

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**BRAZIL**

**CLUSTER COMPETITIVENESS SUPPORT PROGRAM FOR  
MINAS GERAIS**

**(BR-L1021)**

**LOAN PROPOSAL**

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| Monitoring and evaluation arrangements:<br>(i) Draft Program<br>Operating Regulations<br>(ii) Paragraph 3.24 | <a href="http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=1803011">http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=1803011</a>   |
| Procurement plan   | <a href="http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=1770860">http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=1770860</a>   |
| Basic socioeconomic data   | <a href="http://www.iadb.org/RES/index.cfm?fuseaction">http://www.iadb.org/RES/index.cfm?fuseaction</a>   |
| Status of loans in execution and loans approved  | <a href="http://opsgs1/Cartera/LoanPortfolioInExecution.aspx?Country=BR&amp;Language=Eng&amp;Output=Pdf">http://opsgs1/Cartera/LoanPortfolioInExecution.aspx?Country=BR&amp;Language=Eng&amp;Output=Pdf</a>   |
| Tentative lending program  | <a href="http://ops/opsfilters/xmlToHtml.aspx?Output=pdf&amp;AppName=PIPELINELOANS&amp;Language=EN&amp;Sort=&amp;Link=&amp;Region=&amp;Country=BR&amp;Division=&amp;Sector=&amp;PipCat=&amp;OperType=LON&amp;OperSubTypeCode">http://ops/opsfilters/xmlToHtml.aspx?Output=pdf&amp;AppName=PIPELINELOANS&amp;Language=EN&amp;Sort=&amp;Link=&amp;Region=&amp;Country=BR&amp;Division=&amp;Sector=&amp;PipCat=&amp;OperType=LON&amp;OperSubTypeCode</a> |
| Information available in (ICF/CMF) technical files   | <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=617204">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=617204</a>   |
| Draft PPMR   | <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=618550">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?Docnum=618550</a>   |

## ABBREVIATIONS

|        |  |
|--------|--|
| ABDI   | Agência Brasileira de Desenvolvimento Industrial [Brazilian Industrial Development Agency]                           |
| APL    | Arranjo Produtivo Local [Local productive grouping (cluster)]  |
| AWP    | Annual work plan   |
| BDMG   | Banco de Desenvolvimento de Minas Gerais [Minas Gerais Development Bank]   |
| BIT    | Basic industrial technology  |
| BNDES  | Banco Nacional de Desenvolvimento Econômico e Social [National Bank for Economic and Social Development]             |
| CDP    | Conselho Diretivo do Programa [Program Management Committee]   |
| CETEC  | Fundação Centro Tecnológico de Minas Gerais [Minas Gerais Technological Center Foundation]                           |
| CIN    | Centro Internacional de Negócios [International Business Center]   |
| COPAM  | Conselho de Política Ambiental [Environmental Policy Council]  |
| CTA    | Comité Técnico Asesor [Technical Advisory Committee]   |
| EGL    | Entidade de Gobernanza Local [Local Governance Unit]   |
| FEAM   | Fundação Estadual de Meio Ambiente [State Environment Foundation]  |
| FIEMG  | Federação de Indústrias do Estado de Minas Gerais [Minas Gerais Industries Federation]                               |
| GDP    | Gross domestic product   |
| GI     | Grupo Interministerial de APLs [Interministerial Group on Clusters]  |
| GTZ    | German Agency for Technical Cooperation  |
| IBGE   | Instituto Brasileiro de Geografia e Estatística [Brazilian Institute of Geography and Statistics]                    |
| ICT    | Information and communication technology   |
| IEF    | Instituto Estadual de Florestas [State Forestry Institute]   |
| IEL    | Instituto Euvaldo Lodi de Minas Gerais [Euvaldo Lodi Institute of Minas Gerais]                                      |
| IGAM   | Instituto Mineiro de Gestão de Águas [Minas Gerais Water Management Institute]                                       |
| IPEA   | Instituto de Investigação Aplicada [Institute for Applied Research]  |
| LRF    | Lei de Responsabilidade Fiscal [Fiscal Responsibility Act]   |
| PAC    | Plano Anual de Caixa [Annual cashflow plan]  |
| PITCE  | Política Industrial, Tecnológica e de Comércio Exterior [Industrial, Technology and Foreign Trade Policy]            |
| PMC    | Plano de Melhoramento da Competitividade [Competitiveness improvement plan]  |
| PPA    | Programa Plurianual [Multiyear Program]  |
| SEBRAE | Serviço Brasileiro de Apoio à Micro e Pequena Empresa [Brazilian Microenterprise and Small Business Support Service] |
| SECI   | Sistema de Avaliação de Capacidade Institucional [Institutional Capacity Evaluation System]                          |

|           |   |
|-----------|---|
| SEDE      | Secretaria de Desenvolvimento Econômico de Minas Gerais [Economic Development Secretariat of the State of Minas Gerais] |
| SENAI     | Serviço Nacional de Aprendizagem Industrial [National Industrial Apprenticeship Service]                                |
| SEPLANDES | Secretaria de Planificação e Desenvolvimento Social [Social Planning and Development Secretariat]                       |
| SESI      | Serviço Social de Indústria de Minas Gerais [Industry Social Service of Minas Gerais]                                   |
| SIGEO     | Sistema de Gestão Estratégica Orientada pelos Resultados [Results-based strategic management system]                    |
| SME       | Small and medium-sized enterprise   |
| SSE       | Sistema de seguimento e avaliação [Monitoring and evaluation system]  |
| STN       | Secretaría del Tesouro Nacional [National Treasury]   |
| POU       | Unidade de Controlo do Programa [Program Oversight Unit]  |
| PMU       | Unidade Gestora do Programa [Program Management Unit]   |

## PROJECT SUMMARY

### BRAZIL CLUSTER COMPETITIVENESS SUPPORT PROGRAM FOR MINAS GERAIS (BR-L1021)

| Financial Terms and Conditions <sup>1</sup>   |               |          |                                 |  |  |
|---|---------------|----------|---------------------------------|--|--|
| Borrower: Government of the State of Minas Gerais<br>Guarantor: Federative Republic of Brazil<br>Executing agency: Minas Gerais Economic Development Secretariat (SEDE) acting through the Euvaldo Lodi Institute (IEL) of Minas Gerais   |               |          | Amortization period:            | 20 years   |  |
|   |               |          | Grace period:                   | 3 years  |  |
|   |               |          | Disbursement period:            | 3 years  |  |
| <b>Source</b>   | <b>Amount</b> | <b>%</b> | Interest rate:                  | Libor  |  |
| IDB (Ordinary Capital)  | US\$10.00     | 60       | Inspection and supervision fee: | *  |  |
| Local   | US\$6.70      | 40       | Credit fee:                     | *  |  |
| Total   | US\$16.70     | 100      | Currency:                       | U.S. dollar from the Single Currency Facility of the Bank's Ordinary Capital |  |
| Project at a glance   |               |          |                                 |  |  |
| <b>Project objective:</b><br>The objective of the program is to contribute to the economic development of the state of Minas Gerais, by increasing the productivity and competitiveness of firms participating in local productive groupings (clusters) (APLs) and strengthening the tools and mechanisms of innovation and enhancing coordination between local stakeholders and organizations at the state and federal levels (enterprises, support and research institutions, etc) (paragraph 2.1).  |               |          |                                 |  |  |
| <b>Structure:</b> (see Project Outline)   |               |          |                                 |  |  |
| <b>Special contractual conditions:</b><br><i>Conditions precedent to the first disbursement:</i> <ol style="list-style-type: none"> <li>1. Creation of the Program Management Committee (CDP) (paragraph 3.9);</li> <li>2. Establishment of the Program Management Unit (PMU) (paragraph 3.14);</li> <li>3. Entry into effect of the technical and financial cooperation agreement for project execution between the borrower and the IEL as well as a special agreement for program execution between SEDE, SEBRAE-MG, and FIEMG (paragraph 3.19);</li> <li>4. Opening of a special bank account for the management of program funds by the PMU (paragraph 3.19);</li> <li>5. Presentation of the annual work plan (AWP) for the first year of program execution to the Bank's satisfaction (paragraph 3.25);</li> <li>6. Approval by the Bank of the information systems adopted by PGU for internal oversight and financial and accounting management of the program (paragraph 3.19);</li> <li>7. Entry into force of the program's Operating Regulations (paragraph 3.23); and</li> <li>8. Evidence that the program's monitoring and evaluation system is functioning (paragraph 3.29).</li> </ol> <i>Other conditions:</i> <ol style="list-style-type: none"> <li>1. Disbursements for each cluster in component 2 require the corresponding competitiveness improvement plan (PMC) to have been approved, as stipulated in the program's Operating Regulations (paragraph 3.19).</li> </ol> |               |          |                                 |  |  |
| <b>Exceptions to Bank policies:</b><br>None.  |               |          |                                 |  |  |
| Project consistent with country strategy:    Yes [ X ]                      No [ ]<br>Project qualifies as:                      SEQ [ ]                      PTI [ ]                      Sector [ ]                      Geographic [ ]                      Headcount [ ]  |               |          |                                 |  |  |
| Verified by CESI on: 11 November 2005<br>Procurement: See paragraphs 3.35-3.37  |               |          |                                 |  |  |

<sup>1</sup> The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on the lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

## I. FRAME OF REFERENCE

### A. Brazil's economy and competitiveness

- 1.1 Brazil has enjoyed increasing economic stability in recent years; and in 2007 it posted growth of more than 5%, one of the highest rates of the last decade. Greater stability and faster growth are largely the result of disciplined economic policy, backed by favorable external conditions that have allowed for a vigorous expansion in exports, involving both traditional products and industrial goods.
- 1.2 This propitious economic climate has been exploited with varying degrees of success by the country's enterprises. The small and medium-sized firms (SMEs)<sup>1</sup> that survived the competition generated by an external opening in the 1990s have displayed considerable adaptation capacity and flexibility. Nonetheless, such enterprises still lag far behind their larger counterparts in terms of productivity and competitiveness. Similarly, while SMEs have developed greater capacities in manufacturing production (in 2006 nearly 85% of exports were manufactured or semimanufactured goods), their technological and innovation capacity is less than that of larger firms (55% of their exports are of low or medium-low technological intensity).<sup>2</sup>
- 1.3 In recent years, the various public and private organizations that promote SME competitiveness in Brazil have shifted their focus to work with local productive clusters (known in Brazil as *Arranjos Produtivos Locais* or APLs), which consist mainly of SMEs.<sup>3</sup> The consensus on this approach is exemplified by the fact that cluster support is recognized as one of the key pillars of Brazil's new industrial, technological, and foreign trade policy (PITCE)<sup>4</sup>, which took effect in 2003, and of

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<sup>1</sup> The Brazilian Institute of Geography and Statistics (IBGE) defines microenterprises and small businesses as firms employing up to 49 workers in the services sector and up to 99 in the industrial sector. For the National Bank for Economic and Social Development (BNDES) a microenterprise is a firm with sales of less than R\$1.2 million, while a "small" firm has sales of between R\$1.2 million and R\$10.5 million, and a "medium-sized" one between R\$10.5 million and R\$60 million.

<sup>2</sup> Brazilian Microenterprise and Small Business Support Service (SEBRAE) 2006: *As Micro e Pequenas Empresas na Exportação Brasileira* [Microenterprises and small businesses in Brazilian exports].

