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**BUSINESS LINKAGE AND COMPETITIVENESS OF THE ALPACA
TEXTILE SECTOR IN AREQUIPA**

(TC-01-12-06-1-PE)

DONORS MEMORANDUM

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INFORMATION AVAILABLE IN THE SDS/MSM TECHNICAL FILES

PREPARATION:

- Request for financing
- Approved project profile
- MIF eligibility memorandum
- IPAC's bylaws
- Projections for cost recovery

EXECUTION:

- Terms of Reference for project administrative and technical personnel
- IPAC's organization chart
- Implementation schedule
- Operating Regulations
- Itemized budget

ABBREVIATIONS

CESI	Committee on Environment and Social Impact
EAP	Economically active population
GDP	Gross domestic product
IAA	International Alpaca Association
IPAC	Instituto Peruano de Alpaca y Camélidos [Peruvian Alpaca and Camelid Institute]
MSBs	Microenterprises and small businesses
NGO	Nongovernmental organization
ORDESUR	Organismo para la Reconstrucción y Desarrollo del Sur [Organization for the Reconstruction and Development of the South]
PROMPEX	Comisión para la Promoción de las Exportaciones del Peru [The Peruvian Commission for Export Promotion]
TU	Technical Unit

BUSINESS LINKAGE AND COMPETITIVENESS OF THE ALPACA TEXTILE SECTOR IN AREQUIPA

(TC-01-12-06-1-PE)

EXECUTIVE SUMMARY

Executing agency:	Instituto Peruano de la Alpaca y Camélidos [Peruvian Alpaca and Camelid Institute] (IPAC)		
Beneficiaries:	<p>The main beneficiaries of the project are microenterprises and small businesses (MSB) in the alpaca textile sector and organized artisans in the department of Arequipa. The direct beneficiaries will be 50 small businesses and 1,000 workers with an interest in increasing or entering into production of alpaca apparel for the domestic and foreign market. They will do so through formation of business networks to respond jointly to direct production orders and subcontracting requests. Other beneficiaries will be the microenterprises that are potential subcontractors of these businesses. In addition, about 300 organized artisans will have access to higher revenues generated by the growth of effective demand for their finishing services in export-quality knit/woven apparel.</p> <p>Local training and technical assistance institutions and independent professionals will also be strengthened, as recipients of technical know-how transferred to them by manufacturers that are members of IPAC.</p>		
Financing:	Modality:		
	MIF Facility III-A:	US\$470,000	
	Local counterpart:	US\$310,000	
	Total:	US\$780,000	
Execution timetable:	Execution period:	36 months	
	Disbursement period:	42 months	
Objectives:	<p>The general objective of the project is to contribute to the development of an alpaca textile cluster in Arequipa that will provide opportunities for participants to improve their competitiveness. The specific objective is to promote a sustainable system for business</p>		

linkage that will stimulate MSB growth in the sector, based on improved productivity and business networks with broader access to domestic and international markets.

Description: The project will consist of three components that will be executed concurrently. The goals of the components are: (i) business development of MSBs by expanding their direct access to markets and subcontracting by manufacturers; (ii) organization and technical assistance so small businesses can meet quality and productivity and quality standards; and (iii) training of middle managers, workers and artisans.

The abovementioned activities will be supported in large measure by manufacturers that belong to IPAC and have already committed to actively participating in the project. They will provide information, know-how, experience and contacts for the project. A key factor will be the participation of the technical personnel of these companies, who have a first-rate academic education and broad experience in the field with the cluster enterprises. They will serve as trainers, advisers and facilitators of the improvement processes, and have already actively participated in the design of this project.

Special contractual clauses: As a condition precedent to the first disbursement, IPAC will submit evidence of the selection of a Project Coordinator, to the Bank's satisfaction.

Exceptions to Bank policy: None

Environmental and social review: The Committee on Environment and Social Impact (CESI) reviewed and approved the project abstract at the meeting on 22 February 2002. In accordance with CESI's suggestions, IPAC added the following policies to the project's Operating Regulations: (i) all training and technical assistance under the project must promote activities and production techniques that are socially and environmentally sustainable; (ii) the technical assistance for participating businesses will include enhancing facilities to protect worker health and improve the indoor environment, with a view to ensuring worker comfort; and (iii) the Technical Unit will follow open, competitive procedures to select beneficiaries and trainers, promoting the participation of women beneficiaries and businesses owned by women (see paragraphs 3.13 and 3.17).

I. COUNTRY AND PROJECT ELIGIBILITY

- 1.1 The Republic of Peru was declared eligible for all the financing facilities of the Multilateral Investment Fund (MIF) on 14 December 1993. This project is eligible for grants under the Small Enterprise Development Facility (Facility III-A). It is consistent with the MIF's purpose, in that it will support the development and increased competitiveness of microenterprises and small businesses (MSBs) in the production chain of the alpaca textile sector in Arequipa, Peru. The project was declared eligible by the MIF Programming and Operations Committee on 25 February 2002.

