

## PROGRAM TO SUPPORT PRODUCTIVE INTEGRATION

(TC-98-10-50-9)

### EXECUTIVE SUMMARY

<b>Executing agency:</b>	Fundación Mexicana para la Innovación y Transferencia de Tecnología en la Pequeña y Mediana Empresa, A.C. [Mexican Foundation for Technological Innovation and Transfer for Small and Medium-Sized Enterprises] (FUNTEC)	
<b>Beneficiaries:</b>	The direct beneficiaries of this project will be 2,000 microenterprises and small businesses.	
<b>Amount and source:</b>	Modality: MIF	Nonreimbursable Facility IIIA
	Local counterpart:	US\$2,000,000
	FUNTEC:	US\$2,000,000
	Local business owners and governments:	<u>US\$4,560,000</u>
	Total:	US\$8,560,000
<b>Terms:</b>	Execution period:	48 months
	Disbursement period:	54 months
<b>Objectives:</b>	The general objective of this project is to help improve the productivity and competitiveness of small businesses and microenterprises by integrating them into the rest of the national productive structure. Innovative, replicable mechanisms of linkage and technical assistance will be employed. In principle, the project will mainly support various sectors that have been preidentified because of they have significant potential for growth through integration and because they are sectors in which microenterprise and small business predominate. These sectors include fashion, jewelry, footwear, furniture, leather goods, electronics, and graphic arts.	
<b>Description:</b>	Through technical assistance and training activities, support will be provided for a portfolio of seven productive integration projects, some of which will be selected from a list of 11 projects already identified by FUNTEC, targeting small businesses and microenterprises. Each of the projects will group a number of businesses, which will vary according to the integration mechanism required by the businesses. The projects will integrate small businesses and microenterprises into the production chain by linking them with larger businesses and/or	

will promote horizontal cooperation between small businesses. Given the sectors and projects identified, an estimated average of 80% of the beneficiary businesses will be small businesses and microenterprises.

To achieve its stated objectives, the project will be divided into three components: (i) promotion and identification of productive integration activities; (ii) development and implementation of local productive integration projects; and (iii) improvement of the environment, occupational safety and health, and child labor. FUNTEC and MIF resources will cofinance up to 33% of the operating costs of the local projects for activities defined under components (ii) and (iii) of the proposed program.

FUNTEC has already identified 11 productive integration projects. Of these, preparations are well under way for six; agreements have been signed for two projects; and the other four are at an advanced stage of preparation (see Annex V).

**Special  
contractual  
clauses:**

**Conditions precedent to the first disbursement:** (i) submission for the Bank's approval of a plan of action detailing the activities to be carried out under each component during the first year of the project; and (ii) presentation to the Bank by FUNTEC of evidence that it has hired, with resources from the MIF contribution, the personnel for the Integration Unit and the expert in social, labor, and environmental issues (see paragraphs 3.8, 3.13, and 8.1).

**Exceptions to  
Bank policy:**

None.

## **I. COUNTRY AND PROJECT ELIGIBILITY**

- 1.1 The Donors Committee of the Multilateral Investment Fund (MIF), at its meeting of January 21, 1994, declared Mexico eligible for all financing modalities. This operation is eligible for MIF financing under the Small Enterprise Development Facility (III-A) and is consistent with the principles of the MIF, as it seeks to develop the market for nonfinancial services by promoting the incorporation of small businesses and microenterprises into productive networks and encouraging business integration. The project responds to two needs at the national level: (i) the need to increase "national purchasing" by exporting sectors; and (ii) the need to improve occupational health and safety, conditions for the child labor, and environmental management in small businesses and microenterprises, which generally have limited resources to devote to bettering their practices in these areas.

## **II. BACKGROUND**

### **A. The private sector in Mexico**

- 2.1 According to the Bank study on the private sector in Mexico (RE2-98-003, April 1998), in 1993 the sector comprising micro-, small- and medium-sized enterprises accounted for 56% of personnel employed in the manufacturing sector, 38% of total output, and 99% of manufacturing establishments. At the sectoral level, such enterprises account for a majority share in the commerce sector (57%), while the percentages for the service, manufacturing, and construction sectors are 31%, 10%, and 1%, respectively.
- 2.2 The process of trade liberalization initiated by Mexico in the second half of the 1980s has led to increased availability of high-quality foreign inputs and components at relatively low cost, which has placed national suppliers at a competitive disadvantage and reduced national production integration.
- 2.3 The Bank study identifies the problems that have hindered the expansion of small businesses, highlighting those related to their lack of integration with larger businesses, difficulties in adapting to a new competitive atmosphere, limited capacity to absorb technology, and lack of skilled labor, investment in training, and access to credit. It also notes that, given the complexity of the problems faced by small businesses, under certain circumstances support is needed to enable businesses to form partnerships or networks.
- 2.4 The idea of providing support for the formation of business production networks is rooted in the fact that businesses within networks tend to generate an internal learning process. When such a process occurs in a business relationship, the dynamic is interactive, and the external support simply consolidates the relationship in the long term. Mexico currently has a thriving export sector, made up mainly of

large businesses, which affords an opportunity for productive integration as an effective means of cooperation between businesses in the interest of enhancing the productivity and development of small business and strengthening the competitiveness of the overall productive structure.

