

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

DOMINICAN REPUBLIC

SOCIAL ENTREPRENEURSHIP PROGRAM

**PROGRAM TO SUPPORT COTTAGE INDUSTRY WORKSHOPS
IN THE SIERRA REGION**

(DR-S1002)

FINANCING AND TECHNICAL COOPERATION PROPOSAL

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I. PROJECT OVERVIEW

A. Executing agency

- 1.1 Instituto para el Desarrollo y de la Producción Organizada Inc. (INDEPRO)

B. Amount and source

	<u>IDB (US\$)</u>	<u>Local (US\$)</u>	<u>Total (US\$)</u>
Reimbursable financing	200,000	56,000	256,000
Technical cooperation	150,000	232,500	382,500
Nonreimbursable			
TOTAL	350,000	288,500	638,500

The funds will be drawn from the net income of the Fund for Special Operations (FSO).

C. Terms and conditions

Amortization period: 12 years
Grace period: 4 years
Interest rate: 3% per annum in real terms
Currency: Dominican pesos

- 1.2 The reimbursable financing component of US\$200,000 from the Bank will have an execution period of 48 months and a disbursement period of 54 months. The grace period will apply only to amortization of the principal, not the interest. The maintenance-of-value payment will be added to the interest rate, and will be based on the annual average variation in the consumer price index for the prior six months, on an annualized basis, as reported by the Central Bank of the Dominican Republic.

D. Statement of nonobjection

- 1.3 INDEPRO has submitted to the Bank a request for reimbursable financing and technical cooperation as part of the Social Entrepreneurship Program. The Government of the Dominican Republic stated its nonobjection to the Bank's financing of this operation in letter STP-0358 of 21 October 2004 from the Technical Secretariat of the Office of the President.

E. Problem to be addressed

- 1.4 Furniture making in the Sierra region of the Dominican Republic has been a tradition in every sense, from the materials used to the styles created. However, poor quality and design problems have caused this furniture to lose its added value, leading to price deterioration and shrinking natural markets. This erosion of production and marketing conditions has resulted in the temporary or permanent closure of 43% of the workshops in the Sierra community of San José de las Matas, Santiago province, crippling the area's main source of employment.
- 1.5 Because furniture making is the main source of income for families in the Sierra region, the loss of jobs has led to increased emigration with many residents moving to Santiago de los Caballeros and other cities of the Dominican Republic. Ninety percent of families have at least one relative outside the country. Meanwhile, the closure of workshops has also entailed job loss for woodworkers and weavers, exacerbating the impoverishment and marginalization of families in the region.
- 1.6 Added to these social issues of the Sierra community are problems specific to the cottage industry production of wood furniture:
 - (i) The **individualized purchase of inputs and raw materials** for production raises the price of the furniture on the market. Independent purchases of the necessary supplies and raw materials by each furniture workshop and weaver brings down their profit and productivity margins.
 - (ii) The primary input—the wood used by the furniture makers—contains high levels of **moisture due to a lack of proper technology**, which causes problems such as warping of the wood, scratches, and loose assemblies in finished products. Nor is the wood treated in any way against wood pests and diseases. All of this causes problems in, and lowers the quality of, the finished product.
 - (iii) **No knowledge of production specifications, no new designs, repetition of existing designs** and the low level of product diversification reduce the furniture's added value.
 - (iv) As a result of the **lack of knowledge of market trends and organized marketing**, furniture from the Sierra region is being ousted from its market niches by more competitive imported products with greater added value. All this has contributed to sluggish sales and the loss of consumer interest in products from the region, pushing these products into market strata that compete on ever-lower prices. Also, the middlemen who market this traditional furniture keep the furniture makers in a position of dependency.

