

**DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND
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CHILE

INTEGRATING MICROENTERPRISE PRODUCTION

(TC-00-07-03-9)

DONORS MEMORANDUM

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ABBREVIATIONS

CORFO	Corporación de Fomento Productivo (Production Development Corporation)
CPC	Corporación de la Producción y el Comercio (Corporation for Manufacturing and Trade)
FOSIS	Fondo de Solidaridad e Inversión Social (Solidarity and Social Investment Fund)
MIF	Multilateral Investment Fund

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EXECUTIVE SUMMARY

Executing agency:	SERCAL Foundation	
Amount and source:	MIF Window III- A	US\$1,092,000
	Counterpart funding:	US\$ 839,000*
	Total:	US\$1,931,000
Terms:	Execution period:	36 months
	Disbursement period:	42 months
Objectives:	<p>The general objective of the project is to enhance competitiveness in various sectors of the economy where there are many microenterprises and small businesses that now supply, or have the potential to supply, production chains concentrated in specific local areas.</p> <p>The specific objective is to strengthen at least 200 microenterprise and small businesses, to enable them to establish an effective presence as part of a production chain in a local development setting.</p>	
Description:	<p>To achieve these objectives, the project is divided into four components: (i) awareness-raising among leading firms and local development agencies; (ii) preparation of diagnostic studies and action plans for the production chains; (iii) intervention in at least five production chains; and (iv) dissemination, administration and evaluation of the methodology and outcomes.</p> <p>The aim of the first component is to obtain: (i) at least 10 consulting firms or local development agencies trained to intervene locally and foster supplier development for leading local firms; and (ii) at least 25 leading firms potentially interested in submitting supplier development proposals.</p> <p>The aim of the second component is to obtain: (i) at least 10 diagnostic studies and action plans prepared; and (ii) at least five action plans selected.</p>	

* Although SERCAL will be responsible for the local counterpart funding in its entirety, US\$168,500 will consist of contributions from leading companies and US\$670,500 will come from SERCAL itself.

The aim of the third component is to have at least 200 microenterprises and small-scale suppliers effectively participating in at least five production chains in a local development context. The immediate effect will be an increase in local value-added. The project is also expected to significantly improve the competitiveness of leading firms, while affording greater economic stability to the smallest business units and enabling them to compete in other markets on the basis of the reputation they have acquired as active members of a production chain.

The fourth component involves dissemination of the project and its results, together with administration and evaluation activities. The expected outcomes of this component are: (i) a methodological document illustrating project execution; and (ii) an international event held to publicize the Chilean experience and disseminate the document containing the methodology.

Risks:

This project is highly risky, mainly because larger firms have the perception that smaller economic units are inefficient and inept. Accordingly, the main risk associated with the operation is that there will be insufficient demand among leading firms, given the perceived risks of working with microenterprises. The project envisages three actions to mitigate this risk: (i) the intervention will include payment of a percentage subsidy to generate sufficient demand among leading firms; (ii) US\$120,000 will be invested in awareness-raising and promotion activities aimed at the key actors in the process; and (iii) the design of the project itself, which involves execution in defined stages and requires demonstration of the achievements in previous components and concrete commitments prior to proceeding with later components.

There is also a risk of the microenterprises coming to depend on the market acquired through the project. To mitigate this risk, the interventions will not only cover technical considerations, but also address management issues and the opening of new markets.

Beneficiaries:

The project's beneficiaries will be at least 200 microenterprises and small businesses with potential to act as suppliers to large and medium-sized enterprises. These 200 firms will be arranged in at least five production chains.

Environmental and social review:

The operation was reviewed by the Committee on Environment and Social Impact (CESI) at its meeting of 29 September 2000, where it was decided that no special actions were called for.

Special contractual clauses:

Conditions precedent to disbursement of component 1: presentation to the Bank's satisfaction of: (i) Board minutes, recording the appointment of a coordinator, specification of his/her functions, and exclusive assignment of the corresponding work; and, (ii) the first annual project plan, including a detailed timetable of

activities, resources anticipated, targets for each activity and the actions needed to achieve them (paragraph 4.5).

Conditions precedent to execution of component 2: presentation to the Bank's satisfaction of: (i) the bidding conditions for the competitive selection process and criteria for ranking proposals; (ii) report evaluating promotion actions undertaken and results thereof; and (iii) letters of commitment from leading firms, undertaking to contribute a minimum of 10% of the cost of carrying out the action plans (paragraph 4.8).

Condition precedent to disbursement of the financing for components 3 and 4: (i) presentation to the Bank's satisfaction of letters of commitment from selected leading firms undertaking to assume at least 15% of the costs of the intervention; and (ii) a report on the process of selecting the five production chains chosen for intervention (paragraph 4.11).

The consultants to be hired by SERCAL to draw up the bidding conditions for the competitive selection process, along with the corresponding ranking criteria, will automatically be ruled out as potential consultants to be hired by firms for preparing diagnostic studies, action plans and subsequent intervention (paragraph 4.8).

