Tomé and Príncipe are owned by women (about 55.8%) and youth. Nationally, it is estimated that youth under the age of 35 make up over 70% of the population and represent 60% of the total unemployed labour force recorded at 13.9% as of 2020. Women-led and youth-led businesses in the informal and formal economies have been hardest hit by shocks related to the COVID-19 pandemic. The informal nature of women and youth-led businesses is a result of the cumbersome business registration processes and lack of clear incentives. Access to finance is one of the most significant challenges and is attributed to the fact that majority of women and youth do not own any asset collateral, such as land. Additionally, women and youth are more likely to be unbanked, therefore lacking active bank accounts with statements demonstrating a history of cash flow that have adequate debt service coverage ratios.

3. Bank's Added Value: The Zuntámon Initiative builds on the implementation of certain action areas of the Economic and Sector Work (ESW) conducted in support to the Government of STP for private sector development and job creation, namely, the Private Sector Development Strategy 2018-2024, the Diagnostic study on Job Creation and Capacity Building and the Youth Job Creation and Human Capacity Building Strategy "e-jovem 2022". The implementation of the Zuntámon LC Initiative will leverage the existing USD 3 million government-backed line of credit (LoC) to support businesses affected by the COVID-19 pandemic, an emergency facility hosted by the BCSTP and established in 2020 under the Bank's budget support of UA 7.5 million through the COVID-19 Rapid Response Facility. Furthermore, the Initiative will complement the Bank's ongoing support to the Government of STP in transforming the economy, while capitalizing on its investment experience of facilitating access to finance and markets for SMEs. By focusing on creating an enabling environment for SMEs and investors in STP the Project will contribute to (i) addressing the needs of the public and financial sectors to be more effective in accompanying STP's private sector; (ii) establishing the governance and operational structures for improving STP's business environment; (iii) building the capacity of SMEs in growing their businesses and their readiness for financing, including women and youth-led SMEs; (iv) unlocking key value chain efficiency and quality constraints; and (v) establishing facilities and financing to provide quality and affordable access to finance for SMEs. The Initiative also builds on the Bank's experience and success in the design and implementation of country-specific SME-targeted initiatives which provide support to ESOs and BMOs and facilitate access to finance, such as Souk At-tanmia and ANAVA (Tunisia), ENABLE Youth (e.g. Sudan and Côte d'Ivoire), Innov Invest (Morocco), the Rwanda Innovation Fund (Rwanda), MSME Business Linkage Program (Ghana), Support to Blue Economy MSMEs (Seychelles), Le Projet d'appui et de valorisation des initiatives entrepreneuriales des femmes et des jeunes - PAVIE I (Senegal), and the SME Industrial Participation Mechanism (Madagascar).

4. Knowledge Management: The multidisciplinary approach adopted in the project design integrates improving the business environment for SMEs, investors and financial institutions, while providing quality tailored capacity building support to improve SME growth and access to markets and facilitating their access to finance. This holistic approach draws on successful Bank projects on effectively supporting private sector development and provides an opportunity to build the Bank's knowledge and experience in private sector development through SMEs in small island states. Legal and market assessments as part of the design of the Flexible Financing Mechanism (FFM), will not only serve the Project but other development partners as they also focus more on supporting SME-led private sector development. The two-part design of a sovereign operation and an NSO will provide lessons learned and good practices, which will be widely disseminated for the formulation of similar operations for SME support projects.

Results Framework

RESULTS FRAMEWORK					
A	PROJECT INFORMATION				
	PROJECT NAME AND SAP CODE: ZUNTÁMON LUSOPHONE COMPACT (LC) INITIATIVE – PHASE I P-ST-H00-003			COUNTRY/REGION: SÃO TOMÉ AND PRÍNCIPE/RDGS	
	PROJECT DEVELOPMENT OBJECTIVE: Improve the business environment, capacity, and access to markets and finance for SMEs, and therefore their contribution to the economy and job creation.				
	ALIGNMENT INDICATOR (S): 1) MSMEs effect (turnover from investments); 2) Owner-operators and MSMEs provided with financial services; and 3) Direct jobs				
B	RESULTS MATRIX				
	RMF/ADOA INDICATOR	UNIT OF MEASUREMENT	BASELINE (date)	TARGET AT COMPLETION (date)	MEANS OF VERIFICATION
OUTCOME STATEMENT 1: Improved business environment for SMEs, investors, and financial institutions					
OUTCOME INDICATOR 1.1: Time to resolve commercial disputes	<input type="checkbox"/>	Days	1,185 (2020)	600 (2025)	World Bank Doing Business Report
OUTCOME INDICATOR 1.2: Quality of judicial process index score	<input type="checkbox"/>	Score	4.5 (2020)	7 (2025)	World Bank Doing Business Report
OUTCOME INDICATOR 1.3: Registered businesses	<input type="checkbox"/>	Number	3,631 (2020)	4,500 (2024)	MPFEA/INE data
OUTCOME INDICATOR 1.4: Average time spent paying taxes for a business	<input type="checkbox"/>	Hours per year	424 (2020)	250 (2025)	World Bank Doing Business Report
OUTCOME STATEMENT 2: Increased economic contribution of SMEs, including those owned by youth and women					
OUTCOME INDICATOR 2.1: Share of locally sourced contracts by large firms from SMEs, including youth-owned SMEs and women-owned SMEs	<input type="checkbox"/>	Percentage	25% (2020)	35% (2025), of which 20% are youth owned SMEs and 30% are women owned SMEs	Reports from APCI Project Progress Reports Data from Partner Value Chain Lead Firms
OUTCOME INDICATOR 2.2: Average increase in sales of SMEs by 2025	<input checked="" type="checkbox"/>	Dobra/Percentage	500,000 DB	10% increase in sales (2025)	Reports from APCI Project Progress Reports Survey of SMEs
OUTPUT STATEMENT 1: Measures to improve the business environment for SMEs, investors, and financial institutions are established					
OUTPUT INDICATOR 1.1: Cases resolved by the arbitration center	<input type="checkbox"/>	Number	0 (2021)	10 (2025)	Project Progress Reports
OUTPUT INDICATOR 1.2: Updated draft laws and regulations on commercial matters (commercial code, civil procedure code, insolvency regime) are available	<input type="checkbox"/>	Number	0 (2021)	3 (2023)	Project Progress Reports
OUTPUT INDICATOR 1.3: MSME formalization strategy and action plan drafted	<input type="checkbox"/>	Number	0 (2021)	1 (2023)	Project Progress Reports

OUTPUT INDICATOR 1.4: Digital streamlined system for tax declaration and filing for MSMEs established	<input type="checkbox"/>	Number	0 (2021)	1 (2024)	Project Progress Reports Revenue Authority
OUTPUT INDICATOR 1.5: Meetings of government and development partners on entrepreneurship, financial sector, and business environment	<input type="checkbox"/>	Number per year	0 (2021)	4 (2023)	Project Progress Reports
OUTPUT STATEMENT 2: Business and technical capacity support is provided to SMEs and SME support partners and value chain bottlenecks are unlocked					
OUTPUT INDICATOR 2.1: New advisory templates used for every transaction processed by APCI	<input type="checkbox"/>	Number	0 (2021)	At least 1 for every transaction (2025)	Project Progress Reports
OUTPUT INDICATOR 2.2: Business associations trained	<input type="checkbox"/>	Number	0 (2021)	3 (2022), including 1 youth association and 1 women's association	Project Progress Reports
OUTPUT INDICATOR 2.3: SMEs trained in improved business and technical practices, of which 30% are women-led businesses and 30% are youth-led businesses	<input type="checkbox"/>	Number	0 (2021)	60 (2025)	Reports from APCI Training reports from ESOs and partner BDS providers
OUTPUT INDICATOR 2.3: Cold chain export storage purchased for airport	<input type="checkbox"/>	Number	0 (2021)	1 (2023)	Project Progress Reports Airport Authority
OUTPUT STATEMENT 3: Structures to facilitate SMEs' access to finance are established					
OUTPUT INDICATOR 3.1: Flexible Financing Mechanism designed, integrating climate change mainstreaming	<input type="checkbox"/>	Number	0 (2021)	1 (2022)	Non-objection from Executive Agency
OUTPUT INDICATOR 3.2: MOUs signed with Fund Manager	<input type="checkbox"/>	Number	0 (2021)	1 (2022)	Non-objection from Executive Agency
OUTPUT INDICATOR 3.3. Anchor funding invested by the GoSTP in the Flexible Financing Mechanism	<input type="checkbox"/>	Amount (USD)	0 (2021)	USD 3 million (2022)	Non-objection from Executive Agency
OUTPUT INDICATOR 3.3. Financial institutions trained	<input type="checkbox"/>	Number	0 (2021)	2 (2023)	Project Progress Reports

PROJECT TIME FRAME/IMPLEMENTATION SCHEDULE¹

Year	2021		2022				2023				2024				2025			
Quarter	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
INITIAL ACTIVITIES																		
Advance Contracting Request																		
Grant negotiations and approval																		
Signature of Grant Agreement																		
Publication of the GPN																		
Project launch																		
FOSTERING AN ENABLING ENVIRONMENT FOR SMES, INVESTORS, AND FINANCIAL INSTITUTIONS																		
Modernization of legal framework (commercial code, civil procedures code and insolvency regime)																		
Digitalization of justice sector, with a specific focus on commercial dispute resolution																		
Drafting of incentive package for MSME formalization																		
Awareness raising on MSME formalization																		
Streamlining and digitalization of tax declaration and filing for MSMEs																		
Establishment of government and development partners working group on entrepreneurship, financial sector, and business environment																		
STRENGTHENING SMES AND SME SUPPORT PARTNERS AND FACILITATING INVESTMENTS TO UNLOCK VALUE-CHAINS																		
APCI Strategic and Stakeholder Engagement Plan & Relevant Templates Development																		
Capacity building and training of personnel to enhance APCI's administrative and institutional capacity																		
Development of cross-cutting Corporate Governance Code for STP for improved accountability and transparency: Code of Conduct for key institutions, including public sector inst. (APCI, CIAT, etc.) and FIs																		
Technical assistance for enhanced investment marketing, investor outreach and targeting, market facilitation and export promotion, investment facilitation, investor services and investor aftercare																		
Technical advisor(y) to reinforce APCI team																		
BDS training needs assessment and development of improved BDS technical training program																		
Recruitment of a consultant to provide capacity building and training to Women's Business Associations																		
ToT delivery to BDS providers																		
Selection framework for selection of SMEs developed																		
BDS training of SMEs by BDS providers																		
Technical training of SMEs																		
Advisory support for SMEs																		
ESTABLISHING FACILITIES AND FINANCING TO PROVIDE QUALITY AND AFFORDABLE ACCESS TO FINANCE FOR SMES																		
Carry out legal and market assessments																		
Designing of flexible financing mechanism																		
On-boarding of Fund Manager for flexible financing mechanism																		
Capitalization of flexible financing mechanism																		
Phase II: Fundraising																		
PROJECT MANGEMENT AND COORDINATION																		
Recruitment of PIU staff																		
Quarterly Progress Reports																		
Annual workplans and budgets																		
Annual financial audits																		
Mid-term review																		
Completion Report (Q1 – 2026)																		

¹ This is a general project implementation schedule. Detailed annual work schedule will be developed before the beginning of each Project Year.

REPORT AND RECOMMENDATION OF THE MANAGEMENT OF THE AFDB GROUP TO THE BOARD OF DIRECTORS ON PROPOSED GRANT FOR THE ZUNTÁMON LUSOPHONE COMPACT INITIATIVE – PHASE I

Management submits the following Report and Recommendation on a proposed African Development Fund grant of UA 7.50 million to finance the Zuntámon Lusophone Compact Initiative – Phase I.

I – STRATEGIC THRUST & RATIONALE

1.1. Project Alignment with Country Strategy and Objectives

1.1.1 The Zuntámon Lusophone Compact Initiative – Phase I Project (“Zuntámon”, “the Initiative”, and/or “the Project”) aligns with São Tomé and Príncipe’s Vision 2030, which aims to promote national cohesion, macroeconomic stability, climate change resilience as well as improved governance for private sector-driven inclusive and sustainable economic growth. It also is in line with the country’s Private Sector Development Strategy 2015-2024, particularly, (i) The adoption of appropriate legal, regulatory and institutional frameworks for a dynamic private sector; (ii) The development of sustainable infrastructure conducive to the development of economic activities; (iii) Increased productivity of inputs; (iv) Consolidated business structure; and (v) Access to dynamic markets. The Government in its National Strategic Development Plan (2020-2024) remains dedicated to improving the business environment and promoting a broad program for attracting and retaining FDI; deepening and accelerating the continuous process of improved policies for the business environment and investment attraction, in accordance with international best practices; and taking into account the relevant role that the private sector plays in the country's development process. Overall, the Project is well-aligned with the Government’s vision to create a competitive private sector for sustainable economic growth and job creation by ensuring an enabling environment, mobilizing financing, risk mitigation instruments and technical assistance, and facilitating market access.

1.1.2 The Project aligns with São Tomé and Príncipe’s Country Strategy Paper (CSP 2018-2022), particularly Pillar I, which aims to improve the business environment in order to attract private sector-driven transformation and job creation, with particular focus on the agriculture and agri-business sectors, as well as the blue economy and tourism. The Government of São Tomé and Príncipe (GoSTP) sees the proposed Zuntámon LC Initiative as critical in its COVID-19 post-pandemic economic recovery strategies, which places great emphasis on supporting affected businesses and bolstering the recovery in key industries such as agriculture, fisheries, tourism, and hospitality. The Zuntámon Initiative is an important resilience building response to São Tomé and Príncipe’s post-crisis recovery.

1.1.3 The project will also contribute to São Tomé and Príncipe’s (STP) Updated Nationally Determined Contributions (NDCs, 2021) and the country’s request is to be supported by market mechanisms with high environmental integrity, contributing to sustainable development and establishing strong incentives to harness the potential of the private sector. Zuntámon will also contribute to STP’s achievements of the Sustainable Development Goals (SDGs) particularly goals SDG8 (Decent Work and Economic Growth), and Goal 5 (Gender Equality).

