DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

COSTA RICA

SOCIAL ENTREPRENEURSHIP PROGRAM

TECHNOLOGICAL MODERNIZATION OF SMALL MACHINE AND INDUSTRIAL MAINTENANCE SHOPS

(CR-S1004)

FINANCING AND TECHNICAL COOPERATION PROPOSAL

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ABBREVIATIONS

APTAMAI	Asociación de Propietarios de Talleres de Mantenimiento Industrial [Small Industrial Maintenance Shop Owners Association]
CESI	Committee on Environment and Social Impact
COF/CCR	IDB Country Office in Costa Rica
ECLAC	Economic Commission for Latin America and the Caribbean
GDP	Gross domestic product
INA	Instituto Nacional de Aprendizaje [Costa Rican National Institute for Learning]

I. BASIC PROJECT INFORMATION

A. Executing agency

1.1 Asociación Propietarios de Pequeños Talleres de Mantenimiento Industrial [Small Industrial Maintenance Shop Owners Association] (APTAMAI).

B. Amount and source of financing

	NDF (US$)	APTAMAI (US$)	Total (US$)
Reimbursable financing	300,000	65,000	365,000
Nonreimbursable technical-cooperation funding	125,000	65,000	190,000
Total	425,000	130,000	555,000

Source: The Inter-American Development Bank (IDB) financing will be drawn on the Norwegian Development Fund for Latin America (NDF).

C. Financial terms and conditions

Amortization period:	10 years
Grace period (principal):	4.5 years
Annual interest rate:	3% real annual rate
Currency:	Costa Rican colons

1.2 The reimbursable financing will be executed in up to 48 months and disbursed in up to 54 months. It will be repaid by APTAMAI in 10 consecutive, equal, semiannual installments. The grace period will apply only to principal, not to interest. Maintenance of value will be added to the interest rate (3% annual rate), and will be set based on the annualized Consumer Price Index for the preceding six months, as reported by the Bank of Costa Rica. The loan will be denominated in Costa Rican colons.

D. Statement of nonobjection

1.3 In official letter DM 787-05 of 17 May 2005 from the Ministry of Finance, the Government of Costa Rica indicated its nonobjection to the IDB financing for the project.

E. The problem to be addressed

1.4 Over the last decade, the Costa Rican economy has undergone rapid transformation, evolving from an agriculture-based production system to a more diversified economy in which the manufacturing and service sectors play an increasingly important role. This rapid structural change has given rise to new patterns of demand and consumption in industry and among the population, providing opportunities for growth, but also posing complex challenges for sectors of the economy traditionally comprising low-productivity microenterprises.

1.5 One sector in which these opportunities and challenges are particularly evident is metalworking. This is a microentrepreneurial activity that has traditionally generated jobs and income for a significant number of people. Currently, an overwhelming majority of the shops in this sector operate as either *subsistence* or *simple-accumulation* microenterprises, with limited productivity and profitability. Many of these workshops are poorly equipped, and despite a strong market for their services, few have managed to build up the surpluses that are needed to expand and introduce modern technology. It is estimated that no more than 3.5% of the nearly 5,000 workshops in the sector can be characterized as small or medium-sized modern enterprises with high levels of technological development and highly qualified professionals. Another 3.5% of the shops belong to the *broad accumulation* microenterprise segment, with *moderate use of new technology*, having machinery and equipment for diagnostics and repair support, and specializing in the type of service they provide. The owners and employees in this segment combine extensive technical training and experience.