<sup>3</sup> APLs are enterprise clusters located in a specific area, which share an economic dynamic based on formal and informal relations. These firms maintain commercial links and relationships involving coordination, cooperation and learning, both mutually and with other local agents such as the government, business associations, and credit, teaching and research institutions.

<sup>4</sup> To focus this approach at the federal level with a view to developing a national cluster policy, the Interministerial Group on Clusters and the APL 1015 program have been created. Both mechanisms promote coordination among the various federal agents working with such clusters.

the Brazilian Industrial Development Agency (ABDI),<sup>5</sup> created in December 2004. Against this backdrop, the Ministry of Development, Industry, and Trade set up a permanent cluster working group (MDIC/GTP-APL), which is drawing up guidelines for a cluster development plan in every state. The recent Production Development Policy (May 2008) sets development plan targets for the clusters in 10 states in 2009 and for another 9 states in 2010 in an effort to promote more balanced growth throughout the country and greater spatial deconcentration of production. The focus will be mainly on the less developed areas of each state and of each region.

- 1.4 This proposed program aims to help consolidate this approach, developing and implementing a public-private model of cluster support at the subnational level, and systemizing and coordinating the thus-far disperse efforts of the various actors that promote private-sector competitiveness in the state of Minas Gerais.

## **B. The socioeconomic context and competitiveness in Minas Gerais**

- 1.5 Minas Gerais is the second most heavily populated state in Brazil, with 19.8 million inhabitants (10% of the national total); and it has the third largest state economy, accounting for approximately 9% of national gross domestic product (GDP). The composition of its GDP reflects a mature production profile, with large shares for the industrial and tertiary sectors (31.9% and 59.8% of state GDP respectively). The same figures also reveal glaring inequalities between the state's different regions. The central region, where the capital city Belo Horizonte is located, accounts for 45% of the state's GDP and has a per capita income of roughly double that of the north and northeastern regions of the state, which contribute just 10% of its total wealth.
- 1.6 Minas Gerais is also a major exporter of primary and semiprocessed products, accounting for roughly 11.4% of the nation's foreign sales (ranking second after São Paulo). In 2007, the largest exporting primary sectors were mining (26% of the state's total exports), coffee (15%), and iron pellets (5.2%), whereas automotive enterprises are the largest exporters in the industrial sector (4.1%). The state's comparative and competitive advantages are based on: (i) the existence of abundant natural mining and agricultural resources; (ii) the presence of many universities and highly skilled human resources; (iii) an extensive basic infrastructure (Minas Gerais possesses 13% of the country's road network, 17% of its rail network, and 15% of its electric power generating capacity); and (iv) a strategic geographic location that enables it to serve as a link between the country's main regions with access to the

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<sup>5</sup> This agency's main objectives are to coordinate and synchronize efforts made by various government institutions and levels to achieve consistency in productive-sector support policies, and to improve the country's technological base in areas displaying the greatest growth potential, including: (i) strengthening the industrial structure of industrial property; (ii) promoting innovative SME capacity; (iii) creating a favorable investment environment; and (iv) increasing research and development expenditure, in both the public and private sectors (<http://www.abdj.com.br/>).



nation's main ports, in addition to forming part of the Brazil's southeastern region,<sup>6</sup> which accounts for over three quarters of national consumption.

- 1.7 The state's industries, which are mostly traditional and labor-intensive, underwent major restructuring during the last decade, in the wake of reforms to open up the economy, episodes of exchange-rate instability, and the implementation of privatization processes. In recent years, traditional industries such as footwear, textiles, and apparel have attempted to initiate a modernization process by introducing new technologies and more up-to-date production practices. Emerging sectors, such as electro-electronics and biotechnology, are also experiencing rapid growth in certain parts of the state.
- 1.8 Nonetheless, the Minas Gerais economy has been slipping behind the other Brazilian states because of factors such as a decline in private investment in large-scale projects, which had driven economic growth in past decades, and the scant diversification of its exports, which are concentrated in a small number of large firms and low-value-added products. Today, many of the fastest growing productive sectors are concentrated in a large number of clusters with a heavy presence of SMEs (see paragraph 1.12). Such firms face significant barriers that restrict the competitiveness of their clusters and hinder the state's growth possibilities.

### C. Constraints on cluster competitiveness

- 1.9 To address the problems that have been hindering state competitiveness since the previous multiyear program (PPA)<sup>7</sup>, Minas Gerais adopted a strategy that would increase productive activities and reduce the regional deconcentration of the state's economy. The aim is to achieve this strategy through 31 structural projects<sup>8</sup>, including the program being proposed here to strengthen the state's productive clusters.
- 1.10 During preparation of the PPA and its foundation document, the Integrated Mining Development Plan (2003 and 2007), the state brought together various public and private stakeholders, and held consultations with entrepreneurs and the productive sector. These efforts revealed a number of **problems that were common to SMEs belonging to productive clusters in Minas Gerais**,<sup>9</sup> including the following main

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<sup>6</sup> Consisting of the states of Espírito Santo, Minas Gerais, Rio de Janeiro, and São Paulo, the southeastern region encompasses roughly 11% of the country's total area and has 43% of its population.

<sup>7</sup> For the period 2004-2007.

<sup>8</sup> Other initiatives in the state's PPA that seek to promote productive-sector competitiveness include: (i) an MIF public-private partnership project for projects involving public utilities and high-impact infrastructure operated by the private sector; and (ii) the Competitive Mining Enterprise Program, which aims to simplify the bureaucracy and administrative paperwork that accompanies business activity.

<sup>9</sup> See <http://www.seplag.mg.gov.br/governo/governo.asp#>.

constraints: (i) high tax burden; (ii) difficulties in obtaining credit; (iii) ignorance of the mechanisms, export channels and demands of international markets; (iv) lack of laboratories, equipment and technological infrastructure; (v) weak strategies for marketing and promoting the products and image of productive clusters, on both the domestic and international markets; and (vi) low levels of management skills and insufficient technical training among the workforce.

- 1.11 Although both the State government and business organizations in Minas Gerais have taken steps to mitigate the problems faced by its SMEs,<sup>10</sup> **no integrated approach has been developed to promote the innovation and productivity of clusters, through coordination between public and private stakeholders and the creation of a systematic competitiveness support model.** This program represents an innovative attempt to design and implement actions to overcome the constraints on the competitiveness of SMEs in clusters, an area in which the Bank has some experience (paragraph 1.16). The competitive challenge facing the state is to enable productive clusters and their members to maintain their flexibility and capitalize on sector and geographic agglomeration economies, thereby overcoming the problems of scale and dispersion that hinder their capacity to innovate and participate in the international market. A key issue in this context is public-private coordination that embraces government, firms, research institutions, teaching centers, and other relevant stakeholders.

#### **D. The experience of the state of Minas Gerais in the sector**

- 1.12 In recent years, Minas Gerais has made a major effort to map and analyze its productive clusters. In 2000, in conjunction with *McKinsey & Company*, it conducted a study entitled *Cresce Minas* [Minas is Growing] which identified 47 productive clusters in the state, based on an analysis of the most important economic activities, their location, business platform, access to technology, and growth projections. Another major study by the BDMG identified a similar number of clusters, through a more quantitative analysis, based mainly on indexes of economic concentration.
- 1.13 The Minas Gerais Industries Federation (FIEMG) system is also working with a number of clusters in the state, specifically on strengthening local governance and performing diagnostics. This work has been spearheaded by the Euvaldo Lodi Institute (IEL), acting as agent of the FIEMG system, which has a mandate to promote competitiveness, innovation, and technological development among local

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<sup>10</sup> The MG government is working on regulatory issues through programs such as: “Minas Gerais: Simple and up to date” which facilitates paperwork and the payment of taxes for firms. The state also has a number of programs on access to credit, including: the credit lines of the Minas Gerais Development Bank (BDMG) and the Geraminas and Empresa Mineira Competitiva programs; PROE-Ind for enterprises in the automotive and electronics industry; and the State Popular Credit Program aimed at low-income population groups, microentrepreneurs, and small-scale businessmen. BNDES and Banco del Nordeste also offer credit lines for the state’s SMEs.

and regional productive sectors, through coordination and integration of the industry, government, education, and research and development sectors. For 10 of the state's clusters, including the seven proposed for this program, the IEL has begun work on areas such as the identification and coordination of public and private partners, strategic planning, search for resources, assistance for firms in preparing projects, and support for the management and implementation of quality systems, among others. This has resulted in the establishment of management committees in each cluster, which bring together the cluster's main institutions, organizations, and business leaders in an informal decision-making setting, and act as local governance entities.

- 1.14 In addition to the active role played by state agencies and the IEL, there are also a number of actors and programs in Minas Gerais that have targeted their work on productive clusters. The Brazilian Microenterprise and Small Business Support Service (SEBRAE) has developed a pilot methodology for results-based management in productive clusters, and has begun working with 14 clusters, including furniture and electro-electronics. The Minas Gerais Economic Development Secretariat (SEDE) is another major player, which has also undertaken specific actions to support and coordinate productive clusters within the state.

#### **E. Strategy and basis for the Bank's participation**

- 1.15 **The Bank's strategy with the country.** The lines of action of the Bank's strategy with Brazil (2004-2007) are as follows: (i) productivity growth and better infrastructure supply; (ii) improvement in poverty, equity, and human capital indexes; (iii) better living conditions and efficiency in the cities; and (iv) institutional strengthening and modernization of the state. Although this operation contributes to all these strategy lines, it has particular relevance to the first of those mentioned by making it possible to support technological innovation and incorporate it into production processes, while facilitating SME access to goods and services that increase their productivity and participation in new markets.
- 1.16 **The Bank's experience and lessons learned:** Preparation of this project has taken account of lessons learned in the design and execution of previous Bank projects on competitiveness,<sup>11</sup> including the need to: (i) give an active role to the private sector in defining priorities and managing actions in relation to productive clusters; (ii) ensure the existence of a market approach in defining business strategies for productive clusters and their SMEs; (iii) promote cooperation between the public

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<sup>11</sup> In addition to support for PBLs in execution or in preparation in other Brazilian states (paragraph 1.23), the Bank has financed other loans to heighten competitiveness, through cluster strengthening, in Chile (CH-L1019), in Panama (PN-0145), Honduras (HO-0221), and the Dominican Republic (DR-0152). Over 12 technical corporations have also been financed through the MIF to promote business cooperation, including the project for the development of industrial districts in Brazil (TC-01-09-00-5).

and private sectors in fostering SME competitiveness; (iv) ensure the prior existence of a minimum level of cooperation between the members of the productive cluster; and (v) develop a monitoring and evaluation system that fosters continuous learning.