1.2. Rationale for Bank’s Involvement

1.2.1 São Tomé and Príncipe (STP) is a small island state faced with several challenges. Its economy is characterized by a narrow production base due to limited resources and capacity. The economy of STP has faced significant drawbacks in recent years due to declining external inflows, electricity shortages,

and unfavorable climate patterns. In addition, the country's private sector is nascent and has an estimated 9,602 MSMEs, of which 90% are estimated to be micro and small - mostly informal - with limited access to finance, markets and business development services. Furthermore, high risks prevail associated with a significant level of Non-Performing Loans (NPLs) in its banking sector amounting to 29.6% as of December 2020; further exacerbating low lender and investment confidence. Overall, the volume of domestic credit to the private sector is estimated at 19.8% of GDP as of 2020, a significant decrease from 27% in 2016, although higher than the Sub-Saharan Africa (SSA) average of 17.3%. Historically, the Government's efforts to support the private sector have not been matched by a commensurate level of external investment.

1.2.2 The COVID-19 pandemic has hit STP's economy hard with direct repercussions on the economy growth, employment, debt, businesses, and value chain. Though real GDP did not contract in 2020 as expected due to the large amounts of financing received by STP from development partners, it is expected that in 2021 the continued impact of the COVID-19 pandemic on the tourism sector and the decline in external financing will severely affect the growth. Subdued aggregate demand from the pandemic has adversely affected hotels and restaurants, transport, construction, and manufacturing sectors, while cocoa exports were disrupted by widespread border closures internationally.

1.2.3 Formal businesses in STP as of 2020 were recorded at 3,631, dominated by male-ownership representing an estimated 76.2%. On the contrary, most informal businesses are owned by women (about 55.8%) and youth. Nationally, it is estimated that youth under the age of 35 make up over 70% of the population, of which, 60% are unemployed. Women-led and youth-led business in the informal and formal economies have been hardest hit by shocks related to the COVID-19 pandemic. The informal nature of women and youth-led businesses is a result of the cumbersome business registration processes and lack of clear incentives for formalization, particularly for micro and small businesses. Access to finance is one of the most significant challenges and is attributed to both informality and the fact that most women and youth do not own any asset collateral, such as land. Additionally, women and youth are more likely to be unbanked, therefore lacking active bank accounts with statements demonstrating a history of cash flow that have adequate debt service coverage ratios. Furthermore, limited capacity and the lack of linkages limits the competitiveness of SMEs and their room for growth across key value chains. The Government of STP sees the proposed Zuntámon LC Initiative as critical in its COVID-19 post-pandemic economic recovery strategies, which place great emphasis on supporting affected businesses and bolstering the recovery in key industries such as agriculture, fisheries, tourism, and hospitality. The Zuntámon Initiative is therefore an important resilience building response to São Tomé and Príncipe's post crisis recovery. By supporting SMEs, investee firms will benefit from capacity enhancement, tailored advisory services as well as patient capital through equity investments from the Flexible Financing Mechanism (FFM). The Institutional capacity of the Trade and Investment Promotion Agency (APCI) will also be reinforced, to aid SME support, export promotion and investor support. At the onset of Phase I and Phase II of the Zuntámon Initiative the target companies will become more profitable leading to increased employment, expanded tax income for the national and subnational government, improved household income, and reduced fragility. Phase I will focus on building the capacity of key ecosystem actors and SMEs, while establishing the structures for financing businesses in Phase II.

1.2.4 Another key binding constraint to access to finance for MSMEs, and private sector development more broadly, is the lack of confidence in key institutions charged with enforcing contracts, which leads to increased perceptions of risk and lower investment. The 2020 Doing Business report ranks STP 185th for the *Enforcing contracts* indicator, below the SSA average of 126. A case in point is a civil court

system – charged with resolving commercial disputes – which is not only slow in resolving disputes but also ineffective in enforcing its decisions. Indeed, it is estimated that it takes an average of over 3 years to resolve simple commercial disputes through the courts and decisions come either too late for effective enforcement or are not enforced at all. Moreover, the legal framework for commercial matters (i.e. the Commercial Code and the Civil Procedure Code) is outdated and archaic and does not provide the structure or mechanisms to provide legal certainty for businesses operating in today’s economy. These constraints have made commercial lenders and other investors wary of providing the financing the private sector desperately needs given the lack of legal certainty and the challenges associated with the recovery of assets following a default or the resolution of any dispute. As a result, financing for businesses, and particularly for MSMEs, is not only overly costly but in most cases rationed to the point of unavailability. Thus, addressing this issue is critical to unlocking the potential of the country’s MSMEs and this will require enhancing the efficiency and effectiveness of commercial dispute resolution mechanisms as well as putting in place a legal framework that provides certainty and confidence to all private sector stakeholders.

1.2.5 The reduced flow of external funds into the country over the past years and during the pandemic has left little to no room for the Government to respond to key bottlenecks for private sector development, including financial infrastructure. The proposed Project therefore seeks to unlock external (and patient) capital from various investor profiles, as opposed to the traditional external funding through limited grant financing. Some government initiatives in the past 5 years have included the IFC-financed risk-sharing facility with Banco Internacional de São Tomé e Príncipe (BISTP) – the largest and oldest commercial bank in STP with majority state-ownership. The Bank also supported the Government's initiative of developing a Private Sector Development Strategy (2015-2024) and provided training towards the creation of a mediation and an arbitration center.

1.2.6 The proposed project strongly aligns with the Bank’s Ten-Year Strategy (TYS), particularly in its operational focus areas (private sector development) and the promotion of inclusive growth by offering support to women and youth; the extended Human Capital Strategy for Africa (2014-2018, extended until 2021), which aims to address youth and women unemployment and underemployment by tackling low productivity predominated by the informal sector, which employs many youth and women. The Zuntámon LC Initiative is also in line with the Industrialization, Private Sector Development and Financial Sector Development Policy and Strategy (2013–2022) by supporting indigenous firms in key sectors of the economy, including agriculture, hospitality, ICT, manufacturing, renewable energy, and tourism. The target sectors are in line with the Bank’s High 5 priorities, including *Light Up & Power Africa*, *Feed Africa*, *Industrialize Africa*, and *Improve the quality of life for the people of Africa*. Similarly, the proposed initiative is aligned with sub-pillar 2.1 of the Bank’s Strategy for Economic Governance in Africa (SEGA) 2021-2025, which is focused on promoting competitiveness, investment and an improved business climate, including by supporting (i) initiatives to improve private sector access to credit and financial inclusion, (ii) streamlined regulations, processes and procedures for doing business, and (iii) gender equal environments for MSME skills, job creation and entrepreneurship development. The Initiative will contribute to job creation, including for women and youth-owned businesses, thus further aligning with the Bank’s Gender Strategy 2021–2025 as well as the Jobs for Youth in Africa Strategy 2016–2025.

1.2.7 The proposed Project is part of the Bank’s collaborative efforts under the Lusophone Compact to address country-specific bottlenecks to private sector development in the Portuguese-speaking Countries of Africa (PALOP) through innovative concepts such as the “Lusophone Compact Funding Vehicles” (“Compact Funds”). The Project directly aligns with the objectives of the Lusophone Compact

(“Compact”) in providing tailored solutions to promote inclusive and sustainable private sector development. It also is in line with the anchors of the Compact through (i) the implementation of de-risking instruments to attract private investments; (ii) mobilization of capital to support transformative projects through credit enhancement instruments; and (iii) demand-driven technical assistance to build a pipeline of bankable projects, as well as create conducive business environments. Funded by ADF, Zuntámon is in alignment with the ADF 15 Strategic framework pillars, specifically pillar II “delivering human, governance and institutional capacity to promote inclusive growth and decent job creation” and provide opportunities to the continent’s youth.

1.2.8 Given the limited size of the market in STP, the Initiative activities include a focus on enhancing the country’s access to regional markets, in line with pillar II of the Southern Africa RISP 2021 – 2026 focusing on industrialization and market integration by building the capacity of the private sector, specifically MSME capabilities.

1.2.9 Zuntámon also complements the Bank’s existing portfolio and experience in similar projects, such as Souk At-tanmia and ANAVA (Tunisia), ENABLE Youth (e.g. Sudan and Côte d’Ivoire), Innov Invest (Morocco), the Rwanda Innovation Fund (Rwanda), MSME Business Linkage Program (Ghana), Support to Blue Economy MSMEs (Seychelles), Le Projet d'appui et de valorisation des initiatives entrepreneuriales des femmes et des jeunes - PAVIE I (Senegal), and SME Industrial Participation Mechanism (Madagascar).

1.3. Donors Coordination

1.3.1 Coordination of development partners in STP is under the responsibility of the Ministry of Foreign Affairs, Cooperation and Communities. Quarterly meetings, chaired either by the Government or by the UN Resident Coordinator, are held with representatives from the Government and development partners to coordinate the implementation of respective programs and pipeline development in the country.

1.3.2 Development Partners’ (DP) ongoing activities in STP to support SME development, entrepreneurship and job creation include the ILO’s capacity building and entrepreneurship initiatives and the UNDP’s Entrepreneurship Program “Empreende Jovem” which entails incubation for youth entrepreneurship, as well as overall support in the creation of start-ups and the expansion of existing businesses, and export value chains. On the other hand, support to create an enabling environment includes UNDP’s ongoing justice system modernization project, as well as the World Bank’s support in the ongoing implementation of the Doing Business roadmap and the Financial Sector Development Implementation Plan, under which, modernization of the existing credit registry and the legal framework for a centralized establishment of a collateral registry which will include moveable assets are ongoing. The Initiative aims to complement DP activities by working with UNDP to both complement ongoing activities and foster a more inclusive and strengthened private sector. It further aims to build on the lessons drawn from previously implemented private sector development-oriented projects, such as the USD 3 million risk-sharing facility with the International Bank of São Tomé and Príncipe (BISTP), financed by the IFC.

1.3.3 Regular sector meetings are held with DPs working in public finance management, agriculture and energy sectors, for which sectoral working groups were established involving the Government and DPs. While efforts to establish donor working groups are being pursued, the UNDP, European Union, World Bank and IMF have shown interest in working with the Bank on joint programs. Examples of

such partnerships include the co-financing of the Payment System Infrastructure and Financial Inclusion Project with the World Bank, and the Energy Transition and Institutional Support Project (ETISP) with UNDP. In addition, in the wake of the COVID-19 pandemic, the Bank closely coordinated its budget support operation to support the country's response to the pandemic with the World Bank, UN and IMF.

1.3.4 However, discussions held with DPs during preparation and appraisal missions for Zuntámon highlighted the need for a private sector/MSME focused working group. Therefore, under the Project, the establishment of a coordination working group across Government and DPs on entrepreneurship, financial sector/access to finance reforms, and business environment improvements will be encouraged and supported. Zuntámon will leverage the various working groups and meetings to ensure that its approach to supporting SMEs and the private sector is complementary to that of DPs' and to benefit from feedback, avoid duplication and exploit significant potential synergies. As the project seeks to reinforce the positive impact of previous interventions and the dynamics of ongoing projects by DPs, it will partner with UNDP in the implementation of key activities under Component 1.

II – PROJECT DESCRIPTION

2.1. Project Objectives and Components

2.1.1 The goal of this Project is to improve the business environment, capacity, and access to markets and finance for SMEs, and therefore their contribution to the economy and job creation. The specific objectives are to:

- i. Enhance institutional and administrative capacity to be more effective in meeting the needs of STP's private sector and attract foreign investments;
- ii. Establish the governance and operational structures for improving STP's business environment;
- iii. Build the capacity of SMEs in growing their businesses and their readiness for financing, including women and youth-led SMEs;
- iv. Unlock key value chain efficiency and quality constraints; and
- v. Establish the structures and financing to provide quality and affordable access to finance for SMEs.

The Project will be implemented over a four-year period and comprises the four (4) project components described in Table 2.1 below.

Table 2.1: Description of Project Components

No	Component Name	Cost (UA million)	Component Description
1	Fostering an enabling environment for SMEs, investors, and financial institutions	0.62	<p>The aim of this component is to create an enabling environment to build confidence and trust in lenders, investors and other players in the private sector ecosystem, ensuring (1) the sustainability and success of the flexible financing mechanism to be designed and established in Phase I; and (2) the growth of small and medium enterprises (SMEs) in São Tomé and Príncipe.</p> <p><i>Sub-component 1: <u>Support the establishment of the arbitration center for commercial disputes.</u></i> This sub-component will focus on the operationalization of the arbitration center, with the aim of enhancing the efficiency of commercial dispute resolution to build trust among key private sector stakeholders – including lenders, investors, and borrowers – reduce perceived credit and investment risks and unlock financing for MSMEs in the country. Specifically, it will support the following activities (i) a cooperation protocol with the arbitration center in Cabo Verde to support implementation of the STP center; (ii) commercial arbitration training and awareness raising campaign for private sector stakeholders (banks, BMOs, chamber of commerce, etc.); (iii) streamlining the execution of arbitration resolutions by the judiciary system; (iv) the transfer of commercial cases delayed in civil courts to be resolved through arbitration to both address the backlog and position the arbitration center; and (v) the development of an IT system for the management of arbitration cases. These activities will be implemented in partnership with UNDP and have been designed to leverage activities already underway with the aim of maximizing and accelerating impact.</p> <p><i>Sub-component 2: <u>Updating legal framework for commercial matters.</u></i> This subcomponent aims to modernize the legal framework for commercial matters and commercial dispute resolution. A modernized framework will contribute to more legal security and trust, and increased investment. To do this, it will support the following activities: (i) updating the commercial and civil procedures code; (ii) establishing a modern insolvency and business protection framework; and (iii) training and awareness raising of key stakeholders (incl. judiciary, public administration, lawyers, banks, BMOs and chambers of commerce) on the new legal framework. These activities will also be implemented in partnership with UNDP.</p> <p><i>Sub-component 3: <u>Promoting MSME formalization and streamlining of registration and licensing procedures.</u></i> This subcomponent will promote MSME formalization, a key constraint to accessing financing, including from Zuntamón instruments. Currently, the majority of MSMEs in STP are informal, and as a result are unable to access financing from formal financial institutions and vehicles. To address this, the subcomponent will support the following activities: (i) preparing a strategy and action plan for the transition to the formal economy which identifies and addresses the key constraints to formalization; and (ii) supporting the implementation of the action plan by articulating a formalization value proposition for MSMEs, including through social protection, and streamlining tax payment, registration and licensing procedures.</p> <p><i>Sub-component 4: <u>Strengthening business environment reform coordination.</u></i> This subcomponent will provide the foundations for formal mechanisms for the coordination and implementation of business environment reforms. Currently, no such mechanisms exist, yet improving the business environment is an inherently multi-sectoral and multi-stakeholder endeavour and enhancing coordination across government agencies and development partners will be critical to Zuntamón’s success. Specifically, this subcomponent will stimulate the set up and the operationalization of a reform coordination office through the provision of a long term-advisor as well as IT and office equipment.</p>