1.6 All other workshops are low-productivity microenterprises scattered across the country. In this broad category, two microentrepreneurial segments can be identified, according to the most commonly used general classification in Costa Rica: *subsistence* shops and *simple-accumulation* shops (see DOC III). This latter category includes both microenterprises with *incipient use of new technology* and those with *limited use of new technology*. *Subsistence* machine shops operate with basic tools (a basic box of hand tools; hand jacks; simple workbenches, files, etc.); those with *limited use of new technology* use, in addition, drills, power jacks, and compressors, but lack specialized or diagnostic equipment; the shops with *incipient use of new technology* have fairly complete but unsophisticated repair equipment, but not enough for specialized jobs, and they lack diagnostic equipment. In the last two categories, the owners typically have annual incomes of from one to three times per capita GDP.[1]

1.7 New market demands are emerging, for example, in the field of vehicle repair and maintenance, an area that takes in a significant proportion of metalworking microenterprises and that has traditionally accounted for most of the sector's

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[1] The per capita GDP in Costa Rica was calculated as US$4,330 for 2004.

revenue. In the last 10 years, the number of vehicles has grown at an annual rate of 6.3%, as the vehicles themselves have become more sophisticated. These changes in the size and structure of the automobile fleet have been accompanied by new requirements for the type and quality of services demanded of machine shops, pressuring microenterprises in this sector to undergo technological modernization and raise the qualifications of their operators. A similar situation is being experienced by a large number of precision shops that have seen how the machinery in Costa Rican industry, with its progressive integration into export value chains, calls increasingly for improved technological conditions, with greater demands for precision. The production sector also requires increasingly sophisticated industrial maintenance, and shops with greater technical and technological capacity.

1.8 The present project seeks to benefit owners of small machine and industrial maintenance shops who are currently facing major constraints in obtaining financing to address technological change, improve productivity, and increase revenues.[2] Many of these shops were conceived to serve the local market at a time when equipment and vehicles had not yet incorporated electronic and computer-based advances. Now they are experiencing growing domestic demand for their services, but with greater technological requirements, due to the greater precision required in metalwork, or the increased growth and renovation of the vehicle fleet, as well as a regulatory climate in which vehicle owners are subject to greater environmental and highway safety regulation, giving rise to stricter controls on vehicle condition and their environmental impact.

1.9 **Limited access to financial resources to fund technological modernization and updating:** With limited access to financing, metalworking microenterprises have trouble acquiring modern equipment and technology to improve their service and productivity. The financial system has taken little interest in the microenterprise market, and generally does not acknowledge or serve it, considering it to be high risk. Consequently, the system does not offer suitable products for financing the equipment and technology this market requires. Moreover, requirements in the financial system, mainly in terms of guarantees, go well beyond the resources of such customers and, given their small scale, microfinancing activities are not attractive prospects for lending. A significant cross-section of metalworking shops

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[2] For example, in the case of vehicle repair shops, the data from a survey conducted by APTAMAI on a group of metalworking shops shows that the shops in the “incipient use of new technology” segment do not have diagnostic tools (such as gas analyzers and scanners). This situation places them at a disadvantage when customers choose shops for vehicle repairs, tune-ups, and inspections. This is reflected in the low value-added work their customers request of them and, ultimately, in lower average monthly revenues. Shop owners who have begun the modernization process and who are transitioning to a greater use of new technology, have monthly incomes 84% above those in the next highest category, while those who have completed the technological modernization to at least “limited use of new technology” have incomes 20% higher than those in the “incipient use of new technology” category. The situation is similar for precision shops. See DOC III.

in a sample surveyed by APTAMAI expressed interest in participating in technological modernization processes, indicating that their attempts to do so in the past have been frustrated by a lack of funding, since intermediary credit institutions do not accept as collateral their primary assets, the equipment and machinery they use in their repair activities.

1.10 **Lack of adequate technical and management expertise:** The technological modernization of machine shops depends on more than new machinery and equipment to assist with diagnostics and repair. Training is also often necessary to increase a shop owner's level of expertise, as is technical support for enhanced use of the new machines and equipment. It is estimated that over 60% of repair shops are unable to provide the service required by late model vehicles with electronic components, or guarantee customers that their vehicles will pass the mandatory vehicle inspection emissions tests the first time. In general, shop owners have limited access to these technologies, an obstacle that prevents them from: (i) improving vehicle diagnostics and ensuring the quality of repairs; and (ii) facilitating the process of repair by significantly reducing the number of tasks previously done by trial and error.