**F. Program strategy and justification as an innovation loan**

- 1.17 The program's strategy is to increase the competitiveness of SMEs that belong to the state's productive clusters, by developing an environmentally and socially sustainable model of public-private coordination in the state, to capitalize upon subnational and sector agglomeration economies, overcome the market failures that persist in the business development and internationalization areas, and promote greater innovation capacity.
- 1.18 To this end, the program will work in a predefined group of productive clusters, to diagnose and plan pro-competitiveness activities to be built into a competitiveness improvement plan (PMC) for each of the program clusters. This process, supported by national and international experts, will rank and systemize the demands and needs of cluster firms, based on a strategic analysis and methodology for generating consensus around a shared vision and the need to implement processes of change. The program will channel existing services that provide support and technical assistance to the private sector through the PMCs of each productive cluster, within a framework of shared incentives and requirements of business participation,<sup>12</sup> and cofinance collective activities that have no alternative funding sources. The preparation and subsequent implementation of the PMCs through this program will thus be an opportunity to:
- a. motivate and mobilize cluster stakeholders (firms, support institutions, and public agencies) around the need to analyze and compare (*benchmark*) the performance and capacities of the local productive system;
  - b. develop a vision and joint strategy to enhance productivity and learning and innovation capacities among the cluster's firms;
  - c. formulate and implement an integrated set of policies and programs to promote innovation and joint learning, overcome technological and environmental constraints, and strengthen the local innovation system; and
  - d. define mechanisms to continuously monitor strategy implementation and evaluate the impact of policies and programs.

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<sup>12</sup> For example, a cofinancing scheme common to all enterprises participating in the program will be implemented, based on the degree of appropriability of the different types of expenditure, together with procedures for hiring consultants that ensure participation by firms in decision making.

- 1.19 Based on the mapping studies carried out by the state during the design stage, seven productive clusters were selected for the program.<sup>13</sup> The criteria used in this selection exercise include the following: (i) relative development level of the regions in which the clusters are located; (ii) potential to achieve positive results more quickly; and (iii) nonmembership of sectors that are already receiving support through special programs from other sector organizations in the state of Minas Gerais. Selection was necessary because of resource constraints and the need to set priorities for work with the state's productive clusters, based on their chances of achieving results during the program implementation period. The selected clusters represent existing productive realities displaying high economic potential and competitive capacity that seeks strengthening through this program.
- 1.20 Given that there is no well-organized demand from productive clusters, precisely because of the externalities and well-known problems concerning appropriability of collective action and innovation among SMEs, a mechanism is needed for preselecting productive clusters and inducing demand. Nonetheless, the process will be essentially promoted by the cluster's firms, and it will have mechanisms ensuring the relevance of actions undertaken, including a process for preparing PMCs based on needs and demands identified in conjunction with the enterprises in each cluster; enterprise contribution requirements, depending on the degree of appropriability of actions to be cofinanced; requirement for a high level of analysis, commitment, and minimum contents to approve PMCs, and the need to make resources available for their implementation; and inclusion of a requirement for PMC validation, approval, and monitoring by the program's governance mechanisms, at both the state and local levels.<sup>14</sup>
- 1.21 To ensure timely execution and improve the program strategy, studies were performed during the design stage and steps were taken to establish PMCs in a sample of initial clusters: footwear (Nova Serrana) and electro-electronics (Santa Rita do Sapucaí). This process was supported by international consulting services, financed by the Italian Trust Fund (ATN/II-9135-BR), to complement the work done by the state and firms in preparing PMCs for the two initial clusters; and to make a socioenvironmental analysis of the challenges facing those clusters in this area, and propose a socioenvironmental strategy for the program, with specific actions to be included in the PMCs. This work made it possible to fine-tune the

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<sup>13</sup> Footwear (Nova Serrana), electro-electronics (Santa Rita do Sapucaí), furniture (Ubá), traditional drinks (Salinas), apparel (Muriaé region), smelting (Divinópolis, Itaúna and Cláudio) and biotechnology (Belo Horizonte metropolitan region). See *Mapa de APLs de MG* [MG cluster map] and *Descripción de APLs Iniciales* [Description of initial clusters] in the program's technical files.

<sup>14</sup> The experience of CORFO in Chile, with its integrated territorial programs, is an example of this type of approach. Those programs propose an inductive process for the coordination of instruments and public-private actions, for which business contributions are required, and a process of approval, requirements, and conditions is defined to justify the actions to be supported under the strategic plan agreed upon between the various actors of a productive cluster.

design of the two initial PMCs, and to develop a general methodology for application by the program when preparing the remaining PMCs (see Methodological document). Once the loan is approved, these two initial clusters will quickly be able to start financing and implementing the competitiveness support actions contained in their PMCs, while similar studies are performed in the remaining five clusters for implementation later in the program.

- 1.22 This operation is proposed as an innovation loan because of the similarity and consistency that exists between its strategy and the objectives established for operations of that type, including: (i) support for the construction of consensus-building institutions; (ii) extraction and incorporation of lessons regarding the usefulness of such institutions in competitiveness support; and (iii) strengthening of the executing agency's implementation capacity before taking on large-scale programs. The program will support the start of the new Brazilian strategy to use active clusters as a public policy tool to promote productive development, innovation, and an increase in the state's competitiveness. This program stands alongside other efforts being deployed in Minas Gerais; and its value-added consists of introducing and systemizing innovations that make it possible to generate the learning needed to institutionalize a coordinated process of public-private dialogue and consensus in the promotion of cluster competitiveness. The program will thus help to extract and systemize lessons on productive clusters, and to design more effective coordination strategies to maximize the impact of subsequent investments in Minas Gerais and other regions of Brazil.
- 1.23 This program also belongs to a group of five new Bank operations to support competitiveness through the cluster approach in various Brazilian states (the others being Bahia, São Paulo, Paraná, and Pernambuco). These states display a high potential for success, given the significant preliminary work they have been doing in implementing policies to support productive clusters. The specifics of development level, institutional structures, and competitiveness challenges in each of the five states, and the productive sectors in which the activities of the different clusters are focused, will make it possible for the experiences and results obtained from the four programs to provide the Bank, the states, and the country with a balanced view of "best practices" in interventions of this type. This learning should make it possible eventually to lay foundations for the design of future operations of regional or national scope.<sup>15</sup>

## **G. Coordination with other donors**

- 1.24 The World Bank and the German Agency for Technical Cooperation (GTZ) have been engaged in a number of actions that complement the proposed program. The

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<sup>15</sup> During program preparation, the project team tried to promote an exchange of experiences between projects, for example through workshops in which the four states participate along with the national and state SEBRAE, and state business organizations.

World Bank has been implementing promotion activities to encourage discussion and dialogue on productive clusters in various Brazilian states, including workshops and presentations to disseminate best practices and strengthen cooperation between the institutions involved, etc. In addition, for a number of years GTZ has been running programs to promote microenterprises and small businesses grouped in clusters, highlighting aspects relating to: (i) environmental protection and sustainable natural resource management; (ii) creation of awareness of the need to promote partnerships, and make explicit and coordinate the demands of entrepreneurs in productive clusters; and (iii) promotion of dialogue and coordination between public and private stakeholders on competitiveness issues.

## II. THE PROGRAM

### A. Program objectives and description

- 2.1 The goal of the program is to enhance the productivity and competitiveness of firms involved in the participating productive clusters, thus contributing to the economic development of the state of Minas Gerais. Its purpose is to strengthen the tools and mechanisms of innovation and coordination between local cluster members and the state and federal levels (firms, support and research institutions, among others). To achieve this purpose, the program will be organized in three components.
- 2.2 **Component 1: Development of a public-private model to support the improvement of cluster competitiveness.** This component will help coordinate actions by the different cluster promoting entities through their local governance entities (EGLs), and prepare PMCs for each selected cluster in conjunction with the firms and related institutions. The minimum contents of the PMCs will be as follows: (a) definition of the business of the cluster and the firms and related institutions that comprise it; (b) a medium- and long-term view and strategy for positioning in domestic and international markets; (c) diagnostic study of the current situation of the cluster, including social and environmental aspects, and the path to be followed to achieve the various objectives proposed (plan of action); and (d) a proposal for services and investments under each of the program's lines of support, with its respective justification. This component will finance the diagnostics, workshops, surveys, studies, and consultancies needed to complete the PMCs in the two initial clusters, prepare PMCs in the remaining five clusters, and strengthen EGLs.
- 2.3 The program Operating Regulations describe the contents and processes, and indicate the requirements and resources that would be committed to preparation, review, and approval of PMCs in the program clusters. Aspects to be highlighted include: (a) international experts will be hired for PMC preparation, to support the work of diagnosis, prospecting, and development of strategies for the domestic and external markets; (b) based on the socioenvironmental diagnostics, each cluster's

PMCs will include activities to implement clean production practices and actions to ensure that the firms comply with environmental licensing requirements, consistently with the program socioenvironmental strategy; (c) a specific logical framework will be prepared for each PMC, containing indicators that are consistent with the program logical framework; (d) during preparation of the PMCs a baseline survey will be defined and control groups established to support, monitor, and evaluate the indicators in each PMC's logical framework; (e) each PMC should include a detailed plan of activities, with a budget and procurement plan; and (f) an analysis of financial sustainability and cost recovery will be performed in order to cover at least the operating and maintenance expenses of program activities that require an investment greater than R\$500,000.

- 2.4 The relevance and quality of the PMCs will be guaranteed through a validation and approval process involving the program's different management and governance mechanisms, particularly at the local and business levels. The results of this component are expected to be: (i) seven PMCs in the program's clusters, designed in accordance with the methodology and contents defined in the Operating Regulations; and (ii) a state coordination structure and the respective local governance entities created and operating for each of the program's productive clusters.<sup>16</sup>
- 2.5 **Component 2: Execution of plans to improve the competitiveness of the selected clusters.** This component will cofinance the activities proposed in the PMCs designed through component 1, providing support in six categories: (i) cluster governance, management, and administration; (ii) business training and assistance; (iii) basic industrial technology and technological and organizational innovation; (iv) environment and social development; (v) logistics; and (vi) marketing, market research, and exports. The program will initially support the implementation of activities proposed in the PMCs of the initial clusters: electro-electronics (Santa Rita do Sapucaí) and footwear (Nova Serrana). Subsequently, activities will be cofinanced in the PMCs of the other five clusters.
- 2.6 The component will fund consulting and training expenses for groups of firms (a minimum of five), as well as the procurement of machinery and equipment under common use and management in each cluster. The program will not finance the purchase of land or property, nor maintenance and/or operating expenses. Each of the six lines of support has eligibility criteria and requirements for presentation and cofinancing defined in the Operating Regulations, including the following: (i) presentation of the respective PMC to the Bank, and its approval, as a special condition precedent to disbursements under component 2 for each cluster to be supported by the program; (ii) minimum levels of business cofinancing, depending on the appropriability of the expenses to be financed in each activity (see draft

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<sup>16</sup> For further information on EGLs, see paragraphs 1.13 and 3.20-3.21.



Operating Regulations);<sup>17</sup> (iii) nonfinancing of investments or support services provided exclusively to individual firms; and (iv) participation by beneficiary firms in the choice of service providers to be contracted under each line of support and the activities in which they participate.

- 2.7 Implementation of the PMCs will be permanently monitored by the program's various management and governance mechanisms, supported by independent assessors hired specially for the purpose. This component is expected to result in seven PMCs being implemented in the program's seven clusters.
- 2.8 **Component 3: Development of a system for monitoring, evaluation, and identification of lessons learned.** This component will implement a monitoring and evaluation system that will make it possible to closely track the midterm and final results of project activities through studies and surveys to be carried out at the general level and in each cluster, in addition to the systematic compilation of lessons learned during its execution. For that purpose, the program's indicators will be continuously monitored in terms of targets, control groups, and baselines for each of the program's clusters, as established in the logical frameworks of each cluster and the program as a whole. The program's monitoring and evaluation system (SSE) will use an information technology tool adapted from the monitoring software of SEBRAE's Strategic Results Based Management System (SIGEOR), and the information technology system existing in the IEL. The SSE will include a record of the primary data compiled for program monitoring (primary information system) and the secondary data existing in other state data sources (secondary information system), and it will monitor the individual lines of action in each cluster and the impact of the program as a whole.
- 2.9 This component is expected to produce: (i) a monitoring, support, and evaluation system based on SIGEOR and the IEL information technology system, implemented in each cluster and in the program as a whole; and (ii) lessons learned, and achievements and best practices identified, evaluated, disseminated, and publicized for each cluster and for the program generally.