I. ELIGIBILITY OF THE COUNTRY AND PROJECT

- 1.1 The Donors Committee declared Chile eligible for all Multilateral Investment Fund (MIF) financing modalities on 6 October 1993. This operation is eligible for MIF funding under the Small Business Promotion Facility (Facility III-A), and is consistent with MIF provisions that seek to develop the market for non-financial services, by promoting links between microenterprises and small businesses and production chains, and fostering business integration.

II. BACKGROUND

A. The Chilean business sector

- 2.1 According to 1997 figures published by the country's Production Development Corporation (CORFO), Chile's business sector consists of 526,920 firms, most of which (82% of the total) are microenterprises. With small and medium-sized businesses added in, they jointly account for 99% of the business universe. Only 4,814 enterprises are in the large firm category.
- 2.2 Large firms account for 71.9% of total sales; small and medium-sized firms contribute 23.7%, and microenterprises 4.5%. These figures show that economic activity in the country is heavily concentrated in a few firms. The geographic distribution of businesses is such that the larger the firm the more likely it is to be located in the metropolitan region. The latter is home to 72.7% of large firms, 62% of medium-sized firms, 48.8% of small businesses and 34.7% of microenterprises.

B. The problem

- 2.3 Chile's business sector has been performing effectively in international markets for products and services provided by medium-sized and large firms. Further deepening of this model requires such firms to develop competitive capacities based less on product price and input cost and more on other elements such as product quality, speed of response to consumer demand, continuous diversification of supply, the characteristics of after-sales service and flexibility in the production process, among other factors.
- 2.4 The investments needed to develop these capacities, in conjunction with the pace of technological change, rapid product obsolescence and the multiplicity of standards and customs characteristic of the international scenario, have generated so many requirements that it is hard for a firm to satisfy them all with its own resources alone. To successfully respond to this new competitive dynamic, firms need to develop management approaches based on collaboration with other business units drawn from their immediate surroundings. Through cooperation, firms can speed up

their learning processes, achieve economies of scale and focus on the areas in which they have greatest competitive advantages.

- 2.5 Nonetheless, there are a number of obstacles to the development of inter-enterprise cooperation. First, firms face high information and coordination costs in identifying and getting to know potential partners; and from the complexity of reaching agreements on the goals of any partnership, the modalities for distributing benefits, and the responsibilities to be assumed. A second type of obstacle is mutual suspicion between entrepreneurs resulting from the self-sufficiency and individualism that have traditionally characterized business attitudes, compounded by a fear of opportunistic behavior. Lastly, there are major doubts among large firms as to the quality, volume and timeliness with which smaller business units can satisfy their demand.

C. The benefits of productive integration

- 2.6 Productive integration involves inter-enterprise cooperation at different stages of the productive process. It enables smaller firms to enhance their competitiveness by raising quality and productivity levels via the transfer of technology, knowledge and requirements from the larger firms that lead the chain and control the market. Accordingly, it is these firms that are the most interested in generating subcontracting chains enabling them to enhance their own competitive position and cut costs.
- 2.7 There are several different types of productive linkage. **Horizontal integration**, also known as “clustering”, occurs when small firms join together to obtain economies of scale and strengthen their market capacity through common procurement, joint production, specialization in certain production processes that are complementary to those of other agents in the same chain, joint marketing, etc. **Vertical integration** is cooperation between enterprises located in consecutive or different positions in the production chain. These firms associate to achieve competitive advantages that are beyond their reach individually. More specifically, by establishing supplier relationships with larger firms, small business units are ensuring stable markets and assimilating technologies, information and performance standards.
- 2.8 Each of these two integration modes helps to consolidate local economic development processes through the interaction of businesses of any size with local entities, such as regional and municipal governments, business associations, industry chambers, etc. The presence of production chains in a specific zone helps to generate local value added.
- 2.9 Joining a production network or chain forces firms to change their organization, which may mean adopting new technologies. Often the knowledge needed to adapt technology and productive organization to the new competitive environment arising

from collaborative activity is beyond the immediate reach of the firms individually. Alternatively there may be resistance from members of the firm, which therefore requires an investment of time and resources to develop the necessary understanding.

- 2.10 One example of this is the situation faced by the copper industry production chain in the north of Chile. This consists of a group of four or five leading firms that market their products in competitive international markets; they also demand a wide range of goods and services which are partly supplied by firms from the region and partly by companies located in the metropolitan area, even though there are microenterprises and small businesses with the potential to satisfy these needs locally.
- 2.11 The region's leading mining companies could enhance their competitiveness through lower costs and higher input quality, if they found local supply better suited to their needs — for example in metal working, maintenance services, etc. However, limited production and business capacities among small local businesses acts a barrier to supplying leading companies, and the latter do not seem willing to assume on their own the costs and risks of developing these small-scale suppliers.
- 2.12 Another example is the marine product chain, and particularly marine algae derivatives. The production process here is simple, entailing stages of collection, drying, milling and export. The problem with this chain is that the microenterprises that gather the algae do not have the production and business capacities to supply in sufficient quantity and quality the medium-sized firms that carry out milling and export.
- 2.13 The list of examples ranges widely, and includes the electric power sector (parts supply and miscellaneous services), agribusiness, pisco production, etc. In the framework described above, the aim of this project is to enhance capabilities in the Chilean business sector by strengthening relations between large companies and microenterprises/small businesses operating in the same process or production chain. This will be achieved by raising awareness of production chains among the leading firms (large and medium-sized enterprises), and by providing training and technical assistance for their local suppliers (microenterprises and small businesses).