**B. The concept of productive integration**

- 2.5 Productive integration is a form of cooperation between businesses that enables smaller businesses to increase their competitiveness by raising their quality and productivity levels and lowering their costs. The creation of productive networks, in turn, helps to consolidate processes of regional economic development, as these networks involve both groups of business owners and local entities (state and municipal governments, business associations, chambers, etc.), for whom business development is an integral part of the local development process.
- 2.6 Productive integration is defined by means of two typologies, which are not mutually exclusive: (i) **horizontal integration**: small businesses join together to obtain economies of scale and enhance their market and business capacity through, for example, joint purchasing, investment, and/or production; consolidation of sales and marketing in order to access new markets; and development of shared technical, technological, or financial services; and (ii) **vertical integration**: small businesses establish supply relationships that ensure stable demand and support the assimilation of the technologies, information, and performance standards of their client companies through supply contracts that include long-term commercial commitments, technical assistance activities, training, technology transfer, and financial support, among other things.
- 2.7 *Horizontal integration.* The process of horizontal integration, or clustering, arises from the need to address a specific problem, under the leadership of several coordinating businesses. Cooperation among businesses that form such clusters reduces their operating costs. By realizing savings, these businesses increase their profits and rate of growth. The formation of partnerships between small businesses in order to generate economies of scale is the mechanism that has proved most beneficial in the process of integration.
- 2.8 *Vertical integration.* Vertical integration is a modality of cooperation between businesses located at different and consecutive points along the production chain, which join forces in order to gain competitive advantages that they would be unable to achieve individually. The most common example is the establishment of a strategic and stable supply relationship between one or several large client companies and their networks of micro-, small-, and medium-sized subcontractors. Among the benefits of vertical networks are the possibility of reducing supply costs and financial costs stemming from the need to stockpile raw materials and

intermediate products and the increase in flexibility in terms of production volumes and times in response to the demands of the market.<sup>1</sup>

- 2.9 *Advantages of integration.* Productive integration can be an effective instrument for improving the competitiveness of small businesses as it allows them to break out of the isolation that is the main impediment to their development, achieve economies of scale, and accelerate their mastery and assimilation of new technologies. Given the importance of the small business and microenterprise sector within the Mexican productive system—in terms of both employment and output—coupled with the relative isolation of these businesses and their limited capacity to form partnerships, external support to promote productive integration activities could generate the dynamic needed to foster innovations that will lead to sustainable increases in their productivity.

### C. The Program for Industrial Integration (PII)

- 2.10 The Programa de Integración Industrial [Program for Industrial Integration] (PII) came into being in November 1997 under an initiative of the Confederación de Cámaras Industriales de los Estados Unidos Mexicanos [Confederation of Industrial Chambers of Industry of Mexico] (CONCAMIN). The program is executed by the Fundación Mexicana para la Innovación y Transferencia de Tecnología en la Pequeña y Mediana Empresa, A.C. [Mexican Foundation for Technological Innovation and Transfer for Small- and Medium-Sized Enterprises] (FUNTEC), with cofinancing from the United Nations Development Program (UNDP). As of May 2000, the Program had formalized five local projects, having committed the totality of the UNDP contribution of resources (US\$ 1,000,000) (see II Annex).
- 2.11 Some projects are already yielding positive results, thanks to the identification of cost reduction processes, whether through industrial complementarity agreements or shared use of some production resources. In other cases, rather than joining together to reduce production costs, by means of “integrative partnerships” businesses are seeking to facilitate marketing, either through clustering of businesses that offer similar or complementary products or through the creation of a marketing firm for their products. In this type of partnership, local producers maintain their operational independence and only commit to work together on the specific objective of the partnership—for example, joint purchasing of a good or input that can help boost the productivity of all the businesses involved in the partnership. The chief feature of this type of partnership is that the member

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<sup>1</sup> Various international organizations, especially the United Nations Industrial Development Organization (UNIDO) have, from their creation in the 1970s, advocated the establishment of subcontracting exchanges. The purpose of this mechanism is to facilitate exchanges of information between large and small businesses in order to promote partnerships between them (“match-making”). In the majority of cases, this exchange of information has been insufficient because it has not incorporated the concept of learning, as a result of which the relationships have tended to be sporadic and the businesses involved have not come to agreements that would lead to long-term relationships (see Annex III).

producers specialize in some type of product, as occurs in the garment or shoe industry, for instance.

- 2.12 Under the PII, especially in the case of small business, the projects have achieved intermediate integration results—such as joint purchasing or sales, joint investment, and shared services—but have not necessarily led to full productive integration.
- 2.13 Given Mexico's socioeconomic reality and the serious limitations in the microenterprise and small business sector, both in terms of financial resources and human resources, this sector faces serious difficulties in meeting current standards on health and safety in the workplace, as well as child labor and protection of the environment. During the field visits carried out to microenterprises and small businesses as part of the preparation for this project, the project team noted the need to support the beneficiary businesses through technical assistance to enable them to comply with labor standards, including those concerning child labor, occupational health and safety, and environmental protection. This area has been identified as a priority, particularly since it was not included in the UNDP program.
- 2.14 Building on experiences mentioned above, the Productive Integration Program (PIP) proposed here will focus support in the following areas: (i) use of an integration methodology specially adapted to the needs of small business and microenterprise in order to help generate the dynamic necessary to take advantage of the benefits that this integration produces (innovation, learning by doing, reduction of costs, and access to information, among others); and (ii) specific strategies and actions that will help improve the working conditions and environmental impact of the small businesses and microenterprises participating in the project.