1.11 **The project proposal**: To help resolve these problems, the Bank proposes granting financing and technical-cooperation funding to APTAMAI, so that it can apply them in a financing program and in training services geared toward the technological modernization of microentrepreneurial machine shops. APTAMAI is an organization established to support the development of small machine shop owners, which, over 23 years, has developed a service model that integrates management and technical training, onsite technical support, the supply of quality tools and equipment and financing for working capital, equipment purchases, and shop remodeling and expansion. Its integrated operation has allowed it to develop a competitive advantage in serving the sector and to work actively with approximately 500 shops. With the Bank's support (described in the following paragraph), APTAMAI recently developed a pilot microleasing financial product that is well suited to financing metalworking microenterprises and promoting the sector's technological development. Its vast knowledge of the shop equipment aftermarket makes it able to handle this instrument, since it can perform inspections and accept as collateral equipment that other organizations are unable to evaluate. APTAMAI does not have the necessary resources or financial support to offer this new product.

1.12 **Background to this project** includes a prior operation financed by the Small Projects Program (SP/EM-9820-CR and ATN/EM-6327-CR), executed between 1999 and 2003, with the aim of strengthening APTAMAI. Through its two components (reimbursable financing of €215,250, and technical-cooperation funding of €86,110), a loan program for metalworking shops was established and implemented and efforts were undertaken to improve the institutional capacity of

APTAMAI. This project was completed successful, according to the conclusions of the final evaluation.[3] During the execution period, APTAMAI demonstrated solid performance and adherence to the commitments assumed, and is currently repaying the financing it received as agreed. Despite the portfolio's small size, it managed to achieve operational sustainability and approach 95% financial sustainability. Given the experience acquired in handling loans and guarantees, and as a result of the advisory assistance received in conjunction with the technical-cooperation funding for the IDB project, APTAMAI recently developed a pilot program that allowed it to test the microleasing mechanism as an alternative because of problems with guarantees perceived by this group of microentrepreneurs. Microleasing represents an alternative to the chattel mortgage that offsets the lack of collateral for new equipment. It is an innovative financial product in the field, since no other financial institution offers microleasing services to finance microenterprise workshops. The 10 contracts executed in the pilot program demonstrated that the product has wide acceptance and represents a better solution in cases of machinery with an approximate value of US$4,000.

1.13 **Beneficiaries:** The direct beneficiaries will be 300 *subsistence* and *simple-accumulation* microentrepreneurs who own small machine shops in the Valle Central region and in the provinces. These microentrepreneurs work in the shops and support themselves and their families on revenues from the sale of their services. Their incomes vary from under one times the average per capita income in Costa Rica, in the case of *subsistence* shops, to approximately three times this average in the more advanced *simple-accumulation* shops. Of these microentrepreneurs, approximately 130 will receive financing through microleasing (during the project execution period) to provide them with access to machinery and equipment for their shops, and 300 (including the 130 mentioned above) will benefit from training and/or technical assistance. Approximately 70 other microentrepreneurs will receive financing during the remaining term of the Bank's loan to APTAMAI.

[3] See the project's final evaluation report drafted by consultant Edgar Briceño (September 2003).

II. THE PROJECT

A. Objectives

2.1 The project's primary objective is to increase the incomes of microentrepreneur owners of machine and industrial maintenance shops by promoting the technological modernization of their shops to improve their market competitiveness.

2.2 The project's specific objectives are: (i) to facilitate metalworking microentrepreneurs' access to financing through microleasing, for investment in equipment and fixed assets, in order to modernize their shops; (ii) to increase shop owner management skills and technical expertise; and (iii) to strengthen APTAMAI's capacity to provide financial services to a greater number of metalworking microentrepreneurs.

B. Description

2.3 The project will be divided into two components: (i) a reimbursable financing component, to finance microleasing operations that serve metalworking microentrepreneurs' investment needs; and (ii) a nonreimbursable technical-cooperation component to strengthen: (a) technical and management skills in the machine shops; (b) the development of a microleasing product for equipment purchases; and (c) APTAMAI's capacity to assist microentrepreneurs in the metalworking sector, and to manage and execute the project.