## **B. Cost and financing**

- 2.10 The total cost of the program, under the innovation investment loan modalities, will be US\$16.7 million, of which the Bank will finance US\$10 million. The remaining US\$6.7 million will be in the form of local counterpart funding, of which US\$3 million will be contributed by SEBRAE, US\$700,000 by the state of Minas Gerais, and US\$3 million by FIEMG. The execution period will be 30 months, and the disbursement period 36 months.

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<sup>17</sup> These business contribution percentages vary from 5% in environmental protection and social development activities, to 60% for support for participation in commercial events.

| Table II-1. Program costs  |                           |              |               |              |
|--|---------------------------|--------------|---------------|--------------|
| Components   | Estimated cost (US\$000s) |              |               |              |
|  | IDB                       | Counterpart  | Total         | %            |
| <b>Management and evaluation</b>   | <b>682</b>                | <b>698</b>   | <b>1,380</b>  | <b>8.3%</b>  |
| <b>Direct costs</b>  | <b>9,183</b>              | <b>5,882</b> | <b>15,065</b> | <b>90.2%</b> |
| <b>1. Development of a public-private model to support cluster competitiveness improvement</b>                     | <b>383</b>                | <b>257</b>   | <b>640</b>    | <b>3.8%</b>  |
| 1.1 Consulting services for cluster diagnostics  | 304                       | 185          | 489           | 2.9%         |
| 1.2 Preparation of PMCs  | 79                        | 72           | 151           | 0.9%         |
| <b>2. Implementation of cluster competitiveness improvement plans (PMCs)</b>                                       | <b>8,610</b>              | <b>5,176</b> | <b>13,786</b> | <b>82.6%</b> |
| 2.1 Cluster governance, management, and administration   | 637                       | 78           | 715           | 4.3%         |
| 2.2 Business training and assistance   | 1,008                     | 1,690        | 2,698         | 16.2%        |
| 2.3 Basic industrial technology and technological and organizational information                                   | 3,990                     | 1,627        | 5,617         | 33.6%        |
| 2.4 Environment and social development   | 1,119                     | 513          | 1,632         | 9.8%         |
| 2.5 Logistics  | 680                       | 106          | 786           | 4.7%         |
| 2.6 Marketing, market research, and exports  | 1,176                     | 1,162        | 2,338         | 14.0%        |
| <b>3. System for monitoring, evaluation, and identification of lessons learned</b>                                 | <b>190</b>                | <b>449</b>   | <b>639</b>    | <b>3.8%</b>  |
| 3.1 Installation and implementation of the system for monitoring, evaluation and identification of lessons learned | 155                       | 159          | 314           | 1.9%         |
| 3.2 Preparation and implementation of a plan for communication and dissemination of results                        | 35                        | 290          | 325           | 1.9%         |
| <b>External audit</b>  | <b>135</b>                | <b>0</b>     | <b>135</b>    | <b>0.8%</b>  |
| <b>Contingencies</b>   | <b>0</b>                  | <b>107</b>   | <b>107</b>    | <b>0.6%</b>  |
| <b>Financial costs</b>   | <b>0</b>                  | <b>13</b>    | <b>13</b>     | <b>0.1%</b>  |
| Credit fee   | 0                         | 13           | 13            | 0.1%         |
| <b>Total</b>   | <b>10,000</b>             | <b>6,700</b> | <b>16,700</b> | <b>100%</b>  |

### III. PROGRAM EXECUTION

#### A. Borrower, guarantor and executing agency

- 3.1 The borrower will be the State of Minas Gerais, and the guarantor the Federative Republic of Brazil. Program activities will be executed by the Economic Development Secretariat of the State of Minas Gerais (SEDE).
- 3.2 As the program is to be implemented and disbursed over a three-year period, successful implementation will require solid execution and management capacity from the outset. This makes it necessary to draw upon previous experience of work with clusters and the institutional and technical capacity to implement projects of this type already existing in the state. It was therefore agreed that the program would be executed by the SEDE, through the IEL, which forms part of the FIEMG system. As this is the only organization with an extensive presence and wide-ranging experience of successfully supporting the state's productive clusters with the implementation of public policies for the provision of business services and professional education, and given the flexibility of its social purpose and the

advanced level of its integrated information systems, there is justification for designating IEL to accommodate the Program Management Unit (PMU). The PMU will be responsible for implementing actions to support development of the program's clusters, including implementation of goods and services procurement processes on behalf of the state, as envisaged in the respective PMCs.

- 3.3 In order to establish the PMU and make program implementation possible, a technical and financial cooperation agreement will be signed between the borrower, through the executing agency, and the IEL, which will include the authority, rights, duties, and responsibilities specifically arising from the program, including the establishment of the PMU in accordance with national and state laws. A Program Oversight Unit (POU) will also be created in the SEDE to supervise fulfillment of the technical and financial cooperation agreement between SEDE and the IEL and oversee the corresponding activities. **The signing of the technical and financial cooperation agreement for program execution between the state and the IEL and a special agreement between SEDE, SEBRAE-MG, and FIEMG for implementation of the program will be a special condition precedent to the first disbursement of the Bank financing.**
- 3.4 The execution of program activities will also involve participation by two social public and private support entities (partners): the FIEMG and the Minas Gerais SEBRAE, which despite not receiving program funds will carry out support actions, including the implementation of a number of activities included in the PMCs, using their own resources and procedures as technical support and financial counterpart to the program. The FIEMG and SBRAE-MG financial and cash flow statements show that both organizations have a budgetary situation and ample financial capacity to pay their counterpart contributions in full and on time. Also, their wide-ranging experience in activities to promote competitiveness, using tools such as research and training for industry, provide a solid basis for assisting the PMU to supervise the technical quality of the activities of each component.
- 3.5 The FIEMG system encompasses over 100 business associations, and its mission is to give leadership to the process of sustainable strategic development of the state's industry, offering its members support in the following areas: economic, tax, employment and legal advisory assistance and consulting services; foreign trade support, and promotion of international cooperation through its International Business Center (CIN); association relations; the environment; business promotion; legislative matters etc. Its budget is sustained by contributions from the state's employer associations and by the rates that entities in the system charge for their specialized services. The FIEMG system consists of four linked entities: the Industry Social Service of Minas Gerais (SESI); the National Industrial Apprenticeship Service of Minas Gerais (SENAI); the IEL; and the Industries Center of the State of Minas Gerais (CIEPE). The FIEMG system will support the execution of all three program components, through counterpart funding for

diagnostic studies and strategic plans, promotion of business partnerships, organizational innovation, and monitoring of program results, among other things.

- 3.6 SEBRAE, which is a private nonprofit institution with wide-ranging and recognized experience in providing various services for the development of microenterprises and small businesses, has a national directorate and a superintendency in each Brazilian state. Its revenue comes mainly from members fees paid by firms, which underpin a budget of approximately US\$340 million per year, roughly 65% of which is allocated directly to the programs of the institution's state superintendencies. SEBRAE-MG will provide counterpart funding in components 1 and 2 for the hiring of technical assistance, studies, and training; and in component 3, by using SIGEOR as a basis for the program's monitoring, support and evaluation system.

## **B. Project execution and management**

- 3.7 The program will be executed and administered through an institutional arrangement that makes use of the public and private institutional capacities developed in Minas Gerais for managing productive clusters and their innovation processes. This arrangement, described below, includes a number of mechanisms for program management and governance, encompassing the spectrum of institutional environments involved, ranging from the state to the local and business levels (see project organization chart).
- 3.8 The borrower through the executing agency will sign special agreements with SEBRAE-MG and FIEMG for the execution of program activities, specifying: (i) the activities, authority, functions, and responsibilities of each partner; (ii) the obligation of SEBRAE-MG and FIEMG to directly defray expenses or transfer the program's local counterpart resources to the PMU; and (iii) the duty of the POU and PMU to establish and maintain adequate systems of internal, financial, and accounting oversight for the program.
- 3.9 **Program Management Committee (CDP).** As coordination of the various institutions interacting in the program is fundamental for achieving the established targets, a CDP will be established, with permanent members including SEDE (which will chair), SEBRAE-MG, and FIEMG, the PMU manager, and the POU manager. The PMU manager will serve as secretary of the CDP. **Creation of the CDP will be a special condition precedent to the first disbursement of the Bank financing.**
- 3.10 The CDP will be responsible for the program's strategic decisions, and will assist and monitor performance. It will define the program operating modalities and how its financial resources will be used, in consultation with the Bank. Its secretary will coordinate the implementation of Council decisions, ensure the regularity of its meetings and formalization thereof, register its activities, and present information

on actions supported in the productive clusters, or other issues considered necessary for adequate supervision of project execution.

- 3.11 The main functions of the CDP will be to: (a) approve strategic decisions for program development; (b) approve policies and intervention priorities in each cluster, subject to the Bank's no objection. (c) approve the Operating Regulations, annual work plans (AWPs), and the program procurement plan; (d) ensure fulfillment of the technical and financial cooperation agreement for program execution between the SEDE and IEL, along with agreements to be signed between the local governance entities (EGLs) and cluster beneficiaries; (e) appoint and dismiss the PMU manager, and provide the PMU with the resources needed to fulfill its functions; (f) review and approve the program monitoring and evaluation reports, and verify that execution is consistent with both the state's multiyear plan and the program schedule; (g) review and approve changes made to the Operating Regulations during program execution, and submit them to the Bank for its no objection; (h) ascertain the results of internal and external audits and make sure their recommendations are implemented; (i) establish internal controls and monitor their functioning, in accordance with the program's internal oversight guide; (j) approve the hiring of external auditors for the program, follow up on the issues reported by them, and take decisions on corrective actions that fall outside the jurisdiction of the PMU manager; (k) meet at least once every quarter, or as formally requested by the POU or the PMU, to ensure close monitoring of program execution; and (l) validate and permanently monitor implementation of the PMCs.
- 3.12 **Technical Advisory Committee (CTA).** To provide permanent assistance on technical aspects, a CTA will be established within the CDP, staffed by professionals from IEL, SEBRAE-MG, and the POU and PMU managers.
- 3.13 **Program Oversight Unit (POU).** The POU will support the CDP in overseeing progress in program activities and serve as the principal liaison with the Bank. In this capacity, its functions will include: (i) to supervise fulfillment of the technical and financial cooperation agreement between SEDE and IEL; (ii) to transfer resources to the PMU to ensure adequate implementation of cluster support actions in accordance with the work plan, the annual work plans, and the disbursement timetable; (iii) to commission external audits and the midterm and final program evaluations; (iv) to act as the Bank's official contact in preparing and submitting such periodic reports as are required, in accordance with the Operating Regulations and the loan contract; this includes submitting the program annual financial statements to the Bank, prepared in *reais* and in United States dollars, duly certified by an independent firm of auditors acceptable to the Bank; (v) interact with systems established for budgetary, administrative, and state accounting oversight, and establish and implement physical and financial oversight systems based on the legal requirements of the supervisory bodies of the state of Minas Gerais, especially the Finance Secretariat, the Planning and Governance Secretariat, and the State Auditor General's Office; (vi) verify the establishment of internal oversight for program

execution; and (vii) monitor PMU operations, in accordance with the program's Internal Oversight Guide.