No	Component Name	Cost (UA million)	Component Description
			UNDP will be recruited to provide key services under Component 1 given its unique expertise and existing on-the-ground capacity/networks to successfully implement justice sector reforms in line with Zuntamón timelines and specifications. Details of this are provided in Annex C.4 (<i>Technical Annexes</i>).
2	Strengthening SMEs and SME support partners and facilitating investments to unlock value-chains	1.71	<p>This component aims at strengthening the capacity of actors mandated to support investors and SMEs, while ensuring that key value-chain inefficiencies are addressed.</p> <p><i>Sub-component 1: <u>Enhanced Institutional Capacity for Investment and Trade Facilitation</u></i>. This sub-component will focus on streamlining APCI’s operations, enhancing its administrative and institutional capacity, including improving investment marketing, investor outreach and targeting, investment facilitation in resilience and low carbon projects, investor services and investor aftercare. More specifically, the component will support establishing key templates and processes for APCI to efficiently support investors and SMEs. A technical advisor to reinforce the APCI team will be recruited. The International Trade Center (ITC), which was fundamental in establishing APCI and has established tools and templates to provide technical assistance to APCI, will potentially be recruited to provide capacity building support to APCI.</p> <p><i>Sub-component 2: <u>Improving the sustainability and services of Business Membership Organizations and Enterprise Support Organizations</u></i>. This sub-component will focus on improving the business development and sustainability of business associations and the quality of the business development services (BDS) provided to their members through a training of trainers’ approach. To ensure a systematic ecosystem improvement, BDS trainers in other existing SME support programs and agencies will also be included, together with those from other DPs programs and order of accounts staff. Trained ESOs and BMOs, as part of their core business, will be responsible for training 60 growth-oriented SMEs, 30% of which will be women and youth-led SMEs, respectively. Additional capacity building support will also be included under this component with the provision of a technical advisor to reinforce the capacity of the Women’s Business Association of STP to best support and advocate for their members as well as play a key role in the national agenda for the economic empowerment of women overall.</p> <p><i>Sub-component 3: <u>Tailored advisory support and technical training for SMEs</u></i>. This sub-component will focus on improving the competitive, technical knowhow, and capacity of SMEs to meet the requirements and standards of markets and customers, drawn from the market assessment to be conducted. Through tailored technical training and advisory support, 60 SMEs will improve their competitiveness, productivity, and standards compliance. Advisory services will focus on product standards for various markets outside STP i.e, other African Countries for trading under the AfCFTA trade terms.</p> <p><i>Sub-component 4: <u>Facilitating investments to unlock value-chains</u></i>. This sub-component will focus on addressing structural and technological bottlenecks adversely impacting the growth and competitiveness of SMEs in São Tomé and Príncipe, particularly cold storage options. Therefore, key equipment that will improve the competitiveness and quality of products of SMEs will be purchased, a cold storage unit at the airport for perishable goods meant for export.</p>
3	Establishing facilities and financing to provide quality and affordable access to finance for SMEs	4.19	This component addresses challenges of SMEs in accessing finance in STP by introducing a mechanism that de-risks financial transactions by (1) reducing the financing gap of borrowers; (2) supporting sponsors to meet collateral requirements; and (3) facilitating the blending of prices to make them affordable to the borrowers. The mechanism will be endowed with concessional resources that are anchored by the Government funding (UA 3 million).

No	Component Name	Cost (UA million)	Component Description
			<p>Sub-component 1: <u>Flexible Financing Mechanism (FFM) Design.</u> This sub-component will focus on designing and establishing a blended finance (including climate risk financing) response to market needs to be fully operational with the Bank’s support in Phase II. Legal and markets assessments will inform the design of the mechanism.</p> <p>Sub-component 2: <u>Fund Manager Selection & Administration.</u> This sub-component will focus on the recruitment and on-boarding of an external private sector manager for the FFM. The Fund manager in Phase I will focus on supporting the preparation and establishment of the vehicle and fundraising. The management of the FFM requires independence, transparency, and good governance.</p> <p>Sub-component 3: <u>Anchor Funding and Fundraising.</u> This sub-component is focused on fundraising for the FFM once it is designed, and the fund management is established. As the mechanism will be seeded by government funds, allocated by the project, the soft closing will allow the fund manager to immediately deploy resources and generate further proof of concept. As part of Phase II, a first closing is to involve DFIs and other impact capital investors. It is at this stage that the Bank will look to invest from its NSO envelope in a separate operation. See paragraph 2.1.2 and Annex C.3 (<i>Technical Annexes</i>) for more information on Phase II.</p> <p>Sub-component 4: <u>Top-up of Line of Credit.</u> Given the timeline leading to the establishment of the FFM, the Government has suggested topping up the existing USD 3 million government-backed line of credit (LoC) that was designed to support businesses affected by the COVID-19 pandemic. The top-up is to be conditioned on the LoC’s performance, as well as a proven pipeline with considerations for longer term financing of investment projects. Unutilized resources from the planned LoC top-up would be reallocated to the capitalization of the FFM.</p> <p>Sub-component 5: <u>Strengthening Financial Institutions and BCSTP.</u> This sub-component will focus on training financial institutions and the BCSTP on the FFM at its design and implementation stage. It will highlight issues of co-financing, collateral financing, pipeline development, etc. Training of the BCSTP will in addition focus on oversight of the flexible financing mechanism and non-bank financial institutions.</p>
4	Project Coordination and Management	0.97	The Ministry of Planning, Finance, and Blue Economy through an established Project Implementation Unit (PIU) for Zuntámon will manage the project activities including the day-to-day management of project activities based on an adequate results measurement framework; inter-ministerial coordination and supervision of project activities; mid-term and final project reviews; and project procurement, disbursement, financial management, audit and reporting.
Total		7.50	

2.1.2 The government-anchored flexible financing mechanism to be established under the Project aims to unlock mid-to-long term commercial resources from the financial sector towards innovative projects and eligible SMEs. The Project is to set the stage for the scaling up of resources from a broad range of investors, including the Bank in Phase II, to provide patient capital, while the blended resources are to ultimately optimise the affordability of financing available.

2.2. Technical Solutions Retained and Other Alternatives Explored

2.2.1 During the design of the project, three technical alternatives were considered and rejected for their weaknesses in generating the expected impact on a sustainable basis. The technical solutions retained are based on criteria that will ensure project success and sustainability. The design of the Zuntámon is consistent with the Bank’s and DPs’ programmatic evidence that SME support projects need to be

holistic to yield sustainable businesses – the business environment and technical and business knowhow of SMEs must be improved, and access to finance and markets facilitated. Therefore, the Project has adopted an integrated approach of complementary approaches that seek to address ecosystem capacity gaps and enabling business environment issues to ensure they respond to the needs and challenges of SMEs, investors and financial institutions, while introducing a FFM that responds to the fact that SME financial needs are not homogeneous. Alternatives explored are presented in Table 2.2.

Table 2.2: Alternatives Considered and Reasons for Rejection

No	Alternative	Brief Description	Reasons for Rejection
1.	Hiring a firm to train SMEs in business knowhow	Taking into the current quality of BDSPs to serve growth-oriented SMEs in STP, hiring a firm to directly train SMEs was considered.	As Zuntámon aims to sustainably build the capacity of the entrepreneurship ecosystem – BDSPs and ESOs – developing training materials and a methodology that could be shared and used with the ecosystem actors was more sustainable and fit into the core business of existing structures versus temporarily bringing in a firm to carry out the trainings, with no knowledge transfer to BDSPs and ESOs.
2.	Limiting SME support to BDS	Providing BDS to SMEs as the main and only support	The challenges of SMEs in STP go beyond just business management knowhow, technical knowhow in production, meeting standards, and information on accessing new markets are all impediments, in addition to access to finance. Therefore, a holistic and integrated approach is necessary to maximize the growth and job creation potential of firms.

2.3. Project Type

2.3.1 The Zuntámon LC Initiative Phase I Project is an investment project financed by an ADF 15 Grant and project activities are in line with ADF 15 pillars and priorities.

2.4 Project Cost and Financing Arrangements

2.4.1 The total cost for the project activities is estimated at UA 7.50 million, including indirect taxes, duties and price contingencies. The costs are composed of UA 6.33 million (84.47%) in foreign currency and UA 1.64 million (15.53%) in local currency costs. The price contingency has been estimated at 5% of the total baseline costs. The costs were determined based on information obtained from official entities, projects implemented in STP by DPs, and similar projects implemented in other Regional Member Countries (RMCs). The tables below provide the summary of the Project costs. Detailed costs are provided in Annex B.2 (*Technical Annexes*). The tax component of the total costs is estimated at UA 0.50 million (6.7% of the total cost). The makeup of the tax component is estimated at 15% on local costs and a maximum of 30% for duties on goods. Appendice 6 addresses both the justification for

waived counterpart funding and the financing of indirect taxes, where applicable, by the GoSTP during the Project's implementation.

Table 2.3: Summary of the project cost estimates by components

Components	USD			UA		
	Local	Foreign	Total	Local	Foreign	Total
Component 1: Fostering an enabling environment for SMEs, financial institutions, and investors	126,120	714,680	840,800	88,418	501,034	589,451
Component 2: Strengthening SMEs and SME support partners and facilitating investments to unlock value-chains	374,800	1,967,700	2,342,500	262,757	1,379,476	1,642,233
Component 3: Establishing facilities and financing to provide quality and affordable access to finance for SMEs	284,476	5,405,048	5,689,524	199,435	3,789,263	3,988,698
Component 4: Project Management	786,869	524,579	1,311,448	551,642	367,761	919,404
Total Baseline Cost	1,572,265	8,612,007	10,184,272	1,102,252	6,037,534	7,139,786
Price Contingencies (5%)	78,613	430,600	509,214	55,113	301,877	356,989
Total Project Cost	1,650,878	9,042,607	10,693,486	1,157,365	6,339,410	7,496,775

Table 2.4: Project financing by source (UA)

Source	Amount UA			% of Total
	Foreign	Local	Total	
ADF Grant	6,339,410	1,157,365	7,496,775	100
Total	6,339,410	1,157,365	7,496,775	100

Table 2.5: Project cost by category of expenditure

Expenditure Account/Year	Year				Total (UA)
	2022	2023	2024	2025	
Investment costs					
Goods	1,007,996	112,000	-	-	1,119,996
Services	1,904,111	326,419	272,016	217,613	2,720,158
Miscellaneous	701,060	2,103,180	-	-	2,804,240
Total Investment Costs	3,613,167	2,541,599	272,016	217,613	6,644,394
Recurrent costs					
Salaries and allowances	145,418	181,772	181,772	218,127	727,089
Operational costs	43,618	31,156	24,925	24,925	124,624
Total recurrent costs	189,036	212,928	206,697	243,051	851,713
Total Project Cost	3,802,203	2,754,527	478,713	460,664	7,496,775

Table 2.6: Project costs by year (UA)

Components/Year	Year				Total (UA)
	2021	2022	2023	2024	
Component 1: Fostering an enabling environment for SMEs, financial institutions, and investors	402,300	123,785	92,839	-	618,924
Component 2: Strengthening SMEs and SME support partners and facilitating investments to unlock value-chains	1,379,475.76	206,921.36	137,947.58	-	1,724,345
Component 3: Establishing facilities and financing to provide quality and affordable access to finance for SMEs	1,047,033.25	2,303,473.15	418,813	418,813	4,188,133
Component 4: Project Management	289,612	241,343	289,612	144,806	965,374
Total	3,118,422	2,875,523	939,212	563,619	7,496,775

2.5 Project Target Area and Population

2.5.1 The Project will be implemented in both the islands of São Tomé and Príncipe. The total population of STP is 210,240, of which 8,778 is on Príncipe Island. The islands have vast potential in the agriculture, services (including tourism) and blue economy sectors, which account for over 70% of

economic activity. Developing value chains across the country's key economic sectors could meet the local demand for goods and services, while creating sustainable employment.

2.5.2 The Project seeks to support SME activities across the agro-processing (cocoa, palm, coconut, coffee), fisheries (inland and marine), tourism (eco- and agro-), and services sectors, where women and youth are most employed. The expected final beneficiaries are 60 SMEs, especially women and youth-led businesses (30% of target, respectively). Additionally, the project will have an impact on STP's entrepreneurship ecosystem by building the capacity of the three (3) leading business associations supporting key segments of STP's private sector population, women and youth. Enhancing the efficiency of the commercial justice system paired with the introduction of a FFM to the STP market, the financial sector will also be strengthened, including the type of innovative financial instruments to help SMEs access affordable financing. Other beneficiaries include APCI, BCSTP, financial institutions and select business development service providers, who will benefit from capacity building to better carry out their core business of supporting the private sector, especially SMEs.