D. Opportunity for microenterprises

- 2.14 CORFO's Supplier Development Program basically aims to develop productive integration between large companies and their immediate suppliers, but does not pretend to address the whole subcontracting chain. The program has mainly targeted the agribusiness sector, with marginal participation in other sectors, and its main achievements have been limited to creating supplier firms formed by former

employees. Lastly, the CORFO program does not seek to place these vertical integration chains in a local development setting.

- 2.15 The present project will provide the means to develop and strengthen production chains in sectors other than agribusiness, by supporting microenterprises and small businesses located in small geographic areas. It will draw on other supplier development experiences in Chile, which, albeit limited, offer the following lessons: (i) mutual distrust abounds among entrepreneurs, which prevents them from developing cooperative activities; (ii) production chains in regions do not fit local or regional development strategies; (iii) the current CORFO Supplier Development Program does not identify problems from a local perspective, nor does it analyze production chains beyond the second level or the constraints faced by local firms; and finally (iv) it does not stress the need to develop product supply services, which is the key to adding value in products produced by microenterprises and small businesses.
- 2.16 This project is being presented by the SERCAL Foundation, which itself is expected to contribute the following: its capacity for designing, preparing and implementing methodologies to meet specific needs; experience in transferring technical expertise to local counterparts with a view to strengthening their capacities as development institutions; a work team with experience in implementing plans and programs of action in different cultural contexts; and experience in coordinating support networks aimed at giving sustainability to business development programs and projects in Chile and the rest of Latin America.

III. THE PROJECT

A. Objectives

- 3.1 The general objective of the project is to enhance competitiveness in sectors of the economy where there are many microenterprises and small businesses that now supply, or have the potential to supply, production chains concentrated in specific local areas.
- 3.2 The specific objective is to strengthen at least 200 microenterprises and small businesses, to enable them to establish an effective presence as part of a production chain in a local development setting.

B. Components

- 3.3 To achieve these objectives, the project is divided into four components: (i) awareness-raising among leading firms and local development agencies; (ii) preparation of diagnostic studies and action plans for the production chains; (iii) intervention in at least five production chains; and (iv) dissemination, administration and evaluation of the methodology and outcomes.

1. Awareness-raising among leading firms and local development agencies (MIF US\$15,500; SERCAL US\$106,000)

- 3.4 The aim of this component is to encourage local businesses, consulting firms and local development agencies to submit proposals for developing local supplier networks. It is also hoped to encourage firms to become leaders of such networks, by offering experience, markets for smaller business units, quality standards and technology transfer, supported by a network of qualified consultants. SERCAL will prepare implementation manuals for establishing producer chains and for training consulting firms and local development agents therein.
- 3.5 Apart from promotion mechanisms such as motivation meetings, focus groups, communications and the organization of small-scale workshops, a website providing information on the project's objectives and targets is expected to be developed.
- 3.6 The outcomes expected from this component are: (i) at least 10 consulting firms or local development agencies trained to intervene locally and promote the development of suppliers for leading local firms; and (ii) at least 25 leading firms potentially interested in submitting proposals for supplier development.

2. Diagnostic study and design of action plans for integration of production chains (MIF US\$166,500; SERCAL US\$61,000)

- 3.7 Based on proposals submitted by potential leading firms, some 10 production chains will be studied in terms of their general characteristics and the problems affecting their competitiveness, and to identify possibilities for introducing such chains locally and improving overall productivity in the zone. Each diagnostic study will consider the viewpoints of the chain's leading firms, the microenterprises and small businesses that supply the leading firms or have the potential to do so, and also the public and private agents and institutions that engage in activities in the local geographic area in which the production chain operates.
- 3.8 Initial proposals will be appraised by an evaluation committee. Aspects to be considered will include: (i) the general characteristics of the production chain to be diagnosed, including: economic sector, brief history of the leading firms (development over the last three years, current situation and future challenges), commitment to local supplier development by the leading firm; general analysis of local suppliers (current and potential), the number of microenterprises and small businesses making up the production chain, employment and the value of output by size of firm, degree of geographic concentration of the chain, and the problems and opportunities for microenterprises and small businesses associated with the chain, presence of local institutions committed to development of the production chain; (ii) that the production chain to be analyzed has clearly identified market, products

and services; (iii) that the proposals are initiatives in which leading firms in the chain play an active part; and (iv) the methodology for drawing up the action plan.