2.4 **Reimbursable financing component** (IDB: US$300,000 and APTAMAI: US$60,000). The proceeds of this component will be used to expand APTAMAI's microleasing program beyond the pilot level, and to consolidate this new financial instrument. The resources will finance the purchase of machinery and equipment for approximately 130 low-income microentrepreneurs in order to modernize, expand, or strengthen their shops, in various areas of the metalworking sector. The financing will facilitate the technological modernization of the shops to meet market demands. The leasing operations for the microentrepreneurs will have terms of up to three years with monthly payments, using the assets themselves as collateral and financing between 80% and 85% of their value. The leases granted will finance equipment valued at up to US$10,000 and will be governed by Microleasing Regulations.

2.5 **Technical-cooperation component** (IDB: US$130,000 and APTAMAI: US$65,000). This component is designed to: (i) strengthen the technical and management capacity of the metalworking shops served by the executing agency; (ii) contribute to the development of the microleasing product; (iii) strengthen APTAMAI's capacity to provide support to microentrepreneurs in the metalworking sector. The funds will also finance the establishment of a baseline for

the project indicators and project evaluations and audits. The Plan of Operations outlining the technical-cooperation activities appears in DOC V in the project technical files.

C. Sustainability and results of financial analysis

2.6 The project's sustainability was evaluated based on: (i) the relevance of the service APTAMAI offers to its clients, particularly the microleasing product, and the existence of actual demand for the product; (ii) the analysis of APTAMAI as an institution, able to maintain a healthy financial condition and an important presence in the metalworking sector beyond the life of the project; (iii) the establishment of competitive conditions (implicit interest rates) for the microleasing program that cover the operational costs of the services offered, making it possible to honor the financial commitments to the Bank and capitalize surpluses.

2.7 The project design, which takes these elements into account, has been structured to ensure the continuity of APTAMAI's services in the medium and long term. In addition, the growing demand for repair services for an automobile fleet that is growing at an annual rate of 6% and an expanding installed industrial capacity in Costa Rica, associated in particular with value-added export chains, show that there is a demand for the services of metalworking shops, but that the shops must meet performance standards in keeping with the level of technology of the goods being repaired and maintained in this market, and thus, the shops require financing for technological modernization.

2.8 The pilot microleasing program developed by APTAMAI has demonstrated the relevance and applicability of this product to the metalworking sector's needs. An unscientific survey recently conducted by APTAMAI on a sample of automotive repair and precision shops; as well as consultations with sector experts, made it possible to classify and characterize these shops and to learn whether there was any real demand for financing for technological modernization. Although the survey results cannot bear up to formal statistical analysis, they do provide valuable information on shop ownership as well as shop owner financing needs and links to financial markets and sources of credit.

2.9 The survey indicates at least 33% of the shops are transitioning from microenterprises with "incipient use of new technology" to ones with "limited use of new technology". In particular, in this segment, the potential demand for the services that this project plans to provide was noted. Over 60% of those surveyed expressed interest in access to technological modernization processes and indicated the problem of a lack of bankable guarantees for such purposes, because their sole or primary guarantees are their own machinery, equipment, and tools, which are not accepted by regulated credit institutions and rarely accepted by unregulated institutions, with high insurance and transaction costs.

2.10 In addition, the institutional analysis (see DOC II) indicates that APTAMAI has the institutional capacity to assume the obligation under the Social Entrepreneurship Program and to develop support activities for the sector beyond the life of the project. The set of indicators analyzed shows the organization's performance as a whole is acceptable. The indicators, which were calculated by distinguishing between financial and non-financial activities, reflect the performance and structure of the financial activities, and reveal that APTAMAI is now operationally self-sustainable. Lastly, a scale was established for the microleasing program that is consistent with the executing agency's financial capacity. In addition, the guidelines for the Microleasing Regulations (see DOC VI) and the market analysis (see DOC III) indicate that the program can establish competitive microleasing conditions that give the operation long-term viability.

2.11 The projections for the 10 years of the project (see DOC II) show that the resources allocated to the microleasing program will generate surpluses for the gradual capitalization of the program in APTAMAI. The sensitivity analysis performed anticipates the generation of surpluses for the program even allowing for contingencies.