2.6 Participatory Process for Project Identification, Design, and Implementation

2.6.1 During the preparation and appraisal missions, extensive virtual discussions were conducted with Government officials, relevant line ministries and agencies (Youth, Sport and Entrepreneurship; Agriculture, Fishing and Rural Development; Public Works, Infrastructure, Natural Resources and Environment; Tourism; Justice and Human Rights; and the Secretary of State for Trade and Industry), APCI, BCSTP, and other relevant stakeholders, including financial institutions and their associations, the chamber of commerce, women and youth business associations, and large private sector companies to understand their priorities, gain insights on the challenges experienced by SMEs in terms of capacity building, access to finance, and operating under a conducive environment for business growth. A roundtable discussion was also held with the tax and business registration authorities to identify the bottleneck for businesses and processing timelines. Furthermore, meetings with DPs were also held, including the EU and ILO. In-depth discussions were held with the World Bank, ITC, and UNDP to explore areas of collaboration and service delivery by both latter agencies under Zuntámon. The participatory process will continue throughout the project implementation to ensure ownership and its sustainability. An inter-ministerial Steering Committee, in addition to a Project Steering Committee (PSC), comprising actors from the Government will be set up to ensure steering, implementation and performance monitoring as well as internal control and self-assessment.

2.7 Bank Group Experience and Lessons Reflected in Project Design

2.7.1 The project design drew on lessons learned from the implementation of previous Bank interventions in STP and elsewhere, but also on experience gained in the country with projects implemented by other development partners.

2.7.2 As of 30th June 2021, the Bank’s active portfolio comprised of 8 operations, with a sector distribution as follows: (1) finance, (1) transport, (1) health, (2) energy, (2) agriculture and (1) multisector. The total amount of the portfolio stands at UA 35.7 million. Nearly 90% of the total amount of the portfolio is funded by ADF. Public-sector projects account for 100% of the total portfolio, as there are no private-sector operations. The investment operations represent 73% of the portfolio, followed by policy-based operations, accounting for 21%.

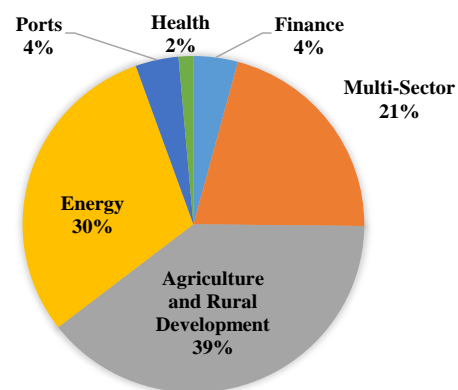


Figure 1: Portfolio distribution by sector

2.7.3 **Portfolio quality and performance.** The portfolio is relatively young with an average age of 3.17 years and a cumulative disbursement rate of 53%. All operations approved in 2020 have fulfilled conditions precedent to first disbursement. The overall portfolio performance is good with an overall rating of 2.8 on a scale of 1 to 4. The percentage of flagged operations decreased from 50% in January 2018 to 20% in June 2021. Following the CPPR survey undertaken at the end of 2020, the key issues undermining portfolio performance included weak fiduciary capacity and poor quality-at-entry, which has hampered the speed at which some of the projects are implemented, particularly the newly approved operations. Delayed project implementation, slow procurement and disbursement, lack and/or untimely availability of counterpart funds, inadequate project sustainability and lack of ownership of results are major concerns requiring attention to improve performance. These issues have been carefully assessed and taken into account as part of the design of the Initiative and implementation arrangements.

2.7.4 The Zuntámon initiative builds on the implementation of some key action areas of the Economic and Sector Work (ESW) conducted in support to the Government of STP for private sector development and job creation, namely, the Private Sector Development Strategy 2018-2024, the Diagnostic study on Job Creation and Capacity Building and the Youth Job Creation and Human Capacity Building Strategy "e-jovem 2022". The implementation of the Zuntámon LC Initiative will leverage the existing government-backed LoC to support businesses affected by the COVID-19 pandemic. The emergency facility hosted BCSTP was established in 2020 with the Bank’s budget support of UA 7.5 million through the COVID-19 Rapid Response Facility. Furthermore, the Initiative will complement the Bank’s ongoing support to the Government of STP in transforming the economy. The Initiative could also play an anchoring role alongside the Bank’s Energy Transition and Institutional Support Project (ETISP) approved in March 2020 which seeks to promote green growth and sustainable development of the energy sector, by strengthening institutional capacity for improved governance and an enabling environment for private investments and exports. Paired with the ongoing Payment System Infrastructure and Financial Inclusion Project, access to finance is expected to improve as well as increased foreign receipts on supported projects with tourism services and export capacity of goods.

2.7.5 The main lessons from the current LoC, under the COVID-19 Response Facility (CRF) Policy Based Operation (PBO), that have been incorporated in the design of the proposed project and STP portfolio management applied to the project are described in Table 2.7.

Table 2.7: Lessons learned and reflected in project design

No	Lessons Learnt	Actions incorporated in the Project design
1.	Actively engage the Government in the design of operations.	Throughout the preparation and appraisal missions, various meetings and roundtables were held with a diverse set of ministries to ensure that the project was designed considering the priorities and guidance of the Government. Deliberate efforts were also made to equally inform authorities of Príncipe.
2.	Provide relevant frequent training and support to the PIU to facilitate project and fiduciary implementation, considering the country's small market size context and language barriers.	The Bank will carry out an in-depth kick off workshop and regular annual fiduciary clinics and hands-on training activities to ensure strengthened capacity in procurement and financial management in the Zuntámon PIU.
3.	Capacity building APCI to better serve the beneficiaries and in general, the country's private sector and investors.	As part of the design of Zuntámon, sub-component 2.1 is dedicated to building APCI's capacity – from its organization structure, IT systems to having an advisor work alongside the team.
4.	Technical assistance and capacity building of SMEs, including project preparation, advisory and coaching for SMEs.	The services provided to SMEs will be holistic and comprehensive to ensure their readiness for growth, to access financing, and new markets as well. This will include BDS training, technical training, and tailored advisory support.

2.8. Project Performance Indicators

2.8.1 Key performance indicators to be measured throughout the lifecycle of the project are presented in the Results Framework. Regular implementation progress will be measured through quarterly progress reports, and annual technical and financial audits. Efforts will be made to ensure gender-disaggregated data at every level and where applicable. To this end, a monitoring and evaluation (M&E) specialist will be recruited within the PIU to ensure the measurement of the logical framework indicators in relation to the services provided by ITC, UNDP, BMOs/ESOs, the Fund Manager and partners involved in the project's implementation. The monitoring framework will consist of the impact, outcome, and output indicators defined in the logical framework and representing sex-disaggregated and gender sensitive data. The PIU will prepare and submit quarterly progress reports according to the format and procedures of the Bank. The M&E specialist of the PIU will carry out the internal project monitoring and evaluation in collaboration with the other PIU staff, service providers, as well as the corresponding AFAP officers covering environment, climate change, gender and social safeguards, to monitor the performance of the project. The Bank will conduct a Mid-Term Review in year 3 and prepare a Project Completion Report during the 3-month project close out. The monitoring and evaluation system will be informed by periodic implementation reports and surveys.

2.8.2 The main indicators defined for monitoring the project outcomes are (i) Number of days to resolve commercial disputes; (ii) Improved quality on judicial process index score; (iii) Number of registered businesses; (iv) Hours spent by a business to pay its taxes; (v) Increase in average sales of SMEs by 2025; and (vi) Share of locally sourced contracts by large firms from SMEs, including youth and women-led SMEs. At output level, some of the indicators include (i) Number of cases resolved by the arbitration center; (ii) Number of digitalized and streamlined tax declaration and filing systems; (iii) Number of business associations trained; (iv) Number of SMEs trained, of which 30% are women-led businesses and 30% are youth-led businesses; (v) Number of cold storage units at airport; and (vi) Number of sustainable financing mechanisms integrating climate change mainstreaming. The M&E specialist of the PIU will carry out internal project monitoring and evaluation in collaboration with the

other PIU staff to monitor the performance of the project. Regular implementation progress will be measured through Quarterly Progress Reports and annual technical and financial audits. Disaggregated data will be captured at every level and where applicable. The overall effectiveness of the project at implementation will be monitored through the Bank’s bi-annual supervision missions (virtual and field). The Mid-Term Review will be undertaken in year 3, while the Project Completion Report will be prepared during the 3-month project close out.

III – PROJECT FEASIBILITY

3.1. Economic and Financial Performance

FIRR (base case)	5%
EIRR (base case)	15%

3.1.1 A financial assessment of the project was undertaken using cost-benefit analysis of Zuntámon phase I, which intends to build the conditions for success of the funds with its components 1 and 2, and with its component 3, which establishes the flexible financing vehicle (FFM) that is expected to be endowed with an equity facility. The Assumptions that serve for the basis of the calculation are (1) the number of portfolio companies (15-20), (2) the size of the fund USD 30-50 (<\$100 mln), and (3) the impact orientation of the fund. The returns of the FFM should be at par with comparable initiatives as well as historical returns for similar funds. These numbers only consider the equity facility of the FFM planned in this project, however, the complementing loan facilities should improve the return profiles for the investors. Further assessment will be conducted by the selected fund manager and will be captured in the fund documentation prior to any disbursements by the Zuntámon project and any other fundraising activities.

3.1.2 In real terms, the project will lead to many tangible benefits, including improved governance, enhanced support instruments and resource mobilization for private sector development, enhanced competitiveness of SMEs and the export value chain, improved efficiency and capacity of public institutions to serve the private sector and a more robust entrepreneurial ecosystem. Furthermore, this Project will serve as a model to other African Lusophone countries and RMCs as a whole, on integrated and innovative SME support programs to accelerate private sector development and sustainable job creation. Tax returns from investees are also to positively contribute to the Government’s revenue and domestic mobilization efforts.

3.2. Environmental and Social impacts, Climate Change and Gender

3.2.1 **Environmental and Social impacts:** In regard to category, the investment is classified Category 3 in line with the Bank’s ISS. The justification for this category is that the investment, that involves technical assistance and capacitation, triggers minimal impacts on the environment and people. The investment therefore does not require safeguard documentation, nor does it trigger disclosure requirements.

3.2.2 **Climate Change and Green Growth:** Due to its nature and using the Bank’s Climate Change Safeguard System, the operation is classified as Category 2. Indeed, the Republic of São Tomé and Príncipe being a small development island is frequently exposed to droughts and floods with enhancing likelihoods by 2030 (CIMA, UNISDR, 2018). Although having a National Strategy for Adaptation to Climate Change (SNACC, 2007), an investment code adopted in 2017, STP does not have a regulatory framework and incentives to promote green entrepreneurship; investment compliance to build climate

resilience and enhance the benefits of its natural capital and ecosystems services. Therefore, the operation through enabling financial access to MSMEs will likely be exposed to climate-related financial risks in the absence of enhancing their investment resilience to physical climate risks. Meanwhile, the operation will take the opportunity to improve access to financing climate-proof activities and enterprises with a green business model. It will also ensure that as part of the technical capacity building, businesses are introduced to climate-compatible technologies and low carbon production systems. As part of facilitating investments to unlock value-chains, the Project will ensure to purchase and invest in climate resilience and low carbon footprint equipment and technologies, such as renewable and solar-powered equipment. Overall, the project is aligned with the Bank Climate Action Plan (CCAP), and 75% of the budget accounts directly and indirectly for climate finance, particularly adaption finance.

3.2.3 Social Issues

3.2.3.1 As of 2020 unemployment was estimated at 13.9% with youth representing 60% of the unemployed and highest in urban areas. Most of the population is engaged in small scale agriculture and fishing. For those employed in the formal sector, the services, agriculture and industry sectors account for 62.5%, 19.1% and 18.4% respectively. Approximately one-third of the population lives below the poverty line of \$1.90 per day, with poverty higher in urban areas. As the country's labour market is unable to absorb the educated youth entering the market every year, approximately one-third of youth with some post-secondary education are living below the poverty line. STP's Human Development Index value for 2019 was 0.625, placing it in the medium human development category; however, its average is below that of other countries in the category. Much of STP's challenges stem from it being a small island state, its limited population and active labour force constrain its ability to produce efficiently to meet local demand in goods and services, especially food.

3.2.3.2 The Zuntámon project will bring forth positive social and economic benefits – improving private sector growth and economic opportunities for women and youth, while challenging existing risk averseness for investing in STP and its SMEs. The benefits will include among others: (i) enhanced employment opportunities; (ii) increased revenue for SMEs; (iii) improved incomes for women and youth; (iv) improved living standards; (v) improved national income through increased exports and formalized businesses; and (vi) improved industrialization through processing and value addition.

3.2.4 Gender

3.2.4.1 The Project is expected to produce significant gender impacts, targeting 30% of women led businesses out of the total project beneficiaries, which is approximately 20 SMEs, as well as technical assistance for the Women's Business Association. Despite significant progress towards women rights more work remains to be done in other to achieve gender equality and empower all women and girls in the country. As per São Tomé and Príncipe's 2019 report on the implementation of the Beijing +25 Declaration and Platform for Action, poverty affects 71.3% of women compared to 63.4% of men and seems to be negatively associated with education levels and employment status. Moreover, the lack of access to quality education, finance, public services, and social protection is regarded as being the main cause for the increased number of women in the informal sector. The ongoing global COVID-19 pandemic has caused the discontinuity of many women-led and youth-led informal businesses. The informal business discontinuity has caused an increase in household poverty by 49.4%. Building on the National Strategy for the Promotion of Gender Equality and Equity (ENIEG III), the Government has committed to elaborating a National Action Plan on Women's Economic Empowerment and Financial

Inclusion. The ENIEG III recommends the fostering of a conducive and inclusive business environment nationwide, supporting women-led entrepreneurship through capacity building programs and technical assistance to ensure the success of instruments designed to meet gender-specific requirements.

3.2.4.2 Access to finance is one of most significant challenges and is attributed to the fact that most women and youth do not own any asset collateral, such as land. Additionally, women and youth are more likely to be unbanked, therefore lacking active bank accounts with statements demonstrating a history of cash flow that have adequate debt service coverage ratios. The most common source of credit is solidarity credit systems, but these can only lend small amounts of funds which are insufficient for business growth and transformation. The Women's Business Association of São Tomé and Príncipe has recently been revived after being dormant for fifteen years. The Project will provide required technical assistance and capacity building to the Association and its members in business management to grow their operations and business pitching to potential financiers and investors. The provision of a technical advisor is also foreseen to reinforce the Women's Business Association of São Tomé and Príncipe, to ensure among other functions, enhanced capacity to support and advocate for its members, as the Government implements women economic empowerment initiatives.