### III. THE PROJECT

#### A. Objective

- 3.1 *General objective.* The general objective of this project is to help improve the productivity and competitiveness of small businesses and microenterprises by better integrating them into the rest of the national productive structure. Innovative, replicable mechanisms of linkage and technical assistance will be employed. In principle, the project seeks mainly to support various sectors that have been preidentified because they have significant potential for growth through integration and because they are sectors in which microenterprise and small business predominate. These sectors include fashion, jewelry, footwear, furniture, leather goods, electronics, and graphic arts.
- 3.2 *Specific objective.* The specific objective of this project is increase productivity and competitiveness and improve labor and environmental conditions for the

microenterprises and small businesses participating in the productive integration projects through transfer to the Mexican context of a methodology for productive integration adapted for small business and microenterprise.

- 3.3 FUNTEC has already identified 11 productive integration projects. Of these, preparations are well under way for six; agreements have been signed for two projects and are being finalized for the other four (see Annex V). Another five projects are in the early stages of development (see Annex VI).

## **B. Description**

- 3.4 Through technical assistance and training activities, it is proposed that support be provided for a portfolio of 7 productive integration projects,<sup>2</sup> some of which will be selected from the list of 11 projects already identified by FUNTEC, targeting small businesses and microenterprises. Each of the projects will group together a number of businesses, which will vary according to the integration modality required by the businesses involved. The projects will incorporate small businesses and microenterprises into the production chain by linking them with larger businesses and/or will promote horizontal cooperation between small businesses. Given the sectors and projects identified, it is anticipated that an average of 80% of the businesses that benefit from this project will be small business and microenterprises.
- 3.5 To achieve its stated objectives, the project will be divided into three components: (i) promotion and identification of productive integration activities; (ii) development and implementation of local productive integration projects; and (iii) improvement of environmental conditions, occupational safety and health, and child labor.
- 3.6 FUNTEC and MIF resources will cofinance up to 33% of the operating costs of the local projects for activities defined under components (ii) and (iii) mentioned in paragraph 3.5. The local businesses involved will make a commitment under the PIP to cover 67% of the required financing with local resources (from governments and local business organizations and directly from the participating businesses). Of the latter resources, a minimum of 33% is to come from the private sector.

## **C. Project components**

### **1. Promotion and support for productive integration activities (US\$ 639,000 MIF, US\$ 895,800 FUNTEC)**

- 3.7 This component seeks to improve the capacity of the FUNTEC Integration Unit (IU) to carry out the following brokerage functions: (i) identification and promotion

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<sup>2</sup> The estimated average cost of each local project is around US\$ 960,000.

of productive integration initiatives for small business and microenterprise; (ii) technical support for the design of horizontal and vertical business networks; (iii) support in negotiations for local cofinancing of local projects; (iv) support for the creation and consolidation of local technical units (LTUs) to take responsibility for the execution of cooperation projects between businesses, as well as the development and implementation of business plans; (v) support for the LTUs in identifying national or international sources of specialized technical assistance to address specific needs; (vi) development and application of methodologies for managing and monitoring business network projects; and (vii) promotion of commitments by businesses to improve environmental, health, safety, and labor practices under the agreements for local projects.

- 3.8 To achieve the objectives of this component, funding will be provided to enable the hiring of the following **additional personnel** for the IU: (i) a technical manager, whose principal responsibility will be the design and preparation of productive integration projects that grow out of business initiatives; in addition, the technical manager will provide technical assistance to the LTUs, technical monitoring for local projects, and support for development of the strategic plans for the PIP; (ii) a manager of planning, monitoring, and evaluation, who will develop and implement monitoring and evaluation systems, including surveys of businesses and case studies; (iii) a financial manager, who will institute a system of financial control and internal accounting, prepare and execute the budget, produce the necessary management reports, and keep the accounts and records of the use of MIF resources; and (iv) an expert in social, labor, and environmental issues (see paragraph 3.13). Funding will also be provided to train the IU personnel in brokerage and in social, labor, and environmental matters.

**2. Development and implementation of local projects (US\$ 822,090 MIF, US\$ 1,035,342 FUNTEC, US\$ 4,380,862 local contribution)**

- 3.9 This component will finance technical assistance for the LTUs to strengthen their capacity to provide productive integration services for local projects. The local projects will be formalized by means of an agreement between the local instigators of the project and FUNTEC. Responsibility for coordinating the local project will rest with a steering committee, composed of the coordinator of the IU, the local project developers, and the director of the LTU.
- 3.10 The LTUs will have the operational structure necessary to carry out or oversee the following functions: (i) situation assessment, brokerage, and technical support for the incorporation of small businesses and microenterprises into export chains; (ii) assistance in the identification, prequalification, and development of businesses that are suppliers to larger businesses; (iii) promotion of the development of horizontal networks of businesses; (iv) negotiation and coordination of joint production and sales; (v) coordination of joint procurement of inputs or services; (vi) intermediation to facilitate access to credit or technical assistance;



(vii) technical advice for the design, promotion, and marketing of the products of groups of businesses; (viii) technology research and development services; (ix) quality certification (laboratory testing of raw materials and finished products); (x) training to facilitate working in groups, improvement of production practices, use of new technologies, design, quality control, inventory management, sales and marketing, business administration, etc.; and (xi) training for workers and other business personnel in matters relating to industrial safety, occupational health, environmental protection, and management of natural resources; and (xii) assistance for groups of businesses that wish to participate in business conferences, fairs, or other events.