- 3.9 The leading firms whose proposals are selected for the following phase (preparation of action plans), will be able to choose consultants from a list offered to them under the program. This list will consist of consultants that have been encouraged to participate and trained in methodologies to develop supplier and subcontracting networks. These consulting firms will carry out the diagnostic study and prepare action plans, with the program co-financing 90% of the costs of drawing up the latter.
- 3.10 The action plans will be assessed by the evaluation committee, with a view to selecting at least five for co-financing by the project. The elements to be taken into account in the evaluation are: (i) track record of the work team—in particular its experience in projects involving training services and technical assistance for microenterprises and small firms, business cooperation, supplier development and local economic development; (ii) characteristics of the action plan: number of microenterprises and small businesses¹ to be assisted, types of services and work methodologies, total cost of the project, co-financing requested, strategic alliances with local institutions for carrying out the action plan, and establishment of a methodology to ensure that issues of quality, timeliness and quantity are addressed, leading to fewer rejections and delays and guaranteeing volumes in the case of goods, or fewer complaints, faster service and greater client satisfaction in the case of services; and (iii) clear integration with local development strategies.
- 3.11 The expected outcomes of this component are: (i) at least 10 diagnostic studies and action plans prepared; and (ii) at least five action plans chosen.

3. Assistance for five production chains (MIF US\$850,000; SERCAL US\$222,000)

- 3.12 This component involves developing action plans for the selected production chains. Over a period of 18 months, production chains will be provided with the technical assistance and training services needed to achieve the objectives. The program will co-finance 85% of the costs of this activity, with the leading firms required to finance the remaining 15%.
- 3.13 Assistance for the development of production chains will last 18 months on average, during which time, according to work plans agreed by the parties, coordination links and technology transfer will be set up between large firms and their smaller-scale suppliers—specifically microenterprises and small businesses with the potential to supply leading firms either directly or through subcontracting; technical assistance for the design, promotion and marketing of products and

¹ CORFO definitions will be followed in this regard.

services; research and technological development; training for cooperative work, improvement of production practices, new technologies, quality control, inventory management, business administration, etc. These interventions will be carried out in accordance with previously approved work plans.

- 3.14 The main expected outcome of this component is to have at least 200 microenterprises and small-scale suppliers effectively participating in production chains operating in a local development setting. The immediate effect will be an increase in local value-added. The component is also expected to enhance significantly the competitiveness of the leading firms, while affording greater economic stability to smaller business units and enabling them to compete in other markets, on the basis of the reputation they have acquired as active members of a production chain.

4. Dissemination, administration and evaluation (MIF US\$60,000; SERCAL US\$450,000)

- 3.15 This component includes the general administration of the project, an international event held to disseminate the results and methodologies used, and activities relating to project evaluation.
- 3.16 The outcomes of this component are: (i) a methodological document illustrative of project execution; and (ii) an international event held to publicize the Chilean experience and disseminate the methodological document.

IV. PROJECT EXECUTION

A. Executing agency

- 4.1 SERCAL is a non-profit foundation with the mission of promoting sustainable economic development in Chile and elsewhere in the region. It fosters the development and strengthening of microenterprises, small and medium-sized businesses and cooperatives, providing support to low-income sectors in particular. The Foundation dates back to 1983, when a group of professionals associated with the Friedrich Ebert Foundation decided to carry out a development project targeting microenterprises and small and medium-sized production units. Its Chilean headquarters are in Santiago, and it has provincial offices in Viña del Mar and Talca. It has recently expanded its activities in the region by opening a subsidiary in Buenos Aires, Argentina, and an office in Lima, Peru.
- 4.2 SERCAL has taken part in a variety of projects run by the Solidarity and Social Investment Fund (FOSIS), both as consultant responsible for carrying out training and microenterprise business development projects, and in project appraisal targeting this sector. It has also acted as consultant for CORFO projects, such as its development projects, the Technical Assistance Fund, and the Supplier

Development Program. In all of these it has provided services aimed at enhancing its clients' competitiveness, building endogenous capacities and preparing for change, by coordinating agents, support and a variety of tools with a participatory and inter-disciplinary approach. It has also developed methodologies for dealing with environmental problems and quality improvements, and in relation to quality standards. It is currently co-executor, together with the CANE Foundation of Argentina, in a recently approved MIF project (ATN/MH-7331-RG) to implement and improve quality standards in small and medium-sized firms in Argentina, Chile and Uruguay.

- 4.3 For all these projects, SERCAL has a stable staff of renowned caliber. It has been responsible for training individual consultants who then collaborate with SERCAL in specific projects.