II. REFERENCE FRAMEWORK

- 2.1 **The importance of alpaca in Peru:** The production chain of the alpaca sector represents a fundamental component of the regional economy of the departments in the highlands of Peru, in terms of both the jobs and revenue it generates and the share of alpaca production in the domestic and international markets. In general, camelids¹ constitute the most important livestock species in the highlands. Approximately 167,000 low-income producer families are involved in camelid farming, which represents their main source of income. Alpaca is the camelid species with the greatest economic impact in the Peruvian Andes, with more than four million animals in Peru, equivalent to 87% of the worldwide population. Peru is also the primary producer of alpaca fiber, with 80% of worldwide production.
- 2.2 **The alpaca textile sector:** The sector represents 1.35% of the total exports of Peru and 5% of nontraditional exports. Alpaca textile exports totaled US\$75 million in 2001. Over the past 10 years, its contribution to manufacturing gross domestic product has been between 2 and 2.5%, and it absorbed 2% of the economically active population (EAP) employed in the manufacturing industry (approximately 22,000 persons). Among the businesses in the sector, 96% are microenterprises and small businesses (MSBs) with less than 40 employees; 3% are medium-scale enterprises (between 41 and 200 employees), and 1% are large companies.
- 2.3 **Markets and products:** The main export markets are China, Italy and the United States for tops² and yarns (products with less value added), and the United States, Germany, the United Kingdom and Japan for finished alpaca apparel. The main exports are alpaca tops and wool, combed and carded yarn, fabric, flat-knit apparel, machine- or hand-made knitwear such as sweaters, cardigans and crafts. Some 80% of alpaca fiber exports are products with low value added (tops, yarn and fabric), and only 20% are finished apparel.

¹ The camelid family includes llamas, alpacas, vicuñas and guanacos.

² "Tops" are rolls of fiber scoured and degreasing with minimal value added, produced by manufacturers mainly in Arequipa.

- 2.4 **The alpaca textile production chain:** The alpaca textile production chain represents one of the main economic strengths of Arequipa. The chain consists of: (i) *large and medium-scale manufacturers* that store the fiber, classify it, scour it and process it into yarn, fabric or apparel for export; (ii) *small businesses* (averaging 20 workers) that produce apparel with high value added for domestic markets or for export, through direct sales or subcontracting³ with manufacturers; (iii) *microenterprises* (averaging three workers) that knit fabric on manual or semi-industrial machines, which they mainly sell in domestic markets or provide subcontracted production services to the small businesses during peak demand periods; and (iv) *artisans* who produce handmade knitwear, weaving, embroidery and finishing for domestic markets, subcontracting or for small special orders for export.
- 2.5 The manufacturers have been developing their own strategic plans and targeting a greater volume of sales on the international market. Their success is based on improving their efficiency indicators and a major marketing effort in a highly competitive international market. The companies have achieved significant success in the international markets based by investing in technology for better quality and productivity and increased flexibility in manufacturing plants and processes.
- 2.6 **Business linkage and subcontracting:** During peak production periods, the companies often need to subcontract a portion of their orders to third parties in order to meet the deadlines and volumes agreed upon. Moreover, they have experienced growing demand for orders that require special production techniques with greater value added and sometimes do not have the internal capacity to supply them. In order for these manufacturers to competitively enter market niches with greater value added, they need to expand their ties with and improve the capacity of the enterprises that supply specialized production services. This will enable the manufacturers to lower their costs and fill the different types of business orders with greater flexibility. The manufacturers are currently unable to fill all the orders they receive because they have not established the necessary linkage with potential suppliers, many of which are small apparel manufacturing enterprises in Arequipa.
- 2.7 Subcontracting relationships are mutually beneficial for both parties. Subcontracting to small businesses by industrial companies represents a significant source of additional orders for the small businesses. For the small group of small businesses that have already participated in subcontracting initiatives, subcontracted production accounts for 30% to 40% of their total production. Moreover, for the manufacturers, the advantages represented by this business-to-business cooperation

³ Subcontracting is a system of breaking down production processes based on cooperation between businesses, consisting of a transaction through which one company entrusts another with carrying out a portion of the production activities. This relationship entails technical specifications for products and processes, which also means that there will be a process of learning and technology transfer to the subcontracting enterprises.

include: (i) greater production flexibility; (ii) lower fixed costs for plants, machinery and equipment; (iii) lower plant personnel costs; and (iv) the ability to fill a broader variety of business orders.

- 2.8 In spite of these mutual advantages, the development of the subcontracting market among industrial and small businesses has been very limited. Only a handful of small businesses have managed to meet the requirements for participating in these initiatives. For more microenterprises and small businesses (MSBs) to participate in both business linkage (subcontracting) and direct ties with other markets, the problems analyzed below must be addressed.
- 2.9 **Current problems of MSBs in the sector in Arequipa:** There are around 350 formal microenterprises and small businesses in the alpaca textile sector in Arequipa. Most of them have problems breaking into subcontracting and building direct ties with export markets due to their low competitiveness, as reflected in the following obstacles:
- a. **Limited market access** due to: (i) little knowledge of their market; (ii) lack of innovative designs and collections due to inaccessibility of current information about the main markets for their products; and (iii) few and weak relationships with brokers. Although there are brokers who come to Arequipa in search of production services to meet orders, there are no mechanisms to connect them with MSBs.
 - b. **Inadequate productivity levels** because of: (i) the lack of skilled labor; (ii) use of old or low-quality machines; and (iii) inadequate business management. This situation gives rise to inefficient production processes that hamper a sustained reduction in costs and absorption of new technologies.
 - c. **Low product quality** for export markets because: (i) the MSBs are unaware of the quality standards and regulations they must meet; (ii) they do not have or manage technical records and quality control systems; and (iii) their work does not include a culture of reliability and responsibility.
 - d. **Lack of interest in and incentives for association and cooperation** with other MSBs to organize production and penetrate the market. This can be partially attributed to mistrust and partially to their unawareness of the opportunities and advantages of working this way. As a result, their bargaining power with providers and buyers is minimal, limiting their development prospects.
- 2.10 To address this situation, the Instituto Peruano de la Alpaca y Camélidos (IPAC) has been taking a number of initiatives to strengthen the skills of all the participants in the sector's production chain. It seeks to consolidate the alpaca cluster by developing suppliers and related initiatives, which will enable them to

competitively penetrate new market niches that are more exclusive and lucrative. They will be able to handle volumes of demand that are currently not being serviced and place alpaca products in the domestic and foreign markets. In this project, IPAC will implement mechanisms to transfer know-how, technology and the skills from manufacturers to MSBs, in order to improve the competitiveness of the production chain and ultimately to increase the value added of domestic production and exports.