- 3.11 To carry out these functions the LTU will have the following personal: (i) a director; (ii) an average of three liaisons; (iii) an administrative officer; and (iv) a secretary. The technical qualifications and precise number of LTU personnel will depend on the characteristics of each project. Financing will also be provided under this component for the provision of technical assistance to groups of small businesses and microenterprises for which common needs have been identified. Such technical assistance might be provided in areas such as computer technology, e-business, marketing, and export markets.
- 3.12 The projects currently at the most advanced stages of development are: (i) Center for Business Networking in León, Guanajuato; (ii) Technological Center for the Industrialization of Dairy and Horticultural Production in Ciudad Delicias, Chihuahua; (iii) Fund for the Industrialization of Fruit Production in the State of Sinaloa; (iv) International Commercial Intelligence Agency for the Handcrafts Sector of the State of Guanajuato; (v) Fund for the Industrialization of Meat Production in Navolato, Sinaloa; and (vi) Integration of the Broom Industry of Sinaloa. (For more detail on each project, see Annex V).

**3. Improvement of social, labor, and environmental conditions (US\$ 386,500 MIF, US\$ 175,000 local contribution)**

- 3.13 This component aims to improve the performance of participating businesses in regard to environmental conditions, occupational health and safety, and child labor. To that end, this component provides for specialized technical advisory services and the recruitment of an expert for the IU to take responsibility for the design and execution of the technical assistance plans to improve business practices in the areas of environment, safety, occupational health, and child labor (see paragraph 3.8). The specialized technical advisory services will be provided by local experts.
- 3.14 The activities planned under this component are: (i) a situation assessment for each project, including physical inspections, to identify the practices and current status of the businesses with respect to environmental protection, industrial safety, occupational health, and child labor, using for this purpose a representative sample

of the beneficiary businesses; (ii) design of plans to improve the practices of those businesses in regard to occupational health and safety, detailing the activities to be carried out for preventive purposes (motivation and training of workers, raising of awareness, modification of work habits, etc.); (iii) implementation of the technical assistance plans in a representative sample of businesses for each of the local productive integration projects; and (iv) monitoring of progress in the implementation of the plans and evaluation of the extent to which preestablished goals are achieved.

- 3.15 Training will be provided for the personnel of the LTU to enable them, as part of their brokerage function, to instruct the businesses in the productive and competitive advantages of incorporating into their productive processes improvements in their practices relating to the environment, industrial safety, occupational health, and child labor (ISO 14,000, recycling of products and byproducts, reduction of absenteeism due to illness, etc.).
- 3.16 The activities envisaged under this component are expected to lead to better voluntary programming on the part of the businesses to ensure compliance with standards and regulations, higher business productivity, greater worker satisfaction, lower accident and illness rates in the workplace, and reduced production costs.
- 3.17 The training will help the project beneficiaries to comply with the requirements of Mexico's Federal Labor Law, especially in regard to child labor and the provisions of the General Occupational Safety and Health Regulations.

#### **IV. EXECUTION**

##### **A. Executing agency**

- 4.1 The Confederation of Chambers of Industry of Mexico (CONCAMIN), established in 1936 with headquarters in Mexico City, is a national organization that represents the interests of small-, medium-, and large-scale industries in dealings with the Mexican government and other national and international agencies concerned with industrial development. The Mexican Foundation for Technological Innovation and Transfer for Small- and Medium-sized Enterprises (FUNTEC) was created to serve as the operational arm of CONCAMIN in 1994. FUNTEC will be the executing agency for the project. FUNTEC, through its Integration Unit (IU), is also responsible for executing the Program of Industrial Integration (PII).
- 4.2 In addition to the PII, FUNTEC is administering the Fondo para Proyectos de Prevención de la Contaminación [Fund for Pollution Prevention Projects] and is the liaison for the Programa de Modernización Tecnológica [Program for Technological Modernization] of the Consejo Nacional de Ciencia y Tecnología [National Council on Science and Technology] (CONACYT).

- 4.3 The FUNTEC Board of Directors has the authority to set policies, approve annual budgets, and evaluate the execution of all programs. The Board is made up of high-level representatives of business organizations and government agencies, including representatives of CONCAMIN, CONACYT, the Secretaría de Comercio y Fomento Industrial [Ministry of Trade and Industrial Development], the Instituto Politécnico Nacional [National Polytechnic Institute], the Consejo Nacional de Exportadores [National Council of Exporters], the Consejo de Cámaras Industriales del Estado de Jalisco [Council of Chambers of Industry of the State of Jalisco], the Cámara de la Industria de la Transformación del Estado de Nuevo León [Chamber of the Processing Industry of the State of Nuevo León], and the Cámara Nacional de Industria de la Transformación [National Chamber of the Processing Industry].

## **B. Execution scheme**

- 4.4 The Productive Integration Program (PIP) to be cofinanced by the MIF will function at two levels: (i) national, overseen by the Integration Unit (IU), whose mission is to identify viable integration proposals at the local level that are sustainable in the long term and to provide technical assistance to support the design and development of the required operational structure and the execution of local projects; and (ii) local, through each integration project undertaken, for which a permanent technical team will be formed within a local technical unit (LTU), which will serve as a link between businesses and a broker for the services required by the businesses. This technical team will also be responsible for collecting the locally contributed funds, with the support of the Integration Unit.

### **1. Integration Unit (IU)**

- 4.5 The IU will be staffed by personnel currently working on the Program for Industrial Integration (PII), also overseen by FUNTEC, as well as the additional personnel to be hired with the MIF financing (see paragraph 3.8). The staff of the IU will consist of six people: five professionals and one administrative officer. The functions of the professional personnel are described below.
- 4.6 *Coordinator of the IU.* Serves as the supervisor of the IU staff. The principal functions of the coordinator will include: (i) identifying and promoting productive integration projects; (ii) participating in negotiations with the businesspeople participating in the local projects; (iii) sitting on the steering committees of the local projects; (iv) supervising and participating in the development and presentation of regular and special plans of work for the IU; (v) coordinating the preparation the progress report on the PIP to be submitted to the Executive Director of FUNTEC; and (vi ) preparing the annual budget for the PIP. The coordinator reports to the Executive Director of FUNTEC.
- 4.7 *Technical manager.* Has primary responsibility for the design and preparation of productive integration projects that originate from business initiatives. The

technical manager's functions will also include: (i) providing technical advice for the development of local project documents; (ii) providing specific technical assistance, as needed, to the LTUs; (iii) technical monitoring of local projects; (iv) supporting the development of the strategic plans for the PIP; (v) evaluating the impact of the PIP on the businesses served by the LTU; and (vi) participating in the preparation of the progress report on the PIP to be submitted to the Executive Director of FUNTEC.

