

**PROGRAM TO EXPAND MARKETS FOR SMALL AND MEDIUM-SIZED  
ENTERPRISES IN NORTHEASTERN BRAZIL (PEM)**

**(BR-0270)**

**EXECUTIVE SUMMARY**

<b>Borrower:</b>	Banco do Nordeste do Brasil (BN)	
<b>Guarantor:</b>	Federative Republic of Brazil	
<b>Executing agency:</b>	Banco do Nordeste do Brasil	
<b>Amount and source:</b>	IDB: (CO)	US\$150 million
	Local:	<u>US\$150 million</u>
	Total:	US\$300 million
<b>Financial terms and conditions:</b>	Amortization period:	20 years
	Commitment period:	3 years
	Disbursement period:	4 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	Single Currency Facility in U.S. dollars
<b>Objectives:</b>	<p>The objectives of this program are: (i) to help raise the efficiency and competitiveness of small and medium-sized enterprises (SMEs) producing goods and services in the Northeast of Brazil; and (ii) to create an operating mechanism within the BN for granting loans to SMEs through financial intermediaries. The program will reinforce strategic regional economic development initiatives already being implemented by public- and private-sector agencies, and help eliminate basic obstacles facing entrepreneurs and workers in the manufacturing sector by taking advantage of business opportunities related to natural resources or tapping existing technological capacity.</p>	
<b>Description:</b>	<p>The program will promote and finance technical assistance, training programs, productive investments (machinery and equipment), projects involving innovations (new management methods, products, processes), research and development of new technology, trade</p>	

promotion activities, development of additional infrastructure and institutional strengthening. The instruments for support and financing of these activities will consist of nonreimbursable contributions (NRCs) and medium- and long-term loans. The program will have two components:

1. **Technical assistance, training, technology research and development, export promotion, and infrastructure and institutional strengthening, financed with nonreimbursable contributions (NRCs) (US\$69.3 million)**

This component will include the following activities:

- **Technical assistance (US\$11.3 million):** preparation of strategic plans for improving quality and developing innovative products and processes; metrology, standardization and testing; minimizing losses and improving ecoefficiency and workplace health and safety planning; and marketing studies, policies and new financial instruments.
- **Training (US\$11 million):** awareness raising activities; technical and business training; training on aspects of quality control, environmental monitoring and occupational safety, and training in new technologies.
- **Technology research and development (US\$28.5 million):** research and development (R&D) projects carried out on an individual or cooperative basis; projects for technology transfer and adoption of clean technologies; support for the development of prototypes and precommercial models; technology platforms; and technological projects.
- **Export promotion (US\$3.3 million):** creation of export consortiums; the search for new products and markets; organization of trade fairs and missions to other countries, and support for marketing activities and advertising.
- **Infrastructure and institutional strengthening (US\$15.2 million):** standards, testing and metrology laboratories; business incubators and technology parks; sectoral service centers; and accreditation and information centers on clean technologies.

The NRCs will come from the Ministry of Science and Technology (MCT) and intermediary entities and institutions such as Brazil's Microenterprise and Small Business Support Service (SEBRAE), its Export Development Agency (APEX), and the National Vocational Training Center (SENAI), which will sign cooperation agreements for

contracts with the BN for participation in the program, thereby assuming responsibility for carrying out activities in support of SMEs.

## **2. Loans for productive investments (US\$224.6 million)**

This component will provide support for expansion of the productive sector and technological modernization of processes and products by financing the purchase and installation of equipment, industrial infrastructure and other capital goods, as well as covering other expenses associated with such investments (technical assistance and training activities). The Bank's contribution will be transferred by the BN in the form of onlending to the enterprises through eligible intermediary financial institutions (IFIs).

### **The Bank's country and sector strategy:**

The strategy defined by the Bank for its activities in Brazil is consistent with objectives of the Brazilian government's multiyear plan, in term of providing support for SMEs and eliminating regional disparities. This strategy is designed to give priority to reducing the "Brazil cost" and modernizing the productive sectors, with emphasis on: (i) aiding the national effort to restore required levels of investment in infrastructure; (ii) strengthening the financial sector, with special attention to promoting SMEs and microenterprises through financing for programs to provide access to loans, technical assistance and venture capital; (iii) improving working conditions through support for occupational health programs; (iv) promoting tourism development, particularly aimed at ecotourism and sustainable development of local communities; and (v) establishing adequate regulatory frameworks.

The need to increase sources of financing for SMEs is justified by their ability to generate employment, their flexibility in adjusting to changing markets, their role as innovators and generators of entrepreneurship, and their capacity to make productive use of scarce resources. The business development strategy for the Northeast, drawn up by the Bank identified as strategic areas in which to concentrate support: (i) promoting new financial instruments; (ii) supporting human resource training programs; (iii) strengthening technical support systems for management and cooperation between firms; and (iv) supporting systems for innovation and development of technology.

### **Environmental and social review:**

The environmental procedures of the BN and the Operating Regulations (OR) will include: (i) an environmental feasibility study meeting the technical, legal and institutional requirements of each state and participating agency, for any activities relating to pollution, sanitation, and occupational health and safety of workers; (ii) a strategic environmental assessment in cases where support is provided

to development areas; (iii) mitigation plans for potential adverse social impact; and (iv) actions to facilitate participation by women in the program's activities.

**Benefits:**

This program is expected to result in increased investment in R&D within the productive sector, and growth in the number of innovative and export firms – aspects which will revitalize the economy. In similar fashion, it is expected to improve the quality and quantity of support services available to SMEs, both those provided by specialized firms and those on offer from private consulting firms.

Important aspects of this process are reflected in the program's contributions to the following: (i) creating the habit and instilling methods of strategic analysis; (ii) imparting the practice of reliance on specialized *expertise* from outside the enterprise; (iii) promoting acceptance of inter-firm cooperation in analyzing problems and seeking cooperative solutions; (iv) expanding credit available to SMEs in the Northeast; and (v) supporting civil society so that the methods used to form strategic committees, create development areas, etc. give entrepreneurs themselves a more active role in identifying problems and solutions.

The benefits accruing to intermediary banks relate to two aspects. First, by participating in the program they will expand their business horizons, extending their services to include clients with other than traditional projects, including innovative technologies and the possibility of reaching foreign markets. And second, the program will provide an incentive for financial intermediaries to approve medium- and long-term loans, which are not common with these entities, facilitating the development of the "know-how" necessary for evaluating this type of operation.

The program will also do a number of things to improve the overall environment in which the firms operate: laying the groundwork for consolidation of the supply of technology and consulting services; narrowing the gap between scientific establishments and firms, and linking their research activities to solve business needs; and building on the as-yet incipient practice of cooperation between technology centers and businesses.

**Risks:**

A downturn in the macroeconomic situation – which is not predicted, but of course cannot be ruled out – would have a dampening effect on the SMEs' willingness to renovate their production facilities. However, the country's economic performance in 1999 exceeded predictions made at the start of the year, and major changes in economic policies are having a significant impact.

The coordination of resources administered by various institutions is essential to the success of this program. So long as these institutions continue operating according to their own agendas without reference to the PEM, there will be a risk that the above-mentioned coordination will not be forthcoming. This risk will be lessened when, according to plan, appropriate cooperation agreements are signed under the program setting out working methods, objectives and resources.

**Special contractual clauses:**

Special conditions precedent to the first disbursement of resources under the Bank's loan include: (i) evidence that the version of the Program's Operating Regulations previously approved by the Bank have entered into force (paragraph 3.24); (ii) evidence that the program coordinating unit (PCU) has been created (paragraph 3.2); (iii) approval by the Bank of the model contract for transfer of funds from the BN to the IFIs participating in the program (paragraph 3.19); and (iv) signing of the technical cooperation agreement between the MCT and the BN, and preparation of the work plan for the program (paragraph 3.19). Within 60 days of the signature of the contract between the Bank and the BN, the latter must present the following to the Bank: (i) at least one funds transfer contract signed with an IFI, based on terms agreed upon with the Bank (paragraph 3.19); and (ii) at least one technical cooperation agreement between the SEBRAE or SENAI of a state and the BN, setting out the corresponding participation in the program according to the model previously approved by the Bank (paragraph 3.19).

**Poverty-targeting and social sector classification:**

This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704) (paragraph 4.18).

**Exceptions to Bank policy:**

None.

**Procurement:**

Where applicable, the Bank's standard procedures will be followed for the procurement of goods and services.

## **I. FRAME OF REFERENCE**

### **A. Socioeconomic characteristics and challenges facing Brazil's Northeast**

- 1.1 The Northeast region of Brazil comprises 9 of that country's 26 states: Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe and Bahia. According to projections made by the Brazilian Institute for Geography and Statistics (IBGE) for 1999, the Northeast has 46.3 million inhabitants, or 28,2% of Brazil's total population. The region's productive sector is dominated by service industries (accounting for 63.6% of regional GDP), followed by manufacturing (23.8%) and agriculture (12.6%).
- 1.2 The social and economic disparity between this region and the rest of the country remains wide despite improvements recorded since 1960. Beginning in that year and continuing through 1997, the region's per capita GDP has risen at an average annual rate of 2.7%, which is higher than average GDP growth for Brazil as a whole (only 1.96% over the same period). During the period 1995-98, the region's per capita GDP grew by 1.9%, once again higher than the average recorded by the rest of the country. This enabled the Northeast to trim the gap in development somewhat, but the disparity between this region and other areas of the country remains significant. Depending on the years chosen for comparison, there has even been a reversal. In 1985, per capita GDP in the Northeast was equal to 48% of the national average, versus only 42% in 1992 and some 46% in 1997. It is worth noting that if per capita GDP in the Northeast were to remain at a steady 1% above the average per capita rate for Brazil as a whole, it would take the region 70 years to reach parity with the rest of the nation.
- 1.3 The region's degree of marginalization compared to the rest of the country can be seen in numerous indicators<sup>1</sup>: the illiteracy rate stands at 28.7% (versus a national average 14.7%), life expectancy in the region is 64.2 (versus 72.4 elsewhere), the rate for infant mortality is 75 per thousand, more than double the national average. Finally, the Human Development Index (HDI) of 0.656 for the Northeast region is considerably below that of Brazil as a whole (0.886), neatly summarizing the region's socioeconomic disparity. Significantly, the region is currently home to approximately 55% of all Brazilians living below the poverty line.

### **B. Current situation of the SME sector in the Northeast**

- 1.4 The economic base of the Northeast region consists primarily of small and medium-sized enterprises (SMEs). According to Ministry of Labor figures,<sup>2</sup> microenterprises

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<sup>1</sup> The following indicators are taken from various years between 1996 and 1999.

<sup>2</sup> The definition of SMEs used for the proposed program is based on the criteria employed by the Banco Nacional de Desenvolvimento Econômico y Social (BNDES), which include companies with less than 250 employees and net operating profit of up to R\$35 million.

and small and medium-sized businesses made up 99.5% of the companies operating in that region in 1997. Among these, the SMEs (firms with from 5 to 500 employees) account for 37% of the total. Using a slightly different yardstick (10 to 250 employees), the IBGE has identified some 40,000 SMEs in the Northeast region. The preponderance of this sector in the region can also be seen in the relative scarcity of large firms: of the 500 largest private companies operating in Brazil (based on value of sales), only 25 (i.e. 5%) are located in the Northeast, with the greatest concentrations in the states of Bahia (14) and Ceará (5)<sup>3</sup>.

- 1.5 The disparity with other regions is further reflected in the level of competitiveness of SMEs, which is lower here than among the other, relatively more developed regions, with the majority of products aimed at local markets within the Northeast. The region's contribution to Brazil's total exports of manufactured products is only 7%, compared to 11% in the 1980s. This is well below the figure of 83% recorded for the states of the South and Southeast, and even less than the Northeast's relatively low (15.7%) contribution to Brazil's GDP.
- 1.6 The Business Development Strategy for the SMEs of Northeastern Brazil (EDE), which the Bank is promoting,<sup>4</sup> identifies the main barriers which are preventing this sector from achieving competitiveness on domestic and international markets. These obstacles include: low levels of formal education and professional qualifications among the work force; reduced access to sources of investment financing; insufficient level of innovation, both in terms of managerial know-how and in the development of technology and quality control; and absence of a culture of cooperation and the formation of strategic alliances between firms.
- 1.7 Another of the region's fundamental obstacles identified in the EDE is its lack of service networks to support small firms (for example, marketing consultants, export promotion and technology transfer companies, and metrology, testing and quality certification services). Of the 108 calibrating laboratories accredited in Brazil, only five are in the Northeast – and all of these are located in the state of Bahia. Again, only five of approximately 100 testing laboratories operating in Brazil are located in the region (4 in Bahia and one in Pernambuco). This means that firms requiring calibration or testing services must transport their instruments, product and prototypes to the laboratories in the South or Southeast regions of the country where the laboratory network is concentrated, thus increasing their cost of doing business.
- 1.8 The inadequate supply of business services and lack of vitality among firms in the Northeast is reflected in the low number of certifications awarded by the Inter-

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<sup>3</sup> EXAME, *As 500 Melhores e Maiores Empresas Do Brasil*, Editora ABRIL, June 1999.