- 3.14 **Program Management Unit (PMU).** The SEDE, as representative of the State of Minas Gerais, will execute the program under the technical and financial cooperation agreement to be signed with the IEL, the organization in which the program's PMU will be established. This agreement will specify among other things: (i) purpose and aim; (ii) objectives and targets; (iii) obligations of the IEL and the state government; and (iv) financial and human resources, management and administration of public goods, supervision, results monitoring and evaluation, presentation of accounts, contract validation and amendments, cancellation, and general provisions. **Establishment of the POU and PMU will be a special condition precedent to the first disbursement of Bank financing.**
- 3.15 The PMU will be responsible for administrative, technical and operational aspects needed for the planning, coordination, execution, oversight, and evaluation of the program components, which will involve actions coordinated and integrated with various public and private organizations and entities, particularly the SEDE, SEBRAE-MG, and the local governance entities of the program's productive clusters. The PMU will maintain a technical dialogue with the Bank in all matters relating to program execution.
- 3.16 The PMU staffing requirement will be at least a manager, a financial and administrative coordinator, a technical coordinator, a specialist responsible for program support, monitoring, and evaluation tasks, and the necessary technical and administrative support staff, also drawing upon the IEL's own financial management capacities for this purpose. With CDP approval, it will also be able to hire specific consulting services to support the technical aspects of the program, when necessary.
- 3.17 Among the unit's specific functions it will: (a) manage the allocation of the program's budgetary resources and their inclusion in the annual cash flow plan (PAC); (b) prepare AWP, in accordance with the PMCs and the program's objectives, components and logical framework; (c) prepare procurement plans, as part of the AWP (or review them in cases where the technical part has been prepared by third parties); (d) review and process CDP approval, and request the Bank's no objection to the PMCs designed for the productive clusters designed in component 1; (e) support clusters in the schematization, formulation, and execution of subprojects associated with PMC activities, in collaboration with each cluster's EGL and following the criteria and procedures established in the Operating Regulations; (f) evaluate the eligibility of formally established EGLs to assume cluster management and governance functions, as envisaged in the Operating Regulations; (g) supervise and monitor the execution of subprojects in the clusters, in accordance with the activities identified in the approved PMCs; (h) ensure the functioning of the evaluation and impact measurement system, consolidate results,

- and disseminate lessons learned; (i) prepare bidding documents and documents for monitoring bidding processes; conduct procurement and contracting processes; obtain and store evidence of receipts and other internal oversight requirements to process and effect payments for goods and services procured, obtaining the Bank's no objection where required; (j) keep accounting and financial records and internal oversight systems that are adequate and consistent with the Bank's requirements for the management of financing resources and the program's counterpart funding; secure, manage, and report on the counterpart resources committed and disbursed, both by the partner organization and by activity; (k) open and maintain separate and specific bank accounts for the management of program financing and the state government counterpart, and process disbursement requests in accordance with the Bank's requirements; (l) prepare and submit to POU semiannual and annual program progress and monitoring reports, together with semiannual reports on the use of the revolving fund and the program's annual financial statements, expressed in local currency and in US dollars, duly certified by an independent firm of auditors acceptable to the Bank, to be hired using the loan proceeds; and (m) furnish the information required by the independent auditors and take action on the findings reported by them, in order to maintain a quality internal oversight and accounting system acceptable to the Bank.
- 3.18 The agreed institutional strengthening plan will be implemented to boost the operating capacity of the POU and the PMU. The program administration and evaluation will cover the cost of this activity. The institutional strengthening activities will include: (i) incorporating international internal oversight standards into program administration systems; (ii) adapting the program information system to Bank financial administration, reporting, and disbursement requirements; and (iii) training POU and PMU staff in Bank policies on financial administration and procurement.
- 3.19 **The following are special conditions precedent to the first disbursement of the Bank financing: (i) opening of a special bank account for the management of program funds by the PMU; and (ii) Bank approval of the information technology systems the PMU uses for internal control and for financial and accounting management. As a special condition precedent to eligibility for disbursement of component 2 for each cluster, the respective PMC will need to be approved, as stipulated in the Operating Regulations.**
- 3.20 **Local Governance Entities (EGLs).** In order to facilitate the execution of PMC activities in each cluster, and to ensure good governance, commitment, and leadership of the program at the local business level, in common agreement between the PMU and representative business associations in each case, an EGL will be established to act as facilitator of PMC execution in each cluster. This will initially consist of a local cluster management body formally recognized by the PMU, and may have a local management committee, consisting of entrepreneurs, business association representatives, and related public and private organizations.

The PMU will coordinate the activities of the EGL set out in the PMC during program execution.

- 3.21 EGL functions will include: (a) to prepare or assist in preparing terms of reference for the consulting services to be contracted, according to their specialty and the activities envisaged for the PMC in the respective cluster; (b) in conjunction with the PMU, and as established in the Operating Regulations, to consult with entrepreneurs participating in PMC activities on the selection of the service providers to be engaged; (c) to collaborate with the PMU in overseeing the quality and timeliness of execution of these consulting services, as provided in their terms of reference; (d) to prepare or review technical reports and those presenting partial and final accounts of suppliers or consultants, in accordance with the guidelines approved by the PMU, before submitting them for review and approval; and (e) monitor activities for ongoing improvement of the subprojects, and help disseminate the results of activities among cluster members, promoting their acceptance and support.
- 3.22 **Beneficiary firms.** Beneficiary entities are firms participating directly or indirectly in each of the activities envisaged in the cluster PMCs, as stipulated in the respective PMCs' activity plans. When the benefits are received directly by the firms, these will be linked to the program through an adhesion agreement. The firms will undertake (i) to fulfill the obligations set out in the agreement; (ii) to collaborate with the EGL in the execution of activities; and (iii) to provide the EGL with the information needed to prepare the reports it is required to deliver to the PMU, as per the respective agreements. The EGLs will, however, consult the beneficiary firms before selecting the service providers for the activities in which they participate.
- 3.23 **Program Operating Regulations.** These include the program execution scheme, procedures for implementing the various components and activities, and the execution responsibilities of each program participant, including the fulfillment of environmental and workplace health and safety standards established under current federal and state law (see draft Operating Regulations). The Operating Regulations will include an internal oversight guide, and will seek to strengthen the program's internal oversight environment through an ethics code for the various bodies participating in program execution. **Entry into force of the Operating Regulations will be a special condition precedent to the first disbursement of the Bank financing.**

#### **C. Program management monitoring and reports**

- 3.24 The Bank, acting through its Country Office in Brazil, will inspect and oversee the program throughout its execution. Also, the project team will perform technical monitoring of the project, making such monitoring missions as are required, particularly for the midterm and final evaluations (paragraph 3.30). The Bank may



wholly or totally delegate program supervision to individual consultants or consulting firms, in which case it will inform the POU of the activities to be carried out by the consultants. In such circumstances, the POU and the PMU will furnish the consultants with the information and support needed for them to fulfill their tasks and the responsibilities entrusted to them by the Bank, which could include: (i) review of or opinion on technical and/or financial aspects of the program; (ii) review of or opinion on institutional aspects of program execution; (iii) ex ante or ex post verification of the documentation needed for disbursements and their eligibility for financing with the loan proceeds; (iv) review of or opinion on the program's accounting aspects; and (v) review of or opinion on correct execution of goods and services procurement, and their conclusion or maintenance.

- 3.25 **Annual work plans (AWPs).** Program activities will be undertaken according to the schedule in the AWP for each component, and will require the Bank's no objection once approved by the CDP. The AWPs will identify specific objectives of each component, the activities to be carried out during the year, and the corresponding timetable and respective budget, distinguishing between the local counterpart funding and Bank financing required to fulfill the established targets. Objectives or targets will also be linked to analyses of risks and actions to manage and mitigate them. **Presentation of the AWP for year one of the program, to the Bank's satisfaction, will be a special condition precedent to disbursement of the Bank financing.**
- 3.26 **Program management reports.** The POU will submit program execution reports to the Bank every six months. The management oversight system, the AWP, and the update of general programming execution will be the elements used for these reports. These reports, which will include information on the status of the revolving fund, must be submitted within 60 days after the end of each six-month period. The semiannual report at the end of each fiscal year will describe progress in program implementation and fulfillment of the targets established in the logical framework, the status of the risks identified when preparing the AWPs, and, in general, the conditions established in the loan contract. The Bank will review these reports to evaluate the technical quality of program implementation and progress made toward the established targets.
- 3.27 **Financial reports.** Document AF-300 on the preparation of financial statements establishes guidelines for their presentation. The program's financial statements will be expressed in United States dollars, but may additionally be presented in Brazilian *reais*. Presentation in the latter currency may only be done in conjunction with financial statements expressed in United States dollars; and also required is a note explaining the conversion method used, whether the statements are presented in dollars only or in both currencies. Other reports will be prepared to expand on the data provided by the projects' basic financial statements and provide analyses and explanations on their financial execution, including account reconciliations, cash flows, and disbursement requests. These must be prepared in the form and by the

deadline set by Bank requirements (described in document AF-300 and the loan contract).

- 3.28 **External audits.** The executing agency will submit the program's annual financial statements to the Bank during the program execution period, certified by independent auditors acceptable to the Bank<sup>18</sup>, and in accordance with terms of reference previously agreed upon (document AF-400). These will require the audit to express an explicit opinion on the functioning or fulfillment of the program's internal oversight guide. The firm will be selected and hired in accordance with the standard bidding process for audit firms set out by the Bank (document AF-200). The audit firm will be hired by the executing agency for duration of program execution, using the proceeds of the financing, subject to a termination clause should the Bank consider its performance to be unsatisfactory. The audited financial statements will be presented within 120 days after the end of the executing agency's fiscal year, and within 120 days after the date of the last disbursement in the case of the program's final audited financial statements.

#### **D. Monitoring and evaluation system**

- 3.29 The program's monitoring and evaluation system (SSE) will include a baseline and control groups and make it possible to continuously monitor indicators and the fulfillment of targets established in the logical framework. To that end, the SSE will record the baseline and performance indicators proposed for each PMC, in accordance with the logical framework indicators. These will be monitored using the SEBRAE results-based management system (SIGEOR) and the IEL tracking and monitoring system, which will record the performance indicators to be included for each PMC and the program in general. A data collection and monitoring plan will be prepared as part of the SSE, which will identify agents responsible for obtaining data, the methodology and frequency of data collection and evaluation, baseline values and program targets and indicators. As a result of implementation of this plan, annual reports will be produced on execution monitoring and the results of PMC activities, which will provide feedback to the program's SSE. **Evidence that the program evaluation and monitoring system is functioning will be a special condition precedent to the first disbursement of the Bank financing.**
- 3.30 A midterm evaluation to be performed 18 months into the program or when 50% of the loan has been disbursed, whichever occurs first, to evaluate the progress made in reaching the program targets and efficiency in its management and execution. Thirty (30) months into the program, or when 80% of the loan has been disbursed, whichever occurs later, a final program evaluation will be conducted to monitor the logical framework indicators and evaluate the program's final results and impact in relation to the baseline and control groups. The midterm and final evaluations will be coordinated by the PMU and the POU, with the participation of international

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<sup>18</sup> Or by the state auditing office subject to the Bank's prior approval.

consulting firms with recognized capacity and experience in evaluations of this kind. The firms would be hired according to the terms of reference agreed in advance with the Bank. As mentioned above (see paragraph 3.26), specific activity and product evaluations will be performed annually, to include at least the indicators established in the program's logical framework. Based on aggregation and analysis of the information compiled during program execution, the final review will also include an ex post evaluation of the main economic benefits for a sample of clusters.