3.2.4.3 According to the Gender Marker System of the Bank, the project is classified as Category II. It is expected to contribute to the growth of women owned businesses by providing technical assistance to entrepreneurs.

IV – IMPLEMENTATION

4.1. Implementation Arrangements

4.1.1 The Project will be implemented over a period of 4 years. The Ministry of Planning, Finance, and Blue Economy will be the Executing Agency (EA). A PIU comprised of a Project Coordinator, Procurement Specialist, an Assistant Accountant, and M&E Specialist with the appropriate qualifications and professional experiences will be recruited. An international procurement consultant who will support the local procurement expert for two (2) years will be recruited. A multi-sector Project Steering Committee (PSC) will be set up and chaired by the Ministry of Planning, Finance, and Blue Economy. The composition of the PSC will be the Investment Promotion Agency (APCI), BCSTP, Ministries of, Sport and Entrepreneurship; Agriculture, Fishing and Rural Development; Infrastructure and Natural Resources; Tourism; Justice and Human Rights; and of Trade and Industry, the Chamber of Commerce, Association of Banks of São Tomé and Príncipe, Women and Youth Business Associations, and representatives from Príncipe. The PSC will meet every quarter. The inter-ministerial committee will also meet every quarter, prior to the PSC quarterly meeting.

4.1.2 *Service Providers:* 1) UNDP through direct contracting by the GoSTP will be responsible for delivering activities under sub-components 1 and 2 of Component 1. This arrangement with UNDP will leverage the current foundational work of UNDP to facilitate the establishment of the arbitration center and updating the legal framework for commercial matters. This arrangement will therefore allow the Zuntámon to achieve results in the legal framework and improve the business environment within the timeframe of the Project. 2) ITC through an MOU with the GoSTP could deliver activities under sub-components 1 and 2 of Component 2. Annex C.4 (*Technical Annexes*) provides, respectively, an overview of UNDP and ITC and their work in São Tomé and Príncipe and comparative advantages.

4.1.3 *Project Readiness*: In preparing the project, measures were put in place to ensure timely start-up, including compliance with the Bank’s Presidential Directive (PD 02/2015) on disbursement. The measures include the use of advance contracting and prompt preparation of tender documents to fast track project implementation, particularly legal and market assessments, the design of the FFM, and onboarding of the Fund Manager. The temporary use of the already existing Project Administration Fiduciary Agency (AFAP) within the Ministry of Planning, Finance, and Blue Economy will ensure timely commencement of project implementation.

4.1.4 **Procurement Arrangements**: Procurement of goods, non-consultancy services and the acquisition of consulting services, financed by the Bank for the project, will be carried out in accordance with the “Procurement Policy for Bank Group Funded Operations”, dated 2015 and following the provisions stated in the Financing Agreement. Specifically, Procurement would be carried out following:

- i. **BPS – Recipient Procurement System**: The BPS shall not be used for any goods, works or consulting services contracts financed by the Bank except for miscellaneous operational costs.
- ii. **Bank Procurement Policy and Methodology (BPM)**: Bank Standard Procurement Methods and Procedures (PMPs), using the relevant Standard or Model Solicitation Documents (SDs), for contracts that are either: (i) above the thresholds indicated in Annex B5, Para. B.5.3.2, or (ii) in case BPS is not relied upon for a specific transaction or group of transactions; and (iii) in case BPM have been found to be the best fit for purpose for a specific transaction or group of transactions.
- iii. **Third Party Procurement Methods and Procedures (TPMPs)**: Third Party PMPs, using the relevant Third-Party Standard or Model Solicitation Documents will be used for some activities under Component 1 to be implemented by UNDP.

4.1.5 **Procurement Risks and Capacity Assessment (PRCA)**:

The assessment of procurement risks at the Country, Sector, and Project levels and of procurement capacity at the Executing Agency (EA), has been carried out and the output were used to guide the decision on the choice of the procurement regimes (BPS, Bank or Third party) being used for specific transactions or groups of similar transactions under the project. The appropriate risks mitigation measures have been included in the action plan indicated in the technical annexes of the project evaluation report. At the time of project appraisal, weaknesses in the national public procurement system remain as the country continues to use the Procurement Law No.08/2009 of 26 August 2009, which is outdated and does not guarantee a clear separation between the activities of regulation and control of the operations of public procurement. The last evaluation of the procurement system (2020-interim RACI) qualified the risk as "**substantial**".

4.1.6 **Summary of the Procurement Arrangements for the Project**. The procurement arrangements for the various components, elements, and items, under the different expenditure categories to be financed by the Project are summarized in technical annexes. Details of each group of similar transactions/contracts, the different PMPs, estimated costs, oversight requirements, and the timeframe as agreed between the Recipient and the Bank, are documented in the Procurement Plan.

4.1.7 *Advance Contracting*: Advance Contracting procedures for the procurement of goods and services shall be used in order to accelerate implementation of the proposed Project, including for the recruitment of PIU staff, the firm to carry out market and legal and assessments and design the FFM, the

consultant to develop the operations manual, and to establish the service provision arrangements with UNDP.

4.1.8 Financial Management and External Audit:

The Ministry of Finance and Planning and Blue Economy has in place a Fiduciary Agency for the Administration of Projects (AFAP) which will be the executing agency of the project and will therefore have the responsibility for the financial management aspects. The EA has an adequate structure to secure management of projects funded by development partners. The Institutional and financial arrangements of the project is appropriate. The PIU will recruit an Assistant Accountant, with the specific and adequate qualifications and professional experience, who will be part of the finance team comprising the FM Expert from AFAP, who is already an integral part of AFAP and already designated as the focal point with which the Bank will have direct contact and an experienced Accountant already in place and part of the project team. The FM Expert will take care of the financial management of the project under the supervision of the Project Coordinator.

The project would be required to design and prepare a financial procedures manual with respect to all the critical financial management operations including budgeting, budgetary controls, internal controls, accounting, financial reporting, external audit arrangements, transaction processing, payment approvals, disbursements and controls over operating expenditure. In accordance with the AfDB's financial reporting and audit requirements, the project would prepare and submit annual financial statements, audited by an independent private audit firm, recruited in accordance with the Terms of Reference approved by the Bank. The Auditor shall issue an opinion together with a management letter to the Bank not later than six (6) months after the end of the financial year. The cost of audit would be financed from the loan/grant resources.

The project would also be required to prepare and submit to the AfDB an unaudited interim financial report no later than 45 days after the end of each calendar quarter. The quarterly financial reports will include a statement of sources and uses of funds, with the uses of funds analysed by activities/components and categories as well as the comparison of actual versus budgeted expenditure together with the explanations of significant expenditure variances.

4.1.9 Disbursement Arrangement:

The project would make use of the Bank's various disbursement methods including (i) Direct Payment, (ii) Special Account (SA) and (iii) Reimbursement methods in accordance with Bank rules and procedures as laid out in the Disbursement handbook as applicable. The Project will open a Special Account in a bank acceptable to the Bank to receive the proceeds of the grant/fund aimed at funding the operating expenditures. The Special Account will be used to meet the smaller eligible expenditure items while the direct payment method will be used for larger contractual payments eligible under the financing agreement. Disbursements into the Special Account will be based upon periodic requests based on approved work plans and budgets. The special account operates in accordance with the Disbursement Handbook. Suspension of Disbursement: Suspension of disbursement of the funds can take place in accordance with the Bank's disbursement regulations contained in the Disbursement Handbook.

4.2. Monitoring

4.2.1 The Zuntámon Project will be monitored using KPIs at input, output, and outcome levels reflected in the logframe. Overall responsibility for M&E will rest with the Project PIU, who will put in place an adequate M&E system and monitor all the activities and prepare periodic reports, highlighting implementation progress, fiduciary and procurement status, stakeholder participation, risks and mitigation measures. The PIU will prepare quarterly progress reports according to the format and procedures of the Bank. The monitoring will ensure data is by age and gender at every level. The Bank through the Southern Africa Regional Development & Business Delivery Office and the STP Liaison Office will closely monitor the implementation of the program and will carry out at least two (2) supervision missions (in country or virtually) annually, including FM and procurement assessments reviews. In addition, the Bank will also carry out a mid-term review of Zuntámon at year 3 and a program completion report will be prepared during the 3-month close out of the Project.

Activity	Responsible Entity	Timeframe
Appraisal	ADF	May – June 2021
Negotiations	Government/ADF	August 2021
Project Approval	ADF	September 2021
Signature of Grant Agreement and effectiveness	Government/ADF	October
Fulfilment of 1 st Disbursement Conditions	ADF	January 2022
Project Launch	ADF/ Government/PIU	February 2022
Service Delivery	PIU/UNDP/Fund Manager	January 2022 – December 2025
Mid-term Review	ADF/Government/PIU	January 2024
Completion Report	ADF/ Government/PIU	December 2025 or when 85% disbursement rate achieved
Auditing	Government/PIU	Annually

4.3. Governance

4.3.1 São Tomé and Príncipe is a politically stable country and a model of democratic alternation in the region. However, STP has seen a deterioration of its policy and institutional environment in recent years. The country's score in the Bank's Country Policy and Institutional Assessment (CPIA) fell from 3.35/6 in 2015 to 3.24/6 in 2016 and 3.13/6 in 2018 – well below the African average of 3.6/6. Indeed, the country has fallen below the threshold of 3.2/6, which is deemed a key indicator of institutional fragility. The fall in the overall score was driven by a decrease in scores across 4 of 5 clusters, with particularly steep falls in Economic Management – from 4.17 in 2015 to 3.5 in 2018 – and Governance – from 3.50 in 2015 to 3.28 in 2018. In contrast, according to the Mo Ibrahim Index of African Governance (IIAG), overall governance in the country has improved gradually in the last decade, with the country obtaining an overall score of 60.4/100 in 2019, up from 57.6 in 2010. While this is above the continental average of 50/100, São Tomé and Príncipe saw a fall in its ranking from 10th in 2010 to 12th in 2019. On Transparency International's Corruption Perception Index, it ranked 63rd out of 180 countries in 2020. Zuntámon will contribute to strengthened institutions for economic governance through component one activities aimed at strengthening the justice system and the policy environment for private sector development, and particularly in terms of strengthening the rule of law, property rights and creating a stable and conducive environment for businesses. These activities will also serve to not only directly mitigate the governance-related risks to implementation of component three, as well as phase 2 of the initiative, related to the creation of financing vehicles for MSMEs, but are key in creating the sound legal and policy framework for their success.

4.4. Sustainability

4.4.1 Zuntámon’s activities such as the introduction and establishment of a FFM and programmatic measures that will enhance the quality of services provided entrepreneurs during and long after the Project will sustainably support the financial and entrepreneurship ecosystem in STP. APCI, BDSPs, ESOs, and BMOs will be equipped with the knowhow, systems, and operational management support to provide investors or members with quality services in a more efficient manner; in addition, their staff will be trained. The FFM will be supported in Phase II to grow in order continue to serve entrepreneurs, including women and youth entrepreneurs, beyond the lifetime of Phase I and Phase II. In addition, establishing and building the capacity of the PIU on planning, delivery, and monitoring of private sector programming will provide the necessary knowledge, experience, and ownership for successfully managing an SME focused program beyond the Project lifespan. Another key area of the Project’s sustainability is the establishment of the business environment reform coordination office to ensure a synchronized and complementary approach between the government and amongst development partners.

4.4.2 Stakeholder consultations undertaken during the identification, preparation, and appraisal confirmed the commitment of the GoSTP, the private sector, and the financial sector. Consultations with the financial sector highlighted the need to provide investors with confidence to invest in STP and to provide banks with assurances of adequate legal recourse. The Project took this into account in the design of Component 1. In addition, consultants with MSMEs and trade and business associations underscored competitiveness and capacity issues for businesses and organisations to grow. Zuntámon will provide under Component 2 technical and advisory training to SMEs and institutions mandated to support SMEs, while also addressing competitiveness and quality issues of STP products by purchasing a cold storage unit for the airport – therefore facilitating exports and improving the quality of products being exported. The ownership of the project shall be maintained through the PSC and inter-ministerial committee comprised of key stakeholders who are committed to seeing SME led private sector growth contribute to the country’s economic growth and job creation, especially for women and youth. The GoSTP’s objective under the Project is consistent with their overarching vision to create a competitive private sector for sustainable economic growth and job creation by ensuring an enabling environment, mobilizing financing, risk mitigation instruments and technical assistance, and facilitating market access.

4.5 Risk Management

4.5.1 In addition to the fiduciary and current low confidence of investors and financial institutions risks discussed in the preceding sections of the Project Appraisal Report, the Project could face other potential risks in the execution of the Project. The overall implementation risk is assessed as ‘moderate to substantial’. The Bank has identified all the risks that are likely to arise and have proposed mitigation measures to address them considering lessons learnt from the on-going projects in STP and based on lessons learned in other RMCs. Specific risks and their appropriate mitigation measures are detailed in Appendix 4. Close supervision coordinated with other DPs will ensure continuous monitoring of risks throughout the implementation period.

4.6 Knowledge Building

4.6.1 The Project will contribute to the knowledge for holistically supporting SMEs, especially in small island states. Lessons learned from two parts SO and NSO will serve other RMCs seeking to innovatively address the question of facilitating access to finance for SMEs and their growth. The knowledge obtained

will be captured through regular supervision, progress reporting and mid-term review, and as part of program completion report (PCR) preparation process, documented and shared within the Bank and with other DPs and RMCs. The Bank will share this knowledge with other development partners and stakeholders engaged in SME-led private sector development in STP. As an operation in line with the LC, learnings from Zuntámon will serve other Lusophone countries seeking to design and implement SME support projects building on the Compact Funds approach.