<sup>4</sup> This document was prepared in 1998 and updated in 1999 by a team which included the BN, the Instituto Nacional de Metrología (INMETRO), the Superintendencia para el Desarrollo del Nordeste (SUDENE), the Ministry of Science and Technology (MCT), the Economics Department of the Universidad Campinas-São Paulo, and a group of international and local consultants hired by the Bank.

national Organization for Standardization (ISO) in the region, which is one indicator of management quality throughout the manufacturing process. In 1999 the Northeast had only 6% of the 4,605 ISO 9000 certifications awarded in Brazil, and approximately 8% of that country's ISO 14000 certifications.

- 1.9 Despite these limitations, a number of nuclei or centers of economic activity have developed throughout the region with the capacity to generate growth, whether by exploiting natural resources to make products offering real competitive advantage, or by introducing new activities to make use of specific technologies. Among the first type (those relying on development/exploitation of local resources) are the integrated development areas (*Polos de Desenvolvimento Integrado*), which are areas containing food processors and other firms utilizing agricultural products. The Banco do Nordeste (BN) has for some time been promoting development activities of this sort in centers distributed throughout all of the region's states. Beginning with just nine such areas, the number has gradually risen as new centers are added. The second type includes sites which offer a more diverse range of activities that take advantage of technological, regional, natural or other resources, sometimes under specific regional development policies adopted by the respective state governments.
- 1.10 A fundamental characteristic of the new initiatives is the effort made to boost the competitiveness of their economic activities, using world markets as a reference point and the *life cycle of a product* as their unit of analysis. Consequently, their analysis of competitiveness covers, on the one hand, the entire production process needed to ready a product for market, including the value added to the product at each stage of that process; and, on the other hand, a global calculation for all ancillary activities, including specific industrial training or instruction in the new technology required for carrying out the manufacturing activity.
- 1.11 Under this approach, for example, primary importance is placed on engineering design or distribution companies as key determinants of competitiveness in the productive sector. This requires adopting a common approach in which actions are organized around a central productive activity, and the strictly sectoral view is abandoned. This integrated view of the production cycle also appears in the Northeast's Special Export Program, which represents a specific application of the national plan of the same name covering the entire country. Table I-1 provides additional information (based on the findings of studies conducted by academic institutions and international organizations) describing sorts of product cycles found in concentrated areas within the northeastern states, and their likely eligibility for participating as beneficiaries under this program.



**TABLE I-1**

**Groupings and clusters of enterprises as potential beneficiaries of the program**

The activities carried out under the Market Expansion Program (PEM) will benefit SMEs located in the Northeast region of Brazil. The PEM program will be widely promoted and enterprises located anywhere in the region will have open access to its benefits. To be eligible, projects submitted by individual firms or groups of SMEs should be part of an overall plan for improving competitiveness, promoting innovation and expanding sales and markets, and must include a financial and economic cost-benefit study.

The PEM will also support group projects submitted by representative bodies (chambers of commerce, employers groups, trade associations, etc.) and non-profit entities that provide services for small enterprises. In this case, the activity financed must target one of the priorities or address a relevant need of the *cluster*, sector or production cycle and identified as such in its strategic plans, and must include the corresponding financial, economic and social cost-benefit study.

The program will pay particular attention to requests originating from *clusters* of SMEs and submitted through their trade associations and business and technological support institutions. The Bank has had success in the past with supporting specific sectoral projects, such as petrochemical complexes in Brazil and Argentina, or shrimp-farming in Guayaquil (Ecuador) which has become Latin America's largest producer and exporter of this product.

In preparing for this program, the Bank sent several missions to visit these production facilities and their supporting institutions. These contacts included *clusters* of software firms (Pernambuco), furniture makers (Ceará), shrimp farmers (Rio Grande do Norte), dairy processors (Pernambuco and Ceará), fruit growers (Bahia, Pernambuco and Rio Grande do Norte), granite producers (Bahia), gas suppliers (Rio Grande do Norte), pharmaceutical firms (Paraíba) and various management and technology development centers in Pernambuco, Rio Grande do Norte, Maranhão, Ceará and Bahia. In addition, studies are being prepared for the formation of new *clusters* in the auto parts (Bahia), handicrafts, clothing, woodworking, poultry and other industries in various states of the Northeast. A number of women's firms have also been identified as possible beneficiaries of the program. The firms in question are in the jewelry, food and beverage, clothing and biotechnology sectors, etc., and typically market their products outside the northeastern region and are in need of modernizing their production methods. In its recent study entitled *Projeto Iniciativa pelo Nordeste*, the World Bank identified four key areas in which the networking of firms into *clusters* could serve to increase the region's exports: tourism, grain growing, fruit production and computers. Also, the Massachusetts Institute of Technology, under its *Northeast Brazil Project*, conducted a study of *clusters* in the clothing (Ceará and Pernambuco), furniture and woodworking (Maranhão), footwear (Piauí and Pernambuco), and fruit growing (Petrolina-Juazeiro) sectors. Taken as a whole, these *clusters* represent a major opportunity for local economic development in the region, as well as providing a critical mass for the design and implementation under the PEM of activities enabling groups and associations of enterprises to promote inter-firm cooperation and seek out economies of scale and synergistic benefits.

- 1.12 Other studies point to the desire of these firms to overcome weaknesses, achieve growth and expand their markets. Specifically, the BN in preparation for the present program conducted a survey of demand in the Northeast, based on a sample drawn from firms of every size, from each sector and all of the region's states, in order to ensure that the responses were representative of all strata<sup>5</sup>. This survey estimated that SMEs in the Northeast intend to invest a total of R\$35.3 billion<sup>6</sup> over the period 2000-2003, which is divided between machinery and equipment (R\$13 billion), training and education (R\$6.8 billion), information costs (R\$6.7 billion), and consultants and technical assistance (R\$8.8 billion).

<sup>5</sup> Banco de Nordeste, "Investimento para o Incremento da Competitividade das Pequenas e Médias Empresas do Nordeste – Uma Estimativa para o Período 2000-2003", Fortaleza-CE, January 2000.

<sup>6</sup> On February 28, 2000, the exchange rate was approximately US\$1.00 = R\$1.8.

- 1.13 Table I-2 presents the survey results concerning the investment priorities (listed in decreasing order) of the firms, and shows that respondents rated the following as key factors for increasing their productivity: (i) increased investment in production technology; (ii) better access to financing; (iii) adoption of internal quality controls; and (iv) obtaining worker and management training.

**Table I-2**  
**Investment Priorities of Enterprises According to Operational Area**

	Mean Value	Value for each Category of Firm (number of employees)		
		10 -49	50-99	100-250
1. Production technology	1.37	1.2	1.5	1.4
2. Financing	1.07	0.9	1.2	1.1
3. Internal quality control	0.77	0.9	0.7	0.7
4. Worker training	0.77	0.8	0.8	0.7
5. Management training	0.63	0.5	0.3	1.1
6. Marketing	0.53	0.6	0.8	0.2
7. Other	0.30	0.2	0.5	0.2
8. Information on the domestic market	0.20	0.3	0.1	0.2
9. Product design	0.20	0.1	0.1	0.4
10. Information on external markets	0.03	0.1	0	0

Source: BN, *op cit.* (prepared by BN staff). The figures represent a weighted average based on order of priority (high, medium, low, none) indicated by respondents. The higher the number, the greater the priority

**C. The Brazilian support system for firms in the Northeast and the difficulties it has encountered**

- 1.14 In most cases, support services for businesses in the Northeast region of Brazil are supplied by semi-private entities. These entities generally provide their services to firms through small private consulting firms or individual consultants. The institutions described below obtain their resources in part through government funding, and in part through fees for their services.
- 1.15 The system for promoting small firms is organized around SEBRAE [Serviço Brasileiro de Apoio às Micro e Pequenas Empresas] (Microenterprise and Small Business Support Services), created in 1990 and administered jointly by the private sector in coordination with government agencies. Its management is extensively decentralized, although the central unit retained responsibility for directing and coordinating the operation of the system, establishing the rules and pertinent strategies. SEBRAE operates programs in the following areas: (i) training; (ii)

sustainable development; (iii) promoting private initiative (new entrepreneurs); (iv) exports; (v) research; (vi) quality control; (vii) technology; and (viii) tourism. Within the Northeast region, SEBRAE provides assistance for over 10,000 firms annually, either individually or in groups or associations. SEBRAE's most important program goes by the acronym PATME (*Programa de Apoio Tecnológico às Micro e Pequenas Empresas*), and was created jointly by SEBRAE and FINEP (*Financiadora de Estudos e Projetos*, a fund which operates under the Ministry of Science and Technology) to improve the technological resources of small firms by providing access to expertise available within the country, by means of consultants supplied by technology centers. PATME finances up to 70% of the cost of approved projects.

- 1.16 Technological development and business innovation are the focus of initiatives undertaken by the Ministry of Science and Technology (MCT), with the support of other related ministries. In the Northeast region, the MCT has technology development programs with the nine state Science and Technology Secretariats, state laboratory and technology institutes, PATME, SEBRAE and the National Vocational Training Center (SENAI), and has signed agreements with the universities of the region and other institutions and research centers (such as the Instituto Tecnológico de Pernambuco and the Instituto de Gas de Rio Grande do Norte).
- 1.17 The CNI (Confederação Nacional da Indústria) is very active in the field of worker and management training where it operates primarily through the SENAI. In addition to teaching courses, the SENAI offers technical assistance and consulting services on technology through its network of centers distributed throughout the country. SENAI is currently engaged in strategy formulation to introduce a quality excellence program in its services (ISO 9000), consolidate the Centro Nacional de Tecnologia (CENATEC) network, launch the Centro Modelo de Educação (CEMEP) network, and promote ongoing programs to develop human resources and upgrade the region's technology base, including modernization in the areas of electronics and general engineering (computer aided design), clothing design (computer modeling), civil engineering (plaster, granite and marble technologies), food products (packaging), dimensional metrology, information technology (internal and external networks, corporate systems, software applications, databases, etc.), and educational technology.
- 1.18 Brazil's Export Development Agency (APEX) operates the Programa Especial de Exportação (PEE) with activities in a number of areas including: export financing (in cooperation with the BNDES), trade promotion (with SEBRAE), exports, quality and technology orientation (Ministry of Development, Industry and Trade), and market access (Ministry of Foreign Relations). These activities include individual (one-off) projects, integrated sectoral projects (support for a given sector or production process), horizontal projects (supporting two or more different sectors), creation of export consortiums, and training activities in export trade and promoting Brazilian products in foreign markets.

- 1.19 Despite the variety of services available, the intermediary agencies providing these support services for SMEs act in a piecemeal manner within their respective areas of competence (technical assistance, training, technological innovation, financing) throughout the region. For this reason, it has not been possible to identify an overall and coordinated strategy for organizing the large number of horizontal programs which are general in nature and do not target the specific needs of SMEs or any given grouping of enterprises<sup>7</sup>. Moreover, according to data provided by the Banco Nacional de Desenvolvimento Econômico e Social [National Economic and Social Development Bank] (BNDES), the region as a whole accounted for just 10% of national lending under its various finance facilities in 1999. Not only is this figure much less than would be expected given the size of the region and its contribution to GDP, but its share of borrowing has actually declined over the past two years, in both absolute and relative terms (Table I-3)<sup>8</sup>. These data show that the region is under a de facto disadvantage in competing with other parts of the country and in obtaining access to existing sources of financing, whether from a lack of qualified projects or inadequate management on the part of borrowers, or because of the piecemeal approach and lack of focus among entities providing support services.

**Table I-3**  
**Investment Financing Approved by the BNDES**  
**(millions of reais)**

Region	1995		1996		1997		1998		1999	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Northeast	996	14	1,324	14	2,422	14	1,874	10	1,211	10
Southeast	3,445	49	5,214	54	10,053	58	11,989	63	7,656	61
Rest of Brazil	2,608	37	3,076	32	4,851	28	5,127	27	3,622	29
TOTAL	7,049	100	9,614	100	17,326	100	18,990	100	12,489	100

Source: BNDES

- 1.20 The conclusion to be drawn from the above is that a new program for SMEs must place greater emphasis not only on the provision of financing, but also on the integration of available (financial and human) resources, linking these to the needs of the enterprises and strengthening their ability to design successful initiatives.

<sup>7</sup> Souza, M.C.; Suzigan, W. (coordinators): *Inserção Competitiva das Empresas de Pequeno e Médio Porte no Brasil*. Campinas and Brasília: MICT, 1999.

<sup>8</sup> However, the decline in the Northeast's share of borrowing is also explained in part by increased demand for growth among companies in the Southeast following the advent of MERCOSUR.