- (v) **The weak organizational capacity and management shortcomings of the furniture makers and weavers** have adversely impacted the sustainability of the traditional woodworking industry in the Sierra region. This limits their ability to plan, to secure new contracts, and to make medium-term business forecasts.
 - (vi) The traditional furniture workshops **lack appropriate financing** to meet their working capital and technology needs. The furniture makers' credit applications are not handled through regular channels due to a lack of formal financial institutions in the region. The only local institutions that provide financial services are the cooperatives, albeit in a haphazard and inadequate manner.
- 1.7 **INDEPRO** is a nongovernmental organization that supports the development of micro and small enterprises and has done prior diagnostic work in the area of influence for this proposal. It has also provided advisory services to the Artisans Association of San José (AASJ) and technical assistance for 24 traditional furniture workshops in the proposal's area of influence. Furthermore, it has the experience needed to locate the technological resources in the area for solar oven construction and to monitor the establishment and administration of a Cottage Industry Production Support Center (CAPA), as well as to recruit the specialists needed for technical assistance to support the furniture makers and weavers. INDEPRO will serve as the project executing agency on the strength of its approach, leadership in the community and professionalism, as demonstrated through its development of new ways to organize production.
- 1.8 **Beneficiaries.** The direct beneficiaries of this project are approximately 240 traditional furniture makers and 200 weavers in the community of Inoa, who are distributed among some 100 workshops in the area of San José de las Matas in the Sierra region. The furniture makers are organized into workshops, while the weavers are generally female heads of household. The furniture makers in the AASJ and the weavers who are the beneficiaries of this project distinguished by: (i) low or very low levels of capitalization; (ii) low levels of market knowledge and information; (iii) shortcomings in the marketing infrastructure for their products; and (iv) experience in the production of wood furniture and the potential to produce furniture of sufficiently high quality for the domestic market.

II. THE PROJECT

A. Objectives

- 2.1 The general objective of this project is to help improve the quality of life in these communities by making the traditional furniture makers of the region of San José de las Matas more competitive.

- 2.2 The specific objectives are: (i) to raise the income of the furniture makers and 200 weavers in the Sierra who are organized under the Artisans Association of San José (AASJ); (ii) to create 400 new jobs for local residents; (iii) to improve the technical skills of the weavers and furniture makers in the AASJ by enhancing their manufacturing processes, work methods and designs; (iv) to increase the distribution channels and enhance the organized marketing of their products through the AASJ's Cottage Industry Production Support Center (CAPA); (v) to increase the number of active members in the AASJ; (vi) to bring weavers into the AASJ as active members; and (vii) to establish new strategic partnerships with wholesale distributors in order to market the furniture.

B. Description

- 2.3 This project will support 240 traditional furniture makers and 200 weavers in at least 100 workshops, in order to develop their competitive strength by improving quality through the introduction of effective production, organizational and business technology.

1. Technical cooperation component (IDB US\$150,000; Local contribution US\$232,500)

- 2.4 This component seeks to raise the income of beneficiary furniture makers and weavers through activities to enhance competitiveness, create local market opportunities, and improve and organize the production of items in demand.
- 2.5 **Design and implementation of the Cottage Industry Production Support Center.** In order to develop the competitive strength of the furniture makers and weavers in the Sierra region, the project calls for the creation of a Cottage Industry Production Support Center (CAPA) as a service outlet for the AASJ. The land, construction materials and equipment will be financed by the local contribution. The technical cooperation resources will finance: (i) an executive coordinator; (ii) the installation of a solar oven; and (iii) a pantograph.
- 2.6 **Technical assistance and training for furniture makers and weavers.** This subcomponent seeks to improve manufacturing methods and furniture quality, as well as to promote job security and the integration of women into the production chain. To this end, the project calls for hiring consultants who specialize in various training areas.
- 2.7 **Marketing support.** The technical cooperation component will also finance (i) a marketing consultant; (ii) a production input management consultant; (iii) participation in trade fairs; (iv) development of a benchmarking database for the AASJ; and (v) a study to identify new domestic market niches for furniture from the Sierra region.

- 2.8 **Organizational strengthening.** A series of activities will be funded, to ensure strategic planning in management, production and marketing, and to see that INDEPRO and the AASJ have the tools and human resources they need to manage the CAPA and the project efficiently, effectively and sensibly.
- 2.9 **Coordination and evaluation.** The ultimate objective is to ensure strategic planning of administrative and institutional activity, and to secure the tools and human resources needed to coordinate activities efficiently, effectively and sensibly.