D. Expected results and benefits

2.12 The project will benefit approximately 300 microentrepreneurs. The primary beneficiaries will be approximately 130 *subsistence* and *simple-accumulation* microentrepreneur owners of metalworking shops, who will see their incomes rise as their businesses increase sales and improve productivity through technological modernization and enhanced business-management skills, and they are able to offer higher value-added services, and better serve the needs of the market. It is estimated that as a result of modernization, the shops will achieve an average increase in net revenues from sales of their services of: (i) 60% in 70% of the cases, and (ii) 45% for the remainder (20%), after three years of individual participation in the project. It is estimated that approximately 60% of the beneficiaries will come from shops with "incipient use of new technology", 30% from shops with "limited use of new technology", and the balance from "subsistence" shops or those with "moderate use of new technology". It is estimated that at least 50% of the shops that receive financing and technical support from the project, through training or technical assistance, will move up to the next technological category. The number of beneficiaries with financing will increase to approximately 200 over the next six years of the loan.

2.13 Considering that a significant number of the shops will receive both benefits: training and microlease financing, approximately 300 shop owners (including the 130 financing recipients) are also expected to benefit from the diagnostics and modernization plans for their shops, and the training and sensitization programs that the project will promote. As an additional benefit, the consolidation of the innovative microleasing product for equipment purchases, the only one in the country targeting microenterprises, is expected to produce experiences that can

eventually be replicated. The executing agency, APTAMAI, will also benefit by having: (i) achieved financial sustainability to a level of 105% (it is currently only operationally sustainable) by year three of project execution; (ii) increased the number of shop owners who are members of the organization to 300 over the life of the project; and (iii) capitalized its microleasing program, once the loan is paid off.

E. The Bank's strategy

2.14 The Bank's strategy with Costa Rica (updated in document GN-2251-7, 22 June 2005) supports the objectives of the Government of Costa Rica as set out in its National Development Plan (PND), consisting in the reduction of poverty over the long term and sustainable growth led by the private sector over the medium term, through the strategic pillars of macroeconomic stability, the creation of favorable business conditions, and support for the development of productive investments. The proposed project is consistent with two of these pivotal elements, as it will promote an innovative financial service (microleasing) which, together with the technical assistance and training services, will support technological modernization of microenterprises in the metalworking sector, contributing to *improving their productivity and competitiveness* and expanding their local market share of greater value-added services.

F. Other international cooperating agencies

2.15 APTAMAI has a relationship with the Pan American Development Foundation (PADF) for the promotion of its tool and equipment marketing activities. PADF has a program that identifies surplus tools in factories that it occasionally passes on to APTAMAI. On occasion, APTAMAI has sold these tools at preferred prices to microentrepreneurs in the sector, and on other occasions, it has donated them to schools. No other international cooperation agencies are known to have projects in the sector.

G. Summary of environmental and social review

2.16 The Committee on Environment and Social Impact (CESI) reviewed this operation on 8 April 2005, indicating that an environmental evaluation was not required. It was recommended that the operation design incorporate the following considerations: (i) integration of the environmental dimension; (ii) assistance for shops with the handling of *toxic products and hazardous waste* associated with metalworking (paints, acids, solvents, batteries, grease, etc.), and occupational health and safety measures; and (iii) support for the transitioning to clean technologies in the small shops. The suggestions made by CESI on these issues have been incorporated into the project design and are described in a separate document in the project technical files. The semiannual project reports will include information on the monitoring of these considerations.

H. Special conditions

2.17 As a condition precedent to the first disbursement of technical-cooperation financing, APTAMAI must present, to the Bank's satisfaction, an execution plan for the first 12 months of the project, which will include an activity plan, a procurement plan, a disbursement schedule, and annual targets for compliance with the performance indicators, to permit the oversight and monitoring of the operation's progress. At the start of the project, technical-cooperation funds will be used to finance the preparation of a project baseline study (see paragraph 2.21), which must be approved by APTAMAI, to the Bank's satisfaction, as a condition precedent to the disbursement of over 25% of the technical-cooperation financing. In order to disburse over 50% of the technical-cooperation financing, at least 20% of the proceeds of the financing component must have been disbursed.