#### **D. The Brazilian banking system**

- 1.21 Brazil has a range of well-established banking services which are spread throughout the country and offer a diverse selection of credit options, with a variety of financial institutions participating within a competitive market. As of June 30, 2000, the Brazilian financial system consisted of 178 banks, out of a total of 1,936 financial institutions conducting operations authorized by the Central Bank. The total assets managed by the financial system were equivalent to US\$734.5 billion and net capital for the system of some US\$69 billion. The density of banking facilities is approximately one branch per 10,000 inhabitants, which is very similar to that of middle-income countries in the region, although far from satisfactory when compared to the rates recorded for European countries.
- 1.22 Based on the services they are authorized to provide, Brazilian banks are classified into the following categories: (i) 24 commercial banks, one of which is owned by the federal government and another by a state government; (ii) 127 multibanks, four held by the federal government and 11 owned by states; (iii) five development banks, of which one is federal and four are state-owned; (iv) 21 private investment banks; and (v) one savings bank which is owned by the federal government. In addition, there are 50 credit and loan societies, 83 commercial leasing companies, 229 securities dealers, 22 savings and loan associations, 231 securities and foreign exchange firms, 2 savings banks and 1,096 credit unions. All financial and non-financial institutions whose operations are authorized by the Central Bank are subject to both individual and collective supervision.
- 1.23 The number of entities dropped substantially between 1994 and 1999, reflecting a trend toward consolidation in the banking sector. The reduction in the number of discrete entities has been disproportionately higher in the poorest regions of the country, however, particularly in the North and Northeast where there are now 21.5% and 17.3% fewer institutions, respectively. This has added to the regional disparity in banking infrastructure, to the detriment of economic activity in the regions affected. Notwithstanding the presence of an innovative and diversified private banking sector, the federal and state-owned banks continue to have an important role: public banks account for 46% of banking infrastructure and 55% of total assets within the system. In the Northeast region, the BN is responsible for 78% of the financing granted to the productive sector by the established banking system in that region.
- 1.24 For all of Brazil, total lending to the private sector in 1996 was equivalent to 29.4% of the country's GDP. Loans granted by the private sector were concentrated in the manufacturing and housing sectors, while agricultural lending was handled by public banks, and individual loans and commercial credit were granted primarily by non-banks or non-financial institutions such as suppliers and moneylenders. While public sector financial institutions, in particular the *Caixa Econômica Federal* (CEF), continued to be major players in housing credit, private banks also

accounted for a significant share of lending in this area thanks mainly to the incentives built into the requirements for savings applications.

- 1.25 In practice, loans made by the private banking sector and denominated in local currency are limited to a period of no more than 60 days, at rates which are generally around 65% per annum. Annual interest rates on consumer credit (which includes overdraft protection, credit to retailers and personal loans) fluctuate between 98% and 178%, with the latter figure applying to overdrafts on current accounts. Although these figures have tended to drop somewhat, the rates charged by the private sector are still very high. The borrowing rate reflected in the interest paid on 30-day certificates of deposit is at 21% per annum, which gives an annualized margin of 62% in favor of the banks. The operating costs of commercial banks in Brazil are high. The following table compares the situation in Brazil with that in a selection of other countries, with respect to the ratio of operating costs to total assets:

**Table I-4**  
**Operating Costs – Commercial Banks**

Country	Operating Costs/Total Assets
Brazil	8%
Argentina	5.7%
Chile	2 to 4%
Germany	2 to 3%
United States	1 to 1.5%

- 1.26 Concerned over the high cost of financing for both companies and individuals, the Central Bank conducted a careful review of borrowing costs throughout the system. This study indicated that the high margins in the sector reflect the relative inefficiency of Brazil's commercial banks, confirmed by their high administrative costs and low leveraging (on average 15% of capital over total assets). The review conducted by the Central Bank identified taxes on financial transactions and profits made by banks, together with high default rates as the causes for their elevated operating costs. These operating costs have in fact shown a rapid decline in recent months. In an effort to bring down high interest rates, the Central Bank has ordered banks to publish the rates applied in their operations at all of their branches, and to make this information available to the public over the Internet.
- 1.27 In line with its policy of lowering the cost of loans in the banking sector, the Central Bank has taken steps to reduce the costs associated with attracting resources from the public through non-fixed deposits, fixed deposits and investment funds. Reserve requirements on current account deposits were reduced from 75% to 45%, the minimum cash ratio for term deposits were lowered from 20% to 0%, and the requirements for investment funds of less than 30 days were dropped to zero from the 50% level in effect prior to the change. Nevertheless, minimum reserve

requirements remain high compared to those of other countries in the region, and the measures taken by the Central Bank will not have an immediate effect on availability of funds for new lending. This will depend on other variables, especially the continuation of macroeconomic stability which, in turn, is dependent upon carrying reforms to Brazil's pension system and tax policy.

- 1.28 To a large extent, long-term lending is provided by state-owned banks, generally through lines of credit especially designed to promote particular socioeconomic activities. On average, the BNDES has supplied the equivalent of between US\$7.5 billion and US\$9.0 billion in medium- and long-term credit per year. In 1999, the BN lent approximately US\$1.4 billion in special credits aimed at particular regions or sectors. Among the primary lines of credit provided are the: Program to Generate Employment and Income (PROGER), Nacional Family Farm Program (PRONAF), Program to Promote Employment and Improve Living Standards for Workers (PROTRABALHO), Program to Support Agrarian Reform (PROCERA), and CEDULA, another project promoting agrarian reform. The funds used by the BN come from the Fundo Constitucional do Nordeste, Fundo de Assistência do Trabalhador (FAT) and resources provided by the BNDES.
- 1.29 While private banks are authorized to offer a wide range of services, public banks are generally restricted to a limited range of operations only. For example, the BNDES serves primarily as a second-tier bank, providing resources to public and private banks at special rates of interest tailored to programs with a particular socioeconomic slant. The CEF is the country's most important supplier of funds for housing. The Banco do Brasil is the primary lender in the agricultural sector. Although all of these entities are authorized to offer a full range of services, they focus mainly on administering these special lines of credit.

**E. Brazil's strategy for developing the productive sector**

- 1.30 In accordance with the Brazilian Constitution, the executive branch has submitted a multiyear national development plan for 2000-2003 entitled "Avança Brasil" (PPA) for congressional approval, specifying the country's investments and expenditures, and providing the conceptual and financial framework for proposed actions over a four-year period. The plan is applied beginning in the second year of each presidential mandate, and includes the first year of the subsequent administration to ensure continuity. The nature of this plan sets it apart from previous multiyear plans and makes the scheduling and execution of the Bank's activities more objective. It does so by enabling planners to clearly identify the external financing needs of specific high-priority projects laid out there, and hence to specify explicitly – in terms of development objectives – the contribution which outside agencies can make.
- 1.31 The PPA identifies as major challenges facing Brazil the need to ensure sustainable growth; maintain economic stability; achieve social and economic development while respecting the environment, social justice and democracy; and maximize

investment in both economic infrastructure and social areas, at the same time ensuring that these investments generate employment and income for Brazilians.

- 1.32 The plan establishes the following pillars for creating a new pattern of development which will enable all regions of the country to grow in a comprehensive manner: increasing competitiveness, raising living standards, and decentralizing decision-making with respect to the environment. Under the heading of integration (development and opportunities for all regions), the plan establishes specific agendas for social development (a more just Brazil), economic infrastructure (a stronger Brazil), information and knowledge (a more competitive Brazil) and the environment (preserving Brazil's environment).
- 1.33 These guidelines result in 28 macro-objectives, some of which are mentioned here to highlight the relationship between the proposed program and the overall national strategy: (i) increase exports to the level of US\$100 billion by 2002; (ii) make the agrifood industry more competitive; (iii) develop the tourism industry; (iv) promote restructuring in the manufacturing sector with a view to fostering competition in domestic markets; (v) stimulate development of new technology; (vi) strengthen Brazil's role in international economic relations; and (vii) promote integrated development in the farm sector.

**F. The Bank's experience and strategy in the sector**

- 1.34 The Bank has been promoting the SME sector in recent years through lending operations with the BNDES (Loans 907/OC-BR for US\$300 million, 1125/OC-BR for US\$750 million, and 1175/OC-BR for US\$1.2 billion), aimed at improving quality among factors of production, including job training (MEC, 1052/OC-BR) and developing new technology with FINEP under a Science and Technology Program (880/OC-BR for US\$160 million). Except for Loan 1125/OC-BR, for which funds are committed through 2001, disbursements under all other lending programs for SMEs will be completed in 2000. In addition to the above-mentioned initiatives, a specific global credit program for microenterprises in the Northeast region (BR-0301) is in the pipeline and will be executed by the BN.
- 1.35 These operations have provided support for the sector either directly or indirectly. For example, Multisectoral Credit Program I (907/OC-BR) of the BNDES was aimed entirely at SMEs. As of December 1997, this program had disbursed all of the funds applied for under 1,036 operations carried out through 90 financial intermediaries (IFIs) located in all regions of the country. In all, 58% of these operations and 31% of total lending corresponded to companies with annual sales of less than US\$500,000. The breakdown of recipients by sector is as follows: manufacturing 27%; trade 24%; agriculture and agrifood industry 25%; and services 25% (with education and health accounting for 14%).



- 1.36 The experience from these operations shows, among other things, that: (i) FINEP concentrated its resources in the states of the South and Southeast, with the rest of the country receiving less than 10% of the total financing provided by that agency (the same is true of the lending operations of the BNDES, as shown in Table I-3). This is not due solely to greater demand in those areas, but also to lack of coverage by these institutions as seen in their extremely limited number of offices in other regions of the country<sup>9</sup>; (ii) lending by the commercial banking system to SMEs for projects involving product or process innovation is very limited; and (iii) financial support for technological innovation is more successful where there is a degree of continuity in the relationship between the development agency and the SMEs involved, and where the initiative includes other aspects as well which help to develop the competitiveness of the enterprises.
- 1.37 The PEM will incorporate these lessons by: (i) channeling medium- and long-term financial resources into the Northeast through regional institutions with a strong local presence in the region; (ii) stimulating and grading demand for credit among the SMEs of the Northeast and expanding their relations with commercial lenders; and (iii) proposing and organizing activities to promote technology and other issues not directly related to lending, but which will help the enterprises become more competitive.
- 1.38 The strategy defined by the Bank for its activities in Brazil is consistent with objectives of the Brazilian government's PPA in providing support for the SMEs and reducing regional disparities. This strategy is designed to give priority to reducing the "Brazil cost" and modernizing the productive sectors, with emphasis on aiding the national effort to restore required levels of investment in infrastructure; strengthening the financial sector, with special attention to promoting SMEs and microenterprises through financing for programs to provide access to loans, technical assistance and venture capital; improving labor conditions through support for occupational health programs; and establishing appropriate regulatory frameworks.
- 1.39 The need to increase sources of financing for SMEs is justified by their ability to generate employment, their flexibility in adjusting to changing markets, their role as innovators and generators of entrepreneurial spirit, and their capacity to make productive use of scarce resources. The EDE for northeastern Brazil identified as strategic areas in which to concentrate support: promotion of new financial instruments; support for human resource training programs; strengthening of technical support systems for management and cooperation between firms; and supporting systems for innovation and development of technology.

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<sup>9</sup> See Inter-American Development Bank (1997), *Project Performance Review. Brazil: Science and Technology Program Evaluation*, p. 22.

## **G. The proposed program**

- 1.40 The Program to Expand Markets for Small and Medium-Size Enterprises in Northeastern Brazil (PEM) is in line with the strategy described above in that it will further efforts to make the SMEs in Brazil's Northeast more competitive by aiding the government's plan to assist these enterprises in areas where financial support is as yet very limited. The program will develop managerial skills enabling SMEs in the region to gain greater access to domestic and international markets; increase the value added to products as a result of processing; promote training for workers and managers in the productive sector; foster innovation and introduction of new technology; eliminate or reduce existing barriers and distortions preventing enterprises from realizing their full competitive potential.
- 1.41 The program closely reflects the conclusions and recommendations of the EDE/Northeast Brazil which seeks to achieve sustainable development of the SMEs in that region. To this end, the program has identified three basic objectives: (i) improve the competitiveness of SMEs; (ii) provide expanded opportunities for SMEs to engage directly or indirectly in markets; and (iii) encourage SMEs to join in cooperative activities that contribute to local development. Technical File No. 22 contains a matrix explaining how the activities of the PEM will address the barriers to managerial development identified in the EDE.
- 1.42 Through its strategy and project support facility, the PEM will adopt an integrated approach in which SMEs will have access to an array of instruments systematically covering the various stages for development of managerial skills and technology within individual firms and, in particular, within clusters of enterprises. The Bank's role in designing the strategy and operations of the PEM is to provide the catalyst for the various institutions supporting business and technology development in the region. The program will assist the efforts of these institutions, helping them to coordinate their instruments in carrying out the scheduled actions, both at the central level (in the Program Coordinating Unit or PCU) and at the local level.
- 1.43 The lack of long-term resources prevents private banks from lending to SMEs<sup>10</sup>. The PEM will help to improve this situation by providing resources over suitable periods for financing investments in the productive sector required for the type of business development projects targeted in this program.<sup>11</sup> In addition, it is hoped that the integrated approach adopted by the PEM will improve the risk profile of

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<sup>10</sup> The difficulties that SMEs have in gaining access to private banks were confirmed in a study conducted by the World Bank: *Northeast Microfinance Development-Project Appraisal Document*, LCSES-WB, p.15, 1999.

<sup>11</sup> At the same time as the PEM is being carried out, the application of new financial instruments is being studied. The MIF is submitting a proposal to the BN for a project to create a Venture Fund for Small Firms in Northeast Brazil, the Abstract of which has already been approved.

targeted SMEs, lowering the transaction costs of private banks and, eventually, attract an increasing flow of private financial resources.