- 2.11 The project is consistent with the Bank's strategies and priorities in the country, in that it will promote the improvement of MSB productivity, and thus contribute to making Peruvian products more competitive on the international markets.

III. PROJECT OBJECTIVES AND COMPONENTS

A. Objectives

- 3.1 The **general objective** of the project is to contribute to the development of an alpaca textile cluster in Arequipa that will provide opportunities for its participants to improve their competitiveness. The **specific objective** is to promote a sustainable system of business linkage that will stimulate MSB growth in the sector, based on improved productivity and business networks with broad access to domestic and international markets

B. Description and components

- 3.2 The project will consist of three components that will be implemented concurrently. The goals of the components are: (i) business development of small enterprises by broadening their direct access to markets and subcontracting by manufacturers; (ii) organization and technical assistance so small enterprises can meet quality and productivity standards; and (iii) training of middle managers, workers and artisans.
- 3.3 The above-mentioned activities will be supported to a great extent by manufacturers that belong to IPAC and are committed to actively participating in the project. They will provide information, know-how, experience and contacts for the project. A key factor will be the participation of the technical personnel of these companies as trainers, advisers and facilitators of the improvement processes, who have already actively participated in the design of this project.

1. Component 1: business linkage and subcontracting (MIF US\$139,000; counterpart US\$96,000)

- 3.4 The purpose of this component is to implement a business development system that will help expand the subcontracting arrangements already being carried out between large and small businesses and to help MSBs directly penetrate various domestic and export markets. The goal of this component is to open new marketing

channels for MSBs that are more profitable and consistent (not seasonal) and to coordinate production. Five independent brokers will be selected and 100 business contracts obtained, which means 240,000 alpaca garments. To achieve this goal, the four activities described below will be implemented.

- 3.5 **Training and support for an independent sales force:** IPAC will assemble this sales force of independent brokers and businesses that specialize in the sector, which will be identified and selected based on the markets they currently serve and the kinds of transactions they carry out, and the types of business contracts and commission/sales systems they use.
- 3.6 The success of this component will depend on the relationships established between the key participants to improve the production chain. The project will support mechanisms for the private brokers, based on their production orders, to establish proactive business relationships with the MSBs in the project, through networks established for this purpose with project support. Independent brokers will contract organized groups to produce apparel according to the specifications of the particular order and will thus link the production capacity of MSBs with international markets. Production supervisors trained under the project (see paragraph 3.19), will help organize MSB networks and will provide support in organizing production and meeting quality standards.
- 3.7 In addition, IPAC will use several practical instruments for supporting the independent sales force, including: (i) a catalog of products for export, to promote the business and productive capability of Peruvian MSBs; (ii) cofinancing for the project brokers and staff to participate in national business conferences and major local and international specialized fairs; (iii) financing for meetings of MSBs with prospective contractors to stimulate subcontracting and help them get acquainted so they can develop the necessary trust; and (iv) short-term internships to learn about similar business initiatives in the textile or apparel sector.
- 3.8 **Sharing business orders:** With the support of the production supervisors (see paragraph 3.19), the brokers will coordinate specific business orders with organized MSB networks, through either subcontracting with manufacturers or sales to other domestic or international clients. The supervisor responsible for an order will write up its features, price, delivery date and other conditions and then distribute the information to the MSBs that accept it. IPAC will provide support for and monitor execution of the business contracts between participating MSBs and the brokers or manufacturers that are the contractors, working with the production supervisors as a team.
- 3.9 **Design and management of a Specialized Clearinghouse:** As an additional tool to support business development, a Specialized Clearinghouse will be established. The Clearinghouse will have systematized information on qualified MSBs, trained workers and artisans, brokers, local trainers and supervisors, trade systems and

costs at destination, input suppliers and financing sources. The system will be available to MSBs and other participants in the cluster to meet their information needs. In addition, a web site will be developed as an instrument to develop the export trade capacity of the textile sector.

- 3.10 **Support for IPAC and project promotion:** Given that receptiveness and commitment to the project activities will be influenced by IPAC'S image, prestige and representativeness in the sector, it will be supported in certain key promotional activities. These will emphasize IPAC'S institutional positioning in the sector, its projects in general and this project in particular. Support will be provided for: (i) a strategic plan and a business plan; (ii) activities for sector coordination and to broaden and diversify IPAC membership and promote its institutional image; (iii) enhancement of internal regulations and manuals to systematize its operations; and (iv) activities to disseminate the results of and lessons learned in the project.

2. Component 2: Improving the quality, efficiency and operating organization of small enterprises (MIF US\$111,000; counterpart US\$53,000)

- 3.11 The purpose of this component is to implement a target organizational model that embodies the standards of productivity, quality and cost required by the international market, in 50 leading small enterprises to be selected. This will allow standardization of products and production methods so the MSBs could handle large-volume production without losing their autonomy. These leading small enterprises are expected to have a demonstration effect, motivating other MSBs to replicate the improvements in their production systems. To that end, the project will carry out the following activities.
- 3.12 **MSB roster and classification:** A consultant will be hired to prepare a roster of MSBs, classified according to their production capacity, specialization, line of production and experience in subcontracting or joint production. The information compiled will be entered into the database to be used to coordinate the production supply, in order to fill the orders obtained (see paragraph 3.8).
- 3.13 **Target organizational model:** While the enterprises are being classified, a consultant, in coordination with IPAC's technical experts, will define the standards and performance indicators to be reached, and the most appropriate processes and instruments for adjustment, based on the needs of each enterprise and its production lines.⁴ The model will emphasize technical factors and management to assure efficiency, quality and compliance with order delivery deadlines. It will pay special