2. Reimbursable financing component (IDB US\$200,000; Local contribution US\$56,000)

- 2.10 Resources for this component will be used to meet the needs for **investment in machinery and equipment** and **working capital credit** for the furniture makers and the AASJ, which through the CAPA will help forge the production and marketing chain.
- 2.11 The investments will be to procure production machinery, tools and equipment for the furniture makers. To keep furniture makers from being forced sell all their products to middlemen at low prices, and to organize the collective purchase of inputs, the CAPA of the AASJ and the furniture makers require permanent working capital. Such resources are essential to run the entire production and marketing system of the 240 furniture makers and 200 weavers.
- 2.12 The Bank will disburse the lending resources to INDEPRO, which will bear full responsibility for repaying them to the Bank. Since it is not a lending institution, INDEPRO will sign an agreement for the management of the reimbursable funds with Cooperativa Médica de Santiago (CMS), located in Santiago de los Caballeros. CMS, in turn, will lend these funds to the furniture makers and weavers according to their working capital and investment capital needs.

C. Sustainability and results of financial analysis

- 2.13 **Sustainability.** This project is socioeconomically viable because of the real need expressed by furniture makers and weavers in Inoa, San José de las Matas, for better conditions to market their products (quantity, quality and margin). Higher incomes from the beneficiaries' improved margins, knowledge transfer and access to financing will generate opportunities to preserve and create jobs in the sector of cottage industry furniture production. The project's marketing strategy through the CAPA **calls for partnerships with three group purchasing associations:** (i) ADIMUEL, the association representing distributors of furniture and home appliances in the Dominican Republic, which has about two hundred members; (ii) in the Cibao region, the products will be marketed through ACOEMCI, an association of furniture and home appliance dealers that makes high-volume group

purchases for distribution to its members; and (iii) another major group-purchasing customer will be the National Hotel and Restaurant Association of the Dominican Republic (ASONAHORES). Eighty percent of beach hotels and resorts use domestically made products and furniture such as those produced in the Sierra region.

- 2.14 **Results of financial analysis.** The project's financial viability is based on: (i) profitability of production at the level of the furniture makers, and (ii) the outcomes of wood seasoning, sourcing and joint marketing by the CAPA. At the level of the furniture makers and weavers, the project will have a direct positive impact by improving product quality and design, raising productivity and increasing sales in stable markets. These three factors will result in higher sustainable income for the 100 workshops participating in the project. For example, it is estimated that a furniture workshop can generate an average of US\$3,444 in annual pretax earnings in the fourth year, which would mean annual pretax earnings of more than US\$344,400 for a group of 100 workshops. Meanwhile, from INDEPRO's point of view, the revenue and cost forecasts show that the outlook is good for the project to generate higher revenues for the various stakeholders and repay the debt to the Bank.
- 2.15 The loan portfolio set up with the project's reimbursable funds will generate surpluses to cover the operating and financial costs of the loans, as well as earnings to build the funds that CMS lends to the furniture makers and weavers.
- 2.16 The financial analysis indicates that the technical cooperation resources provided during project execution will enable the CAPA of the AASJ to remain profitable after project completion, creating job opportunities and higher income for the beneficiaries.

D. Expected outcomes and benefits

- 2.17 Successful execution of the project components should result in significant improvement in the economic condition of participating furniture makers and weavers. The direct, measurable benefits that the project will bring to the workshops of the furniture makers and weavers will include (i) greater productivity through a 30% increase in sales per operator; (ii) a 30% increase in the net income of furniture makers and weavers organized under the AASJ; (iii) training to 240 furniture makers and 200 weavers in design and production methods; (iv) at least 50% of furniture makers' production marketed in organized fashion through the CAPA in the fourth year; (v) at least 200 weavers' joining the AASJ as active members; (vi) three strategic partnerships with group purchasing associations; and (vii) 400 new jobs for community residents.
- 2.18 The logical framework and project indicators showing the expected outcomes of the project may be found in the technical files.