## II. THE PROGRAM

### A. Objectives

- 2.1 The objectives of the program are: (i) to help raise the efficiency and competitiveness of small and medium-sized enterprises (SMEs) producing goods and services in the northeastern region of Brazil; and (ii) to create an operating mechanism within the BN for granting loans to SMEs through financial intermediaries.. The program will reinforce strategic regional economic development initiatives already being implemented by public- and private-sector agencies, and help eliminate basic obstacles facing entrepreneurs and workers in the manufacturing sector by taking advantage of business opportunities related to natural resources or tapping existing technological capacity.
- 2.2 The PEM will increase the entrepreneurial, technological and globalization potential of SMEs in the Northeast of Brazil through product innovation and the introduction of modern management, production and distribution processes. The program will seek to make use of opportunities and potential advantages detected or proposed by participating Brazilian institutions (Banco do Nordeste, Ministry of Science and Technology, state governments, etc.). The PEM will include projects under the following initiatives: Integrated Development Centers, prepared by the BN, Special Export Plan for the Northeast, and state plans for development of their science and technology systems, which are interrelated programs being carried out by various institutions. Other plans may be incorporated into the program during the execution period in the manner set out in the Operating Regulations, which have already been discussed with the Bank and are available in Technical File No. 24.
- 2.3 To achieve its objective, the PEM will provide support for activities designed to accomplish the following:
  - (i) Make use of the opportunities offered by national and world markets for the products of the Northeast, developing the tools necessary to facilitate access to those markets (information services, consultants, organization, logistics, financing, etc.). In many cases, acting on the firm's *environment* will not suffice, and it will be necessary to make the product itself more competitive (in terms of quality, price, design, features, packaging, etc.), examining all stages of the production and marketing process;
  - (ii) Foster cooperation between firms and universities, technology and standards bodies, in order to increase the level of integration and efficiency at the production and marketing stages, bring about economies of scale and promote synergistic effects resulting in innovations.

- 2.4 To ensure a broader view of these activities, the operation will also facilitate coordination between the PEM and other programs being managed by public agencies in Brazil with which the program will share many elements in common, both in the area of execution and in terms of attracting additional resources. The plan is to use an executing agency that is able to help entrepreneurs develop an integrated approach to managing the production process and improving the firm's competitiveness, and above all, that is capable of coordinating the existing array of tools, bodies, measures, support mechanisms, etc., and arrange for their services when required to support that integrated management approach. It is important that the organization of the executing agency be able to reach out to and motivate the entrepreneurs of the Northeast. Table II-1 provides a summary of the strategic and operational guidelines for the program resulting from the Bank's study, the EDE, and interviews with stakeholders (enterprises, trade associations, government institutions, universities, etc.).

**Table II-1**  
**General Guidelines for the Program**

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| <ul style="list-style-type: none"><li>a. <b>Subsidiarity of the State.</b> Tools and resources available from the government will be used in support of the SMEs.</li><li>b. <b>Institutional coordination.</b> Coordination will be provided between institutions and programs that provide support services for the firms, and existing programs will be linked with demand.</li><li>c. <b>Participation by the private sector.</b> The private sector will play a central role in the execution of the program. Private sector services will be hired to provide technical assistance and training for the firms.</li><li>d. <b>Demand-driven approach.</b> Priority will be given to market signals in guiding the application of program instruments.</li><li>e. <b>Open access to the services.</b> Firms will have open access to any of the services, without the need to follow a particular sequence between loans and nonreimbursable contributions, provided the feasibility of the business project has been verified.</li><li>f. <b>Fostering cooperative activities.</b> Various strategies and instruments will be adopted for encouraging firms to develop cooperative activities.</li><li>g. <b>Additionality.</b> The resources will be invested in business development projects which demonstrate the potential for obtaining positive results that would not occur, or would be delayed, in the absence of the program.</li><li>h. <b>Sustainability.</b> The activities of the program will have the capacity to continue operating after the resources of the Bank's loan are exhausted.</li><li>i. <b>Preservation of the environment.</b> Given the concern over the environmental impact of manufacturing activities, participants will be given information on programs, providers and consultants on "clean" production processes and those that are most efficient from the standpoint of energy and natural resource usage.</li><li>j. <b>Social perspective and gender awareness.</b> The program will keep track of the number of women's firms participating, and project future participation in this and other similar programs. The mid-term review will pay particular attention to this area and interpreting the results of the breakdown by gender. In addition, the program will give special consideration to activities and technologies to facilitate participation by persons with physical disabilities.</li></ul> |
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**B. Description of the program**

- 2.5 The program will promote and finance technical assistance, training programs, productive investments (machinery and equipment), projects involving innovations (new management methods, products, processes), research and development of new technology, trade promotion activities, building additional service infrastructure and institutional strengthening. The instruments for support and financing of these activities will consist of nonreimbursable contributions (NRCs) and medium- and long-term loans.
- 2.6 The NRCs will apply to activities in the areas of technical assistance, training, projects involving technological innovation, trade promotion activities, development of additional infrastructure and institutional strengthening. The medium- and long-term loans will be used to finance investments for expansion of manufacturing processes and products, and to supplement the required counterpart contribution which firms must have to qualify for NRCs.
- 2.7 The NRCs will come from the Ministry of Science and Technology (MCT) and such intermediary institutions as SEBRAE, APEX and SENAI, which will sign agreements, contracts or terms of cooperation with the Banco Nacional (BN) for participation in the program and assuming responsibility for carrying out activities in support of the SMEs. Also taking part in the program will be the state Secretariats for Science and Technology, and for Industry and Trade, as well as universities, research centers and technology institutes, etc., wherever a project requires the assistance of one of these entities.
- 2.8 The BN will act as a second-tier bank, using the Bank's resources to provide loans to the enterprises through eligible IFIs. Recognizing the importance of promoting equitable growth in the country, in 1952, the federal government established three regional banks to provide services to economically disadvantaged states that receive less attention from agencies like the BNDES, one of which is the BN. Although the BNDES does provide support to the northeast, the BN focuses all of its financial activity on that region. The federal government—the main shareholder of both institutions—has deemed it necessary to have an agency primarily devoted to the northeast to speed up its growth and help it achieve a level of development more similar to that of the mid-south part of the country.
- 2.9 The geographical area and states that comprise the northeast and the population located in the region have similar physical and socioeconomic characteristics, aspects that justify the creation of an agency exclusively devoted to the region. The Brazilian federal government selected the BN to execute this program in order to have a more targeted mechanism for addressing the region's needs. The size and heterogeneity of the country justify the existence of more than one second-tier bank specifically to provide more specialized attention to the complex regional group.

- 2.10 The BNDES and the BN both provide medium- and long-term funds to supplement the financing of investments aimed at expanding production, productivity, and jobs. Despite the similarities in the type of financing provided by the Bank, the terms and conditions of the loans to be granted by each of the programs that they would carry out are different, although both apply the same technical criteria in terms of market rates and risk ratings of intermediaries and end users. The Bank's loans to the BNDES and the BN will be denominated in U.S. dollars. The BNDES uses the real as a transfer currency and uses the long-term interest rate (TJLP) plus 1% to lend to banks and financial institutions in the northeast. The interest rates to be applied to the IFIs will be equal to the BN's average rate for attracting funds for international banking loans in U.S. dollars or to the cost of the IDB loan (interest, fees, and other charges), whichever is higher, plus the BN's administration and risk costs. Still, the BN and the intermediaries will not incur exchange risk, making the operation more transparent.
- 2.11 SMEs located in the northeast region and meeting the requirements set out in the Operating Regulations will be eligible for the benefits provided by this program, as will entities whose corporate purpose consist primarily of providing services for SMEs in areas needed for management development (R&D, quality control, market information, metrology and standardization, trade promotion, training, etc.). For purposes of this program, small and medium-sized enterprises are defined as firms which meet the following requirements: (i) they must have less than 250 employees and gross annual sales totaling no more than R\$35 million; and (ii) no more than 25% of their shares are held by companies that fail to meet these same requirements.
- 2.12 To be eligible, projects submitted by individual enterprises or groups of firms must:
- (i) have a strategic plan (business plan) to improve competitiveness, generate innovations or expand sales in domestic or international markets, prepared according to the requirements set out in the Operating Regulations. This plan must include elements to determine the firm's ability to compete in the market. For this purpose the following indicators will be used: productivity (sales per employee, costs per employee, median cost per employee, etc.), profitability (percentage increase in net profits from equity, sales, and operating expenses, etc.), financial position (capital structure, creditworthiness, liquidity, etc.), and growth potential (increase in sales, value added, profitability of capital, specialized labor, use of new technologies, etc.);
  - (ii) include the corresponding economic and financial cost-benefit study, establishing the results they expect to achieve (in terms of sales, jobs, exports), which must exceed the minimum standards set in the Operating Regulations for ensuring the financial viability of the operation. Projects which include investment in production processes or buildings must carry out the necessary environmental impact

assessments and, where applicable, present proof of approval by the pertinent environmental authorities.

- 2.13 Table II-2 provides examples, by type of institution, of typical projects that could participate in the PEM.

**TABLE II-2**  
**TYPES OF ELIGIBLE PROJECTS IN THE NON-LENDING COMPONENTS**

Institution	Projects
<b>APEX</b>	<ul style="list-style-type: none"> <li>- <b>Sector-wide projects (support for a productive chain):</b> i.e., software; poultry products; gems and jewelry.</li> <li>- <b>Horizontal projects (support for two or more sectors):</b> i.e., promotion of Brazilian products in Arab countries; setup of international business centers.</li> <li>- <b>Creation of export consortiums:</b> i.e., auto parts, food sector, furniture.</li> <li>- <b>Isolated projects (single event)</b></li> </ul>
<b>MCT/Science and technology secretariats</b>	<ul style="list-style-type: none"> <li>- <b>Technology platform projects:</b> i.e., gypsum platform in Pernambuco; cocoa platform in Bahia.</li> <li>- <b>Local innovation systems:</b> i.e., adaptation of technologies in the semiarid region, Xingó project; technology parks.</li> <li>- <b>Information technology development projects:</b> i.e., strengthening of software companies for export; information technologies and advanced automation.</li> <li>- <b>Technological undertakings:</b> i.e., Cesar project for software development in Pernambuco; business incubator of the Pernambuco Institute of Technology.</li> <li>- <b>Technological services development program:</b> i.e., management technologies, use of intellectual property for competitiveness.</li> </ul>
<b>SEBRAE</b>	<ul style="list-style-type: none"> <li>- <b>Sector support programs:</b> i.e., clothing chain in Ceará; handicrafts program in Bahia; biochemical chain in Paraíba.</li> <li>- <b>Total quality program:</b> i.e., through training activities, self-implementation and consulting services for groups of businesses.</li> <li>- <b>Certification programs:</b> i.e., preparation of firms for NBR ISO 9001, 9002 or 9003 certification in industrial, trade, and services sectors.</li> <li>- <b>Environmental management program:</b> i.e., garbage consortium for the establishment of recycled waste companies (paper, plastic, glass, and metal) in Ceará.</li> </ul>
<b>SENAI</b>	<ul style="list-style-type: none"> <li>- <b>Skilled labor program:</b> i.e., in areas of industrial automation and electronics; marble and granite, refrigeration.</li> <li>- <b>Technical assistance projects:</b> i.e., application of comprehensive computer technologies in manufacturing; dissemination of environmental management technologies and waste reduction in ornamental rock sector.</li> <li>- <b>Market surveys for the identification of regional and subregional human resource needs.</b></li> </ul>



- 2.14 The PEM will have two components: (a) technical assistance, training, technological innovation and infrastructure, financed with ANCs; and (b) loans for investments in the productive sector.

**1. Technical assistance, training, technology research and development, export promotion, and infrastructure and institutional strengthening (US\$69.3 million)**

- 2.15 The NRCs will come from the services that intermediary institutions and entities provide for the SMEs of the Northeast. Through its coordination, the BN will ensure that participating firms make use of these services. The activities of the program eligible for NRCs are described below, along with the institutions involved.

- 2.16 **Technical assistance (US\$11.3 million):** access by SMEs to business management and production services will be facilitated, from the business planning stage to the consolidation and expansion of operations. The use of instruments supporting innovative managerial organization will be sought, targeting improvements in management techniques. Training will be provided to help entrepreneurs take advantage of existing benefits, reducing the information gap that currently limits their access to same. These activities may include:

- (i) preparation of strategic plans, diagnostic assessments and feasibility studies (APEX, SEBRAE, SENAI);
- (ii) plans for introduction of quality control, product and process innovations (APEX, MCT, SENAI);
- (iii) metrology, standardization and testing (MCT);.
- (iv) minimizing losses, energy efficiency and environmental measures based on studies and modernization plans for certification, accreditation under ISO 9000 and 14000, or Environmental Management Systems (EMS), and occupational health and safety plans (MCT, SENAI, SEBRAE);
- (v) market studies, regulations and preparation of studies for new financial instruments (BN).

- 2.17 **Training (US\$11 million):** to develop expertise, skills and awareness in order to meet immediate and medium-term requirements of organization of the work linking new managerial and production technologies. Among other things, the training will cover reducing costs, improving customer service and delivery times. Incentives will be sought to help firms appreciate the need for continuous training and updating of entrepreneurs' qualifications, and to convince them that a firm's staying power in the market depends upon its ability to diversify. The activities may include:

- (i) awareness-raising activities (SEBRAE, APEX);
- (ii) technical and business training (SENAI, SEBRAE);
- (iii) training of consultants (SEBRAE, APEX, MCT);
- (iv) training on aspects of quality control, environmental monitoring and occupational health and safety (SENAI, SEBRAE);
- (v) training in new technologies (MCT, SENAI).