⁴ A model will be defined for each one of the following production lines: (i) machine-made knitwear (semi-industrial and/or nonindustrial); (ii) handmade knitwear; (iii) fabric woven flat on a nonindustrial loom; (iv) apparel (cutting, assembly, steaming, labeling, etc.); (v) hand embroidery and finishing; (vi) miscellaneous: carpets, rugs and curtains.

attention to safeguarding the profit margin for the small enterprises and ensuring equitable pay for workers and artisans. Standards to be set will include: respecting workers' rights, a ban on child labor, meeting worker safety standards, using processes that do not harm the environment, and promoting the participation of women beneficiaries or businesses owned by women.

- 3.14 **Technical assistance for selecting the enterprises and bringing them into line with the established models:** Fifty leading MSBs will be selected to receive support, focusing on those that are duly incorporated, with the potential and desire to be part of business networks and linked with export channels and that work mainly with alpaca fiber. The project will place production supervisors trained under the project at the disposal of the enterprises selected, to carry out an initial review of the business and establish a plan for bringing it into line with the target organizational model. In addition, qualified supervisors will provide in-plant advisory services to the enterprises as they bring their production and organization into line with the methodology established in the activity described above. This will enable the enterprises to reduce their production and management deficiencies and improve their capacity to commit their employees to meeting standards, retain staff and increase their efficiency and profitability.
- 3.15 **Test load:** After implementing the plan to bring the enterprises into line with the models, the new production and control processes will be tested by test loading in each enterprise. The workers at each enterprise will conduct tests on an average of 200 garments, with supervision by the supervisors, to verify compliance with standards. Incentive policies will be established to reward timely delivery by the participating businesses, through an annual call for proposals by production line.

3. Component 3: training of qualified personnel based on productivity and quality levels (MIF US\$77,000; counterpart US\$75,000)

- 3.16 The purpose of this component is to train production staff in knitting/weaving, cutting, sewing and finishing, as well as production supervisors and trainers, which will allow the enterprises supported to reach the levels of efficiency, quality and reliability required. It is expected that 18 training modules will be developed (three per line) and that 1,000 workers, 300 artisans, 40 production supervisors and 20 trainers will be trained. This component will lead to greater transfer of technology between large and small businesses. To achieve this goal, IPAC will carry out the four main activities described below.
- 3.17 **Developing training content and methodology:** IPAC, with the support of training experts hired with project funds, will develop the training curriculum and methodology for production supervisors and local trainers. It will take into account the efficiency parameters used by the manufacturers, the type of infrastructure currently in place in the small businesses, the manufacturers' own experience training their staffs, and fashion trends. The curriculum will be modular so it can

be adapted to the specific needs of the participants, and the methodology will favor practices in use at the facilities of manufacturers. Selection and training of the participants as well as adaptation of the workshops will be carried out based on the recommendations of the Committee on Environment and Social Impact (CESI) specified in paragraph 6.7, which are included in the Operating Regulations.

- 3.18 **Trainer training:** The project will use the content, methods and teaching instruments developed in the above-described activity to train individuals and local institutions with broad practical experience in the sector (NGOs and consulting firms) in retraining for workers and artisans. The final content and methodologies for worker training will be based on consensus-building during the trainer training sessions, taking advantage of the participants' experiences and knowledge. Training will be provided for two groups of 10 trainers, with 40 hours of training each.
- 3.19 **Training of production supervisors:** IPAC will use the technical personnel of its manufacturer members to train production supervisors, using the modules developed. After receiving the training, the supervisors will gain on-the-job experience on the production lines of the manufacturers for 30 days. Supervisors will be trained to review the enterprises registered and to support the adjustments required to bring them into line with the target organizational model. They will also be responsible for organizing the joint orders and supporting the enterprises in organizing production, maintaining quality standards and overseeing the performance of each individual enterprise in order to take any corrective measures previously agreed upon. They are expected to gradually be hired by the same enterprises.
- 3.20 **Worker and artisan training:** Trainers trained under the project will provide the training to current and prospective workers and organized artisans, so their enterprises can achieve efficiency levels of at least 70%.⁵ Every operator or artisan will be subject to an initial efficiency test to determine the most appropriate package of training modules for the worker to reach the efficiency and quality levels required. The training packages will provide instruction in the use of industrial and semi-industrial machinery according to quality and speed parameters, understanding basic calculations and the technical specifications of different garments, and quality and responsibility awareness. The effectiveness of the training will be evaluated by the enterprise that hires the worker.

⁵ Efficiency is measured according to the following formula: ideal production time/actual time. Ideal time is determined by methods experts based on industry benchmarks.

IV. COST AND FINANCING

A. Cost

- 4.1 The total project budget is US\$780,000, of which the MIF will finance US\$470,000 on a nonreimbursable basis from Facility III-A. IPAC will contribute US\$310,000 as the local counterpart funding, in accordance with the following budget.

(US\$)

Description	MIF	IPAC	TOTAL
I. Business linkage and subcontracting	139,000	96,000	235,000
II. Improving quality, efficiency and organization	111,000	53,000	164,000
III. Training skilled staff	77,000	75,000	152,000
IV. Technical Unit and operations	80,000	66,000	146,000
V. Monitoring, Evaluation and Auditing	53,000	20,000	73,000
VI. Contingencies	10,000	0	10,000
TOTAL	470,000	310,000	780,000
Percentages	(60%)	(40%)	(100%)

- 4.2 IPAC will be responsible for providing 100% of the counterpart contribution: 56% of the counterpart contribution will be in cash, from IPAC's own resources and from the Commission for Export Promotion of Peru (PROMPEX) and the Organization for the Reconstruction and Development of the South (ORDESUR); 44% of IPAC's contribution will be in kind, which will basically consist of the value of the time contributed by the staff of IPAC member. Manufacturers that provide services for the project and raw materials for test loads.