B. Execution mechanism

1. Responsibility for execution

- 4.4 The SERCAL Foundation will be responsible for: (i) monitoring fulfillment of the project's objectives and targets; (ii) reviewing budgetary execution; (iii) reviewing and approving the annual project activities plan and budget, including the use and appropriation of local counterpart funding; (iv) allocating financial resources to ensure project continuity; (v) designing and running the competitive selection process to hire technical staff; and (vi) signing the necessary contracts with the consultants in charge of the interventions to ensure the project is correctly carried out.
- 4.5 The technical staff needed to carry out the project are: (i) a project coordinator; and (ii) a secretary. Other staff will be hired on a temporary basis for specific tasks. Apart from management as such and general coordination, the project coordinator's functions include: (i) giving technical advice in preparing local project documents; (ii) providing specific technical assistance to the consultants; (iii) providing support in drawing up action plans; (iv) participating in all activities related to the monitoring and evaluation of action plans; and (v) preparing annual project activity plans that include a detailed timetable of activities, anticipated resources, targets for each activity and the actions needed to achieve them. The project coordinator will be a current SERCAL director, and will have exclusive responsibility for project coordination and execution. Conditions precedent to disbursement will be presentation to the Bank's satisfaction of: (i) Board minutes appointing the coordinator, specifying his/her functions and assigning the job exclusively; and (ii) delivery of the first annual plan.

2. Operating mechanism

- 4.6 SERCAL will be responsible for promoting the project and its benefits among local development agencies, consulting firms and leading enterprises. To this end it is expected to adapt its website, publicize the program in national newspapers, and train parties interested in participating in the mechanics of productive integration (both local development consultants and leading firms). It will also take steps to encourage leading firms to participate in a competitive selection process by submitting proposals for diagnostic studies and for integrating smaller economic units into supplier networks.
- 4.7 The main incentive for the leading firms is that they will participate actively with micro-entrepreneurs in designing the training and technical assistance that microenterprises and small businesses are likely to need in order to act as their suppliers. The benefits of this framework will be perceived by all firms in the chain. Microenterprises and small businesses receive an effective technology transfer, generate additional value-added and secure their market; the leading firm becomes more competitive and keeps part of the value-added arising from scale economies. SERCAL will be responsible for obtaining commitments from leading firms to provide the necessary co-funding for developing the supplier subcontracting chain. It will also ensure that microenterprises and small businesses assign to consultants a percentage of the cost of the intervention, which will be payable as the parties comply with the performance indicators set out in the corresponding action plans.
- 4.8 The leading firms will present proposals for diagnostic studies of supplier development in the local context, to be carried out by consulting firms or local development agencies. These proposals will be initially evaluated by staff hired by SERCAL for this purpose, and finally by the evaluation committee, in accordance with the technical selection criteria indicated above. The following conditions will apply precedent to disbursements in component 2: (i) presentation to the Bank's satisfaction of the rules of the competitive selection process and proposed classification criteria; (ii) report evaluating promotion actions undertaken and outcomes thereof; and (iii) presentation of letters of commitment from selected leading firms interested in participating in the project, undertaking to put up a minimum of 10% of the cost of preparing the action plans. The consultants hired by SERCAL to draw up the rules of the competitive selection process and corresponding criteria will be automatically disqualified from being hired as consultants by the firms for the preparation of diagnostic studies, action plans and subsequent intervention.
- 4.9 The evaluation committee will assess the diagnostic study proposals and action plans, and will permanently monitor the work of the consultants from a methodological point of view. The evaluation committee will consist of CORFO, the Corporation for Manufacturing and Trade (CPC), the Technical Cooperation

Service, together with industrial, financial and commercial leaders, and consultants that currently act as intermediate agencies of CORFO.

- 4.10 Once the supplier development proposals have been selected, a further contest will be held to select the corresponding action plan proposals. At least five action plans are expected to be chosen, involving at least 200 microenterprises in their capacity as suppliers to larger firms. Among the criteria for choosing the winning action plans, the evaluation committee will take particular account of the willingness of the leading firms to co-finance the training microenterprise process, as demonstrated in letters of commitment to this effect.
- 4.11 Conditions precedent to disbursements to finance the intervention in the development of supplier networks (component 3), and those corresponding to dissemination, administration and evaluation (component 4), will be as follows: (i) presentation to the Bank's satisfaction of letters from the selected leading firms expressing a commitment to assume at least 15% of the costs of the intervention; and (ii) a report on the process of selecting the five production chains for intervention.

C. Goods and services procurement

- 4.12 The procurement of goods and the hiring of consulting services during the project will follow the corresponding Bank procedures; procurement or hiring will be open to all MIF member countries.

D. Beneficiaries

- 4.13 The beneficiaries of the project will be at least 200 microenterprises and small businesses with the potential to act as suppliers to large and medium-sized firms. These 200 firms will be drawn from at least five production chains.
- 4.14 The project will provide support to at least five production chain projects for microenterprises and small businesses. The number of firms included in each case will vary according to the integration modality preferred by the entrepreneurs concerned, but on average there will be about 40 microenterprises and small firms per production chain.
- 4.15 Eligibility criteria: (i) be a microenterprise or small business; (ii) belong to a production chain or have the potential to belong to one; and (iii) show a commitment to participating in the activities of the action plan.

E. Monitoring

- 4.16 The logical framework contained in Annex I to this document, sets out the elements of project execution, monitoring and evaluation. SERCAL will monitor execution and prepare the corresponding reports. Every six months it will prepare a progress

report documenting activities carried out during the period. These reports—in a presentation format to be agreed with the Bank's country office in Chile—will verify compliance with the performance indicators established in the logical framework and include a work plan and disbursement timetable for the following period, among other things. The progress report will be delivered to the Bank's country office within 30 days following the end of the corresponding semester. The country office will use these reports to monitor the program and to prepare a final report on the effects of the project no later than three months after the final disbursement.

