

SMALL BUSINESS DEVELOPMENT FOR THE TIJUANA IN-BOND ASSEMBLY INDUSTRY

(TC-9808322/TC-9808330)

EXECUTIVE SUMMARY

Executing agency:	Consejo de Desarrollo de Tijuana [Tijuana Development Council] (CDT)																
Project number:	TC-9808322/TC-9808330																
Beneficiaries:	Small businesses in Tijuana and Baja California																
Financing:	<p>Grant (III-A):</p> <table> <tr> <td>MIF:</td><td>US\$1.37 million</td></tr> <tr> <td>CDT:</td><td>US\$1.37 million</td></tr> <tr> <td>Total:</td><td>US\$2.74 million</td></tr> </table> <p>Investment (III-B):</p> <table> <tr> <td>MIF:</td><td>US\$ 4 million</td></tr> <tr> <td>NAFIN:</td><td>US\$ 3 million</td></tr> <tr> <td>Private</td><td>US\$ 4 million</td></tr> <tr> <td>Other instits.:</td><td>US\$ 1 million</td></tr> <tr> <td>Total:</td><td>US\$12 million</td></tr> </table>	MIF:	US\$1.37 million	CDT:	US\$1.37 million	Total:	US\$2.74 million	MIF:	US\$ 4 million	NAFIN:	US\$ 3 million	Private	US\$ 4 million	Other instits.:	US\$ 1 million	Total:	US\$12 million
MIF:	US\$1.37 million																
CDT:	US\$1.37 million																
Total:	US\$2.74 million																
MIF:	US\$ 4 million																
NAFIN:	US\$ 3 million																
Private	US\$ 4 million																
Other instits.:	US\$ 1 million																
Total:	US\$12 million																
Terms:	The execution period will be four years and the disbursement period, four years and ten months. The financial facility must be disbursed in five years.																
Environmental and social review:	The CESI approved the project at its October 4, 1999, meeting.																
Objectives:	The objective of the project is to promote the development of small businesses and startup companies that supply components for the in-bond assembly industry and/or for exports, in the context of regional development through cross-border integration. The specific objectives of the project are to: (i) strengthen local development in the Tijuana-San Diego area; (ii) give small businesses access to appropriate services; and (iii) launch a pilot investment facility.																

Description: The project calls for the implementation of three components. The first two will be financed with nonreimbursable funds, and the third will establish a financial investment facility.

1. **Support for local development.** Under the first component, project personnel will be trained to better execute the project and participate in local development. A participatory planning process will also be financed to incorporate the needs of small businesses into the strategic plans for the project area, and will result in a concrete plan of action. The results of this exercise will be confirmed at local and cross-border business forums, the latter coordinated and cofinanced by San Diego Dialogue. To support this economic integration process, the project will help establish an economic information system that will be put on a web site. Information from different sources will thus be compiled, supplemented, and standardized, to establish databases for the business community in Tijuana and Baja California and for local governments. There will be a charge for access to the databases that will vary based on the value added by the project.
2. **Development of business services and assistance for startup companies.** The following activities will be carried out under this component: (a) boosting demand; in addition to the specific studies on the demand for services to be conducted under the project, a fund will be established to boost demand for business services on the part of small businesses; these incentives may finance no more than 50% of the cost of the services and only at the outset, provided no other subsidy is being given for that purpose, with preference given to the use of vouchers; a percentage of the expenses for services that must be customized may also be financed; (b) establishing and improving business services; during project preparation, demand for a series of products was identified in the following areas: business training, support for startup companies, and ISO 9000. The project will finance training for trainers and the transfer to institutions in Tijuana of successful experiences in supporting new businesses and setting up business networks, based on experiences in California; (c) developing suppliers. This will be done with NAFIN support. At least three in-bond assembly companies will be identified as pilot cases and provided with an organizational plan to develop their chains of production.
3. **Investment financing facility for small businesses.** Under this component, a facility will be established with two investment instruments that will finance small businesses that