- 4.8 *Project development manager.* Supports the coordinator in identifying productive integration projects and participates in negotiations for formulating and determining the feasibility of projects. The project development manager's functions will include: (i) aiding in the development of the local project document; (ii) preparing the project participation agreements; (iii) providing support for the institutional formalization of projects and establishment of the respective LTU; (iv) assisting the coordinator in preparing the progress report to be submitted to the Executive Director of FUNTEC; (v) assisting the coordinator in preparing the annual budget.
- 4.9 *Planning, monitoring, and evaluation manager.* Has primary responsibility for developing and implementing monitoring and evaluation systems, including businesses surveys and case studies. The planning, monitoring, and evaluation manager's functions will include: (i) developing a protocol for monitoring and evaluation of the PIP; (ii) designing an assessment methodology, as well as the corresponding questionnaires; (iii) compiling and analyzing the information received; (iv) systematically documenting project experiences and results in a management information system; (v) preparing guidelines and procedures based on the analysis of experiences in order to replicate them; (vi) providing technical advice to the LTU; (vii) assisting in the development of the work plans and budget for the PIP; and (viii) assisting the technical manager in the development strategic plans for the PIP.
- 4.10 *Financial manager.* Primarily responsible for the development of the operating budgets for the IU and for periodic revision and updating thereof. The financial manager's functions will include: (i) keeping the financial accounts of the PIP; (ii) documenting the objectives, regulations, work plans, and budgets of each of the projects supported under the PIP in order to monitor and verify their execution; (iii) training and supervising administrative personnel of the LTUs to enable them to adhere to the accounting standards established for the PIP and each project; (iv) maintaining records of the banks accounts out of which the operating expenses of the PIP are to be covered; and (v) preparing the accounting reports for the PIP to be submitted to the Bank/MIF.
- 4.11 In addition, an expert in social, environmental, and labor issues will be hired to work part-time for the IU (see paragraphs 3.8 and 3.13).

## **2. Local Technical Unit (LTU)**

- 4.12 The LTUs will be made up of personnel specializing in the specific sector to be integrated. The staff of each LTU will include: (i) a director, (ii) liaisons,<sup>3</sup> (iii) a financial manager, and (iv) an administrative assistant.
- 4.13 Up to 33% of the operating costs of the LTUs and the costs of implementing local projects will be financed out of the MIF/FUNTEC contribution, with the rest to be financed out of local contributions, for a period of not more than three years. The contribution of MIF/FUNTEC funds will be made concurrently with the contribution of funding by businesses and local governments. The latter amount is not to be less than 67% of the total cost of the local project.

### **C. Selection of local projects**

- 4.14 In identifying, promoting, and formulating projects, a large number of initiatives will always be examined so as to select those that are most attractive for small businesses and microenterprises. The basic criteria for the selection of proposed projects will be: (i) the initiative is oriented toward productive integration, with good potential for developing networking capacity in a sector; (ii) the project has a clearly identified market, product, and services; (iii) there is evidence of potential demand for the products and services that the LTU would offer; (iv) a business model is presented that will enable the center, after the three-year financing period ends, to generate sufficient resources to cover the 33% of the operating costs previously covered under the PIP; (v) the initiative is being put forward by businesses; (vi) the promoters and/or beneficiaries of the project are willing to cofinance it; and (vii) the initiative aims to produce measurable results in terms of increased productivity and competitiveness.
- 4.15 Should there be several suitable projects that exceed the amount of resources available under the PIP, projects will be selected according to the following criteria: (i) a greater number of small businesses and microenterprises will benefit; (ii) higher impact in terms of creation of sustainable employment; and (iii) higher percentage of business cofinancing.

### **D. Reporting**

- 4.16 FUNTEC, through the IU, will be responsible for monitoring and for preparing the corresponding reports. It will submit biannual progress reports on the PIP, documenting the activities carried out during each six-month period, with emphasis on the results and impacts achieved by the project, both within the IU and at the level of local projects. The structure and content of the progress reports will be

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<sup>3</sup> In budget estimates for the LTUs an average of three liaisons per local project has been envisaged; the number may be greater or smaller, depending on the magnitude of the project.

decided by common agreement between FUNTEC and Bank's Country Office prior to their preparation. In addition, a plan of work and timetable of disbursements for the following period will be drawn up. The report will be submitted to the Bank's Country Office for its approval within 60 days from the end of each six-month period. The Bank's Country Office will submit the project completion report to the MIF within three months of the project's conclusion.