F. Project sustainability

- 4.17 This project is expected to help establish microenterprises and small businesses as suppliers of high value-added production chains. Expected outcomes will include new consultants specialized in developing supplier networks and in local economic development, as well as new proven working methodologies that will reduce entry costs to the business development services market. The payoff to the experience acquired by SERCAL and the investment of its resources will be the ability to continue undertaking similar initiatives once the project has ended. Lastly, the micro-entrepreneurs benefiting from the project will become full project participants by repaying a percentage of the cost of the services received.

G. Accounting and audit

- 4.18 SERCAL will be responsible for: (a) setting up and maintaining adequate accounting, financial and internal controls, together with filing systems making it possible to identify in detail the sources and use of project funds. The institution's project records will contain: (i) identification of resources and their different sources; (ii) information on project expenses, distinguishing MIF contributions from funds coming from other sources; and (iii) the details needed to identify goods acquired and services contracted; (b) the opening of separate bank accounts for the administration of the MIF contribution and local counterpart funds; (c) the processing of disbursement requests and respective expense justifications, in accordance with the Bank's disbursement procedures; and (d) preparation and presentation to the Bank of the project's final financial statement, audited by an independent firm acceptable to the Bank, together with reports on the revolving fund.

H. Execution and disbursement periods

- 4.19 The project will be carried out over 36 months, with disbursements being made over a 42-month period. Project disbursements will be made through a revolving fund, equivalent to 10% of the contribution. Control mechanisms will be set up to monitor the use of project resources.

I. State of progress of the project

- 4.20 SERCAL has identified a number of production chains² and has the methodology and minimum parameters needed for training consultants. It estimates that demand for this type of service is likely to mean dealing with over 800 micro- and small-scale entrepreneurs. It also has preliminary agreements with consulting firms and local development consulting agencies, such as Centro de Desarrollo Productivo del Norte Grande (CDP), Corporación Santiago Innova and Corporación de Investigación Tecnológica (INTEC), as well as a number of universities, and regional development corporations in general.

V. COST AND FINANCING

- 5.1 The project has a cost of US\$1,931,000. MIF will finance US\$1,092,000, SERCAL will contribute US\$670,500, and the leading firms and consultants will jointly contribute US\$168,500, as indicated below:

Components	MIF	SERCAL	Firms	TOTAL
Awareness-raising among leading firms and local development agencies	15,500	106,000		121,500
1. Consulting services	10,500	14,400		24,900
2. Training		71,600		71,600
3. Travel and representation expenses		6,000		6,000
4. Miscellaneous project promotion expenses	5,000	14,000		19,000
Diagnostic studies and action plans	166,500	42,500	18,500	227,500
1. Consulting services	166,500	42,500	18,500	227,500
Intervention in five production chains	850,000	72,000	150,000	1,072,000
1. Consulting services	850,000	72,000	150,000	1,072,000
Dissemination, administration and evaluation	60,000	450,000		510,000
1. Consulting and management services		345,000		345,000
2. Dissemination event		80,000		80,000
3. Contingencies	40,000	25,000		65,000
4. Intermediate and final evaluations	20,000			20,000
TOTAL	1,092,000	670,500	168,500	1,931,000
Share %	56.0%	35.0%	9.0%	100.0%

² See Annex II.

- 5.2 SERCAL is responsible for 100% of the local counterpart funding, i.e. for US\$839,000. In this it is important to include the contribution by leading firms, so as not to depart from CORFO standards for the Supplier Development Program; and, essentially, because this is an effective way to involve leading firms in the investments needed to achieve the increase in competitiveness that their markets demand, and thereby guarantee their ownership of the project.

VI. JUSTIFICATION AND RISKS

- 6.1 The advantages for the supplier firms are the expectation of a relatively secure market, and being able to rely on technical support from the buyer firm, which, in certain cases, could be a strong incentive to innovation and a transmission chain for technological updating. Support for strengthening production chains in a local development setting has a greater impact on microenterprises and small businesses, than programs that merely provide technical training and assistance to these small business units.
- 6.2 Local companies presently forming part of subcontracting chains that are selected must make every effort to remain competitive and cost-efficient so that they are not displaced by microenterprises that have been trained to compete in these markets.

A. Risks

- 6.3 The project being considered is highly risky, mainly because larger firms perceive smaller economic units as inefficient and inept. Accordingly, the main risk associated with the operation is that there will be insufficient demand from leading firms due to the perceived risks involved in working with microenterprises. To mitigate this risk, the project envisages three actions: (i) a percentage subsidy will be built into the intervention in order to generate sufficient demand among leading firms; (ii) US\$120,000 will be invested in promotion and awareness-raising activities among the main actors in the process; and lastly (iii) the design of the project itself, to be carried out in defined stages that require demonstration of achievements in previous components and concrete commitments before proceeding with subsequent components (paragraphs 4.8 and 4.11).
- 6.4 There is also a risk that microenterprises may become dependent on the market acquired through the project. To mitigate this, interventions will address not only technical aspects, but also management and the opening of new markets.