**2.18 Technology research and development (US\$28.5 million):** to support the efforts of individual enterprises and groups of firms working in technology centers to develop new processes and products, or to solve technology problems or improve quality, the following activities may be included:

- (i) individual and cooperative R&D projects (MCT);
- (ii) technology transfer projects and adoption of clean technologies (SENAI and MCT);
- (iii) support for the development of prototypes and precommercial models (MCT, SENAI, SEBRAE, APEX);
- (iv) technology platforms (MCT);
- (v) technology projects (MCT).

**2.19 Export promotion (US\$3.3 million):** to increase the capacity of northeastern firms to penetrate foreign markets and ensure sustainability of exports by fostering cooperative actions and organizational changes in the productive sector. Activities will be developed to promote individual, integrated sectoral and horizontal projects, and to support the formation of consortiums. Direct export promotion will consist of developing exportable products and preparing firms to penetrate and hold on to export markets, and will include activities such as:

- (i) formation of export consortiums (APEX);
- (ii) the search for new products and markets (APEX, SEBRAE);
- (iii) organization of trade fairs and missions to other countries (APEX);
- (iv) support for marketing activities and advertising (APEX, SEBRAE).

**2.20 Infrastructure and institutional strengthening (US\$15.2 million)** to upgrade, improve quality and strengthen the operations of centers providing services for SMEs, including:

- (i) standards, testing and metrology laboratories (MCT);
- (ii) incubators and technology parks (MCT, SENAI);
- (iii) sectoral service centers, support services for generating business contacts, identifying distribution channels, preparing samples, conducting market studies and carrying out activities to facilitate the expansion of businesses (APEX, SEBRAE);
- (iv) accreditation and information centers on clean technologies, and services carrying out studies of innovation among SMEs (MCT, SENAI).

## **2. Loans for investments in the productive sector (US\$224.6 million)**

- 2.21 This component will provide support for expansion of the productive sector and technological modernization of processes and products by financing the purchase and installation of equipment, industrial infrastructure and other capital goods. The loans to enterprises may also cover additional expenses associated with capital investment (such as technical assistance and training activities). The limitations on the granting of loans are established in the Operating Regulations and require, among other things, that loans granted to SMEs with the program's resources may not exceed the equivalent of US\$5 million per enterprise.

### **C. Size of the program**

- 2.22 The beneficiaries under this program will be the small and medium-sized enterprises of the region, with preference given to those of the manufacturing or agroindustrial sector, with export capacity or potential. According to the latest cadastral census carried out by the Brazilian Institute for Geography and Statistics (IBGE) in 1994, and the annual yearbook of the Ministry of Labor, *Relação Anual de Informações Sociais* (RAIS), this group is made up of some 6,000 industrial enterprises. Including firms in the construction, wholesale trade, service (excluding financial, education and public administration services) and agriculture sectors, the number swells to at least 25,000 enterprises.
- 2.23 The inclusion of targeted firms in the program is dependent on satisfying specified innovation and market expansion objectives, based on the preparation of rigorously defined strategic plans. Firms in the retail trade, financial entities, teaching institutions and those involved in public administration are not eligible for the programs benefits. The existence of other specific plans for the tourism sector make it advisable to exclude firms in that field as well.
- 2.24 The size of the bank financing component of the program was determined in the following manner: (i) based on the target population, a conservative estimate was made of the demand for new investment (broadly defined) for the period 2000-2004, using estimated values prepared by potential beneficiary firms and comparing

the average for these with typical amounts under loan operations of the Banco do Nordeste (*deductive* method); and (ii) a survey of expected demand was conducted based on the random selection of 223 firms in the Northeast region. The contrast between the deductive method and the second (survey) method provided a consistent range of results used to determine the possible size of the program.

- 2.25 The demand calculation using deductive criteria and a basic sample of 6,000 SMEs in the manufacturing sector indicated that over the four-year span of the program, one-third of the firms will invest the equivalent of US\$6,250 per employee to improve its competitiveness. It is estimated that 50% of the investments made in this way will be eligible for loans under the program. This results in a total borrowing demand of US\$356.7 million, consisting of 2,258 operations with an average value of US\$158,000 over the entire four-year period<sup>12</sup>. Extending the same reasoning to the remaining 24,833 firms, it is assumed that their average investment will be no greater than one-third the amount invested by manufacturing firms. This results in a reasonable estimate that the volume of investment for the period 2001-2004 would be US\$1.459 billion, which is equivalent to a borrowing demand of US\$730 million, spread over 9,400 operations.
- 2.26 Turning to the estimate made on the basis of a survey, interviews were conducted to determine the investment intentions of a sampling of 223 firms. Predictably, the results here are much higher. The sectoral composition of the sample was similar to that used in the earlier estimate<sup>13</sup>, with 93% of the respondent firms indicating that they are prepared to make the respective investments. The amount of their intended investments are likewise higher, representing 27% of the firms' annual turnover (during the four years of the program). This resulted in a total investment intention of R\$38.8 billion (US\$21.6 billion), so that borrowing demand (50%) is around US\$10.8 billion, a figure which is nearly 15 times greater than the earlier estimate. On this basis, the average investment per firm for the four years would be R\$2.1 million (US\$1.15 million).
- 2.27 By way of contrast, in 1999 the Banco do Nordeste financed over 404,500 operations involving some US\$1.353 billion in credit resources, for an average value of US\$3,350 per operation. The BN's share of the market for lending in the region rose from 35% in 1995, to 78% in 1999.
- 2.28 Consequently, these two methods estimate potential borrowing demand at between US\$730 million and US\$2.000 billion. Since it is proposed that priority be given to the manufacturing sector, the figure arrived at by the deductive method has been retained as a baseline for the volume of credit operations (US\$357 million), leaving

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<sup>12</sup> Alternatively, it would be possible to plan for double the number of operations, with the average figure per operation set at half the indicated amount, on the understanding that instead of a single investment for the four years there would be two operations for an equivalent total.

<sup>13</sup> Representing 23,520 firms versus the figure of 24,833 for the previous estimate.

the possibility open for expansion of lending operations in subsequent phases. Finally, the actual figure for the credit component was determined by opting for a conservative 70% of this estimate (US\$250 million), plus the nonreimbursable component of US\$60 million.

- 2.29 The scale of the non-lending components to be financed with NRCs is based on an estimate prepared by the BN through the use of a sampling survey. On the basis of this survey, demand among the SMEs of the Northeast for: (i) training and instruction, and (ii) consultants and technical assistance, exceeds US\$500 million per year. In the case of research and technology development activities, the demand for resources from SMEs and support firms can be inferred from the quantity of requests received each year and judged to be viable potential projects by the BN's Fundo de Desenvolvimento Científico e Tecnológico (FUNDECI). In 1999, projects in this category totaled R\$25 million, whereas FUNDECI had only R\$4 million to allocate. These data show that the US\$17 million per year which the program earmarks for these activities will go at least part way toward meeting the needs of the enterprises in this area.
- 2.30 The program requires concerted action on the part of the agencies involved in business development and modernization processes. The cooperation of the MCT, APEX, SEBRAE, and SENAI has been agreed to and will be governed by written agreement. The Bank analyzed these institutions and deemed them suitable for participation in the PEM. The majority of the services they deliver are contracted out to consulting firms or private consultants. This ensures broad participation and constant improvement of the consulting industry in the northeast. Their main characteristics are set out in Table II-3 below.

**TABLE II-3**  
**Characteristics of institutions providing nonfinancial services**

<i><b>Mission</b></i>	<i><b>Performance/efficiency</b></i>
<p><b>1. APEX</b></p> <p>Support small businesses to increase their exports, the number of companies that sell to the external market, and the number of products exported.</p> <p><i>Main areas of action:</i></p> <p>Food, footwear, clothing, fruits, furniture, software, export communities, setup of export consortiums, headquarters of international business centers, training, publications, etc.</p>	<p>Promotes an "export culture" among small businesses. The number of projects under consideration, being executed, and approved annually is constantly on the rise. Given the significant financial contribution required by the businesses and the requirement of presenting projects that involve partnerships, APEX projects are growing and it has proven its capacity to promote cooperation in the private sector. In two years of activities, it has 84 projects totaling US\$70 million, of which 45% are financed by APEX. Of this total, 12 have been completed, 32 are under way, and the remainder are under analysis.</p>
<p><b>2. SENAI</b></p> <p>Contribute to the sustainable strengthening of the country's industrial sector, promoting job training, technical assistance and technology, production and dissemination of information, and technology improvement, management, and dissemination.</p> <p><i>Its main services include:</i></p> <p>Services for the agroindustrial production chain in the Northeast, industrial design development, management modernization, industrial automation, information technology, dimensional metrology, quality of products and processes, middle-management technology training.</p>	<p>These institutions are improving activities in the areas of vocational training, technical assistance and technology, technological information, occupational safety, and research applied to increasing revenues. They are improving their operations as they prepare for the ISO 9001 quality seal for the purpose of setting up a center of excellence in quality and industrial technology. It maintains agreements with national (SEBRAE) and international (GTZ-Germany) agencies..</p>
<p><b>3. SEBRAE</b></p> <p>Address the training and management modernization needs of small businesses.</p>	<p>Uses innovative methods to solve common problems using "network cooperation agreements", "mass" innovative systems through information technology, and traditional tools for human resource management, know-how, marketing, production, finances, costs, etc.</p>
<p><b>4. MCT/Science and technology (S&amp;T) Secretariats</b></p> <p>The state science and technology systems (S&amp;T secretariats, technology institutes, universities, etc.) work to promote S&amp;T activities and interactions with the productive sector and the academic-scientific sector.</p>	<p>The S&amp;T network in the states seeks primarily to disseminate technology to the national technology training effort by incorporating technologies related to the introduction of information technology and industrial automation, modern biotechnology and genetic engineering methods, application of new management methods, development of quality control and certification programs, ecoefficiency, software production, etc.</p>

**D. Social and environmental aspects**

- 2.31 One effect of added support for productive activities will be to reduce the emission of pollutants, with beneficial results for the environment. And the attention which

workers receive in the form of training activities and health protection will have a positive impact on the social environment as well. But one of the most important positive effects will come about indirectly as the BN hones its analysis activities and begins demanding that environmental control organizations at the state and municipal level take a more active role in enforcing their regulations.

- 2.32 The potential adverse effects deriving from activities financed by the program have to do with the impact on physical, biological and anthropogenic aspects of the environment from extractive, agricultural or manufacturing activities. The program activities that improve productivity may reduce the need for non-specialized labor, adversely affecting this social group. The agroindustrial projects could cause excessive depletion of natural resources or exceed the local capacity to assimilate pollutants. To help avoid or minimize potential adverse effects of the program, the BN has a team of environmental specialists and an adequate environmental management system already in operation as part of its lending program.
- 2.33 At its meeting on February 4, 2000, the CESI recommended that the preparation of the PEM should include a review of the BN's environmental procedures, and that the drafting of the Operating Regulations should include: (i) submission of an environmental feasibility study including the technical, legal and institutional requirements of each state and participating organization with respect to possible pollution-causing activities, and health and safety in the workplace; (ii) in the case of support for development centers, submission of a strategic environmental assessment; (iii) where there may be potential adverse social effects, submission of plans for mitigating these; and (iv) formulation of ways to facilitate the participation of women in activities to be financed by the program. These recommendations were incorporated in the design of the operation.

#### **E. Costs and financing of the program**

- 2.34 The program will have a cost of US\$300 million, the breakdown of which is given in Table II-1. The Bank's financing will amount to US\$150 million and will be charged to the resources of ordinary capital (basket of currencies). The periods for amortization, commitment and disbursement of the resources are 20, 3 and 4 years, respectively. The rate of interest is variable and the credit fee is 0.75% per annum on undisbursed balances. The inspection and supervision fee is 1% of the loan. The funds are deemed committed when the agreements are signed with the beneficiaries of the projects.
- 2.35 The local counterpart contribution totals US\$150 million and will be provided by the BN, the Ministry of Science and Technology, support agencies, IFIs and the target enterprises. The contributions of the BN, Ministry of Science and Technology and support agencies are manageable in relation to the annual budgets executed by these entities, so that no problems are anticipated with respect to their capacity to fulfill the commitments undertaken. The costs for technical administration of the program will be approximately US\$52,000 per month to pay

for specialized consulting services to assist the program coordinating unit, distributed between the central office and the five regional superintendencies of the BN<sup>14</sup>, which is equivalent to US\$2.5 million over the execution period of the program. The details concerning program costs and sources of financing are presented in Technical File No. 23.

**Table II-4**  
**Cost of the Program (in thousands of U.S. dollars)**

	IDB	LOCAL CONTRIBUTION	TOTAL	%
<b>1. Administration</b>	<b>1,500</b>	<b>1,000</b>	<b>2,500</b>	<b>0.8%</b>
<b>2. Direct costs</b>	<b>146,000</b>	<b>147,900</b>	<b>293,000</b>	<b>98.0%</b>
2.1 Nonreimbursable contributions		*69,300	69,300	23.1%
Technical assistance		11,300	11,300	3.8%
Training		11,000	11,000	3.7%
Research and development		28,500	28,500	9.5%
Promotion of exports		3,300	3,300	1.1%
Additional infrastructure and institutional strengthening		15,200	15,200	5.1%
2.2 Loans for investments in the productive sector	146,000	78,600	224,600	74.9%
<b>3. Recurrent costs</b>	<b>500</b>	<b>-</b>	<b>500</b>	<b>0.2%</b>
Promotion and awareness raising	200	-	200	0.1%
Audits and evaluations	300	-	300	0.1%
<b>4. Financial costs</b>	<b>1,500</b>		<b>1,500</b>	<b>0.5%</b>
Inspection and supervision	1,500		1,500	0.5%
<b>5. Other</b>	<b>500</b>	<b>1,100</b>	<b>1,600</b>	<b>0.5%</b>
Contingencies	500	1,100	1,600	0.5%
<b>TOTAL</b>	<b>150,000</b>	<b>150,000</b>	<b>300,000</b>	<b>100%</b>
<b>% TOTAL</b>	<b>50%</b>	<b>50%</b>	<b>100 %</b>	

\* Of this amount, at least US\$30 million equivalent will be provided by the MCT and the rest by companies and other institutions in the region such as SEBRAE, SENAI, and APEX.