V – LEGAL FRAMEWORK

5.1. Legal instrument

5.1.1 The legal instrument for the proposed ADF grant to the Democratic Republic of São Tomé and Príncipe (the “Recipient”) is an ADF Protocol of Agreement between the Fund and the Democratic Republic of São Tomé and Príncipe for an ADF Grant of Seven Million Four Hundred and Ninety Thousand Units of Account (UA 7,490,000).

5.2. Conditions associated with the Fund’s intervention

5.2.1 Conditions precedent to Entry into Force

The Protocol of Agreement shall enter into force on the date of signature by the Fund and the Grant Recipient as indicated in Section 10.1 of the General Conditions Applicable to Protocols of Agreement for Grants of the African Development Fund.

5.2.2 Conditions precedent to First Disbursement

In addition to the provisions relating to entry into force of the Protocol of Agreement, the obligation of the Fund to make the first disbursement of the Grant shall be subject to the satisfaction of the following condition by the Recipient:

- i. Submission of evidence of the establishment of a Project Implementation Unit (PIU) composed of the following key members: (i) a Project Coordinator and (ii) an Assistant Accountant, with qualifications and experience that shall be acceptable to the Fund.

5.2.3 Other Conditions

The Recipient undertakes to:

(i) Recruit /designate a Procurement Specialist, a Monitoring & Evaluation Specialist and all other personnel required for the PIU within the first three months of disbursement; and

(ii) Establish a Project Steering Committee within the first three months of disbursement composed of the Ministry of Planning, Finance, and Blue Economy as the chair, the Investment Promotion Agency (APCI), BCSTP, Ministries of, Sport and Entrepreneurship; Agriculture, Fishing and Rural Development; Infrastructure and Natural Resources; Tourism; Justice and Human Rights; and of Trade and Industry, the Chamber of Commerce, Association of Banks of São Tomé and Príncipe, Women and Youth Business Associations, and representatives from Príncipe.

5.3. Compliance with Bank Policies

5.3.1 This project complies with all applicable Bank policies. It is however important to note that, in accordance to the Policy on Expenditures Eligible for Bank Group Financing, it is proposed that the resources of the grant be used to finance indirect taxes and duties under the Project. As required by the Policy, the justification for this proposal is contained in Appendice 6, section 6.

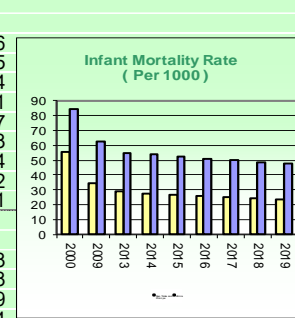
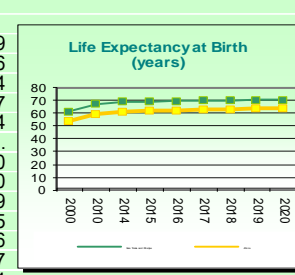
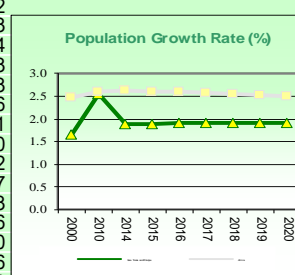
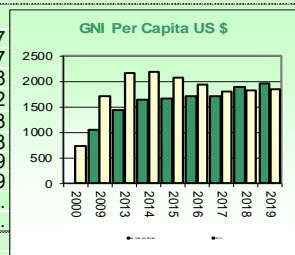
VI – RECOMMENDATION

6.1 Management recommends that the Board of Directors approves: (i.) the proposed ADF-15 grant of UA 7.50 million to the Democratic Republic of São Tomé and Príncipe for the purposes of this project and subject to the conditions stipulated in this document; and (ii.) the use of the grant resources for financing of indirect taxes and duties under the Project in accordance with the Policy on Expenditures Eligible for Bank Group financing.

Appendix 1: São Tomé and Príncipe – Comparative Socio-economic Indicators

Sao Tome and Principe COMPARATIVE SOCIO-ECONOMIC INDICATORS

	Year	Sao Tome and Principe	Southern Africa	Africa	Developing Countries
Basic Indicators					
Area ('000 Km²)	2020	1	6,571	30,067	94,557
Total Population (millions)	2020	0.2	213.2	1,338.8	6,437.7
Urban Population (% of Total)	2020	74.0	50.0	43.8	50.8
Population Density (per Km²)	2020	228.3	32.8	45.6	67.2
GNI per Capita (US \$)	2019	1 960	2 814	1 843	5 093
Labor Force Participation *- Total (%)	2020	55.4	68.5	61.3	58.3
Labor Force Participation ** - Female (%)	2019	41.6	62.7	55.8	45.9
Sex Ratio (per 100 female)	2020	100.2	96.8	99.9	106.9
Human Develop. Index (Rank among 189 countries)	2019	135
Popul. Living Below \$ 1.90 a Day (% of Population)	2007-18	35.6	45.5	34.4	...
Demographic Indicators					
Population Growth Rate - Total (%)	2020	1.9	2.3	2.5	1.2
Population Growth Rate - Urban (%)	2020	3.2	3.2	3.6	2.3
Population < 15 years (%)	2020	41.8	38.9	40.4	27.4
Population 15-24 years (%)	2020	19.9	19.3	19.3	16.3
Population >= 65 years (%)	2020	3.0	3.6	3.5	7.3
Dependency Ratio (%)	2020	81.0	73.8	78.1	54.6
Female Population 15-49 years (% of total population)	2020	23.5	25.2	24.2	25.1
Life Expectancy at Birth - Total (years)	2020	70.6	63.7	63.8	71.0
Life Expectancy at Birth - Female (years)	2020	73.0	66.6	65.6	73.2
Crude Birth Rate (per 1,000)	2020	30.8	30.4	32.6	19.7
Crude Death Rate (per 1,000)	2020	4.7	7.8	7.8	7.3
Infant Mortality Rate (per 1,000)	2019	23.5	41.0	47.9	30.6
Child Mortality Rate (per 1,000)	2019	29.8	57.0	69.5	41.0
Total Fertility Rate (per woman)	2020	4.2	3.8	4.3	2.6
Maternal Mortality Rate (per 100,000)	2017	130.0	245.8	432.3	231.0
Women Using Contraception (%)	2020	44.5	54.6	39.1	59.1
Health & Nutrition Indicators					
Physicians (per 100,000 people)	2010-18	5.3	48.0	33.4	127.9
Nurses and midwives (per 100,000 people)	2010-18	192.4	102.1	107.8	247.6
Births attended by Trained Health Personnel (%)	2010-18	92.5	73.5	64.7	79.4
Peop. Using at least basic drinking water services (% of Pop.)	2017	84.3	69.5	66.3	87.7
Peop. Using at least basic sanitation services (% of Population)	2017	43.0	44.6	40.3	68.4
Percent of Adults (aged 15-49) Living with HIV/AIDS	2019	...	11.3	3.1	...
Incidence of Tuberculosis (per 100,000)	2019	114.0	382.2	198.2	152.0
Child Immunization Against Tuberculosis (%)	2019	95.0	83.8	81.0	88.0
Child Immunization Against Measles (%)	2019	95.0	75.6	71.9	84.9
Underweight Children (% of children under 5 years)	2010-19	8.9	13.4	18.1	14.5
Prevalence of stunting	2010-19	36.9	31.6	32.4	23.6
Prevalence of undernourishment (% of pop.)	2018	12.	20.3	15.1	9.7
Current health expenditure (% of GDP)	2018	6.3	6.8	5.2	5.4
Education Indicators					
Gross Enrolment Ratio (%)					
Primary School - Total	2010-20	106.8	114.9	101.0	101.6
Primary School - Female	2010-20	105.0	112.9	98.8	100.5
Secondary School - Total	2010-20	89.3	63.0	53.5	72.4
Secondary School - Female	2010-20	95.9	58.8	50.5	72.1
Primary School Female Teaching Staff (% of Total)	2010-20	54.9	59.3	49.2	63.7
Adult literacy Rate - Total (%)	2010-18	92.8	81.7	67.9	84.3
Adult literacy Rate - Male (%)	2010-18	77.6	78.7	73.5	88.4
Adult literacy Rate - Female (%)	2010-18	89.5	79.4	61.7	80.2
Government expenditure on Education (% of GDP)	2010-19	5.1	5.7	4.8	4.1
Environmental Indicators					
Land Use (Arable Land as % of Total Land Area)	2016	9.1	6.1	8.0	11.3
Agricultural Land (as % of land area)	2016	50.7	55.7	38.2	38.3
Forest (As % of Land Area)	2016	55.8	30.9	13.2	31.9
Per Capita CO2 Emissions (metric tons)	2016	0.6	2.9	1.1	3.4



Sources : AfDB Statistics Department Databases; World Bank: World Development Indicators; last update : March 2021
 UNAIDS; UNSD; WHO, UNICEF, UNDP; Country Reports.
 Note : n.a. : Not Applicable ; ... : Data Not Available. * Labor force participation rate, total (% of total population ages 15+)
 ** Labor force participation rate, female (% of female population ages 15+)

Appendix 2: AfDB's Active Portfolio in São Tomé and Príncipe (as of June 2021)

Flashlight	Operations	Source of Funding	Sector	Approval date	Age (since approval)	Signature	Entry into Force Date	Effective for First Disbursement	Completion date	Amount (UA)	Disbursement rate	Commitment rate
1	Payment System infrastructure and Financial Inclusion Project	ADF	Finance	2/3/2017	4.41	4/18/2017	7/26/2017	12/20/2017	12/31/2021	1,500,000	21%	17%
2	Energy Sector Transition and Institutional Support Project (ETISP)	ADF	Energy	3/25/2020	1.27	5/20/2020	5/20/2020	01/29/2021	12/31/2024	10,000,000	1%	0%
3	Infrastructure Rehabilitation for Food Security Support Project II (PRIASA II)	ADF	Agriculture	6/10/2015	6.06	7/15/2015	3/7/2016	4/15/2016	12/31/2021	11,500,000	83%	75%
4		GEF	Agriculture	6/10/2015	6.06	6/13/2019	6/13/2019	6/21/2019	12/31/2021	2,578,119.27	21%	37%
5	Emergency Budget Support COVID-19	ADF	Multi-sector	7/22/2020	0.94	7/29/2020	7/29/2020	7/29/2020	6/30/2021	7,500,000	100%	100%
6	Emergency assistance to support COVID-19 response in the SADC region and São Tomé and Príncipe	ADF	Social	6/23/2020	1.02	8/28/2020	8/28/2020	8/28/2020	4/13/2022	500,000	100%	100%
7	STP Mini-hydropower projects support program	SEFA	Energy	6/4/2018	3.07	7/11/2018	7/11/2018	7/11/2018	9/30/2021	729,927	24%	56%
8	Complementary Technical Studies and PPP Structuring for the Construction of the Deep-Sea Transshipment Port	NEPAD/IPPF	Transport	12/14/2018	2.55	3/1/2019	3/1/2019	11/27/2019	12/29/2021	1,459,854	19%	0%
	TOTAL				3.17					35,767,900.27	53%	48%

Appendix 3: Matrix on M&E Arrangements

A. Alignment indicators							
Indicator name	Definition/description	Source	Baseline and targets (where possible)				
1) MSMEs effect (turnover from investments); 2) Owner-operators and MSMEs provided with financial services; and 3) Direct jobs			Baseline (date): Target (date):				
B. Outcome and output indicators (<i>performance indicators</i>)							
Indicator name	Definition/description	Methodology for collection	Responsibility for collection	Frequency of reporting	Results planning		
					DATE 1	DATE 2	DATE 3
Time to resolve commercial disputes	The time it takes for commercial disputes to be resolved in the courts is reduced	Recording of total time from submission of dispute to court to resolution/decision by court	PIU	Once a year after year 2	Jan 2024	Jan 2025	Dec 2025
Quality of judicial process index score	The judicial process index score is improved	Measuring index score at start of project and index score at project closure	PIU	Three times – at start of project, mid-term and close out	Feb 2022	Dec 2023	Nov 2025
Registered businesses	The number of registered businesses has increased	Recording the number of new businesses registered with the registration authority	PIU MPFEA/INE	Three times – at start of project, mid-term and close out	Feb 2022	Dec 2023	Nov 2025
Average increase in sales of SMEs by 2025	The increase in sales by 2025 for SMEs who have received business training under Zuntámon	Recording the percentage by which the sales for businesses trained has increased by 2025 – the change from the initial turnover amount before trained by Zuntámon and the turnover amount 1 year after being trained by Zuntámon. This should be recorded at every intake of a new SME to be trained and one year after their training	APCI PIU	Quarterly	July 2023	July 2024	July 2025
Share of locally sourced contracts by large firms from SMEs, including youth-owned SMEs and women-owned SMEs	Proportion of procurement from local SMEs by large national firms increases, including proportion procured from women-led and youth-led SMEs	Recording the difference in amount in contracting large firms have with local SMEs at the start of the project and then the amount in contracting large firms have with local SMEs at the end of the project.	PIU	Annual after year 1	July 2023	July 2024	July 2025