B. Committee on Environment and Social Impact

- 6.5 The operation was reviewed by the Committee on Environment and Social Impact (CESI) at its meeting of 29 September 2000, and it was decided that no special actions were called for.

VII. EVALUATION

- 7.1 Using technical cooperation resources, the Bank will hire a consultant to carry out an intermediate evaluation when 50% of the resources have been committed, or 18 months into the project, whichever occurs first. The evaluation will cover at least the following aspects: (i) activities carried out to promote the project among potential leading firms; (ii) activities related to evaluating the proposals received; and (iii) the process of selecting the five production chains to be targeted. This report will indicate the corrective actions needed to ensure appropriate project execution, and suggest a suspension of disbursements in the event of structural shortcomings in the way it is carried out. Disbursements may be resumed once the executing agency shows that it has taken such steps as are needed to remedy the deficiencies.
- 7.2 Once the project has been running for 36 months, and using technical-cooperation resources, the Bank will hire a consultant to carry out the final evaluation. This will assess the impact of the project and evaluate the following aspects, among others: (i) activities carried out to bind leading firms into the project; (ii) details of training and technical assistance activities undertaken; (iii) actions taken to adapt production-chain programs to practical aspects of local economic development; (iv) the number of microenterprises and small businesses participating, and the number of smaller firms effectively operating in production chains; (v) sales growth at the local level, generation of regional value-added, the number of new suppliers, the number of subcontracts resulting; and (vi) fulfillment of project activities in general, specifically reviewing resources applied and the allocation of counterpart funding.

VIII. EXCEPTIONS TO BANK POLICIES

- 8.1 None.

IX. SPECIAL CONTRACTUAL CONDITIONS

- 9.1 **Conditions precedent to disbursement of component 1:** presentation to the Bank's satisfaction of: (i) Board minutes appointing the project coordinator, specifying his/her functions, and assigning the job exclusively; and (ii) the first annual project plan, including a detailed timetable of activities, the resources anticipated, targets for each activity and the actions needed to achieve them (paragraph 4.5).
- 9.2 **Conditions precedent to execution of component 2:** (i) presentation to the Bank's satisfaction of the ground rules of the competitive selection process and the proposed classification criteria; (ii) evaluation report on promotion actions carried

out and outcomes thereof; and (iii) presentation of letters of commitment from selected leading firms interested in participating in the project, undertaking to contribute a minimum of 10% of the cost of carrying out the action plans (paragraph 4.8).

- 9.3 **Condition precedent to disbursement of the financing for components 3 and 4:**
(i) presentation to the Bank's satisfaction of letters of commitment from selected leading firms undertaking to contribute at least 15% of the cost of the intervention; and (ii) a report on the process of selecting the five production chains for intervention (paragraph 4.11).
- 9.4 The consultants hired by SERCAL to draw up the rules of the competitive selection process and the corresponding classification criteria, will automatically be disqualified from being hired by firms to prepare diagnostic studies, action plans and subsequent intervention (paragraph 4.8).

LOGICAL FRAMEWORK

MIF – TC-00-07-03-9 – Production chains for microenterprises

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Objective of the project is to enhance business in sectors of the economy where microenterprises and small businesses have the potential to supply goods and services concentrated in specific local markets and ready doing so.			
Objective is to strengthen at least 200 microenterprises and small businesses, to enable them to participate effectively in a production chain in a local development setting.	<p>By the third year of the project</p> <ul style="list-style-type: none"> 200 microenterprises and small businesses to the participating in productive chains led by medium size or large firms. 	<ul style="list-style-type: none"> Publication Final project report 	
<p>Business-raising among leading firms and development agencies</p> <p>Diagnostic study and preparation of action plans for integrated production chains</p>	<ul style="list-style-type: none"> At least 10 consulting firms or local development agencies trained to intervene locally and foster supplier development programs. At least 25 leading firms interested in submitting proposals for the development of supplier networks. At least 10 diagnostic studies of production chains presented. At least five action plans selected for financing through the project. 	<ul style="list-style-type: none"> Project execution reports. Documentation received for the competitive selection process. Report of the proposals evaluation committee. Report of the action plans evaluation committee. Surveys of beneficiary and non-beneficiary microenterprises and large firms. Publication 	<ul style="list-style-type: none"> There is a significant number of entrepreneurs carrying out activities in various sectors of the economy with potential to become supplier members of a subcontracting chain.