- 3.31 The POU and PMU will compile and store information, including the AWP, monitoring reviews, and the final evaluation: (i) to enable the Bank to prepare the program completion report (PCR); and (ii) to enable the Bank's Office of Evaluation and Oversight (OVE) to determine the impact of this operation through an ex post review, if required, in accordance with guidelines established in document GN-2254-5.

#### **E. Execution period and disbursement timetable**

- 3.32 The execution period will be 30 months, and the disbursement period 36 months, as shown in table III-1. The Bank will review disbursements on an ex ante basis for the first six months of execution, or until the first replenishment of the revolving fund takes place. Depending on the results of these reviews, sample-based ex post reviews could then be allowed, with at least one review every six months.

| <b>Table III-1: Disbursement schedule (US\$000s)</b> |               |               |               |               |
|--|---------------|---------------|---------------|---------------|
| <b>COMPONENTS</b>                                    | <b>Year 1</b> | <b>Year 2</b> | <b>Year 3</b> | <b>Total</b>  |
| Management, audits, and evaluation                   | 0.30          | 0.26          | 0.26          | 0.82          |
| Direct costs   | 4.17          | 3.03          | 1.98          | 9.18          |
| <b>Total</b>   | <b>4.47</b>   | <b>3.29</b>   | <b>2.24</b>   | <b>10.00</b>  |
| <b>%</b>   | <b>44.7%</b>  | <b>32.9%</b>  | <b>22.4%</b>  | <b>100.0%</b> |

#### **F. Revolving fund**

- 3.33 A revolving fund in an amount of up to 10% of the financing will be established. The executing agency will submit semiannual reports to the Bank on the status of this fund within 60 days after the end of each calendar six-month period during program execution.

#### **G. Recognition of expenses**

- 3.34 The borrower has asked the Bank to recognize expenses or liabilities assumed during program preparation up to the equivalent of roughly US\$500,000, charged against the local counterpart resources. These expenses can be recognized once the Bank has verified that they were incurred in procurement procedures that followed procedures substantially similar to those subsequently established in the loan contract with the Bank, and were incurred no more than 18 months prior to the date

of loan approval by the Bank's Board of Executive Directors, and after approval of the program profile.

## **H. Goods and services procurement**

- 3.35 The PMU will operate and supervise the program's bidding processes. Any works that are needed will be undertaken by private firms; studies and technical assistance services will be provided by independent specialist firms or entities. Goods procurement, works contracting and the hiring of consulting services will be conducted in accordance with the procedures stipulated in the Bank's procurement policies and procedures.
- 3.36 Procurement of works with an estimated cost of US\$25 million or more, and of goods and related services with an estimated cost of at least US\$5 million will be carried out through international competitive bidding. Procurement of works with an estimated cost of at least US\$500,000 but less than US\$25 million will be carried out through national public bidding, and works valued at less than US\$500,000 may be conducted using the shopping procedure. Goods procurements with an estimated cost of US\$100,000 or more but less than US\$5 million will be carried out through national public bidding, while those for less than US\$100,000 may use shopping. Consulting services whose estimated cost is at least US\$200,000 will be hired by international advertizing. Short lists of consultants for work whose estimated cost is the equivalent of US\$1 million or less per contract may consist entirely of national consultants, with the exception of consulting services required to prepare the PMCs and perform the midterm and final evaluations, which may be carried out by consulting firms assisted by international firms or specialists, if necessary, in keeping with Bank procedures.
- 3.37 Bidding processes for works and goods procurement will use the standard documents agreed upon and approved previously by the Bank. In order to streamline program execution, the Bank's prior no objection will only be required for works contracts when these involve amounts in excess of US\$500,000, and for goods procurements worth more than US\$250,000. For contracting and selection of consulting services, the Bank's prior no objection will be required for amounts in excess of US\$100,000 in the case of consulting firms and US\$50,000 for individual consultants. Bidding processes will be reviewed ex post by the Bank on a sample basis, with at least one such review being undertaken every six months.

## **IV. VIABILITY AND RISKS**

### **A. Institutional viability**

- 4.1 The structure of the program defines the roles and functions of each institution participating in program execution, through specific agreements between the

parties. The program aims to benefit from a responsive and flexible institutional framework to respond to the needs of participating firms.

- 4.2 During program design, an exhaustive evaluation was made of the institutional capacity of the entities involved in its execution, using the institutional capacity evaluation system (SECI). This analysis confirmed that the IEL has extremely solid institutional capacity, and that it has processes, systems, and technical and human resources that are adequate for future execution of the program. The analysis specifically recommended strengthening the institution's internal oversight system to bring its structure into line with international standards.
- 4.3 The SECI found that the IEL represented a low risk in terms of organization and programming capacity, low risk for execution capacity, and medium risk for oversight capacity, with individual ratings of 90.91%, 93.67%, and 77.00%, respectively, and a weighted average of 87.98%. The results of the SECI were discussed with the counterpart, and an institutional strengthening plan was agreed upon, whose recommendations were incorporated into the design and implementation of the PMU. Implementation of the institutional strengthening plan<sup>19</sup> is considered necessary for the start of program execution, and includes the incorporation of international internal oversight standards into the IEL's management systems, and adaptation of its integrated information system in line with the Bank's requirements for financial accounting, contract, and procurement management.

## **B. Socioeconomic viability**

- 4.4 The program's socioeconomic viability is based mainly on the possibility of increasing the competitiveness of the state's SMEs in the participating productive clusters, by implementing a model for public-private coordination in the state to promote actions to capitalize upon territorial and sector agglomeration economies, overcome market failures that remain in terms of business development and internationalization among smaller scale firms, and encourage greater innovation capacity. In this way, firms participating in the program's clusters are likely to achieve greater competitiveness, shown by the development of new products and penetration of new markets. The program's strategy also seeks to promote more efficient use of the resources invested by the various agents that support the private sector in Minas Gerais, by organizing their interventions around a strategic plan that responds to the demands of the firms, in the context of an exhaustive market analysis and generation of a consensus-based joint vision for each cluster.
- 4.5 As the starting point for achieving the program's socioeconomic viability, a general mapping was made of the clusters in the state of Minas Gerais (paragraph 1.12), based on quantitative and qualitative criteria relating to the geographic

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<sup>19</sup> The matrix of the institutional strengthening plan can be found in the program's technical files.

concentration of firms in a given sector, the presence of different linkages in the chain and related actors, and growth projections. Based on this mapping, which identified 47 clusters in the state, a group of seven clusters was chosen for the program, using objective criteria to select those of greatest economic importance and competitiveness (see paragraphs 1.19 and 1.20). The cluster identification and selection process ensures that the program will work with those that display greatest potential to improve the productivity and commercial performance of their firms, by capitalizing on agglomeration economies and overcoming the market failures mentioned above.

- 4.6 Given the innovative nature of the interventions envisaged and the lack of data to estimate the program's benefits in advance,<sup>20</sup> it was decided to propose a detailed ex post economic evaluation. This will be held during the final program evaluation, and will analyze socioeconomic benefits in a sample of clusters. To ensure the financial viability of the main investments to be undertaken, financial evaluations and cost recovery strategies for investments in excess of R\$500,000 will also be required, as part of the minimum contents to be included in preparation of the PMCs for each cluster participating in the program.

### **C. Fiscal and financial viability**

- 4.7 Financial and fiscal viability was analyzed from the standpoint of the capacity of the Minas Gerais government to take on the loan and provide the local counterpart funding. This analysis showed that in recent years the fiscal situation of the state has been quite solid, and that public finances have been prudently managed. The state is fulfilling all targets and the principles characteristic of sound fiscal management, as also reflected in its fulfillment of all targets established by the Fiscal Responsibility Law (LRF) for 2007. With reference to the financial viability of the loan associated with this program in particular, the state recently received (October 2008) the findings of an evaluation by the Ministry of Finance's Treasury Secretariat (STN) which concluded that the state was meeting all the targets and complying with the commitments of the Fiscal Adjustment and Restructuring Program signed on 24 October 2006 under Federal Law 9.496/1997; and it is considered that Minas Gerais currently has significant borrowing capacity to assume the new financial commitments stemming from the three operations it is negotiating with the Bank and other financial entities. These two conditions, borrowing and repayment capacity, are important requirements for the STN to be able to recommend federal government backing for the state loan.

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<sup>20</sup> The projection of program benefits is highly uncertain because they include a major public-good component, there are significant externalities, and the specific actions to be carried out in each cluster will only be defined during program execution.

#### **D. Socioenvironmental impact**

- 4.8 The legal basis for state licensing and the oversight of actually or potentially polluting activities is established in Law 7.772 of 8 September 1980, and in the decree regulating Law 39.424 of 5 February 1998. Regulations issued by COPAM specify conditions for environmental licensing (such as classification of enterprises and activities according to their scale and pollution potential, the establishment of limits for the emission of polluting substances into the air, water, or soil, procedures to be adopted by the entrepreneur to obtain environmental licenses, etc).
- 4.9 As in federal legislation, there are three types of environmental permit: preliminary permit; installation permit; and operating permit, which can be issued separately or successively, depending on the nature, characteristics, and phase of the enterprise or activity in question. Presentation of the COPAM environmental permit is a prerequisite for other government organizations and entities in Minas Gerais to directly or indirectly approve projects for the implementation or expansion of activities that are actually or potentially environmentally harmful, or to release funds arising from fiscal or financial incentives, under the sanction of administrative accountability and annulment of their actions.
- 4.10 Recently COPAM Regulatory Resolution 74 of 9 September 2004 was promulgated in Minas Gerais, establishing classification criteria, according to the size and pollution potential of enterprises and activities with potential impacts on the environment that require environmental authorization or licensing at the state level. The regulation also sets out rules for paying analysis costs in respect of requests for environmental authorization or licensing, and procedures to obtain environmental licensing or authorization, among other items. The regulation exempts small-scale undertakings from licensing, while establishing that they require authorization for operation.
- 4.11 In aspects relating to workplace hygiene and safety, Brazil also has wide-ranging legislation at different levels of government, with many actions implemented at the state level, including specific standards for noise abatement, disposal of solid waste matter of various types, air pollution, sanitary effluents, etc.
- 4.12 The program's socioenvironmental benefits include: (i) better knowledge among entrepreneurs and workers on aspects relating to environmental management; (ii) adoption by firms of quality and cleaner production programs, with positive impacts both on their productivity and competitiveness and on the environment; (iii) creation of new jobs; (iv) potential income growth resulting from quality improvement and reduction of input losses; (v) community benefit arising from the increased environmental knowledge and adoption of socioenvironmental responsibility programs; and (vi) increased compliance with environmental and worker health and safety legislation.