B. Project sustainability

- 4.3 Some of the activities started under the project will continue after the MIF project. Others will have met their objectives of raising the productivity, efficiency and organization of MSB textile businesses in Arequipa and creating new productive capacity through training of production supervisors and trainers and accordingly will not need to be continued. Upon project completion, the brokers will have acquired the experience needed to offer their intermediation services to MSBs, which would be willing to pay 100% of the cost of the service to be able to place their products in domestic and international markets. The supervisors are expected to be hired by the small enterprises. Moreover, the technical assistance activities and the Specialized Clearinghouse will be paid for by MSB users and will generate revenues that will gradually make the services self-sufficient after the MIF project. As an additional way to monitor these developments, the evaluations will assess the

revenues generated by the different project activities and will suggest measures to increase their sustainability.

V. PROJECT EXECUTION

A. Executing agency

- 5.1 The project will be executed by the Instituto Peruano de la Alpaca y Camélidos (IPAC), a private, nonprofit Peruvian institution, that represents and specializes in the alpaca and camelid sector in general. IPAC began its activities prior to starting operations in 2000, with a mission to promote and develop the competitiveness of the production chain of alpaca and other camelids in Peru. Its activities to support the alpaca textile sector, include initiatives to help the enterprises to competitively enter new, more exclusive and lucrative market niches, handle volumes of demand currently not being filled and place alpaca products in the domestic and foreign markets. IPAC is financed by contributions from its members and State funds from the Commission for Export Promotion of Peru (PROMPEX). IPAC's board of directors consists of representatives of PROMPEX, textile manufacturers, the International Alpaca Association (IAA), NGO's and the scientific community.
- 5.2 IPAC's members are key participants in the alpaca production chain, including: alpaca producers, textile and apparel manufacturers, the International Alpaca Association (IAA), small textile manufacturing businesses, NGOs working with microenterprises and small businesses in the sector and PROMPEX. The broad experience and knowledge of its membership gives IPAC the capability to develop plans and execute projects that have significant impact at all levels of the alpaca sector. Among IPAC's strengths are that: (i) several outstanding business people and leaders with extensive experience in the alpaca sector sit on the board of directors. Thereby ensuring a business focus and sound execution for the project; and (ii) its manufacturer members are committed to providing their technical personnel, know-how and experience in the alpaca textile sector to the project to benefit the MSB participants and strengthen the alpaca cluster. The project will support IPAC's efforts to expand and diversify its membership so that it will be ever more representative of the interests of *all* the sector stakeholders.

B. Execution mechanism

- 5.3 For execution of the project, a **Technical Unit (TU)** will be established in IPAC, reporting to senior management and made up of a project coordinator, a business unit chief and a technical unit chief. The TU will be responsible for: (i) management of project activities according to the action plan and the Operating Regulations; (ii) procurement of goods and services; (iii) supervision of the consultants hired; (iv) oversight of budget execution and management; (v) processing requests for disbursements from the Bank contribution;

(vi) preparation of financial statements on funds used; (vii) presentation of technical and administrative reports to the Bank and to IPAC management; and (viii) coordination of the activities required with the various participants in the project. The Project Coordinator will be responsible for carrying out project activities and meeting the project objectives. The TU will report directly to the IPAC General Manager and board of directors, which will be responsible for the respective activities with respect to the public and private institutions, in order to assure achievement of the objectives set forth in the project.

- 5.4 The TU will have the support of: (i) advisory services by a Specialized Technical Committee made up of highly qualified professionals and experts from the manufacturers involved in the project; (ii) an administrative and accounting unit; and (iii) an outside monitoring unit. The TU will execute the project in accordance with the Operating Regulations, which are set forth in the project's technical files.
- 5.5 **Cost recovery mechanism:** Each beneficiary will pay an annual fee to participate in the project activities, which will cover a portion of the services offered. Beneficiaries will also make payments for the additional services of training and supervision of the business orders provided under the project. These payments will increase over time and may be adjusted annually by IPAC in accordance with: (i) the payment capacity of the beneficiaries and participating MSBs; (ii) the market cost of equivalent services in Arequipa; and (iii) the sustainability plan for services provided by the project. The policy of payment for services appears in the Operating Regulations submitted to the Bank, which will be updated annually. It is estimated that the project will generate a total of US\$9,000, US\$30,000 and US\$50,000 in years 1, 2 and 3 respectively, covering an average of 50% of the costs of the services provided under Component 1, 32% under Component 2 and 25% under Component 3.
- 5.6 **Execution and disbursement periods:** The execution period for the project will be 36 months, and the disbursement period will be 42 months. Given the small size of the project, the Bank will need to establish a revolving fund of up to 20% of the total amount approved, based on the spending plan that IPAC will submit to the Bank for approval.
- 5.7 **Procurement:** IPAC will procure goods and services and award contracts for the consulting services needed for project execution, in accordance with the applicable policies and procedures of the Bank and the MIF.
- 5.8 **Accounting:** The executing agency will establish and will be responsible for maintaining appropriate accounting of finances, internal oversight and records systems, which will enable it to identify the sources and uses of program funds. The accounting system will be organized to provide the documents necessary to help verify transactions and allow the timely preparation of financial statements and reports. Project records will be kept in such a way that: (i) amounts received from

different sources can be identified; (ii) project expenses are recorded in a chart of accounts previously approved by the Bank and differentiate MIF contributions from funds received from other sources; and (iii) the necessary detail is provided to identify goods procured and services hired, as well as the use of these goods and services. The executing agency will also open separate, specific bank accounts for administration of the MIF contribution and local counterpart funding.