<sup>14</sup> The PCU will have the services of experienced consultants and senior technical experts. This will include the following profiles: experts in process, product, quality and materials engineering; specialists in foreign trade (rules of the World Trade Organization; technical specifications for "warehousing", "packaging", and distribution; product preservation and phytosanitary specifications, etc.), specialists in basic industrial technology (metrology, certification of processes, products and technical standards, etc.) and experts in information technology.



### III. EXECUTION OF THE PROGRAM

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

- 3.1 The borrower and executing agency for the program will be the Banco do Nordeste do Brasil (BN), and the guarantor of the operation is the Federative Republic of Brazil. To ensure efficient supervision of program execution, the BN will create a program coordination unit (PCU) which will report to the Operations Process Superintendency of that entity. The PCU is needed because of the complex activities involved in coordination, review, analysis and supervision of operations which are carried out by independent bodies and require specialists not currently to be found among the personnel of the BN (referred to in paragraph 2.30).
- 3.2 The PCU is located in the central offices of the BN in Fortaleza where the technical team works, and will have the assistance of experts located in the five regional superintendencies of the BN. It will also make use of support services offered by other divisions at the central offices<sup>15</sup>, as well as the decentralized branches<sup>16</sup> of the BN. The creation of the PCU is a special condition precedent to the first disbursement of the Bank's financing.

#### B. Duties of the PCU

- 3.3 The PCU will work in close integration with the BN and the other institutions linked to the program in accordance with the Bank's Loan Contract, the Operating Regulations and the Logical Framework. Its principal duties and responsibilities include:
- (i) administration of all activities linked to the execution of this operation, maintenance of the accounting system detailing the Bank's resources and local counterpart funding, and producing the progress reports;
  - (ii) drafting and submission of reports, requests for disbursements and vouchers, organization of missions, and other transactions with the Bank;
  - (iii) coordination of institutional and operational relations with the intermediary entities taking part in the execution of the various components of the program;
  - (iv) controlling lines of credit and supervision and monitoring of the IFIs;

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<sup>15</sup> ETENE, Operational Support Centers, etc.

<sup>16</sup> Agencies, municipal development committees (*farol de desenvolvimento*), and development agencies.

- (v) identification, preparation and processing of projects submitted by enterprises, technological entities and university bodies that may be eligible to carry out activities under the MCT.
- (vi) implementation of promotional and educational activities under the program;
- (vii) verification of environmental compatibility of manufacturing projects, and measurement of the gender impact of the program<sup>17</sup>.

### **C. Institutional Aspects**

- 3.4 The BN was created by Law No. 1649 of July 1952. Its objective is to contribute to the sustainable development of the Northeast region, promote its economic integration with the rest of the country and foreign markets, and reduce the prevailing economic and social disparities vis-à-vis other regions of Brazil. The BN provides leadership, coordination and experience for the various entities in the region responsible for providing technical and financial support for small, medium-sized and microenterprises to improve their productivity, quality control and marketing capacity, and in general to sustain, consolidate and create employment and raise the standard of living in the region.
- 3.5 At present, the BN represents a unique combination of development entity and commercial and investment bank. To carry out its mandate of contributing to sustainable development of the Northeast region, it maintains 161 branches which cover the 1955 municipalities that make up the nine states of the region. The central offices of the BN are located in the city of Fortaleza, capital of the state of Ceará. The BN is a corporation of perpetual duration, financed jointly by government and private capital and not subject to bankruptcy procedures, with the federal government as its principal stockholder. At close of the 1999 fiscal year, the federal government accounted – either directly or indirectly – for 91% of its paid-in capital and its employees' pension fund held a further 5% share of ownership, with the remaining 4% in the hands of various private stockholders. The BN operates under the jurisdiction of the Ministry of Finance, which appoints the Chairman of its Governing Council. In addition to its Chairman, the Council consists of four members elected by the Annual General Meeting of Shareholders for a three-year term of office. The Vice-Chairman of the Governing Council, who also serves as Chairman of the Board of Directors, is appointed by the President of Brazil. The Board of Directors is the primary management body of the BN and is made up of the Vice-Chairman of the Council and four Directors appointed by the Governing Council.

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<sup>17</sup> For this purpose, four technical personnel with the PCU will receive training in environmental management of projects and promoting participation by women in program activities.

- 3.6 In 1995, the BN began a major restructuring process designed to improve its delivery of services and reduce operating costs. The results under the first of these objectives can be seen in the increase and decentralization of its operations, reflected in a significant increase in loans to the rural sector and to small and medium-sized producers. At the same time, project analysis and decisions approving loan requests for lesser amounts were delegated from offices in state capitals to local agencies. As a result, the approval procedure was shortened from an average 210 days to a maximum of between 21 and 60 days, depending on the amount applied for. In 1999, the BN covered over 70% of the loans granted in the region.
- 3.7 As to its second objective, the BN drastically trimmed its administrative costs, lowering them by 38% between 1994 and 1999. Remarkably, the proportion of total administrative costs represented by wages dropped from 87% in 1994 to 58% in 1999, as a result of a 40% cut in salaries. The institutional reforms resulted in a reduction of 29% in the number of employees of the BN between 1995 and 1999. Of the 3,832 employees on the BN's payroll in December 1999, over 51% hold university degrees.
- 3.8 Meanwhile, the reassignment of personnel from central offices to branches and local agencies made it easier to shift decision-making on loans to the units in direct contact with borrowers. The distribution of personnel between the central offices and local agencies or operating units went from a 46%-54% split in 1994, to 10%-90% in 1999. To handle the substantial increase in operations and facilitate access to the larger number of cities and small population centers, the BN created the "Agente de Desenvolvimento" as a new staff position with responsibility for maintaining direct contact with clients. In addition, the BN is making innovative changes in local development, such as creating new operating units called "Fundos de Desenvolvimento Municipal" and "Faróis do Desenvolvimento", which are taking BN activities into areas that have had only limited access to financial services up to now. Technical Files Nos. 26 and 27 contain an analysis of the BN's performance in the last ten years, along with a description of other institutional, administrative and financial aspects of both the BN and the Fundo Constitucional do Nordeste (FNE) which is administered by the BN.
- 3.9 The BN is one of two regional government agencies in Brazil that have access to international capital markets. In the last two years it has floated two international bond issues, having obtained a positive rating from two prestigious American bond rating companies (Moody's and Standard & Poors), which have certified its financial creditworthiness and administrative and managerial capacity. Moreover, one of these two companies conducts a quarterly review of the BN's solvency, certifying the the rating it has been given. The BN is audited by a recognized firm of national auditors and its accounting statements regularly receive a positive report.

**D. Financial aspects**

- 3.10 The financial structure of the BN is reasonably solid and since the restructuring in 1995 its performance has improved significantly. In terms of its national currency, the BN's assets have grown continuously since 1995. In March of 1996 on instructions from the Central Bank, the BN transferred the accounts of the "Fundo Constitucional de Financiamento do Nordeste" (FNE) to memorandum accounts in order to ensure that movements in the BN's accounts are reported separately. The FNE, which was created by the federal government to support socioeconomic development of the region, receives its resources from a 1.8% levy on all tax revenues and is administered by the BN which receives for this service a 3% commission on its holdings while bearing 50% of the risk for unrecoverable losses. The FNE is an important source of revenues and its holdings as of December 1999 stood at US\$3.599 billion, an amount similar to the total portfolio of the BN.
- 3.11 As at December 31, 1999, the assets of the BN totaled the equivalent of US\$4.337 billion, with its portfolio accounting for 90% of this amount. If the FNE is included, its total portfolio rises to US\$7.570 billion, making the BN Brazil's leading regional development bank. Of the BN's total portfolio, 85% consists of private sector loans and 15% is made up of lending to the public sector. Around 90% of these are medium- to long-term development loans, and some 46% are loans to the rural sector. The percentage of nonperforming loans in its portfolio at the end of December 1999 was 19.5%. Loans in default net of provisions stood at 5.2% at the end of that period. The concentration of loans in the ten largest borrowers dropped from 322% of total equity in December of 1995, to 199% in December 1999. Over this same period, the concentration of the portfolio in the 100 largest clients fell from 606% to 436% of net equity. At December 1999, the loans to its 100 largest borrowers represented 59% of the total for the BN, and 31% of the consolidated portfolio of the BN and FNE.
- 3.12 The BN's loan portfolio has improved in relative terms since the reorganization carried out by the entity in 1995. The BN's policy is to maintain strict margins in both its cash position and credit periods. According to the financial statements at December 31, 1999, the cash reserve ratio was a healthy 152%. The number of loan approvals in excess of R\$10 million (equivalent to US\$5.6 million) has plummeted; in 1999 there was only one loan approved for an amount higher than this figure.
- 3.13 The financial resources that the BN obtains from third parties had, at December 31, 1999, risen to the the equivalent of US\$3.803 billion. Including those of the FNE, the external funds controlled by the BN totaled US\$7.479 billion. Its liabilities arise primarily from transactions (transfers) with government agencies (62%), followed by deposits from the private and public sector (15%), funds from external sources including IDB loans (13%), bond and security issues (6%), and other lesser sources (4%). Current account deposits make up 12% of total funds on deposit, a figure far higher than the 4.9% recorded in 1996. At the end of fiscal 1999, the BN had

approximately 80,000 current accounts, reflecting the expansion of its financial services into many smaller population centers. The assets of the BN had maturity dates averaging 8 years, versus 8.5 years for liabilities at the close of 1999. As a rule, the BN maintains a narrow gap between the maturity periods for its assets and liabilities.

- 3.14 Changes in the BN's net assets in Brazilian currency shows a steady upward trend. The devaluation of the *real* in 1999 lowered the value of its assets in current dollars by an amount equivalent to US\$534 million as of the close of that fiscal year. Notwithstanding this drop, the ratio of liabilities to net assets at the end of that year remained at a satisfactory level of 14%.