E. The Bank's strategy

- 2.19 The Government of the Dominican Republic launched the National Competitiveness Program in 2003 to develop and implement competitive strategies in the key productive sectors of the Dominican economy. The Bank approved a loan program for the development of competitive advantages (DR-0152), aimed at strengthening institutional mechanisms and developing a communication process between the public and private sectors to foster the country's competitive advantages. This loan includes a menu of actions, among other items, to help dismantle restrictions in the business environment for productive sectors, especially for micro, small and medium-sized enterprises, in the interest of diversified economic growth. This project is part of that loan program and is intended to promote the competitiveness of the furniture makers in the area of San José de las Matas; its direct beneficiaries are rural, low-income micro and small furniture makers.

F. Cooperation with other international development agencies

- 2.20 During analysis and design of the operation, the project team consulted with several agencies active in supporting the country's rural productive sector, to coordinate efforts and seek complementarity between the operation and the various agencies' activities. In meetings with representatives of the European Union (EU), it was decided that the EU will contribute to this project through the PROEMPRESA project in the Dominican Republic by paying a percentage of the training costs for the furniture makers and weavers. Likewise, INDEPRO and the Northern Region Business Association (AIREN), which is running the competitiveness program for small and medium-sized enterprises of the textile and furniture sector in Santiago de los Caballeros, will promote a framework agreement for improving the productive and business organization of the furniture makers in relation to the markets.

G. Summary of environmental and social review

- 2.21 The Committee on Environment and Social Impact (CESI) reviewed this operation at its 18 June 2004 meeting, and issued a recommendation to determine whether current methods are enough not to burden forest resources.
- 2.22 The project is expected to lead to an increase in the demand for wood, but this demand can be directly met by the Sierra Plan. This would not increase the burden on forests, since the productive potential of the forests that fall under the Sierra Plan is about five times greater than the current demand for wood. The project's greatest risk of adverse environmental impact is related to the treatment of wood, due to the process by which the wood is cured. To reduce the environmental impact, protection and safety measures have been indicated for treating the wood. The Bank

submitted to INDEPRO the SDS/MSM social and environmental impact analysis guidelines for microenterprise operations.

- 2.23 Integration and training activities will be developed to strengthen the skills of the weavers, assimilating new techniques and materials, to enhance their ability to add value in the making of traditional furniture in the Sierra region.

H. Special contractual clauses

- 2.24 As conditions precedent to the disbursement of technical cooperation resources, INDEPRO will submit, to the Bank's satisfaction, (i) evidence that the project's executing agency has been established; and (ii) an execution plan that includes annual targets for meeting project objectives and outcomes.
- 2.25 The CAPA, as the AASJ's service center, will have no separate legal status of its own. However, nine months after the start of project activities, INDEPRO and the AASJ will sign an agreement setting out each party's obligations and the responsibilities of each for getting the CAPA up and running. Likewise, six months after the start of project activities, INDEPRO will submit the report on the initial collection of baseline customer data.
- 2.26 For more than 60% of the technical cooperation resources to be disbursed, INDEPRO will submit evidence that Cooperativa Médica de Santiago (CMS) has disbursed for working capital at least 30% of the loan proceeds.
- 2.27 As a condition precedent to the disbursement of reimbursable financing resources, INDEPRO will submit, to the Bank's satisfaction, (i) the final Credit Regulations for managing the loan proceeds with CMS/INDEPRO, specifying that the interest rate charged to the beneficiaries is to be fixed over the life of each loan; (ii) the framework agreement between INDEPRO and CMS for execution of the reimbursable financing component, specifying that CMS is to use its own resources to provide up to 30% of each loan made to project beneficiaries; and (iii) a valid sales contract between the AASJ and a wholesale distributor.

I. Reports, evaluations and audits

- 2.28 **Reports.** INDEPRO will deliver progress reports to the Bank's Country Office within 30 days after the end of each six-month period, and a final report 60 days after the end of the disbursement period. These reports will include an analysis of performance indicators, the problems that have emerged in the course of project execution, the actions taken to overcome them, and projections for the following six-month period. They will also include at least the following:
- 2.29 For the financing component: (i) the number and interest rates of loans to the furniture makers and weavers in the area; (ii) characteristics of beneficiaries, including the percentage of beneficiaries in communities identified as high-priority;

(iii) CMS's consolidated financial statements and performance indicators in other loans, and a summary of its cash contribution to the project; and (iv) the movements in the interest rate spread charged to project beneficiaries and the spreads charged by other cooperatives in the local microlending market.