- 5.9 **Financial audit:** Within 90 days after the last disbursement for the project, the executing agency will prepare and submit to the Bank the final financial statements on the Bank contribution and local counterpart funding. An independent auditing firm acceptable to the Bank will audit these financial statements. The cost of the financial audits will be financed with funds from the MIF contribution, in accordance with Bank procedures.

VI. PROJECT JUSTIFICATION, BENEFITS AND RISKS

- 6.1 **Justification:** The project is justified because it will help improve the competitiveness of MSBs in the alpaca textile sector. This will translate into a stronger industry and will increase nontraditional exports based on valuable raw materials with a high level of value added.⁶ The project seeks the generation of this value added at the MSB level of the sector, so as to create jobs for the region. In addition, by increasing the demand for the highest quality alpaca fiber, the project will create incentives for the expansion of the lower links in the production chain (alpaca breeders).
- 6.2 The project shows high levels of **innovation** and **additionality**. The **innovation** is reflected in: (i) the active participation and leadership of the technical personnel of the manufacturers, who will help solve technical and management problems at MSBs, allowing a significant transfer of know-how between the two business strata; and (ii) the establishment and strengthening of new business networks among MSBs to access the export market, with a strong business focus. For these reasons, the project will be incorporated into the MIF cluster of projects for production chains and business networks. The **additionality** of the project is reflected in the establishment of new business linkage mechanisms to connect the production capacity of the MSBs with brokers to market their improved products.
- 6.3 **Benefits:** The project will benefit four major groups: (i) **MSBs** in the apparel industry will benefit through: (a) greater sales and revenues achieved through the business linkage of their production with the market; (b) improved levels of

⁶ Currently, in terms of value added, the percentage of fine hair alpaca products exported are 77% in degreased fiber (tops), yarn and fabric, and only 23% in finished apparel. If finished garments replaced the less processed exports—even only 20% of tops exports in 2001 (560,000 kilos).—it is estimated that the alpaca textile-manufacturing sector could generate 2,000 new jobs.

productivity and quality and better conditions for competing on international markets; and (c) proven experience working in networks and business-to-business cooperation to meet market demand; (ii) **textile manufacturers** will have qualified suppliers, which will give them production flexibility, reduce costs, and enable them to handle special orders and production peaks more expeditiously; (ii) **the alpaca textile cluster** will be strengthened through actual experience in mutual cooperation in a competitive environment to achieve positive results for all the participants in the alpaca sector production chain; and (iv) **IPAC** will benefit by being strengthened as an institution representing the sector, showing its ability to propose, coordinate and lead practical initiatives that will result in palpable benefits for its members and the sector in general. Successful execution of the project will also have a **demonstration effect** to stimulate and offer lessons learned for the establishment of clusters in other sectors in Peru, as a tool to improve the competitiveness of the businesses involved.

- 6.4 **Beneficiaries:** The project beneficiaries will mainly be microenterprises and small businesses (MSBs) in the alpaca textile sector and organized artisans in the department of Arequipa. The direct beneficiaries will be 50 small businesses and 1,000 workers interested in expanding or launching production of alpaca apparel for the domestic and foreign markets, through subcontracting and the establishment of business networks. Microenterprises will also benefit, as potential subcontractors for the small businesses. In addition, about 300 organized artisans will have access to greater revenues generated by the growth of effective demand for their finishing services for export-quality apparel. Local institutions that provide training and technical assistance will also be strengthened, along with the independent professionals who receive the technical know-how transferred by the large company that belongs to IPAC.
- 6.5 **Risks:** The project has two main risks: (i) in the short term, not enough business contacts may be made to expand the linkage between textile MSB networks and the markets, leading to MSB mistrust of other MSBs and the executing agency; and (ii) the project may mainly benefit the IPAC member manufacturers.
- 6.6 To mitigate the first risk, from the start, the project will focus its efforts on achieving immediate, concrete successes in handling new business contracts, in order to cultivate mutual trust among the participating MSBs, IPAC members and the project's Technical Unit. The project emphasis on business development and market demand is expected to establish a solid foundation to motivate the MSBs to improve quality and productivity. The second risk will be mitigated by: (i) close and continuous monitoring of the project, through reports and evaluations, which will identify any adjustments needed to ensure that the MSBs reap the expected benefits; and (ii) project emphasis on direct business linkage between the MSBs and brokers, which will help reduce MSB dependence on manufacturers.

- 6.7 **Committee on Environment and Social Impact (CESI):** CESI reviewed and approved the project abstract at its meeting on 22 February 2002. In accordance with CESI's suggestions, IPAC added the following policies to the project's Operating Regulations: (i) all training and technical assistance activities in the project must promote activities and production techniques that are socially and environmentally sustainable; (ii) the technical assistance for participating enterprises will include enhancing facilities to protect worker health and improve the indoor environment, with a view to ensuring worker comfort; and (iii) the TU will follow open, competitive procedures to select beneficiaries and trainers, promoting the participation of women beneficiaries and businesses owned by women. IPAC will report on compliance with these policies during project execution in the progress reports.