export and/or supply inputs for in-bond assembly plants, in general startup companies. The first instrument, called the Angel Fund, will be made up of private investors who will play an active part in investment decisions and oversight. The second, called the Institutional Fund, will have public investors, which prefer a more passive role. The two funds will invest in the same operations at a ratio of 1:2, respectively. This component is a seed capital facility, which is structured to contribute to the active role of private investors, like “angel investors” in the United States: individuals with resources and extensive business experience who invest generally in startup companies and are actively involved in their oversight. Due to the innovative nature of this component, only 20% of project resources may be used in a proposed first phase of execution. Based on the results of that phase, in terms of the participation of private investors and investment opportunities, the MIF will authorize new disbursements. **Eligible investment projects** will: (i) involve capitalization of a small export business and/or small in-bond assembly supplier established in Baja California, with emphasis on the Tijuana area; (ii) have a financially feasible project; (iii) have an investment commitment from a sponsor and from the Angel Fund; and (iv) be in compliance with labor and environmental regulations. The joint investment of the two trust funds may not exceed a 49% stake in the business, with a maximum amount of US\$1 million, although most operations will range from US\$300,000 to US\$500,000. The facility will primarily use financial instruments, such as quasi-equity or equity.

Benefits:

The project **benefits** are to incorporate small businesses into the development process in Tijuana and into the in-bond assembly industry. The project will boost private investment by establishing a flexible instrument with a managerial structure, incentives, and controls to help experienced entrepreneurs, who will act as angel investors, support the most promising startup businesses in the Tijuana area. The project is expected to promote direct investment in 25-30 small businesses. In addition, it will facilitate the participation of small businesses in border area integration between Tijuana and San Diego.

Risks:

- (i) CDT capacity. Project personnel must be selected with the Bank's concurrence and will receive adequate training. A competitive system will also be established to select and assess suppliers. The CDT, a development agency that is recognized by the private sector, has an extensive capacity to bring players together and can bridge the gap between the in-bond assembly industry and small businesses and between small businesses and business service providers.

- (ii) Insufficient investment opportunities. The CDT will serve as a channel to attract investment opportunities to the facility, and the Angel Fund investors themselves will use their networks of contacts to identify new opportunities. The activities under component 2 of the project (business networks and support for business plans) will produce another set of opportunities.
- (iii) Insufficient participation by private investors in the Angel Fund. The first phase of the project is expected to attract new investors to the project and the small businesses and will help the CDT organize a group of private investors. Nonetheless, if the expected conditions are not achieved, the operation may be cancelled.
- (iv) Business development assistance. A conversion agreement between the two trust funds will require Angel Fund investors not only to make a financial investment but also to ensure appropriate oversight, representing the interests of all investors. Giving the Angel Fund a 20% stake in the earnings of the Institutional Fund is an important incentive to reconcile the interests of all the investors.
- (v) Potentially diverging interests between investors in the two trust funds. All investment decisions will require the nonobjection of the institutional investors, who will also establish a trustee relationship with the Angel Fund investors and be represented by the latter. The 20% stake in the earnings of the Institutional Fund will help reconcile the interests of the investors in the two trust funds.
- (vi) Outflow of investment. Acquisitions by strategic investors will be facilitated by the networks of contacts of the CDT, those generated by the project, and those of the Angel Fund investors themselves. The 20% stake in the earnings of the Institutional Fund will be a major incentive for the Angel Fund investors to ensure an outflow advantageous to all the investors. Furthermore, the facility will almost exclusively use quasi-equity instruments or equity instruments with quasi-equity features.
- (vii) Significant change in the frame of reference, particularly in implementing NAFTA. The in-bond assembly industry has already shown clear interest in expanding its network of local suppliers for reasons of efficiency (just-in-time delivery) due to the close connections required with suppliers. The project is also geared towards export companies or businesses that have a comparative advantage in local markets. Furthermore, Baja California has a large business sector.

Special conditions:

Initially, Bank procedures for selecting consultants will be followed. Given the large number of contracts and the private nature of the CDT, these procedures may be modified, with the Bank's agreement, to adapt them to execution requirements. It is further suggested that for contracts under US\$30,000 an ex post evaluation of compliance with the procedures agreed upon be conducted by sampling. In any event, the standard transparency requirements for this type of project will be maintained.

The disbursements for the investment component will be made *pari passu* with the other investors. The first disbursement may be made once the following conditions have been met: (i) in addition to the MIF resources, US\$4 million has been committed (US\$1 million committed in the Angel Fund); (ii) the parallel investment facility has been legally established; (iii) the specialized advisory services to evaluate and organize the operations have been prequalified by the MIF; and (iv) the CDT has prepared a model contract to regulate Institutional Fund investments in businesses, agreed upon with the MIF. During phase one, up to US\$800,000 (20% of the contribution) may be disbursed. The funding is expected to be fully disbursed in five years.