#### **E. Project preparation status**

- 4.17 FUNTEC already has two local projects that are sufficiently advanced to formalize them immediately after the PIP is approved by the MIF. These projects are: (i) Center for Business Networking in León, Guanajuato and (ii) Technological Center for the Industrialization of Dairy and Horticultural Production in Ciudad Delicias, Chihuahua. The aim of the first project is to establish a center that will provide services to small manufacturers of footwear to assist them in improving their production processes, quality assurance, compliance with environmental standards, supplier development, and execution of joint activities. The second, which is being promoted by industrialists, crop-farmers, and stockbreeders in the region of Delicias, Chihuahua, together with the state government, seeks to create a center for technological research and development whose services will enable the member businesses to meet national and international market standards. Another four projects are in an advanced stage of preparation. They are: (i) Fund for the Industrialization of Fruit Production in the State of Sinaloa; (ii) International Commercial Intelligence Agency for the Handcrafts Sector of the State of Guanajuato; (iii) Fund for the Industrialization of Meat Production in Navolato, Sinaloa; and (iv) Integration of the Broom Industry of Sinaloa. (For more detail on each project, see Annex V).
- 4.18 FUNTEC has reviewed the logical framework for this project (see Annex I) and has expressed its agreement with the performance indicators to be evaluated during and following the completion of the project.

### **V. COST AND FINANCING**

#### **A. Cost**

- 5.1 The cost of the project is estimated at US\$ 8.56 million, of which US\$ 2 million will be a nonreimbursable contribution from the MIF and US\$ 2 million will be a counterpart contribution from FUNTEC, both in kind and in cash. The remainder will come from contributions by governments and local businesses to the productive integration projects, for a total of not less than US\$ 4.56 million. The following table shows the consolidated budget.

**Table 5.1 Consolidated Budget**

Categories	MIF	FUNTEC	Local Contribution	TOTAL
<b>I. Promotion and support of productive integration activities</b>	<b>639,000</b>	<b>895,800</b>	<b>0</b>	<b>1,534,800</b>
1.1 Professional fees	624,000	648,000		1,272,000
1.2 Training	15,000	3,000		18,000
1.3 Travel and per diems		192,000		192,000
1.4 Office and equipment		48,000		48,000
1.5 Publications		4,800		4,800
<b>II. Development and implementation of local projects</b>	<b>822,090</b>	<b>1,035,342</b>	<b>4,380,862</b>	<b>6,238,294</b>
2.1 Professional fees	436,590	977,130	3,122,280	4,536,000
2.2 Technical assistance	280,500		569,500	850,000
2.3 Training	105,000			105,000
2.4 Travel and per diems		58,212	118,188	176,400
2.5 Office and equipment			210,000	210,000
2.6 Other contributions and expenditures			360,894	360,894
<b>III. Improvement of social, labor, and environmental conditions</b>	<b>386,500</b>	<b>0</b>	<b>175,000</b>	<b>561,500</b>
3.1 Professional fees	96,000			96,000
3.2 Training	31,500			31,500
3.3 Technical assistance	245,000		175,000	420,000
3.4 Travel and per diems	14,000			14,000
<b>IV. Evaluation, auditing, and unanticipated expenditures</b>	<b>152,410</b>	<b>68,858</b>	<b>4,138</b>	<b>225,406</b>
4.1 Evaluation	50,000			50,000
4.2 Auditing	40,000			40,000
4.3 Unanticipated expenditures	62,410	68,858	4,138	135,406
<b>Total</b>	<b>2,000,000</b>	<b>2,000,000</b>	<b>4,560,000</b>	<b>8,560,000</b>
<b>Percentages</b>	<b>23%</b>	<b>23%</b>	<b>54%</b>	<b>100%</b>

- 5.2 Existing office facilities and equipment turned over for the use of the project will be recognized as counterpart contributions in kind up to an amount not to exceed 5% of FUNTEC's local counterpart contribution.

**B. Financial sustainability**

- 5.3 *Of the Integration Unit for the project.* The financial sustainability of the operational structure of the Integration Unit will be ensured by the financial yield of the public trust FILANFI which, in accordance with its bylaws, provides ongoing financing for the basic costs of the operational structure of FUNTEC. FUNTEC also expects to derive additional revenues from the sale of services.
- 5.4 *Of the local technical units.* The projects will include plans for operational sustainability through the sale of services. For services that can be taken over by individual businesses, the amount charged is expected to gradually reach 100% of the cost of these services. For services that cannot be taken over by individual businesses, it is expected that the costs will be shared by the businesses, chambers of commerce, and business associations, as well as federal and state public funds, in

varying amounts according to the characteristics of the projects. This shared financing will cover the 33% of the costs that will be financed through the contributions of FUNTEC/MIF during the execution of the project.

**C. Execution and disbursement period**

- 5.5 The execution period for the project will be 48 months, with a disbursement period of 54 months. Disbursements for the project will be made through a revolving fund for advances, equivalent to 10% of the contribution.
- 5.6 FUNTEC will be responsible for internal accounting and financial control of the project funds, which are to be maintained separately from any funds from other sources administered by FUNTEC. The financial information on the project should distinguish between the contributions of the MIF and funds from other sources and should also clearly identify necessary expenditures for procurement of goods and services. FUNTEC will open two separate bank accounts to be used exclusively for the administration of the project: one for the counterpart resources and the other for the MIF resources. The disbursement of MIF funds and the procurement of goods and services will be carried out in accordance with Bank and MIF procedures. FUNTEC will prepare and submit to the Bank audited financial statements, annually and at project completion.

**D. Committee on Environment and Social Impact (CESI)**

- 5.7 CESI, at its meeting of May 14, 1999 (TRG 18-99), commended the project team for including social and environmental concerns in the project and approved the profile.