RATIVE SUMMARY OF OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>ion in production chains</p> <p>ation, administration and</p>	<ul style="list-style-type: none"> • 200 microenterprises and small businesses participating in five production chains assisted by the project improve their productivity by an average of 20% compared to microenterprises not receiving assistance. • 200 owners of microenterprises and small businesses participating in five productive chains improve their business capacity compared to entrepreneurs NOT receiving assistance. • Five large firms, leaders of selected production chains, improve their competitiveness (higher sales, lower costs, better quality) compared to large firms not benefiting from the project. • One methodological document published on the development of production chains. • 150 people involved in the development of microenterprises and small businesses familiar with the new methodology. 		
<p>web page</p> <p>tion and promotion events with</p> <p>elopment agencies and potential</p> <p>firms</p> <p>call for proposals in newspapers</p> <p>for firms submitting proposals:</p> <p>on of manuals for firms and</p> <p>ts</p> <p>f workshops</p>	<p>US\$ 5,000</p> <p>US\$ 24,900</p> <p>US\$ 12,000</p> <p>US\$ 50,000</p> <p>US\$ 5,100</p>	<ul style="list-style-type: none"> • SERCAL financial statements • Audit reports • Project evaluation reports 	<ul style="list-style-type: none"> • There are consultants willing proposals to design diagnostic action plans on production c • There are large firms and int organizations willing to cont resources to strengthen micr

NARRATIVE SUMMARY OF OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>workshops for firms submitting</p> <p>ground rules for competitive</p> <p>to select 10 proposals to carry out</p> <p>ic studies and prepare action</p> <p>and evaluate proposals to prepare</p> <p>ic studies and action plans on</p> <p>on chains.</p> <p>e preparation of action plans.</p> <p>action plans</p> <p>on of action plans and selection of</p> <p>best</p> <p>ntation of action plans.</p> <p>nd monitoring of interventions</p> <p>an event to disseminate</p> <p>logy.</p> <p>ration of project</p> <p>ns</p>	<p>US\$ 16,500</p> <p>US\$ 8,500</p> <p>US\$ 28,000</p> <p>US\$185,000</p> <p>US\$ 8,500</p> <p>US\$200,000</p> <p>US\$ 72,000</p> <p>US\$ 80,000</p> <p>US\$ 345,000</p> <p>US\$ 20,000</p>		

FOUR EXAMPLES OF PRODUCTIVE CHAINS TO ANALYZE AND DEVELOP

DESCRIPTION OF THE CHAIN	KEY ISSUE (OBJECTIVE)	SUCCESS INDICATOR	MICROENTERPRISES TO BE INTEGRATED	POSSIBLE ACTION ACTIVITIES
REPAIR. Chain with leading firms. Scant microenterprises. Final output is a repair with a constant	<ul style="list-style-type: none"> - Increase efficiency through cost reductions and improvement of local input quality (products and services). 	<ul style="list-style-type: none"> - Increased sales. - Increased profits - Greater stability. 	Small local firms from the repair shop, metal working and electric services sectors.	<ul style="list-style-type: none"> - Group workshops in training and strategic planning. - Initiatives aimed at diversification, cost improvement and quality assurance.
POWER AND COMMUNICATIONS. Chain in which one firm provides mass scale. Firms operate customer at the end and the leading firm.	<ul style="list-style-type: none"> - Improve the image of the leading firm in the eyes of final customers. - Increase bargaining power of microenterprises vis-à-vis the leading firm. 	<ul style="list-style-type: none"> - Fewer complaints from final customers - Increased sales - Obtain new clients 	Small local businesses working in installation maintenance, electric power, and communication technologies.	<ul style="list-style-type: none"> - Group workshops in training and strategic planning. - Initiatives aimed at customer service and image commitment.
PRODUCTS. Chain of medium-sized firms that are growing market. Firms operate in the field of the productive sector, maquila,	<ul style="list-style-type: none"> - Reduce environmental and product-supply risks. - Create alliances based on trust and balanced bargaining power. 	<ul style="list-style-type: none"> - Ensure minimum sales level. - Reduce environmental risks relating to product quality. 	Microenterprises engaged in collection, maquila and logistics services.	<ul style="list-style-type: none"> - Training in methodology for building trust for medium-sized firms. - Strategic planning. - Initiatives relating to production, trust-based management.
AGRICULTURE. Chain of a large group of firms facing a declining	<ul style="list-style-type: none"> - Product diversification and technological restructuring. 	<ul style="list-style-type: none"> - Alleviate unemployment. 	Agricultural producers, providers of agribusiness services, machinery, materials and equipment	<ul style="list-style-type: none"> - Group workshops in training and strategic planning, vision, market and opportunities for new products. - Initiatives aimed at diversification and technological restructuring.

PROPOSED RESOLUTION

CHILE. NONREIMBURSABLE TECHNICAL COOPERATION FOR THE
PRODUCTIVE INTEGRATION OF MICROENTERPRISES

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank or such representative as he shall designate is authorized, in the name and on behalf of the Bank, as Administrator of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Fundación SERCAL, and to take such additional measures as may be pertinent for the execution of the project proposal contained in Document MIF/AT-_____ with respect to a technical cooperation for the Productive Integration of Microenterprises.
2. That up to the amount of one million ninety two thousand dollars (US\$1,092,000), or its equivalent in other convertible currencies, shall be authorized for the purpose of this resolution, chargeable to resources of the Small Enterprise Development Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.