**E. Coordination with participating institutions**

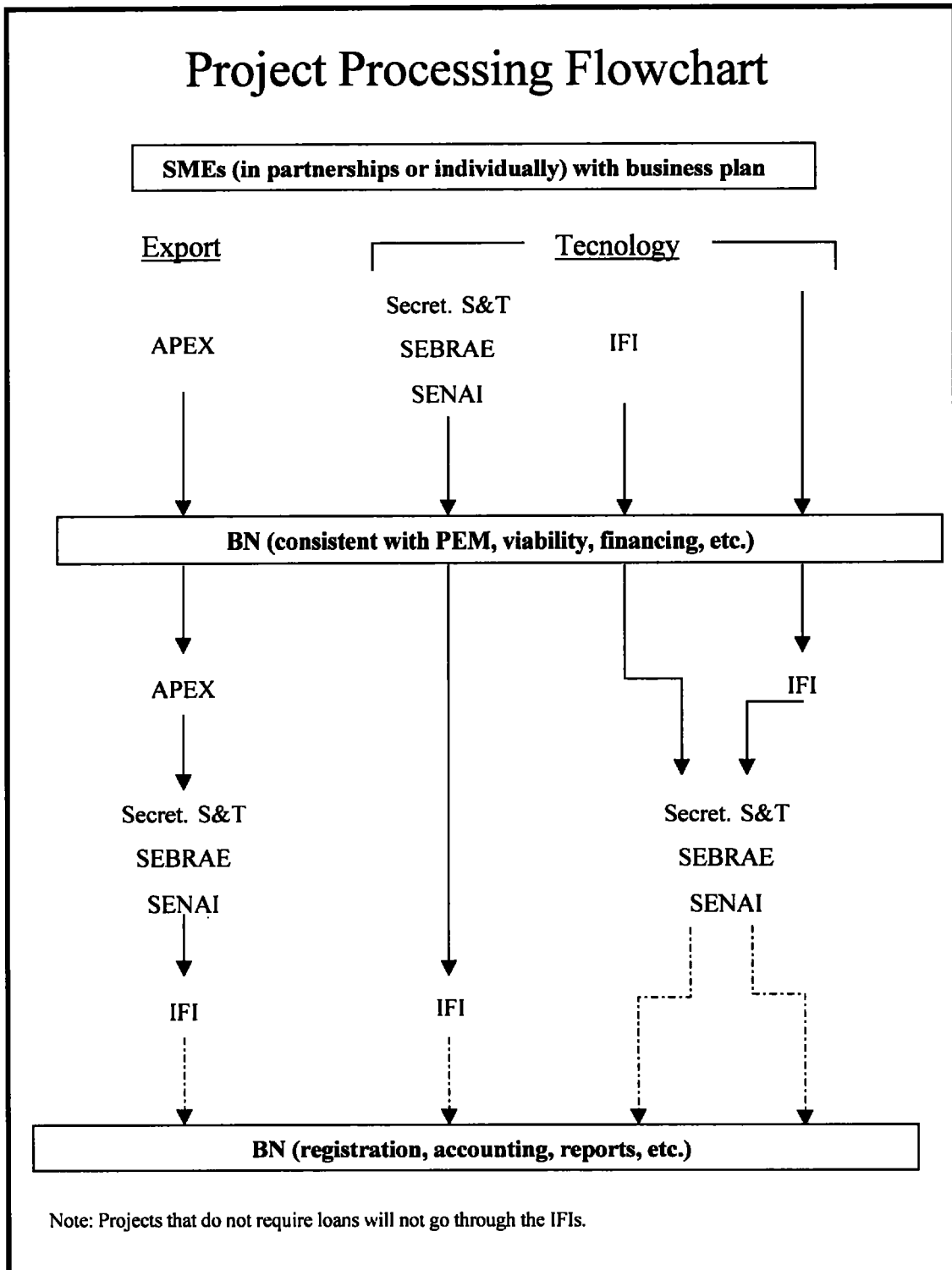
- 3.15 The PCU will coordinate institutional and operational relations with the entities participating in execution of the different components of the program (IFIs, MCT, SENAI, SEBRAE and APEX).
- 3.16 The relationship between the BN and the Ministry of Science and Technology will be defined in a technical cooperation agreement establishing the objectives and general terms for the activities carried out in common between these two entities (not limited solely to activities planned under the program) and by an annex which will establish the program's work plan and identify its strategic characteristics (productive sectors and geographical areas with the highest priority for development of technology), activities and the instruments under which the MCT will participate in the PEM, as described in the Logical Framework. The PCU will provide the necessary support for identification, preparation and processing the projects submitted by enterprises, technological organizations and universities who may be eligible for the activities of the MCT. In addition, the PCU will define and coordinate the activities of the program (technical assistance, export promotion, investment loans, etc.) that may be used to enhance or incorporated into the projects submitted to the MCT.
- 3.17 The working methods for cooperation between the BN and SEBRAE, APEX and SENAI will be set out in terms of cooperation to be drawn up by the Regional Superintendencies of the BN and the executive personnel of the latter institutions. The regional nature of these agreements will enable these authorities to: (i) define objectives and strategies that target the productive sectors with the greatest potential in each of the different states of the Northeast; and (ii) adjust the specific institutional structure in each case to include other decentralized institutions that provide support services for small firms (e.g. science and technology secretariats, trade associations, international business centers, universities, IFIs, etc.).
- 3.18 The relationship between the BN and participating IFIs will be governed by contracts which, in addition to specifying the financial details for the transfer of program resources, will establish certain additional criteria that IFIs must meet to

qualify. These criteria will require IFIs to: (i) participate in training activities for managers, officers and technical personnel involved in the supervision of lines of credit under the program, including instruction in the economic objectives and financial procedures of the PEM; (ii) hold meetings with the BN, and perhaps other participating institutions, for execution and supervision of the program; and (iii) provide potential clients of the program with information on the plans for nonreimbursable activities and instruments to be offered under the PEM.

- 3.19 With regard to coordination between participating institutions, the first disbursement of resources by the Bank under this program will be subject to fulfillment of the following special conditions: (i) signing of the Technical Cooperation Agreement between the MCT and the BN, and preparation of the Work Plan for the program between the MCT and the BN; and (ii) approval by the Bank of the model contract for transfer of funds to be used by the intermediary financial institutions (IFIs) participating in the program. Within 60 days of the signature of the contract between the Bank and the BN, the latter must present the following to the Bank: (i) at least one funds transfer contract signed with an IFI, based on terms agreed upon with the Bank; and (ii) at least one technical cooperation agreement between the SEBRAE or SENAI of a state and the BN, setting out the corresponding participation in the program according to the model previously approved by the Bank.
- 3.20 **Promotion and supervision of the cooperation agreements.** During the design and preparation phase of the PEM, the Bank's Project Team and experts from the BN held numerous meetings in various states of the region to promote the program among the business support institutions and IFIs of the region, and to establish the modalities for their eventual participation. Among other activities, the effort to promote the program included seminars with the state directors of the SENAI, SEBRAE and APEX, and with the MCT's State Secretaries of Science and Technology in the nine states of the region.
- 3.21 Prior to the start of the program, the PCU will organize two seminars – one to include all IFIs and the other for the remaining institutions participating in the program – for the purpose of completing the process of coordination and synchronizing of strategies. In addition, the BN is developing a computerized system for keeping track of all contracts and cooperation agreements in the region. This system will provide access at any time to data on the status of activities specified in the interagency agreements and work plans established under the program.
- 3.22 **Modalities for accessing program activities.** The individual enterprises or groups of firms in the region will have access to all of the programs activities and may submit projects to the appropriate windows at participating institutions. When contacted by an individual enterprise or group of firms, the participating institution must:

- a. verify the competition potential of the firms and their eligibility to take part in the activities of the program (including their credit capacity in the case of projects submitted to the IFIs or the BN);
  - b. forward the application for support to the PCU for processing after determining the potential increase in the competitiveness of applicants;
  - c. propose and directly supply requested services to the firms, carrying out the activities related to their specific duties (e.g. APEX for globalization, SENAI and SEBRAE for training, assistance with management and technology, and the MCT in the case of support for development of innovations).
- 3.23 The PCU will be at the center of the flowchart where it can channel the projects toward program activities carried out by the BN, the IFIs, or the other institutions that can strengthen the competitive position of the firms in question. Table III-1 contains a diagram showing firms' access to the program, and how projects will be processed through the various participating institutions.

**Table III-1**





**F. Operating Regulations**

- 3.24 Program execution will be in accordance with the Operating Regulations consisting of Rules of General Application (Section A), Specific Rules on Loans to SMEs (Section B), and Nonreimbursable Contributions (Section C). These Regulations contain provisions governing areas such as the use of program resources and restrictions on same, loan denomination, the supervision to be carried out by the PCU and the Bank, and the obligation in the case of each individual operation to review its environmental impact assessment and handling of gender issues. The Bank's approval of the final version of the Operating Regulations and submission of evidence of its entry into force are two of the special conditions that must be met prior to the first disbursement of the Bank's financing.
- 3.25 Loans to financial intermediaries will be denominated in U.S. dollars. The rates of interest applied by the financial intermediaries in the program will be consistent with prevailing market costs and interest rates for such resources. To this end, the IFIs will be free to determine the rate of interest charged to SMEs according to their assessment of the risk in each operation. The interest rates to be applied to the IFIs will be equal to the BN's average rate for attracting funds from international banks in U.S. dollars or to the cost of the IDB loan (interest, fees, and other charges), whichever is higher, plus the BN's administration and risk costs.
- 3.26 The term for each loan will be: (i) up to a maximum of 12 years for investments in capital assets, including a grace period of up to 2 years; and (ii) up to a maximum of 2 years in the case of permanent working capital loans, including a grace period of up to 12 months.
- 3.27 The IFIs may include interest on arrears and penalties for defaulting on loans in their contracts with borrowing firms. The spread earned by IFIs will be freely negotiated between the lending institutions and the borrowing firms, according to the characteristics, terms and conditions of each loan.
- 3.28 The BN has ample experience in using other banks to channel financial resources to public and private firms in the productive sector under specific programs. Since 1991 when it began this type of operation, the BN has had occasion to assess 70 of the country's 178 banks in deciding whether to utilize them as intermediary financial institutions. As a general rule, the maximum limit for transfers of funds is 10% of the BN's net worth, or 5% of the annual budget of the FNE, per institution (depending on the source from which the funds to be transferred are drawn). The eligibility criteria for intermediaries are strict and involve: (i) maximum permissible levels of indebtedness; (ii) minimum levels of liquidity and profitability; (iii) coefficients for determining the financial soundness of the portfolio; (iv) administrative capacity; (v) equity position; (vi) appropriateness of margins in terms of cash position and credit periods; and (vii) previous experience with the BN. The IFIs taking part in the program will be selected on the basis of the strict

classification criteria adopted by the BN. Finally, the legislation and regulations governing supervision of financial entities by the Central Bank of Brazil and the BN provide an adequate regulatory framework to control the performance of these agencies and safeguard their creditworthiness, stability and liquidity.

- 3.29 The instruments to regulate the operation of the BN's second-tier activities established in the program are included in the special regulations that will quantitatively rate future financial intermediaries based on the following: (i) financial structure; (ii) creditworthiness; (iii) liquidity; (iv) operating cost; (v) profitability; and (vi) growth.
- 3.30 The eligibility criteria to be adopted will take into account: the BN's maximum exposure (no more than 10% of its lending capital per entity) and the indebtedness level of the respective IFI with the BN and the BNDES. The BN has set up an appropriate unit in the Central Operational Support Office for rating, risk analysis and monitoring, and supervision of the financial institutions that will participate in the program.
- 3.31 The expenses for preparation of technical, economic and financial feasibility studies of projects for purposes of loan applications will be borne by the SMEs. However, firms that adopt the integrated approach of the program may benefit from the nonreimbursable instruments available for the preparation of capital investment projects to modernize technology and increase exports.
- 3.32 The **nonreimbursable contributions** (NRCs) will finance technical assistance, training, technology research and development, trade promotion, development of complementary infrastructure, and institutional strengthening activities. These activities will be financed in their entirety with counterpart resources. The eligibility requirements for access to the NRCs will vary according to the different executing institutions: (i) APEX will support export SMEs formed into associations and consortiums; (ii) SEBRAE will support small individual and partner firms; (iii) SENAI will support individual and partner firms of all sizes; and (iv) the MCT will support technology centers, trade associations and cooperatives formed between centers and trade associations (the technical functions of these institutions are summarized in paragraphs 1.14 through 1.18).
- 3.33 The specific characteristics of the NRCs will differ according to the method of operations and activities that the MCT and the other participating institutions (SEBRAE, APEX and SENAI) provide and/or execute directly under the program. In general, the level of subsidy inherent in the NCRs will be variable. For example, APEX covers from 25% to 50% of the cost of export promotion activities for groups of firms, according to the scope and level of integration of the business plans submitted; the MCT covers between 50% (e.g. R&D cooperative projects between firms) and 100% (e.g. metrology laboratory infrastructure) of the cost of activities; and the SENAI provides from 30% to 80% of the costs for training and

technology assistance for firms. Technical File No. 28 includes a detailed table explaining the financial characteristics and eligibility criteria of the various NRC instruments specified in the program.

- 3.34 **Relationship between loans and NCRs.** The SMEs will be able to make use of the program's instruments either jointly or separately, provided they are following a strategic plan as requested in the Operating Regulations (see paragraph 2.10).
- 3.35 However, the characteristics of the program will provide an incentive for firms to adopt an integrated approach in developing their competitive strategy, and to combine the two instruments and activities. On the one hand, SMEs can receive credit under the program where their business plan shows that their project is integrated (i.e. where the specific productive investment is being made in a broader context than promoting the firm's competitive growth) and their needs for support services other than credit facilities are sufficiently covered from own resources or other sources. And on the other hand, in preparing an export plan as part of their participation in a consortium supported by APEX, or in developing new product or process technologies through research supported by the MCT, SMEs may identify areas where capital investment is necessary, which would lead them to request financing under the loan component.
- 3.36 Moreover, the act of developing trade expansion and investment plans through a process supported and evaluated by the specialized institutions participating in the PEM may raise the profile of the SMEs as potential borrowers, and therefore lower the financial risks and cost of the credit they request from the IFIs.
- 3.37 **Program indicators.** The logical framework will contain indicators for the program's activities which will be reviewed and expanded upon during program execution. These indicators will be aimed primarily at the following areas: technology development and innovation; access incursion of businesses to the international marketplace; financial support; and management of the program in general. The impact of the program will be measured in terms of end beneficiaries, participating institutions, and, to some extent, the regional economy.
- 3.38 Table III-2 shows a list of preliminary performance indicators for the PEM. This list is tentative and not exhaustive, and will evolve with program execution.