2.18 As a condition precedent to the first disbursement of the *financing component*, APTAMAI will present, to the Bank's satisfaction, evidence that: (i) its new corporate bylaws have been approved and registered with the appropriate authorities (see DOC II in the technical files); (ii) its Board of Directors has approved the Microleasing Regulations;[4] (iii) it has selected the project's leasing officer; (iv) it has approved the consultant's recommendations for the restructuring of the loan department and the consultancy on diagnostic methodology and the plans for technological modernization of the shops.

2.19 During the disbursement of the *reimbursable financing component*, APTAMAI will ensure that the Bank's contributions to this *component* do not replace other APTAMAI liabilities, as of 30 July 2004, with the Bank or other financial backers. This requirement will be verified through progress reports and financial statements that APTAMAI submits to the Bank periodically, in which there must be evidence of increases in APTAMAI's gross loan and leasing portfolio balances in amounts at least on a par with the disbursements made by the Bank. Failure to fulfill this condition may result in the suspension of disbursements by the Bank.

2.20 Recoveries of principal from the Bank's contribution to the financing component must be used for the purposes set forth in this operation and stipulated in the Microleasing Regulations, and may not be used for any other purpose without the express consent of the Bank.

I. Reports, evaluations, and audits

2.21 **Baseline:** The executing agency will be responsible for collecting and analyzing information relevant to the monitoring of the project's performance indicators. At the start of the project, APTAMAI will hire a consultant to establish baseline parameters and design a system of indicators to monitor and evaluate the project's

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[4] The guidelines for the Microleasing Regulations appear in DOC 2 in the project technical files.

activities and performance, that will complement or update those indicators established in the logical framework, and in the performance indicators agreed upon with the Bank. The baseline study will establish and validate the initial measures for all of these indicators, as well as others considered necessary. It will also include a compilation of socioeconomic information on the target group in order to compare changes in project beneficiary incomes. The baseline will identify a *control group* that will facilitate the objective evaluation of the project's impact on beneficiary income, allowing for the control of other variables that may influence them, and will establish a methodology for measuring the project impact indicators. Once agreed upon, these parameters and indicators, together with the content of the logical framework, will serve as a basis for monitoring project performance. The executing agency and the Bank will use the monitoring system and the indicators for project supervision and evaluation. These indicators will be considered in the progress reports as well as in the midterm and final evaluations.

2.22 **Progress and monitoring reports:** At the start of the project, APTAMAI will present an execution plan for the first 12 months of the project.

2.23 APTAMAI will submit reports on project progress and the use of the Bank's resources to the Bank's Country Office (COF/CCR) within 60 days after the end of each six-month calendar period. These reports will include: (i) a description of the progress made in project execution and its indicators, as well as an account of the main accomplishments and any difficulties encountered in attaining the project targets and objectives, and with the current execution plan; (ii) an update of the performance indicators and project execution plan for the next 12 months, including steps taken to overcome the obstacles identified; (iii) information on the benefits that have been transferred to the owners of small metalworking shops, financially and in terms of training and technical support; (iv) information on the execution of environmental and occupational health activities; (v) a report on the use of the Bank's resources and the counterpart contributions; (vi) information on accrued surpluses; (vii) statistical, financial, and narrative information on the expansion of the microleasing program, including: (a) the number of new clients provided with leasing; (b) portfolio performance indicators—aggregated for APTAMAI and broken down for the leasing program—including placements, current portfolio, and portfolio over 30 days in arrears; (c) information on the number of operations; (d) commissions and interest rate (implicit or explicit) charged for the financing and how they compare with the benchmark lending rates in the financial system for similar operations, including an analysis of the factors determining interest rates in the microleasing program, based on the Microleasing Regulations; and (e) a report on the origin and type of equipment financed; and (viii) information on increases in APTAMAI's gross loan and leasing portfolio balances. The latter report, which will be the final report, must contain a summary of the achievements as they relate to the project's objectives.