VII. MONITORING AND EVALUATION

A. Monitoring

- 7.1 **IPAC monitoring activities:** IPAC will be responsible for gathering and analyzing relevant information to monitor of the main indicators set forth in the project's logical framework on an ongoing basis. To facilitate this work, at the start of the project, a consultant will be hired to support the design of a system to monitor indicators and activities and its subsequent implementation. IPAC and the Bank will use this system and the indicators for supervising and evaluating the project. Both the semiannual progress reports and the midterm and final evaluations must include information on the indicators.
- 7.2 **Progress reports:** IPAC will be responsible for preparing semiannual progress reports, in which it will document the activities carried out during the previous six-month period. IPAC will prepare a work plan and a disbursement schedule for the next period, in accordance with the indicators in the logical framework. The reports will be submitted to the Representative of the Bank for approval, within 60 days after the end of each six-month period.
- 7.3 The reports must be prepared in a format previously agreed upon with the Bank and must contain information on the activities carried out during the period under review, budget execution and the results achieved. The first report must indicate the base/line data that will be used to monitor project progress with respect to the performance indicators. The reports must also include information on the order in which the activities for each component will be implemented during the following six-month period, ensuring a logical sequence for interdependent activities. Progress reports will pay special attention to: (i) quality and the fulfillment of project objectives (logical framework); (ii) the status of the business plan and the project budget execution; (iii) financial performance of the project, including the degree of cost recovery for each component; (iv) number and profile of

beneficiaries served; (v) number, size and type of enterprises that benefited from the project and a description of the benefits achieved; (vi) number and features of new IPAC members; and (vii) any problems encountered and measures adopted to resolve them. The Representative will also be responsible for providing the MIF with a report three months after project completion, indicating its results.

- 7.4 In the event of significant adverse deviations (of more than 20%) in fulfillment of the performance indicators in the project's logical framework, the Bank may suspend disbursement of project funds. Once the deterioration of any of these indicators has been established, IPAC will have 30 calendar days to agree with the Bank the necessary measures to correct the situation. At the end of this period, if the situation has not improved to the Bank's satisfaction, the Bank may suspend or cancel future disbursements.

B. Evaluations

- 7.5 Once at least 50% of the MIF funds have been disbursed, or 18 months after project startup (50% of the project execution period), the Bank will hire the services of a consultant, using project funds, to carry out an independent midterm evaluation of the project results. The purpose of the evaluation will be to rigorously verify execution of the project activities, using the performance indicators as benchmarks, the use of the funds, products and services delivered and achievement of the objectives in terms of impact on the beneficiaries and other agents involved. The findings will be used to support the decision-making process regarding strategic adjustments for the rest of the project. The midterm evaluation will also include a review of: (i) the statistics on the sales contracts entered into, broken down by source (subcontracting vs. direct sales through independent brokers) and destination (domestic markets vs. international markets); (ii) satisfaction levels of MSBs and employers of trained workers with respect to the effectiveness and quality of the training and technical assistance received; and (iii) revenues generated by the project and measures to improve the future sustainability of its activities.
- 7.6 In addition, once 95% of the Bank resources have been disbursed, the Bank will hire an independent consultant to conduct a final evaluation that will review: (i) the impact of the project on its beneficiaries and participants, taking into account the indicators in the logical framework; (ii) statistics on sales contracts entered into, broken down by source (subcontracting vs. direct sales through independent brokers) and destination (domestic markets vs. international markets); (iii) changes in the business relationships and bargaining power of the participating MSBs; (iv) breakdown of project beneficiaries; (v) membership trends in IPAC; (vi) based on revenues generated by each activity: which activities are sustainable, which may be sustainable at a later time, and which have no prospects of sustainability; (vii) social and environmental impact; and (viii) lessons learned and best practices.

VIII. SPECIAL CONTRACTUAL CONDITIONS

A. Conditions precedent to the first disbursement

- 8.1 As a condition precedent to the first disbursement, IPAC will submit evidence of the selection of the Project Coordinator, to the Bank's satisfaction.

B. Project preparation status

- 8.2 The design, budget and activities planned have been prepared with the active involvement of the project participants, with the assistance of the Bank team. The availability of funds for a local contribution, in both cash and kind, was negotiated and documented by the executing agency and the project team, including letters of commitment to provide a contribution in kind from IPAC members manufacturers. As of June 2002, the project has the final versions of an itemized budget, terms of reference for the professionals of the Technical Unit; beneficiaries estimated by component and by activity; and the Operating Regulations, including the schedule of activities.