- 2.30 For the technical cooperation component: (i) the execution of training and technical assistance programs; (ii) the operation of the CAPA and AASJ; (iii) the percentage of furniture makers and weavers who received technical assistance and training; and (iv) environmental monitoring, including safeguards and safety measures for wood treatment.
- 2.31 **Evaluations.** The Bank will use technical cooperation resources to perform a midterm evaluation and final evaluation of the project. A midterm evaluation will be done once 24 months have elapsed since the agreement was signed and at least 40% of the funds have been disbursed, to measure: (i) improvement in the income and quality of life of furniture makers and weavers of the Sierra region organized under the AASJ, compared to initial data; (ii) the number of new jobs created for local residents; (iii) outcomes of the improvement in technical skills of weavers and furniture makers organized under the AASJ, through better manufacturing processes, work methods and designs; (iv) the current use of new furniture distribution channels and organized marketing through the Cottage Industry Production Support Center (CAPA); (v) the involvement of weavers as active members of the AASJ; and (vi) the degree to which project objectives have been met.
- 2.32 A final project evaluation will be done after 48 months of project execution once 90% of the funds have been disbursed, to measure and document: (i) improvement in the income of the furniture makers and weavers; (ii) the number of new jobs for local residents, the level of participation, and the impact of the project on the groups studied in the initial evaluation; (iii) the status of the fulfillment of project objectives; and (iv) lessons learned from the project.
- 2.33 **Audits.** The Bank's contribution will fund a final audit of the project.

J. Risks

- 2.34 The most significant risk to the project is that the furniture will not sell well, and the AASJ will fail to create and maintain a climate of trust with furniture makers and customers due to complications or delays affecting delivery and payment obligations. To mitigate this risk, resources have been provided for working capital, and INDEPRO's marketing experience and support has been enlisted. Also, the CAPA's ability to secure new sales contracts will be strengthened with the help of technical cooperation funds that INDEPRO will use to hire the professional services of experts in marketing wood furniture. For disbursement of the loan proceeds to

begin, INDEPRO will submit evidence of at least one sales contract between the AASJ and a wholesale distributor.

- 2.35 A second risk is that the reimbursable funds will be mismanaged. To mitigate this risk, a fund management agreement (including the Credit Regulations) between INDEPRO and Cooperativa Médica de Santiago (CMS) has been set as a condition precedent to the first disbursement. This agreement will specify that CMS must use its own funds to contribute a portion (30%) of each loan made, so that the risk is shared. This is a clear indicator that CMS will ensure the success of the project and that it has an economic and social commitment to the sector of furniture makers and weavers.
- 2.36 A third risk is that the beneficiaries will decline technical assistance and training. To mitigate this risk, the AASJ and INDEPRO will determine the main needs in terms of technical assistance and training, which will keep these services in line with the actual needs of project beneficiaries organized under the AASJ.
- 2.37 A fourth set of risks stems from the macroeconomic conditions that the country is experiencing. In 2004 the government's economic program has suffered major fiscal and monetary setbacks, which led to suspension of the standby arrangement with the International Monetary Fund (IMF). The main sources of macroeconomic instability in the near term include: (i) a fiscal deficit that in 2004-to-date has already exceeded the targets for the entire year; and (ii) the quasi-fiscal deficit of the Central Bank of the Dominican Republic, which is greater than 10% of gross domestic product. The project is not equipped to minimize these risks, but the sense is that they will be mitigated once the Dominican Republic enters into a new arrangement with the IMF in December of this year.
- 2.38 The final risk is related to the persistence of vulnerability in the banking sector after the failure of three commercial banks in 2003. Although this type of risk falls outside the scope of the project, the Bank is supporting institutional reforms to enhance financial sector governance and achieve more effective oversight.

K. Exceptions to Bank policy

- 2.39 None.