## **VI. RATIONALE AND RISKS**

**A. Rationale**

- 6.1 The project will help improve the viability of small businesses in Mexico. The development of this sector is critical, given its significant impact on employment, income, and living conditions for the population. Support for productive integration activities will improve the capacity for technological innovation and mastery, and strategic management and will permit economies of scale and strengthen the negotiating power of small businesses and microenterprises.
- 6.2 The project responds to a need that is not being met by traditional mechanisms of financial support and technical assistance for small business, focusing its activities on the promotion of innovative brokerage mechanisms between businesses that minimize transaction costs (lack of information, mistrust, lack of a "culture of partnership," etc.) and constitute indispensable elements for the development of productive integration.



- 6.3 The project will support local productive integration initiatives in which the identification of needs and the design of projects to address them originate with local businesses themselves. The Bank will thus contribute to strengthening of the business sector at the local level.

**B. Risks**

- 6.4 Under this project, an innovative methodology for productive integration of microenterprises and small businesses will be developed, tested, and evaluated. The methodology will have to overcome sociocultural factors inherent in the Mexican business environment (mistrust, lack of a spirit of cooperation, localism, etc.). The project proposes to mitigate this risk by requiring that a majority of the financing for local projects come from the private sector. It will also seek to contribute the external mediation elements necessary to surmount these sociocultural impediments.
- 6.5 Another important risk is related to the difficulties and delays that might occur in the process of identifying, structuring, and negotiating local projects and to the possibility that the number of projects programmed initially might not ultimately be formalized. To mitigate this risk, additional personnel will be hired for the IU, with a view to strengthening FUNTEC's operational capacity to identify and formalize projects and meet the demand for services that the local projects are expected to generate. Furthermore, the Bank, depending on the results of the midterm evaluation (see paragraph 7.1 below), reserves the right to cancel the uncommitted portion of the funding, in the event that the formulation of local projects has not been achieved to the Bank's satisfaction within the first 24 months of project execution.

## **VII. EVALUATION AND MONITORING**

- 7.1 The MIF will hire consultants to carry out two independent evaluations. A midterm evaluation is to be initiated 21 months after the start of project execution and submitted to the Bank during the 24th month of the execution period. This evaluation will focus especially on performance indicators, including: (i) number of active projects (contributions for shared costs made, work plans formulated and implemented); (ii) number of businesses involved and participating in cofinancing of the project; (iii) number of small businesses and microenterprises participating in business networks and indicators of improvement in their productivity and competitiveness (cost reductions due to shared purchasing and services, joint investments or joint production; increased revenues due to joint marketing and sales strategies); (iv) number of suppliers incorporated into the productive network; (v) evaluation of the quality of services provided under the PIP to participating businesses; (vi) reduction in occupational accidents in the participating businesses; (vii) evaluation of the effectiveness of technology transfer resulting from the

participation of businesses in the productive network; and (viii) institutional capacity and sustainability of the projects and of the LTU.

- 7.2 At the end of the execution period, a final evaluation will be carried out, which will complement the midterm evaluation and will determine, using similar criteria, the project's impact. The final evaluation will also include recommendations on how to replicate the methodology. The cost of the evaluations will be covered out of the MIF contribution.
- 7.3 *External auditing.* FUNTEC will submit to the Bank, within 90 days of the close of each fiscal year, annual financial statements on the project, audited by an independent auditing firm acceptable to the Bank. The cost of the audits will be charged to the MIF contribution.

### **VIII. SPECIAL CONTRACTUAL CONDITIONS**

- 8.1 *Conditions precedent to the first disbursement:* (i) a detailed plan of action must be submitted for the Bank's approval, indicating the activities to be carried out under each component during the first year of project execution; and (ii) FUNTEC will be required to submit to the Bank evidence that it has hired, with resources from the MIF contribution, the personnel for the IU and the expert in social, labor, and environmental issues.

### **IX. EXCEPTIONS TO BANK POLICY**

- 9.1 There will be no exceptions to Bank policy. The procurement of goods and services for the project will be carried out in accordance with Bank procedures.

## LOGICAL FRAMEWORK

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>the productivity and competitiveness of small and microenterprises through the development of productive integration projects that will promote and support the integration by means of innovative technical assistance replicable in the Mexican context.</p>	<ul style="list-style-type: none"> <li>Reduction in the volume of imports with high added value.</li> </ul>	<ul style="list-style-type: none"> <li>National statistics: amount and types of imports, purchases of inputs from national suppliers.</li> </ul>	<ul style="list-style-type: none"> <li>Stable macroeconomic conditions.</li> <li>Continued government policies promoting small business development.</li> </ul>
<p>improvement in the productivity and competitiveness and working conditions in the small and microenterprises participating in productive integration projects under the program of FUNTEC in the Mexican context of a productive integration adapted for small and microenterprise.</p>	<ul style="list-style-type: none"> <li>Improvement in levels of productivity and competitiveness of the participating businesses (reduction of costs for purchase of inputs, shared services, increased revenues, etc.)</li> <li>Demonstrated institutional and financial capacity and sustainability of the productive integration projects after the three-year period of financing and assistance.</li> <li>Decrease of at least 20% in occupational accidents and 20% in occupational illnesses in the participating businesses.</li> </ul>	<ul style="list-style-type: none"> <li>Biannual reports.</li> <li>Evaluation surveys.</li> </ul>	<ul style="list-style-type: none"> <li>The Mexican economy is growing and open and neighboring countries keep their markets open to the industry.</li> </ul>
<p>strengthening of FUNTEC's capacity for productive integration projects.</p>	<ul style="list-style-type: none"> <li>Strengthening of the Integration Unit with additional personnel prior to the start of project execution.</li> <li>Reduction of project formalization time.</li> <li>Formalization of 7 productive integration projects by the 24th month of project execution.</li> <li>A minimum of 60% of the businesses participating in local projects are small businesses and microenterprises.</li> </ul>	<ul style="list-style-type: none"> <li>Contracts for additional personnel.</li> <li>Signed agreements for local projects.</li> <li>IU progress reports.</li> </ul>	<ul style="list-style-type: none"> <li>Continued funding for the project.</li> <li>The PIP will be viable for small businesses and microenterprises means of strengthening the productive integration process.</li> </ul>