- 4.13 Given the diversity of firms and activities in the clusters, potential negative impacts arise from factors such as: industrial structure; firm size; technological level; management practices; and the existence of pollution abatement equipment. Nonetheless, the program will support already existing firms, which will have to fulfill legislation on the environment, health and labor safety, and adopt mitigating measures to prevent and reduce environmental, occupational, and social hazards and impacts.
- 4.14 **Socioenvironmental strategy.** The proposed program will not directly finance productive investments, but will seek to improve the productivity, efficiency and profitability of firms already forming part of the clusters, through support on issues such as cluster governance, management, and administration; business training and assistance; basic industrial technology and technological and organizational information; environmental and social development; logistics; and marketing, market prospecting, and export promotion. No construction projects of any significance are envisaged. Small-scale adaptations to existing buildings will be undertaken where necessary, and technical equipment will be installed as needed to offer the specialized services required by the clusters.
- 4.15 To minimize the socioenvironmental impacts, a methodology was developed to identify, for each cluster, the potential impact on the environment and on workers' health, and the main mitigating measures, including elimination and minimization of impacts; applicable environmental and occupational legislation, and compliance status; and actions undertaken in the environmental and social areas. This methodology was applied in the footwear and electro-electronics clusters, resulting in the identification of the main environmental, social, and occupational impacts. Once the impacts have been identified for each cluster, they will be minimized or reduced by applying the socioenvironmental strategy developed for the program. This methodology will form part of the program's operating regulations and will be applied to all participating clusters.
- 4.16 The socioenvironmental strategy to be applied in the clusters includes actions to promote two agendas: (i) conformity agenda, which will be mandatory for beneficiary firms, to enable them to comply with the requirements of national and state legislation; and (ii) socioenvironmental responsibility agenda, based on the United Nations Millennium Goals, which include six components: (1) eradicating hunger and poverty; (2) universalizing education; (3) promoting gender equality and mother-child health (4) combating AIDS and other illnesses; (5) guaranteeing environmental sustainability and (6) promoting partnerships with the community. The latter agenda will be contractually agreed between the cluster partners, focusing on negative aspects to be overcome, and identifying possible program support actions. At least one activity will be chosen in each of the six components listed, with the possibility of opting for: (i) programming and development of activities; and/or (ii) identification and support for ongoing actions. Fulfillment of the activity



relating to the goal of guaranteeing environmental sustainability (organization of a cleaner production program) will be mandatory in each cluster.

#### **E. Benefits and risks**

- 4.17 Clusters play a major role in seeking a type of development not only based on economic growth but which also attempts to achieve a significant degree of sustainability, by respecting the environment and the local territory that accommodates the clusters, introducing considerations of social cohesion, and perhaps contributing to poverty reduction. Nonetheless, as they are a productive reality, clusters have to respond to market demands and, in particular, to the constraints and challenges facing SMEs, if they intend to be able to compete in a globalized economy. The competitive advantage frequently adduced as a positive effect on the specific organization of clusters in a local area continues to require the member SMEs to constantly improve their individual competitiveness and general cluster efficiency. Hence, the definition of policies and interventions that make it possible to improve the competitiveness of clusters and the SMEs that comprise them, by increasing their productivity, can unleash a virtuous circle that has a considerable impact on the well-being of society and the environment.
- 4.18 As a result of the proposed program, the beneficiary firms in each cluster are likely to increase their sales, profitability, and productivity, and improve their technological processes and products supplied; and they will have developed a joint vision enabling the cluster to improve its positioning on the national and international market, to face the challenges of an increasingly competitive and globalize market on a more sustainable basis. The program is also expected to help improve public policies in this domain, developing and validating a participatory model of state incentives for the productive sector, based on identification of the specific demands and needs of cluster firms with a market approach, facilitating better coordination and organization of interventions by public and private agencies in support of the productive sector.
- 4.19 Given the institutional innovations introduced by the program, the main risk to be faced concerns the coordination of institutions that have traditionally worked more independently. This risk is minimized by three factors: (i) in recent years, the relevant state organizations have begun a process to coordinate cluster diagnostics and support; (ii) these actors will provide a counterpart for execution of the operation; and (iii) program management involves participation by the main public and private actors in the state, both at the strategic level and in each cluster.
- 4.20 There is also a risk that firms might not experience the expected level of demand for program services; this has been minimized through the following actions: (i) during program preparation, extensive visits were made to the different clusters, and a high degree of interest and business participation was observed; (ii) the services to be provided in the clusters have been defined in conjunction with the

firms through a participatory planning process that will be incorporated into the PMCs; and (iii) business associations at the cluster level participated very actively in all stages of program preparation.

### Cluster Competitiveness Program for Minas Gerais (BR-L1021) Logical Framework Matrix

| Narrative summary  | Indicators <sup>1</sup>   | Means of verification  | Assumptions   |
|--|---|--|---|
| <p><b>GOAL</b></p> <p>The aim of the program is to boost the productivity and competitiveness of firms in the participating productive clusters (APLs), thereby contributing to the sustainable development of Minas Gerais.</p> | <p>By the end of the program, and two years after its conclusion, compared to the control group and as an average for the program's clusters in relation to the respective baselines:</p> <ol style="list-style-type: none"> <li>1. An increase of at least 15% in the value of exports by firms in the clusters served by the program; and</li> <li>2. An increase of at least 10% in the value of sales per employee in firms belonging to clusters served by the program.</li> </ol>   | <p>Program management report.</p> <p>Annual surveys of a sample of firms participating in the program.</p> <p>SEBRAE-GEOR surveys</p> <p>Official statistics (secondary data).</p> <p>Program midterm and final review</p> <p>PMC activities execution report.</p> | <p>A stable political and macroeconomic environment, favorable to investment, with an exchange rate within the acceptable range and sustained access for Brazilian products to international markets.</p> <p>Legislation in support of SMEs is consolidated, and export support programs are continued.</p> |
| <p><b>PURPOSE</b></p> <p>To strengthen instruments and mechanisms for innovation and coordination of local cluster members with the state and federal levels (firms, support and research institutions, and others).</p>         | <p>By the end of the program, in relation to the baseline and as an average for the clusters participating in the program:</p> <ol style="list-style-type: none"> <li>1. An increase of at least 15% in the number of firms participating in the program, relative to the total number of firms in the cluster;</li> <li>2. A 10% increase in the number of consortia, associations, etc, among cluster firms, and between these and other actors in the productive chain, to undertake common activities;</li> <li>3. An increase of at least 10% in the number of firms using design methodology and which develop new product lines; and</li> <li>4. An increase of at least 15% in the number of entities (universities, research centers, and others) participating in cluster development actions.</li> </ol> | <p>Program management report.</p> <p>Annual surveys of a sample of firms participating in the program.</p> <p>SEBRAE-GEOR surveys</p> <p>PMC activities execution report.</p> <p>Program midterm and final review</p>  | <p>Incorporation of the local development model into the clusters, based on coordinated action among firms.</p> <p>Continuity of public programs in support of clusters, at the federal and state levels.</p>   |

<sup>1</sup> The indicator baseline values for each cluster and the design of control groups will be finalized during preparation of the respective PMCs and will be a minimum eligibility requirement for approval and subsequent financing.

| Narrative summary  | Indicators <sup>1</sup>  | Means of verification  | Assumptions   |
|--|--|--|---|
| <p><b>Component 1</b></p> <p>Development of a public-private model of support for improving cluster competitiveness.</p> <p>(i) State and local cluster promotion entities coordinated; and</p> <p>(ii) Competitiveness improvement plans (PMCs) prepared for each selected cluster.</p>   | <p>By the end of the first 18 months of program execution:</p> <ol style="list-style-type: none"> <li>1. Structuring and operation of a state coordinating mechanism, and seven local governance entities created and operating for the program's clusters; and,</li> <li>2. One PMC prepared for each of the seven clusters in the program, and approved by local and state governments (EGL and CDP).</li> </ol>   | <p>Program management report.</p> <p>Formal operating records of the state coordination structure and seven local governance entities (e.g. minutes of meetings and evidence of the approval of PMCs).</p> | <p>State government, SEBRAE, and FIEMG coordinated in support of strategic planning processes in the respective clusters.</p> <p>Local actors interested in coordinating and mobilizing cluster firms for coordinated planning of their development.</p>  |
| <p><b>Component 2</b></p> <p>Cofinancing of specific actions of cluster competitiveness improvement plans (PMCs), according to the following lines of support:</p> <p>(i) Cluster governance, management, and administration;</p> <p>(ii) Business training and assistance;</p> <p>(iii) Basic industrial technology (BIT), and technological and organizational innovation;</p> <p>(iv) Environment and social development;</p> <p>(v) Logistics; and</p> <p>(vi) Commercialization, market prospecting, and exports.</p> | <p>By the end of the program (interim targets after 18 months):</p> <ol style="list-style-type: none"> <li>1. Consolidation of local governance entities (EGLs) in the program's local productive groupings, with periodic meetings and capacity to make decisions on improving APL competitiveness.</li> <li>2. 2,050 individuals trained (1,100 after 18 months); <ol style="list-style-type: none"> <li>3.1 600 firms benefit from BIT activities (250 after 18 months);</li> <li>3.2 1,100 individuals trained in BIT activities (500 after 18 months);</li> </ol> </li> <li>4.1 190 environmental permits obtained (80 after 18 months);</li> <li>4.2 200 clean production programs implemented (100 after 18 months);</li> <li>4.3 310 firms participating in socioenvironmental responsibility programs (150 after 18 months);</li> <li>5. 310 firms participating in community logistics activities (190 after 18 months); and</li> <li>6. 1,200 firms participating in marketing and market research activities (900 after 18 months).</li> </ol> | <p>Program management reports.</p> <p>PMC activities execution report.</p> <p>Program midterm and final review</p> <p>Adapted SIGEOR</p> <p>Minutes of meetings with EGLs</p>                              | <p>Management functions strengthened and transferred to local governance entities.</p> <p>Favorable attitude toward partnership between firms and willingness of private actors to invest.</p> <p>Coordination of the State government, SEBRAE, and FIEMG in support of the implementation of PMC activities.</p> |

| SUMMARY<br>NARRATIVE  | INDICATORS   | MEANS OF<br>VERIFICATION  | ASSUMPTIONS  |
|---|--|---|--|
| <p><b>Component 3</b></p> <p>Development and implementation of a system for monitoring, evaluation, and identification and dissemination of lessons learned from the program.</p> <p>(i) Monitoring system based on the SEBRAE-GEOR system and the system existing in IEL, adapted and implemented (includes primary and secondary information); and</p> <p>(ii) Lessons learned, program achievements and impact evaluated and disseminated.</p> | <p>After the first 18 months of program execution:</p> <ol style="list-style-type: none"> <li>1. Monitoring and evaluation system (SSE) based on the GEOR system implemented at a general level and for each of the seven clusters in the program; and</li> <li>2. Communication plan and dissemination of program results designed and implemented.</li> </ol> <p>By the end of the program (interim targets after 18 months):</p> <ol style="list-style-type: none"> <li>1. 2 documents of analysis of experience and dissemination of achievements published for each cluster; and</li> <li>2. 2 workshops and activities for evaluation, learning, dissemination, and exchange of experiences, held for each cluster (after 18 months: 1 workshop and activity for evaluation, learning, dissemination, and exchange of experiences held in the footwear and electro-electronics clusters.)</li> </ol> | <p>Program management reports.</p> <p>SSE inspection</p> <p>Program management reports.</p> | <p>Participant firms provide reliable information on business dynamics.</p> <p>There is continuity and interest among actors to engage in monitoring, learning, and evaluation activities.</p> <p>Implementation of information systems based on primary and secondary data.</p> |