LOGICAL FRAMEWORK
BUSINESS LINKAGE AND COMPETITIVENESS IN THE ALPACA TEXTILE SECTOR IN AREQUIPA
TC-0112061-PE

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>Objective 1 Contribute to the development of an alpaca textile cluster in Arequipa that will provide opportunities for its participants to improve competitiveness.</p>	<p>At the end of 3 ½ years: (i) a 30% increase in sales of alpaca yarn in the Arequipa market, and a 30% increase in the total amount paid by manufacturers to third parties for subcontracting services in the Arequipa market. [Baseline year 2001: Alpaca yarn sales: 69,000 kilos, and amounts paid for subcontracting: US\$620,000.]</p>	<ul style="list-style-type: none"> Records for sales of alpaca yarn in Arequipa from the four local textile manufacturers. Reports of payments for subcontracting services to third parties: Arequipa textile manufacturers. 	
<p>Objective 2 Establish a sustainable system of business linkage that will promote the growth of enterprises in the sector, based on improved productivity and business networks with greater access to domestic and international markets.</p>	<p>Upon project completion:</p> <ul style="list-style-type: none"> Contracts entered into for 240,000 garments through subcontracting or sale thanks to channels promoted under the project (domestic and international) involving 75% of participating MSBs. A 25% increase in productivity rates in 60% of participating MSBs. 	<ul style="list-style-type: none"> Semiannual progress reports on the project prepared by IPAC Copies of business contracts Midterm evaluation of the project Final evaluation of the project 	<ul style="list-style-type: none"> The Peruvian economy remains stable during project execution The strategy "Alpaca of Peru" is successfully implemented No new international trade restrictions are implemented
COMPONENTS			
<p>Component 1: Business linkage and subcontracting of all alpaca fabric businesses</p>	<ul style="list-style-type: none"> 5 independent brokers supported and prepared to provide marketing services 100 business contracts for joint production executed Specialized Clearinghouse and web site established 75% of MSBs registered fill orders contracted 20% of trained artisans become organized and fill orders 	<ul style="list-style-type: none"> Semiannual project reports prepared by IPAC Reports by brokers and Project Coordinator Midterm evaluation of the project Final evaluation of the project 	<ul style="list-style-type: none"> There are brokers willing to work under the conditions of the project Mutual trust is stimulated among participants in Arequipa alpaca textile sector There are suppliers and trainers in the market with the capacity and requirements for by the project
<p>Component 2: Improving the quality, efficiency and organization of small business production</p>	<ul style="list-style-type: none"> 50 leading enterprises selected and brought into line with a target organizational model that meets international standards 50 enterprises provided with technical assistance 	<ul style="list-style-type: none"> Semiannual reports of the project prepared by IPAC Midterm evaluation of the project Final evaluation of the project 	

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Training skilled personnel in productivity and quality	<ul style="list-style-type: none"> • 40% of new workers trained placed in enterprises • 50% of artisans trained improve their productivity and quality • 50% of trainers active • 50% of supervisors trained active 	<ul style="list-style-type: none"> • Semiannual progress reports on the project prepared by IPAC • Midterm evaluation of the project • Final evaluation of the project 	
Support for institutional strengthening IPAC	<ul style="list-style-type: none"> • Strategic plan developed and implemented • Business Plan developed and implemented • 10 new members join IPAC • 3 meetings held with suitable agents in the sector • 10 meetings held for sector cooperation 	<ul style="list-style-type: none"> • Member registry • Reports on meetings • Minutes of board of directors meetings • Semiannual progress reports on the project prepared by IPAC • Midterm evaluation of the project • Final evaluation of the project 	
Activities			
Component 1: Business linkage for small alpaca textile businesses			
<ul style="list-style-type: none"> • Develop material to support brokers • Meet business orders and subcontracting • Participation of brokers in fairs and business conferences in Peru • Participation of the Coordinator in local and international fairs • Travel grant to visit similar initiatives • Design and management of Clearinghouse • Design, management and linkage of web site 	<ul style="list-style-type: none"> • Promotional material developed. • 240,000 garments made to fill orders under joint production contracts • 5 brokers participate in 3 fairs and business conferences • 15 national and 5 international fairs attended • 6 technical exchanges carried out • Clearinghouse established and operational • 720 requests for information met, thus providing service to participating MSBs • Web site designed and operational 	<ul style="list-style-type: none"> • Promotional materials • Garment reference guides completed • Semiannual progress reports on the project prepared by IPAC • Midterm evaluation of the project • Final evaluation of the project 	<ul style="list-style-type: none"> • There is a pre commitment of MSBs to coordinate joint activities • IPAC membership remains stable and increases. • Manufacturers are willing to transfer know-how and the project activities

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Component 2: Improving the quality and efficiency of business production Preparation of indicators, manuals, formats, and production systems by line of production Baseline data /review of capacity and line of production Technical assistance for bringing the enterprise into line with the target organizational model Test loading for bringing production up to standards	<ul style="list-style-type: none"> • 6 lines of production with formats, manuals and indicators prepared • Baseline data/review prepared • 50 small businesses with technical assistance plans for modernization established and carried out • 5,000 kilos of yarn processed in test loads to verify upgrading of standards at small businesses 	<ul style="list-style-type: none"> • Manuals and indicators for each line • Company registration records • Baseline Report • Technical assistance records • Semiannual progress reports prepared by IPAC • Midterm evaluation of the project • Final evaluation of the project 	
Component 3: Training skilled staff in productivity and quality Development of training modules Trainer training Identification and training of production supervisors Training of workers and artisans	<ul style="list-style-type: none"> • 18 training /instruction modules prepared (3 x 6 lines) • 20 trainers trained and accredited • 40 production supervisors identified and trained • 1,000 workers and 300 artisans trained to 70% efficiency 	<ul style="list-style-type: none"> • Training material • Technical Committee reports • Semiannual progress reports on the project prepared by IPAC • Midterm evaluation of the project • Final evaluation of the project 	
Component 4: Support for institutional strengthening of IPAC Preparation of strategic plan Preparation of business plan Facilitation of meeting spaces Promotion of institutional image Support for internal institutional development	<ul style="list-style-type: none"> • Strategic plan prepared and approved • Business plan prepared and approved • Active participation of IPAC in the Alpaca/Camelid Sector Coordination Committee • 75% of trainees surveyed have a favorable opinion on IPAC's performance • Regulations and manuals drafted and implemented 	<ul style="list-style-type: none"> • Strategic plan • Business plan • Surveys reviewed in project evaluations • IPAC financial statements • Agreements signed with other projects • IPAC manuals and regulations 	

PROPOSED RESOLUTION

**PERU. NONREIMBURSABLE TECHNICAL COOPERATION FOR THE
COMMERCIAL LINKAGE AND COMPETITIVENESS IN THE ALPACA
TEXTILE SECTOR OF AREQUIPA PROGRAM**

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 Instituto Peruano de la Alpaca y Camélidos, of the Republica del Perú, 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 Commercial Linkage and Competitiveness in the Alpaca Textile Sector of Arequipa Program.

2. That up to the amount of US\$470,000, 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.