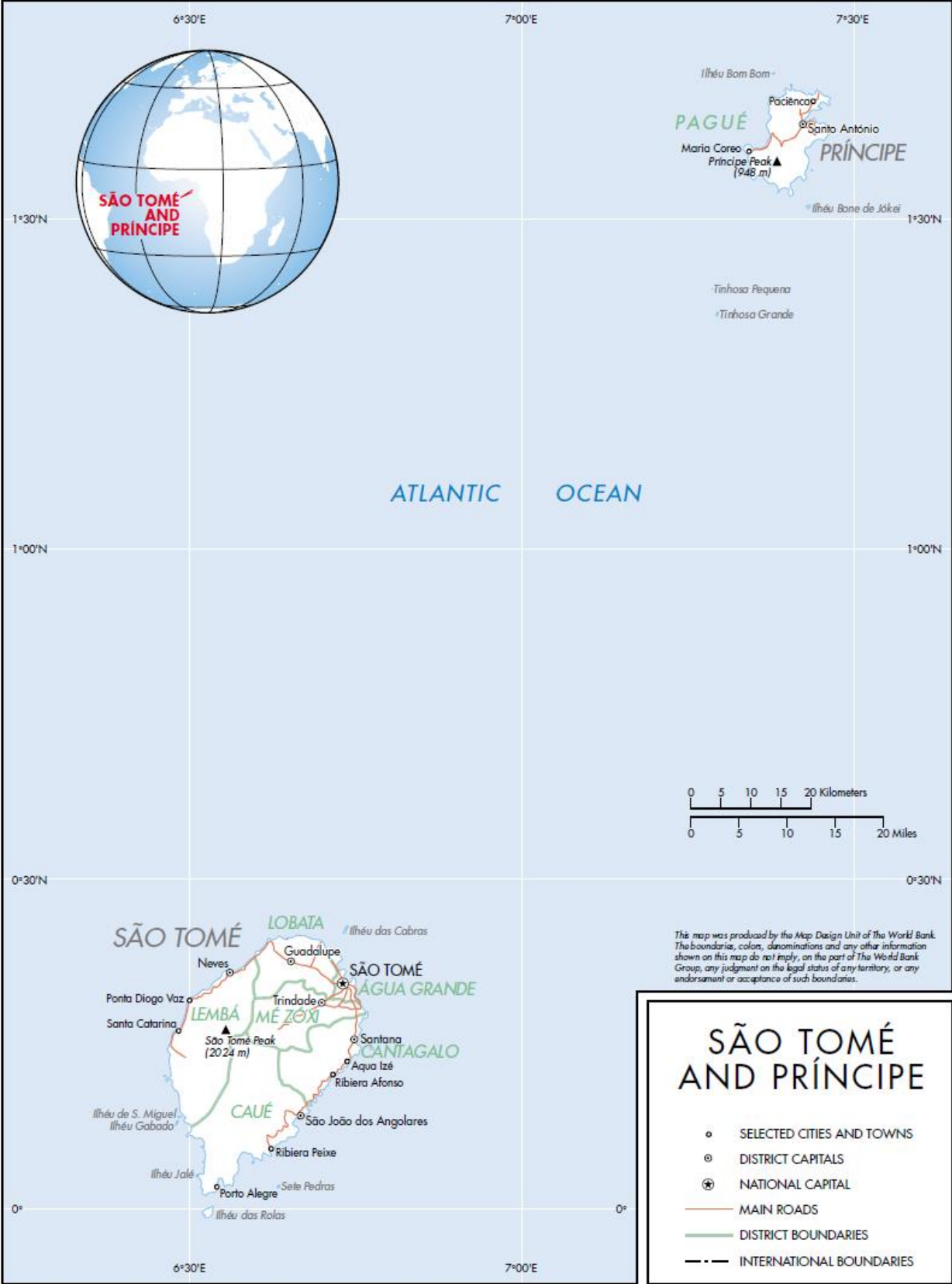
Cases resolved by the arbitration center	Number of cases resolved by the arbitration center	Counting the number of cases resolved by the arbitration center once the center is operational under Zuntámon and until the end of the project	PIU	Three times – at start of project, mid-term and close out	Feb 2022	Dec 2023	Nov 2025
Updated draft laws and regulations on commercial matters (commercial code, civil procedure code, insolvency regime) are available	Number of updated draft laws and regulations on commercial matters (commercial code, civil procedure code, insolvency regime) that are available	Tracking number of updated draft laws and regulations on commercial matters (commercial code, civil procedure code, insolvency regime) as they are drafted	PIU	Three times – at start of project, mid-term and close out	Feb 2022	Dec 2023	Nov 2025
MSME formalization strategy and action plan drafted	Number of MSME formalization strategy and action plan drafted	Tracking the number of MSME formalization strategy and action plans drafted	PIU	Twice (at mid-term and end of project)	Dec 2023	Dec 2025	
Digital streamlined system for tax declaration and filing for MSMEs established	Number of digital streamlined systems for tax declaration and filing for MSMEs established	Confirming that one digital streamlined system for tax declaration and filing for MSMEs is established	PIU	Twice (at mid-term and end of project)	Dec 2023	Dec 2025	
Meetings of government and development partners working group on entrepreneurship, financial sector, and business environment	Yearly number of meetings of government and development partners working group on entrepreneurship, financial sector, and business environment	Tracking how many meetings of government and development partners working group on entrepreneurship, financial sector, and business environment happen during a given year	PIU Coordination Office	Annual from year 1	Dec 2022	Dec 2023	Dec 2024
New advisory templates used for every transaction processed by APCI	Number of new advisory templates used for every transaction processed by APCI	Tracking that for every transaction processed by APCI, at least one of the new templates is used.	PIU APCI	Annual from year 1	Dec 2022	Dec 2023	Dec 2024
Number of business associations trained	ToT methodology for ESOs and SME training partners has been designed and each partner has been trained in it	Reporting on the creation of the ToT methodology and how many partners have been trained in it	PIU	Twice (after year 1 and at mid-term)	Dec 2022	Dec 2023	
SMEs trained in improved business and technical practices, of which 30%	Number of SMEs under Zuntámon are trained by associations and BDSPs	Reporting on the number of SMEs trained and in which areas and for how long	PIU ESOs and training partners	Annual from year 1	Dec 2022	Dec 2023	Dec 2024

are women-led businesses and 30% are youth-led businesses							
Cold chain export unit for exports purchased	Number of cold chain units for exports purchased for airport	Tracking that the cold chain unit for exports is purchased for airport	PIU Ministry of Trade	Twice (at mid-term and end of project)	Dec 2023	Dec 2025	
Flexible Financing Mechanism designed	Number of Flexible Financing Mechanisms designed	Reporting on the fact that the Flexible Financing Mechanism is designed	PIU BCSTP	Once (after year 1 end of project)	Dec 2022		
MOU signed with Fund Manager	The fund manager who will manage the Sustainable and Flexible Financing Mechanism is hired on	Reporting on contract and deliverables are met by fund manager	PIU	Once (after year 1 end of project)	Dec 2022		
Anchor funding invested by the GoSTP in the Flexible Financing Mechanism	The Flexible Financing Mechanism is initially capitalized by the GoSTP through the Zuntámon grant	Reporting on the shareholders agreement signing	PIU	Once (after year 1 end of project)	Dec 2022		
Financial institutions trained	Number of financial institutions trained on the FFM	Tracking the number of financial institutions trained on the FFM	PIU	Twice (after year 1 and at mid-term)	Dec 2022	Jan 2024	

Appendix 4: Matrix of Risks

RISK CATEGORY	RISK DESCRIPTION	RATING	MITIGATION MEASURE	RISK OWNER
Market Absorptive Capacity	Due to the size of the country and the market, there is a risk that there may not be adequate SMEs for the designed financing vehicle to be established.	MODERATE ■	Using an integrated value chain approach to identify SMEs to be supported and establishing a database of SMEs. In addition, through capacity building, the adequateness of SMEs to access financing for growth will be improved.	BMOs BDSPs
Legal and regulatory framework	Inadequate framework for the set-up of the designed financing vehicle in STP as well as entry of investors.	SUBSTANTIAL ■	An assessment of the legal framework will be conducted to address any framework gaps that may exist for such a financing vehicle. Relevant contractual arrangements will also be agreed upon with the relevant stakeholders (Governments, investors etc.)	GoSTP
Technical design of the operation	Low attractiveness for commercial investors to capitalize the designed vehicle	SUBSTANTIAL ■	Subordination from Government and DFIs.	GoSTP
Capacity of implementing entity and key partner	Lack of capacity of two key partner agencies in ability to deliver programmatic activities and to meet Bank rules and procedures	MODERATE ■	Capacity building of PIU and APCI are designed as an integral part of the Zuntámon and will be provided throughout the project implementation	GoSTP APCI PIU
Political Risk	Change in Government with the upcoming legislative elections in São Tomé and Príncipe in 2022 could affect the implementation and strategic ownership of the initiative.	MODERATE ■	Close monitoring of the political situation will be carried out during preparation, appraisal and implementation. In addition, the Initiative has been designed in line with the country's long-term development strategy (Vision 2030) objectives. The Bank and other Development Partners will also strengthen policy dialogue on private sector as a key driver for sustainable and inclusive economic development.	GoSTP

Appendix 5: Map of Program Area



SÃO TOMÉ AND PRÍNCIPE

- SELECTED CITIES AND TOWNS
- ⊙ DISTRICT CAPITALS
- ⊕ NATIONAL CAPITAL
- MAIN ROADS
- DISTRICT BOUNDARIES
- - - INTERNATIONAL BOUNDARIES

Appendix 6: Rationale for Government Counterpart Funding Waiver Request and Justification for the use of ADF to finance indirect taxes under the Project

In accordance with the African Development Bank Group's Policy on Expenditure Eligible for financing, a proposal for this operation to be 100% financed by the Bank through ADF resources and with 0% counterpart funding and indirect taxes coverage from the Government, is based on the following justifications:

1. Policy on Expenditure Eligible for Bank Financing

The Bank's Policy on Expenditure Eligible for Bank Financing Section 4.2.1 states that, the Bank may exceptionally finance taxes and duties where it is satisfied that:

- (i) the said country's level of taxes and duties is reasonable; and
- (ii) such taxes and duties do not constitute a high proportion of project costs or are not directed at the financed projects, or activities.

The Country Team approved that STP qualifies for the above exception.

2. Country's commitment towards Private Sector-led Development

In light of the global economic downturn and the further impact of the COVID-19 pandemic on the country's economy, the Government of STP has acknowledged the catalytic role of the private sector in unlocking the country's potential for diversified, inclusive and resilient economic growth, as well as sustainable job creation. The Government in its National Strategic Development Plan (2020-2024) underlines its dedication towards improving the business environment and promoting a broad program for attracting and retaining FDI, deepening and accelerating the continuous process of improving business environment policies and promoting investment policies in accordance with best international practices, taking into account the relevant role that the private sector plays in the country's development process.

STP's overall 2020 Doing Business ranking was 170, lower than the SSA average of 140. The country's ranking has deteriorated from 153 in 2015, with the lowest performance being the "Starting a Business" indicator, from 23 to 150, due to high costs and multiple procedures. The Government therefore seeks to improve the business environment through ongoing reforms which include: (i) the updating of the country's investment code; (ii) judicial reform which includes modernization of the commercial justice system so as to protect creditor rights and gain investor confidence; (iii) establish clear procedures for land acquisition; and (iv) streamline licensing procedures for key sectors such as tourism, with the integration to single window for business registration. Currently, the modernization of the existing credit registry at the Central Bank and the establishment of a moveable asset collateral registry with support from the World Bank are underway, which, when paired with the financial inclusion and women economic empowerment strategies, are expected to improve inclusive access to credit. Furthermore, the underdeveloped energy sector remains a key impediment to the country's productivity and reforms are ongoing, including the transition to renewable energy with the support of the African Development Bank, the World Bank, UNDP and UNIDO, which over the medium-term are expected to secure reliable, efficient and affordable energy.

3. Governance and ongoing efforts in light of pandemic COVID-19

The Government of Sao Tome and Principe has shown a steadfast commitment to the implementation of reforms to improve governance and economic management, with the Bank as a key partner. According to the Mo Ibrahim Index of African Governance (IIAG), overall governance in the country has improved

gradually in the last decade, with the country obtaining an overall score of 60.4/100 in 2019, up from 57.6 in 2010. However, the country has faced significant macroeconomic management challenges in recent years as signaled by stagnating economic growth, high budget deficits, rapidly growing public debt and dwindling international reserves. In response, the authorities embarked on a program of reforms aimed at restoring macroeconomic and fiscal sustainability supported through an IMF Extended Credit Facility (ECF) program approved in October 2019, as well as through the Bank’s Economic Reform and Power Sector Support (ERPSSP) budget support program approved in January 2020. The onset of the COVID-19 pandemic in March 2020 had a severe impact on Sao Tome and Principe’s economy exacerbating fiscal and external imbalances, leading to increased public debt and pressures on international reserves. In this context, the Government has demonstrated robust ownership of policy and structural reforms for macroeconomic stability, including the stringent fiscal measures adopted at the end of 2020 with external support, that allowed for better economic performance than earlier foreseen². Indeed, despite the crisis, the IMF approved the second review of the ECF program in February 2021 in light of strong reform implementation performance as the authorities continued commitment to strengthen fiscal transparency and public financial management as signaled by progress on work to introduce VAT in 2021 (with support through the Bank’s ongoing Energy Transition and Institutional Support Project (ETISP)), the publishing of large public procurement contracts and monthly reports on COVID-19 related spending.

The Government’s leadership has been agile towards the containment and mitigation of the health, social and economic effects of the COVID-19 pandemic. To articulate the response, the authorities established a COVID-19 Response Commission, which led the design and oversight of response programs across sectors, which have achieved significant results with support from the Bank through the COVID-19 Response Support budget support program approved in July 2020. Specific results include: (i) in the health sector the country has gone from having no in-country laboratory capacity to carry out PCR tests as well as having only 2 operational ventilators to treat COVID-19 patients, to carrying out 70 COVID-19 PCR tests per day and having a capacity of 17 beds with ventilators; (ii) on the social front more than 22,000 individuals have benefitted from cash-transfer and partial-income support schemes to dampen the impact of the pandemic on livelihoods; and (iii) in terms of support to the economy and private sector businesses have benefitted from tax relief measures as well as from a USD 3 million low-interest rate credit facility established by the government in partnership with the Central Bank and commercial banks.