| ACTIVITIES   |  | BUDGET                    |
|--|--|---------------------------|
| <b>Component 1</b>   |  | <b>Total: US\$640,000</b> |
| 1.1 Additional activities for up to 5 APLs.<br>US\$489,000   | 1.1.1 Awareness building workshops in up to 5 APLs to disseminate the program and mobilize thematic groups   | 24,000                    |
|  | 1.1.2 Interviews and survey of information in up to 5 APLs in production chain, market, and socioenvironmental areas.                                  | 443,170                   |
|  | 1.1.3 Release of results of diagnostic assessments and discussion of recommendations in the 5 APLs.  | 21,830                    |
| 1.2 Preparation of competitiveness enhancement plans – local productive grouping PMCs<br>US\$151,000 | 1.2.1 Review and consolidation of the local productive grouping PMCs for footwear and electric appliances.   | 10,000                    |
|  | 1.2.2 Preparation of economic technical viability studies for the electric appliance APL laboratories.   | 15,000                    |
|  | 1.2.3 Updating of economic technical viability studies of the Nova Serrana Design Center   | 13,008                    |
|  | 1.2.4 Workshops with Thematic Groups from footwear and electric appliance clusters on implementation of PMC activities                                 | 6,000                     |
|  | 1.2.5 Workshops with leaders of Thematic Groups in up to 5 APLs to establish and plan the activities and goals (shared PMCs)                           | 20,000                    |
|  | 1.2.6 Studies of economic indicators, establishment of baselines, and control groups for APLs.   | 35,000                    |
|  | 1.2.7 Preparation of economic technical viability studies for activities for which allocations of program resources are expected to exceed R\$500,000. | 30,000                    |
|  | 1.2.8 Workshops in up to 5 APLs to discuss PMC presentation and approval.  | 20,000                    |
| 1.3 Functioning of the Program Management Committee  | 1.3.1 Functioning of the Program Management Committee  | 1,992                     |
| <b>Component 2</b>   |  | <b>US\$13,786,000</b>     |
| 2.1 Business training and assistance.  | 2.1.1 Business management training program   | 2,698,000                 |
|  | 2.1.2 Operational improvement program  |                           |
|  | 2.1.3 Other  |                           |
| 2.2 Basic industrial technology and organizational and technological innovation                      | 2.2.1 Methodology for product project development (except artisanal beverages)   | 5,617,000                 |
|  | 2.2.2 Quality management system  |                           |
|  | 2.2.3 Basic industrial technology workshops  |                           |
|  | 2.2.4 Other  |                           |

| ACTIVITIES  |  | BUDGET   |
|---|--|--|
| 2.3 Environment and social development  | 2.3.1 Support environmental permits for companies<br>2.3.2 Health and worker safety programs<br>2.3.3 Other  | 1,632,000  |
| 2.4 Logistics   | 2.4.1 Mapping and strengthening of distribution channels<br>2.4.2 Other  | 786,000  |
| 2.5 Marketing and market research and exports   | 2.5.1 Strategic positioning actions for APLs in the market<br>2.5.2 Support for trade fairs<br>2.5.3 Support for business missions<br>2.5.4 Competitiveness seminar for trade representatives<br>2.5.5 Matchmaker events<br>2.5.6 Other  | 2,338,000  |
| 2.6 Governance, management, and administration of local productive clusters                   | 2.6.1 Training for EGL technical teams<br>2.6.2 Implementation and monitoring of PMC activities<br>2.6.3 Culture of cooperation  | 715,000  |
| <b>Component 3</b>  |  | <b>US\$639,000</b>                                       |
| 3.1 Implementation of primary information system (SIP)<br>US\$192,444                         | 3.1.1 Field research for monitoring of logical framework indicators and PMC control groups<br>3.1.2 Training for EGL technical team in secondary indicator monitoring  | 186,444<br>6,000   |
| 3.2 Implementation of primary information system (SIP)<br>US\$4,000                           | 3.2.1 Training for EGL technical team in secondary indicator monitoring  | 4,000  |
| 3.3 Implementation and support for monitoring system (SGE, SGP, FIEMG)<br>US\$40,000          | 3.3.1 Functioning of SGE (SEBRAE) and SGP (FIEMG) of IDB program<br>3.3.2 Implementation of web tools for SIP and SIS systems  | 5,000<br>35,000  |
| 3.4 Plan to heighten awareness and disseminate the program and lessons learned<br>US\$325,000 | 3.4.1 Implementation of public relations plan<br>3.4.2 Engagement of media and media services<br>3.4.3 Creation of program website and other resources for transmittal of information, findings, and lessons learned<br>3.4.4 Production processing and publication of information, findings, and lessons learned from program<br>3.4.5 Organizing and holding workshops and periodic meetings in the 7 APLs to discuss the monitoring and evaluation of program and lessons learned<br>3.4.6 Workshops for APLs to exchange experiences | 70,000<br>70,000<br>25,000<br>40,000<br>80,000<br>40,000 |
| 3.5 Evaluation of program impact<br>US\$77,556  | 3.5.1 Workshops to evaluate the impact of the program  | 77,556   |

PROCUREMENT PLAN - 18-MONTH PERIOD

|             | Reference No. | Description of activities  | Modality                                    | Observations   | Estimated cost (US\$000s) | Method of Selection | % IDB  | \$ IDB    | Bank review       | Starting date | End date |
|-------------|---------------|--|---|--|---------------------------|---------------------|--------|-----------|-------------------|---------------|----------|
| COMPONENT 1 | 1             | APL assessments  | Operational/consulting services PMU and EGL | -  | 489,000                   | QCBS                | 62.17% | 304,000   | Ex post           | 4/6/09        | 8/31/09  |
|             | 2             | Preparation of competitive improvement plans – APL competitive improvement plans | Operational/consulting services PMU and EGL | -  | 149,008                   | QCBS                | 53.02% | 79,000    | Ex post           | 4/6/09        | 9/30/09  |
|             | 3             | Start up of the CDP  | Travel, per diems, and related services     | -  | 3,328                     | S                   | 0.00%  | -         | Ex post           | 3/2/09        | 8/30/10  |
| COMPONENT 2 | 4             | Business training and advisory assistance  | Consulting and related services             | Procurement of at least 12 consultancies of up to US\$100,000 each | 1,185,418                 | QBS                 | 57.27% | 799,169   | Ex post           | 6/1/09        | 8/30/10  |
|             |               |  | Furniture and miscellaneous equipment       | Basic structure for 50 training positions                          | 210,000                   | S                   |        |           |                   |               |          |
|             | 5             | Basic industrial technology and technological and organizational innovation      | Consulting services                         | Procurement of at least 12 consultancies of up to US\$100,000 each | 1,975,581                 | QBS                 | 69.81% | 3,447,800 | Ex post           | 6/1/09        | 8/30/10  |
|             |               |  | Furniture and miscellaneous equipment       | Laboratory to serve APL enterprises                                | 2,963,372                 | S                   |        |           | Ex post / Ex ante |               |          |
|             | 6             | Environment and social development   | Consulting and related services             | Procurement of at least 11 consultancies of up to US\$100,000 each | 1,037,458                 | QBS                 | 70.22% | 728,484   | Ex post           | 6/1/09        | 8/30/10  |
|             | 7             | Logistics  | Consulting and related services             | Procurement of at least 4 consultancies of up to US\$100,000 each  | 319,274                   | QBS                 | 88.91% | 473,132   | Ex post           | 6/1/09        | 8/30/10  |
|             |               |  | Equipment                                   | -  | 212,849                   | S                   |        |           |                   |               |          |
|             | 8             | Marketing, market research, and exports  | Consulting and related services             | Procurement of at least 16 consultancies of up to US\$100,000 each | 1,530,921                 | QBS                 | 56.45% | 864,244   | Ex post           | 6/1/09        | 8/30/10  |
|             | 9             | APL governance, management, and administration                                   | Operational/consulting services PMU and EGL | Procurement of at least 5 consultancies of up to US\$100,000 each  | 407,537                   | QBS                 | 89.49% | 364,701   | Ex post           | 6/1/09        | 8/30/10  |
|             | 10            | Implementation of the primary information system                                 | Operational/consulting services PMU and EGL | -  | 116,722                   | QBS                 | 79.49% | 92,778    | Ex post           | 5/4/09        | 8/30/10  |



|             |    |   |  |                       |         |     |        |         |         |        |          |
|-------------|----|---|--|-----------------------|---------|-----|--------|---------|---------|--------|----------|
| COMPONENT 3 | 11 | Implementation of the secondary information system                                    | Operational/consulting services PMU and EGL                | -                     | 2,000   | DC  | 0.00%  | -       | Ex post | 6/1/09 | 8/30/10  |
|             | 12 | Monitoring system implementation and support (SGE, FIEMG)                             | Operational/consulting and related services PMU and SEBRAE | -                     | 75,000  | QBS | 87.80% | 108,000 | Ex post | 3/2/09 | 8/30/10  |
|             |    |   | Miscellaneous equipment                                    | -                     | 48,000  | S   |        |         |         |        |          |
|             | 13 | Public relations plan and dissemination of information on program and lessons learned | Operational/consulting and related services PMU and EGL    | -                     | 166,868 | QBS | 51.14% | 85,334  | Ex post | 4/6/09 | 8/30/10  |
|             | 14 | Workshops to evaluate program impact  | Consulting and related services                            | Facilitator           | 12,500  | IC  | 0.00%  | -       | Ex post | 8/2/10 | 31/09/10 |
|             |    |   |  | Operational structure |         | LCS |        |         |         |        |          |

PROCUREMENT PLAN - 18-MONTH PERIOD

|                        | Reference No. | Description of activities       | Modality  | Observations   | Estimated cost (US\$ thousand) | Method of Selection | % IDB   | \$ IDB  | Bank review | Starting date | End date |
|------------------------|---------------|---------------------------------|---|--|--------------------------------|---------------------|---------|---------|-------------|---------------|----------|
| PROGRAM ADMINISTRATION | 1             | PMU establishment and operation | Operational/consulting and related services PMU | Outlays for PMU team (Manager; Coordinators: Technical, Financial, Monitoring; Communications Expert, Accounting Analyst, Distribution Analyst and 2 Analysts in Training) | 499,562                        | QBS                 | 58.46%  | 321,284 | Ex ante     | 3/2/09        | 8/30/10  |
|                        |               |                                 | Miscellaneous equipment                         | Basic structure for 8 positions  | 50,000                         | S                   |         |         | Ex post     |               |          |
|                        | 2             | PCU establishment and operation | Operational/consulting and related services PMU | -  | 149,997                        | QBS                 | 0.00%   | -       | Ex ante     | 3/2/09        | 8/30/10  |
|                        |               |                                 | Miscellaneous equipment                         | Basic structure for 4 positions  | 25,000                         | S                   |         |         | Ex post     |               |          |
|                        | 3             | Program audit                   | Specialized consulting services                 | -  | 65,000                         | QBS                 | 100.00% | 65,000  | Ex ante     | -             | -        |
|                        | 4             | Midterm program evaluation      | International consulting services               | -  | 155,000                        | QBS                 | 100.00% | 155,000 | Ex ante     | 3/1/10        | 31/09/10 |