2.24 **Audits:** Within 120 days after the close of each fiscal year for the duration of the project, beginning with the year in which financing is first disbursed, APTAMAI

will provide the Bank with a report, to include the financial statements for the project's financing component and information on all activity in the special accounts, audited by an independent auditor approved by the Bank. Funds have been budgeted for this purpose. APTAMAI will also present its annual financial statements examined by an independent auditor. Within 120 days after the deadline for the last disbursement of the proceeds of the nonreimbursable technical-cooperation funding, APTAMAI will present a financial report audited by independent experts showing how the Bank's contribution was used.

2.25 **Evaluations:** The project envisages two evaluations, performed by individual consultants selected and engaged by the Country Office in Costa Rica out of technical-cooperation funding. A midterm evaluation will be carried out 18 months after the first disbursement and another 36 months after the first disbursement. The first evaluation will gauge at least: (i) the progress made in raising the incomes of small shop owners and in improving the quality and productivity of their work and the certification process, compared to the initial situation; (ii) the extent to which the project performance indicators have been met; (iii) the lessons learned and recommendations on improving the project; and (iv) the institutional capacity of the executing agency.

2.26 The final evaluation will measure and document, in addition to the issues indicated for the first evaluation: (i) the effects of the project on the groups studied in the initial evaluation and the project baseline; (ii) the results in terms of meeting the project objectives; (iii) the lessons learned; and (iv) the sustainability of the project itself over time. The indicators presented in the logical framework, those developed in the baseline, and the observations on the beneficiaries and the control group will be considered in measuring these factors. The *final evaluation* will be commissioned once 90% of the reimbursable financing component has been disbursed. The evaluators will be hired directly and monitored by the Country Office in Costa Rica.

2.27 The Bank will review the outcomes and recommendations set out in the progress and evaluation reports. Every six months, APTAMAI and the Bank's Country Office in Costa Rica (COF/CCR) will hold project monitoring meetings to review the semiannual report, the progress made towards achieving the performance indicators, and the work plan. Factors observed in the project and reported in the semiannual reports may give rise to review of the commissions and lending rates (implicit or explicit) charged to project beneficiaries, if they are not in line with the benchmark rates previously agreed with the Bank. The results of the semiannual reports and meetings will determine future disbursements for the operation. In the event that significant problems are found with project execution, the Bank will take such steps, as it deems appropriate, and may suspend disbursements if necessary.

J. Project risks and mitigating factors

2.28 The following project risks have been identified: (i) *Risk*: The legal framework for financial leasing in Costa Rica is not very well developed and case law is not extensive enough to provide guidance on the settlement of disputes related to this type of contract. This may cause difficulties for APTAMAI when it comes to exercising its right of ownership to the goods granted under the lease. The risk is less for operational leasing operations. The primary instrument that defines leasing is a tax rule issued by the Ministry of Finance, which defines *operational leasing*, among other things, as a lease with a residual value that is equal to or greater than 10% of the present value of the goods granted under the lease, and *financial leasing*, as a lease with a residual value of less than 10%. *Mitigating factor*: The Credit Regulations foresee this problem, establishing that microleasing operations be implemented as operational leases. A leasing expert will be hired to provide a detailed review of this issue. (ii) *Risk*: One project has to do with the insufficient capacity of owners to adequately recognize opportunities offered on the market. Although APTAMAI has, in the past, been fertile ground for the development of a large number of owners, who now have a comfortable market position, current conditions pose a greater challenge in less time. *Mitigating factor*: Diagnostics and customized technological modernization plans financed by the project will be developed to help orient shops in identifying new technology. (iii) *Risk*: The slow assimilation by shops of technologies and work systems, delaying gains in efficiency and competitiveness anticipated by the project and, therefore, adversely affecting the performance indicators. *Mitigating factor*: The training and technical support to be provided by APTAMAI to achieve technological levels associated with higher productivity and efficiency will enable them to bring in more revenue than planned.

K. Exceptions to Bank policy

2.29 None.