4. Prioritization of use of ADF-15 allocation

The Government of STP’s allocation of resources during the ADF-15 cycle to-date has been centered on responding to the impact of the COVID-19 pandemic and is now focused on supporting a robust and sustainable post-pandemic economic recovery by spurring private sector growth. The unprecedented health, social and economic effects of the COVID-19 pandemic required a robust response to mitigate its impact and preserving the development gains made in recent decades – with significant Bank support – became a top priority for support under ADF-15. Indeed, to date 50% of Sao Tome and Principe’s ADF-15 allocation of UA15 million has been utilized on the COVID-19 Response Support Program (CRSP), which was focused not only on mitigating the health and social impact of the pandemic, but also on preserving the economy by providing relief to business and maintaining the productive capacity of the economy. Following the successful response to the pandemic, supported by the Bank’s CRF budget support, the Government’s top priority is a strong economic recovery driven by a flourishing private sector. This would make the economy not only more resilient to future shocks but also more

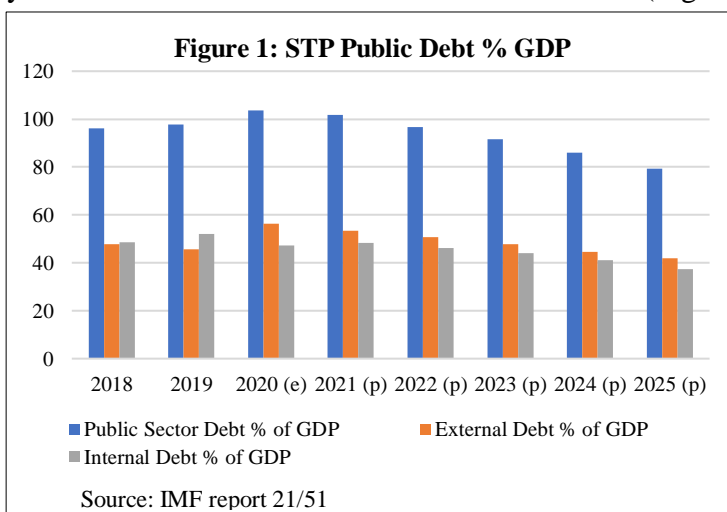
² Real GDP growth for 2020 is now preliminarily estimated by the Government at 3.1% attributed to the positive effects of the fiscal measures adopted in 2019 and 2020, allowing for conclusion of works and upscaled palm production. This is in comparison to the earlier baseline projections of -5.8% in the State Budget, -6.5% by the IMF and -6.1% by the AfDB.

dynamic and inclusive, and accelerate progress towards the country’s development goals. In light of this, the Government decided to frontload the remaining ADF-15 allocation balance (UA7.5 million) to the Zuntámon LC Initiative, to complement and accelerate ongoing efforts, including the government-established credit facility supported through CRSP.

5. Country Budget Situation, Fiscal Constraints and Debt Level

STP’s primary budget balance has been negative from 4.5% in 2016 to 0.7% of GDP in 2019. The fiscal position has deteriorated in 2020, compounded by measures to contain the COVID-19 pandemic. The fiscal deficit widened to 5.0% of GDP in 2020 from 2.4% in 2019 and 0.2% in 2018. The structural drivers of the deficit are a low tax base, low resource mobilization capacity and high level of economic informality, compounded by the shock of the COVID pandemic. Domestic fiscal revenue declined from 48.6% of the total revenue in 2018 to 37% in 2020, while grants increased from 31.7% of the total revenue in 2018 to 50% in 2020. As a result, total revenue (including grants) declined from 24.1% of GDP in 2018 to 22.4% in 2020. Total expenditure also declined from 26.0% of GDP in 2018 to 22.5% in 2019 but returned to 2018 level in 2020 at 26.7% due to government expenditure on COVID-19 containment measures. The government in 2020 approved a stimulus package of about USD 6.8 million to support the economy and finance health contingency measures in response to the COVID-19 pandemic, reaching 1.6% of GDP. The fiscal deficit is expected to improve to 3.9% in 2021. It is being financed mainly through external borrowing, thereby adversely impacting external debt levels. Before the pandemic, the government embarked on fiscal consolidation through expenditure rationalization, which is expected to be revived in 2021. The government also plans to introduce a value added tax (VAT) by the end of 2021 to help broaden the tax base and increase tax revenue in the short and medium term.

Although still sustainable, public debt has risen considerably in recent years, placing STP in the debt distress category. Total public debt rose sharply from 96.2% of GDP in 2018 to 103.5% in 2020 (Figure 1), mainly due to increased government spending related to COVID-19 containment measures and infrastructure development. Domestic debt declined from 48.5% of GDP in 2018 to 47.3% in 2020 as external debt rose sharply. The bulk of the domestic debt is owed by STP’s Power and Water Utility company (EMAE) to the National Oil company (ENCO). External debt increased from 47.7% of GDP in 2018 to 56.2% in 2020, mainly due to increased public spending on infrastructure, food, health and oil imports. The total external debt service to export ratio is projected to increase to reach 7.2% in 2021 from 2.6% in 2018. According to the December 2020 IMF Debt Sustainability Analysis (DSA), STP’s debt is considered sustainable, although the country is classified as being in the debt distress because of the ongoing regularization of the post-Heavily Indebted Poor Country (HIPC) (to Angola, Brazil, and Equatorial Guinea) arrears, as well as those of EMAE to its supplier. According to the DSA report, from 2022, all external debt sustainability indicators are projected to remain below their respective thresholds under the baseline scenario if STP continues to implement reforms in the loss-making state-owned enterprise (EMAE), borrow externally at concessional terms and renegotiate its debt repayment agreement.



STP has been experiencing a recurrent negative fiscal deficit and high level of donors' budget contribution, reaching up to 50% of the total revenue. Moreover, the country has also a high level of debt, which places an extra constraint to the budget, making it unfavourable to meet counterpart funding of new donor-funded operations. The Government's dedication to diligently implement reforms during the implementation period of Zuntámon Phase I and beyond would in turn be a significant contribution to ensure the success of not only the initiative, but sustainable private sector development in STP.

6. Financing of Indirect Taxes and Duties


Taxes and duties in STP in general do not constitute a high percentage of project costs, nor are there specific taxes and duties targeted only at Bank financed activities. The main taxes in the country are: corporate taxes (25%), stamp duty on receipts (0.3%), social security contribution (6%), property tax (0.1%), stamp duty on interest (1.2%), sales tax (5%), and employee social security contribution (4%). The recently approved Value Added Tax (VAT) set at 15% is broadly within the continental average and will replace the current consumption tax. The VAT is expected to be introduced in the last quarter of 2021 or first quarter of 2022. The Government is working with the World Bank to select a company to design the information system and roll it out once all pre-requisites are in place. Likewise, the other tax and duty rates in STP are also broadly in line with the continental average: Common External Tariff – 5% for Category One products (e.g., basic products), 10% for Category Two (e.g., raw materials), 20% for Category Three (e.g., intermediate products such as most food and cosmetics). In addition, port fees, miscellaneous customs expenses, brokerage, and in some cases phytosanitary expenses are required. In the case of vehicle imports, there is an additional registration fee, but the cost to import in terms of border compliance stands at USD 406, below Sub-Saharan Africa average of USD 690.6 and cost to import in terms of documentary compliance stands at USD 75 below Sub-Saharan Africa of USD 287.2. Likewise, cost to export in terms of border compliance stands at USD 426 below the Sub-Saharan average of 603.1, and cost to export in terms of documentary compliance is USD 194, slightly higher than the Sub-Saharan Africa average of USD 172.5.

In an effort to improve revenue collections, the tax department is being restructured to support the introduction of the VAT and improve the Government's ability to increase tax mobilization. In 2020 grants/donations accounted for 33% and current taxes 49.3% of total revenues. Although fiscal revenue mobilization increased by 28.7% compared to 2019, it was mainly due to increase in grants in the form of budget support from the AfDB, IMF and World Bank, representing an increase of 77.2%. Fiscal revenue represented only 0.2% of GDP which demonstrates the low resource mobilization capability of the country. São Tome and Principe has a total of 46 commercial taxes, slightly higher than the Sub-Saharan African average of 36.6. Sao Tome and Principe total revenue in 2020 experienced a slight increase of 22.68% accounted for by the development partners contributions, which amounted to USD 143 million, a slight increase compared to 2019 total of USD 110 million. However, fiscal revenue stood only at USD 64.7 million in 2020, a slight increase of 13.8% compared to 2019 of USD 55.8 million. It is clear that the country's own resources are very limited and not capable of responding to emerging public expenditure needs. In this context, the country, with support from the AfDB, World Bank and IMF, is carrying out a number of reforms to improve its resource mobilization capacity. The Government created a Macro-Fiscal unit, restricted the opening of new bank accounts by public institutions, controlled/limited the payment of overtime hours by government staff, limited the acquisition of new loans to only those loans carrying concessional terms, and elected a national public debt committee to better advice, control, monitor and discuss public debt management and fiscal policy issues. In terms of doing business, according to the 2020 World Bank Doing Business Report, the country scores 92.2 on the paying taxes index, which was higher than the Sub-Saharan Africa average score of 54.7.

Compliance with Bank fiduciary requirements is generally satisfactory, with especially annual audits submitted on time, or with minimum delays. There is however some room for improvement when it comes to timely submission of quarterly interim unaudited financial reports, an area the bank team is working closely with active projects to address.

It is recommended that the Bank finances the duties and indirect taxes relating to project expenditures because of the current fiscal situation in the country, with revenues hit hard by the COVID pandemic and debt considered to be in distress under the latest IMF/WB DSA. The tight fiscal space would hamper the ability of the Government to provide timely VAT/consumption tax refunds, which in turn could significantly affect project implementation. Moreover, and reflecting the requirements of the Bank policy on eligible expenditures, the taxes are neither discriminatory towards Bank financed projects, nor excessive in nature. Financing indirect taxes and duties, as well as removing the need for counterpart contributions would remove one burden on the government's already constrained fiscal position, as well as help reduce possible implementation bottlenecks that may arise should the government fail to meet the usual contribution requirements.


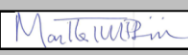

Appendix 7: ENVIRONMENTAL AND SOCIAL COMPLIANCE NOTE (ESCON)

ENVIRONMENTAL AND SOCIAL COMPLIANCE NOTE (ESCON)	 AFRICAN DEVELOPPEMENT BANK GROUP
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A. Basic Information¹	
Project Title: Zuntamon Lusophone Compact Initiative – Phase I	Project "SAP code": P-ST-H00-003
Country: São Tomé and Príncipe	Lending Instrument²: DI <input checked="" type="checkbox"/> FI <input type="checkbox"/> CL <input type="checkbox"/> BS <input type="checkbox"/> GU <input type="checkbox"/> RPA <input type="checkbox"/> EF <input type="checkbox"/> RBF <input type="checkbox"/>
Project Sector: Social Development	Task Team Leader: Josephine NDAO
Appraisal date: May 25 th to June 10 th , 2021	Estimated Approval Date: September 28, 2021
Environmental Safeguards Officer: xxxxxx	
Social Safeguards Officer: Edith KAHUBIRE	
Environmental and Social Category: 3	Date of categorization: 16/04/2021
Operation type: SO <input checked="" type="checkbox"/> NSO <input type="checkbox"/> PBO <input type="checkbox"/>	
Is this project processed under rapid responses to crises and emergencies? Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>	
Is this project processed under a waiver to the Integrated Safeguards System? Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>	

B. Disclosure and Compliance Monitoring	
B.1 Mandatory disclosure	
Environmental Assessment/Audit/System/Others (specify:)	
Was/Were the document (s) disclosed <i>prior to appraisal</i> ?	Yes <input type="checkbox"/> No <input type="checkbox"/> NA <input checked="" type="checkbox"/>
Date of "in-country" disclosure by the borrower/client	[Date]
Date of receipt, by the Bank, of the authorization to disclose	[Date]
Date of disclosure by the Bank	[Date]
Resettlement Action Plan/Framework/Others (specify:)	
Was/Were the document (s) disclosed <i>prior to appraisal</i> ?	Yes <input type="checkbox"/> No <input type="checkbox"/> NA <input checked="" type="checkbox"/>
Date of "in-country" disclosure by the borrower/client	[Date]
Date of receipt, by the Bank, of the authorization to disclose	[Date]
Date of disclosure by the Bank	[Date]
Vulnerable Peoples Plan/Framework/Others (specify:)	
Was the document disclosed <i>prior to appraisal</i> ?	Yes <input type="checkbox"/> No <input type="checkbox"/> NA <input checked="" type="checkbox"/>
Date of "in-country" disclosure by the borrower/client	[Date]
Date of receipt, by the Bank, of the authorization to disclose	[Date]
Date of disclosure by the Bank	[Date]
If in-country disclosure of any of the above documents is not expected, as per the country's legislation, please explain why: NA.	

B.2. Compliance monitoring indicators	
Have satisfactory calendar, budget and clear institutional responsibilities been prepared for the implementation of measures related to safeguard policies?	Yes <input type="checkbox"/> No <input type="checkbox"/> NA <input checked="" type="checkbox"/>
Have costs related to environmental and social measures, including for the running of the grievance redress mechanism, been included in the project cost?	Yes <input type="checkbox"/> No <input type="checkbox"/> NA <input checked="" type="checkbox"/>
Is the total amount for the full implementation for the Resettlement of affected people, as integrated in the project costs, effectively mobilized and secured?	Yes <input type="checkbox"/> No <input type="checkbox"/> NA <input checked="" type="checkbox"/>
Does the Monitoring and Evaluation system of the project include the monitoring of safeguard impacts and measures related to safeguard policies?	Yes <input type="checkbox"/> No <input type="checkbox"/> NA <input checked="" type="checkbox"/>
Have satisfactory implementation arrangements been agreed with the borrower and the same been adequately reflected in the project legal documents?	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> NA <input type="checkbox"/>

C. Clearance			
Is the project compliant to the Bank's environmental and social safeguards requirements, and to be submitted to the Board?			
Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>			
Prepared by:	Name	Signature	Date
Environmental Safeguards Officer:			
Social Safeguards Officer:	Edith KAHUBIRE		9/15/2021
Task Team Leader:	Josephine NDAO		9/15/2021
Submitted by:			
Sector Director:	Martha T.M. PHIRI		16.09.2021
Cleared by:			
Director SNSC:	Maman-Sani ISSA		16.09.2021

¹ Note: This ESCON shall be appended to project appraisal reports/documents before Senior Management and/or Board approvals.

² DI=Direct Investment; FI=Financial Intermediary; CL=Corporate Loan; BS=Budget Support; GU=Guarantee; RPA=Risk Purchase Agreement; EF=Equity Financing; RBF=Results Based Financing.