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<ul style="list-style-type: none"> <li>• of capacity of LTUs.</li> </ul>	<ul style="list-style-type: none"> <li>• Institutional capacity and sustainability of the projects and the Integration Unit (technical, managerial, and operational capacity, cost recovery through sales of services, quality and degree of client satisfaction with the services provided).</li> <li>• As of the second year, 60% of the businesses receiving technical assistance from each LTU rate that assistance as "good" or better.</li> <li>• As of the third year, LTUs finance at least 66% of the operating costs of their programs through the participating businesses.</li> <li>• By the 24th month of project execution, at least 7 of the local integration projects are being executed without difficulty.</li> </ul>	<ul style="list-style-type: none"> <li>• Biannual reports (LTU).</li> <li>• Inspection visits.</li> <li>• Assessment survey.</li> <li>• Midterm evaluation.</li> <li>• Execution of the business plan.</li> <li>• Records of the businesses involved.</li> <li>• Copies of contracts.</li> <li>• Reports of specialized consultants.</li> </ul>	<ul style="list-style-type: none"> <li>• Local financial continuity.</li> <li>• Sufficient demand for the LTUs.</li> <li>• Services of the LTU appropriate and respectful.</li> <li>• Promotion and publication will be effective.</li> <li>• Microenterprises and businesses will see LTUs as important partners in their productive integration.</li> <li>• Adequate local financial situation.</li> <li>• Adequate motivation of business owners and finance and implementation conditions in their business.</li> </ul>
<ul style="list-style-type: none"> <li>• of social, labor, and environmental integration projects.</li> <li>• the businesses participating in</li> </ul>	<ul style="list-style-type: none"> <li>• Improvements in the businesses in the areas of safety, occupational health, and environmental protection.</li> <li>• Plans for improving environmental, safety, and occupational health conditions fully implemented in the participating businesses by the end of the third year of project execution.</li> </ul>	<ul style="list-style-type: none"> <li>• Environmental, labor, and social situation assessments for the projects.</li> <li>• Inspection visits.</li> <li>• Midterm evaluation.</li> <li>• Biannual reports (LTU).</li> </ul>	<ul style="list-style-type: none"> <li>• Availability of consulting services.</li> <li>• Curriculum for courses.</li> <li>• Course evaluations.</li> <li>• Vouchers.</li> </ul>
<ul style="list-style-type: none"> <li>• personnel for the IU.</li> <li>• coverage for IU personnel.</li> <li>• problems.</li> </ul>	<ul style="list-style-type: none"> <li>• Contracts signed prior to first disbursement. US\$1,272,000</li> <li>• Training courses imparted. US\$18,000</li> <li>• One monthly visit made. US\$192,000</li> </ul>	<ul style="list-style-type: none"> <li>• Availability of consulting experience.</li> <li>• Availability of required partnerships.</li> <li>• Continued interest in</li> </ul>	

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>• Establishment of LTUs.</p> <p>• Brokerage for LTU personnel.</p> <p>• Assistance for local projects.</p> <p>• Per diems.</p>	<ul style="list-style-type: none"> <li>• Agreements signed for 7 local projects, establishing LTUs, with signed personnel contracts. US\$4,536,000</li> <li>• Training courses imparted. US\$105,000.</li> <li>• Contracts for specialized consultants signed. US\$850,000.</li> <li>• Travel undertaken. US\$176,400</li> </ul>	<ul style="list-style-type: none"> <li>• Agreement</li> <li>• Contracts for LTU personnel</li> <li>• Curriculum for courses.</li> <li>• Course evaluations.</li> <li>• Contracts for consultants.</li> <li>• Vouchers</li> </ul>	<ul style="list-style-type: none"> <li>• Availability of local personnel for the LTU.</li> <li>• Availability of required resources.</li> <li>• Availability of consultants with relevant experience.</li> <li>• Continued interest in local partnerships.</li> </ul>
<p>• Employment of an expert in social, environmental, and labor issues.</p> <p>• Training for LTU personnel.</p> <p>• Support for environmental and labor projects for approved projects.</p>	<ul style="list-style-type: none"> <li>• Contract signed as of month 1 of project execution. US\$96,000</li> <li>• Training course imparted. US\$31,500</li> <li>• Plans for improving labor and environmental conditions implemented.</li> </ul>	<ul style="list-style-type: none"> <li>• Contract.</li> <li>• Consultant's reports.</li> <li>• Curriculum for course.</li> </ul>	<ul style="list-style-type: none"> <li>• Availability of local personnel.</li> <li>• Continued interest in local partnerships.</li> </ul>

**PROPOSED RESOLUTION**

**MEXICO. NONREIMBURSABLE TECHNICAL COOPERATION PROGRAM FOR  
SUPPORT OF PRODUCTIVE INTEGRATION**

**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 Multilateral Investment Fund, to enter into such agreements as may be necessary with the "Fundación Mexicana para la Innovación y Transferencia de Tecnología en la Pequeña y Mediana Empresa, FUNTEC, A.C." and to take such additional measures as may be pertinent for the execution of the donor's memorandum referred to in Document MIF/AT- with respect to a technical cooperation program for Support of Productive Integration.
2. That up to the amount of US\$2,000,000, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.