**TABLE III-2**  
**PRELIMINARY PERFORMANCE INDICATORS FOR THE PROGRAM**

TYPES OF PROJECTS	YEARS				
	I	II	III	IV	TOTAL
<b>TECHNOLOGY DEVELOPMENT AND INNOVATION</b>					
1. Projects to improve products and/or processes approved	100	150	180	150	580
2. Quality certification and/or ecoefficiency projects approved (ISO9/14000)	50	50	50	50	200
3. Assistance to technology support projects (incubators, technology centers)	10	10	10	---	30
4. Basic industrial technology projects (metrology, tests, technical standards, etc.)	10	10	10	5	35
5. Cooperative innovation projects	20	35	35	20	115
6. Technology platform projects	20	30	30	10	90
<b>ENTRY INTO INTERNATIONAL MARKETPLACE</b>					
1. Number of enterprises that increase exports	50	50	50	50	200
2. Creation of export consortiums	30	60	60	30	180
3. Participation in international fairs (enterprises)	10	10	15	---	35
4. Insertion of enterprises "in sites"	50	100	100	50	300
5. Projects to improve quality for export	50	50	50	50	200
6. Training in foreign trade (individuals)	200	300	300	200	1,000
<b>FINANCIAL SUPPORT</b>					
1. Preparation of businesses for access to capital markets	20	30	30	20	100
2. Number of IFIs participating (cumulative)	5	10	15	20	20
3. Transfer contracts between the BN and IFIs signed	100	150	180	150	580
4. Number of technology projects financed	50	100	150	100	400
5. Number of projects for entry into international marketplace financed	50	50	50	---	150
6. Internal training BN (individuals)	50	50	50	---	150
<b>PROGRAM MANAGEMENT</b>					
1. Cooperation agreements between BN/SEBRAE/SENAI signed	6	6	6	4	22
2. Number of BN/APEX projects	50	50	50	50	200
3. MCT/IFIs projects	50	100	100	50	300
4. Training of IFI managers	50	50	50	50	200
5. Awareness campaigns	20	40	40	---	100
6. Training of consultants (individuals)	20	40	40	---	100
7. Dissemination seminars	5	10	10	---	25
8. Program reports	2	3	3	2	10
9. Projects approved (in millions of U.S. dollars) (cumulative)	50	150	240	300	300
10. Projects approved/analyzed (%)	70	70	70	70	70
11. Projects that find investors through the program	50	50	50	50	200
121. Level of satisfaction of IFIs (surveys)	1	1	1	1	4
13. Jobs generated through the program	5,000	5,000	5,000	5,000	20,000
14. Level of satisfaction of the SMEs (surveys)	2	2	2	2	8
15. Productivity (increase sales/employee) (%)	20	20	30	30	25
16. Periodic review of the logical framework	1	1	1	1	4

**G. Social and environmental impacts and proposed actions**

- 3.39 The system used in evaluating projects will require each proposal to undergo an environmental analysis by the PCU. In the instructions received by the program's beneficiaries, they will be informed of the need to assess the possible negative and positive effects on the environment. At the same time, the PCU will measure the percentage of women participating in the program.

**H. Procedures for procurement of goods and consulting services**

- 3.40 The procurement of goods by firms and other private sector entities for execution of the credit component of the program will be subject to the guidelines established by the Bank. The selection and contracting of consulting services (which may also include promotional, supervision and auditing activities) will be carried out in accordance with the Bank's procedures. The contracting of consulting services carried out by SMEs participating in the program, given that they are private sector entities, will use procedures that respect the policy on appropriate use of loan funds, eligibility based on nationality, eligibility of the services, and policies for applying the rule of economy and efficiency.
- 3.41 The Bank will supervise the critical stages of the procurement procedure and administration of the resulting contracts. The PCU, in turn, must cooperate with the Bank in providing this supervision. To this end, and as part of the orderly process for procurement of goods and contracting of services, the PCU is required to preserve and place at the Bank's disposal all documents and background material relating to procurement processes and administration of the contracts.

**I. Disbursement schedule and revolving fund**

- 3.42 Given the rate of execution planned over the four years as indicated in Table III-1, and the reimbursement system established in the program, it is recommended that an advance on funds be authorized (revolving fund) in an amount of up to 5% of the loan. The percentage proposed is based on the initial costs anticipated.

**Table III-3**  
**Annual Disbursements under the Program**  
**(millions of U.S. dollars)**

<b>Year</b>	<b>I</b>	<b>II</b>	<b>II</b>	<b>IV</b>	<b>Total</b>	<b>%</b>
IDB	22.5	52.5	45.0	30.0	150.0	50%
Local Funds	22.5	52.5	45.0	30.0	150.0	30%
<b>TOTAL</b>	<b>45.0</b>	<b>105.0</b>	<b>90.0</b>	<b>60.0</b>	<b>300.0</b>	<b>100%</b>
% per annum	15%	35%	30%	20%	100%	

**J. Accounting and audits**

- 3.43 The PCU must: (i) maintain a separate system of accounts for recording financial transactions financed with resources of the local counterpart funds; and (ii) prepare and submit annually to the Bank, within a period of 120 days following the close of each fiscal year, the financial statements of the BN and the program, audited by a firm of external auditors acceptable to the Bank.

**K. Monitoring and supervision by the Bank during execution of the program**

- 3.44 For monitoring of the program, performance indicators (benchmarks) have been agreed upon in advance and are included in the Logical Framework, along with follow-up action to generate information on these measures during their execution. This information will serve to identify the possible need to introduce changes, both in the management and the operating mechanisms of the program, and to verify fulfillment of the agreed conditions. As part of its control and supervision duties, the PCU will generate status reports which will be submitted to the Bank within two months of the anniversary date for completion of each year of execution, and which will also serve as regular progress reports. Evaluation meetings between the Bank and the BN will be held within 60 days following the receipt of the annual report for analysis of its contents.
- 3.45 Bank resources have been included for design and implementation of permanent monitoring and continuous evaluation of the program through the status and progress reports, and for an independent evaluation to be carried out 18 months from the effective date of the loan from the Bank, or when 25% of the resources of the loan have been disbursed.

## IV. FEASIBILITY OF THE PROGRAM

### A. Socioeconomic feasibility

- 4.1 For the **NRC component**, it is necessary to justify the reasons for subsidizing this area from various perspectives, among which are a social cost-benefit analysis, that is, by identifying the benefits that will result from the subsidized actions, which it is hoped will more than compensate for the costs incurred by the Brazilian intermediary entities<sup>18</sup>. The PEM earmarks US\$69.3 million for this type of activity, to be contributed by the Brazilian institutions. The benefits that can be achieved through these activities are of various types. In the first place, there are clearly identifiable and quantifiable financial effects on the participating SMEs: (i) increased sales and market share; (ii) increase in the operating margin per unit of production; and (iii) if markets expand significantly and production capacity rises, the activities will result in an increase in employment.
- 4.2 These effects will directly impact the earnings of SMEs and public administration accounts. The first will provide the basis for the economic viability of the planned investments, and at the same time ensure repayment of loans; and the second will affect public revenues through increased future tax flows (from levies on profits and income tax) to which the program gives rise.
- 4.3 For public administration, the above results have a further influence which is not limited to the effect on future tax flows: (a) the increase in employment will have an impact on social well-being; and (b) the increase in exports will aid in the balance of payments and help to stabilize the national currency. Among the effects on exports, the following are worth noting: (i) improved capacity of firms to effect and react to changes in the market, either anticipating or adjusting to them through training, innovations, etc.; and (ii) networking among firms to produce a general increase in the efficiency of individual SMEs.
- 4.4 In the **credit component for investments in the productive sector**, the full cost of activities is borne by the beneficiary firms, and therefore the private benefit expected must outweigh this cost and be justified by demand for the program<sup>19</sup>. Through the PEM, the Bank will pump an average of US\$36.5 million in loan funds per year into the region's financial system. This contribution represents an increase of 22% added to the funds channeled through all of the region's financial

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<sup>18</sup> Technical File No. 29 describes aspects of the program's socioeconomic and technical feasibility in greater detail.

<sup>19</sup> The ordinary practice of Banco do Nordeste is to require that investment projects for which loans are being sought project an internal rate of return of 12%. While a subsequent check of the results achieved by borrowing firms is carried out, the data collected are not routinely put to use.

institutions<sup>20</sup> to medium-sized rural and manufacturing enterprises (who are most likely to become clients of the program), for which reason the expected impact will certainly be important. The assurance that the program meets the additionality requirement is based on the fact that the IDB funds will be distributed through the private banking sector, which has shown little activity in this type of operation to date.

**Table IV-1**  
**Influence of the PEM in Relation to**  
**Long-term Regional Financing**

Long-term Financing for Medium-Sized Rural and Manufacturing Firms	Millions of R\$
Average for BN over the three-year period 1997-1999	208
Total average for banking sector +	298
Average annual contribution from IDB * 2001-2004	65
% over three-year mean 1997/1999	22%
Average annual financing from PEM * 2001/2004	93
% over three-year mean 1997/1999	31%

+ Assuming the BN represents 70% of the regional total

\* Exchange rate used: US\$1 = R\$1.84

- 4.5 This factor regarding the additionality of the Bank's resources, together with the impact on the private banking sector of this first relevant contribution under the program, justifies the Bank's participation. It is hoped that the program will have a demonstration effect in inducing a portion of the private banking sector to continue providing longer-term financing for the activities of the SMEs.
- 4.6 In the course investigations carried out for this program, an analysis was made of the impact of a notable sampling of *similar* projects financed by the BN in the past. These projects consist in large part of training activities. The selection includes **77 projects**, the majority of which are from the integrated development areas which have originated 108 loan operations for investment purposes. Most of these cases (68), are loan operations carried out in the last four years (between 1996 and the present), with only a handful (9) dating from the previous four-year period. The selection was made by each manager based on three indicators: **job creation**, and an increase in **gross sales** and/or **exports**. Following are the results obtained in these three fields:
- (i) gross sales: the distribution of the 75 firms with data on this item shows that almost half (45%) bill less than one million reales per year. At the opposite end of the scale, 11% of the firms bill in excess of R\$20 million. As a result of the investments made, important advances were

<sup>20</sup> For purposes of these calculations it is assumed that the Banco do Nordeste will channel 70% of total financing into long-term loans to the private sector.



made in this area: a 134% rise in gross sales over a 3-4 year interval. And when the 30 newly created firms are excluded, the rates are much higher still (309<sup>21</sup>);

- (ii) job creation: here again important results were achieved in that the investments created a total of 4,286 jobs, for an average of 56 per firm. The average ratio between increase in gross sales and increased employment is R\$42,311, and 55% of the firms showed a ratio of less than R\$50.000;
- (iii) in exports increases were recorded both in the number of new firms (exporters in the area rose from only 4 to 13) and in the volume of those already present in the field. As a result of their investments, exports rose by some 157%, climbing from R\$10.6 to R\$27.3 million (an increase of R\$16.8 million). In virtually every case, the firm involved expanded its markets, and either initiated or increased its presence in the other states of Brazil.

4.7 Consequently, there is reason to hope that the PEM will have at least this much success.

#### **B. Technical feasibility**

4.8 The survey of 223 of the region's firms conducted by the BN<sup>22</sup> demonstrated a generally favorable attitude toward expansion, innovation and greater market penetration.

4.9 The respondents shared the view that investment is not a decision to be taken in isolation, that it requires changes in levels of training, organization and management. Hence the consensus that in almost all cases new investment should be accompanied by training programs, as well as preceded by technical assistance or advice. Secondly, those entrepreneurs who have put off their investments because of the market (e.g. a downturn) and the terms and conditions of available loans (3 out of 4 respondents<sup>23</sup>) are willing to cope with additional training. In most of the cases, the objectives of the firm are restricted to the domestic markets<sup>24</sup>

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<sup>21</sup> There are two values which distort the mean because they are abnormally high. Consequently, it was necessary to salvage the mean by eliminating the three highest and the three lowest values.

<sup>22</sup> Banco do Nordeste, "Investimento para o Incremento da Competitividade das Pequenas e Médias Empresas do Nordeste – Uma Estimativa para o Período 2000-2003", Fortaleza-CE, January 2000.

<sup>23</sup> Not forgetting that the sample itself is very small.

<sup>24</sup> One reason for this high percentage is the fact that the sample included a sizable proportion of service firms that could not become direct exporters. Also the typical profile of the firms surveyed includes enterprises which serve only very local (not even regional) markets, except for those that qualify as medium-sized firms (with over 100 employees).

(73%). The remaining respondents included increasing foreign sales among their objectives for investment.

- 4.10 The important conclusion from the survey is that the small business sector gives evidence of clear demand for nonlending services, and that the design of the program shows every sign of filling the gap detected in this area, especially since its executing agency is among those agencies with the highest level of interaction with the target firms and is held in high repute by them.

**C. Institutional and financial feasibility**

- 4.11 The program has strong institutional backing, both among the authorities of the country – in particular, the BN, the federal Ministry of Science and Technology, the state Secretariats of Science and Technology, Industry and Agriculture—and among the private banks and other institutions such as SEBRAE, SENAI and APEX, the SMEs themselves and consulting firms. The support was confirmed during the design stage through interviews, surveys, seminars and the preparation of a business development study.
- 4.12 The BN's capacity to act as executing agency for the program is highly relevant in that it is the key to the program's being able to mobilize the SMEs as a group. The BN provides 70% of the credit allocated to the private sector. It has 161 branches, of which only 22 are located in the urban areas of the state capitals, the rest being distributed among the remaining municipalities. The BN maintains a presence in towns where it does not have branches through its 450 development agents who guarantee that it is represented in all of the region's municipalities. A municipal development committee (*Farol do Desenvolvimento*) has been created in each of these. Between them, the agents and committees serve to mobilize local initiatives in favor of development projects.
- 4.13 The experience of the BN has confirmed that the Northeast has a varied supply of management, technology, credit and globalization services to offer SMEs, in both the public and private sectors. However, the program will help current and new service providers to reorganize and adapt, so as to shape a broader and more efficient market. The combination of the above factors supports the conclusion that, from the institutional and financial point of view, the program is feasible.

**D. Counterpart funds**

- 4.14 The analysis of the feasibility of counterpart funding was directed to determining the rationality of the items to be financed and amounts planned for—vis-à-vis the required contribution which is greater on average by around US\$75.0 million per year—and the fact that there will be a cash contribution from both the financial intermediaries and the beneficiaries themselves. No problems are anticipated in obtaining the resources during the program execution period.

## **E. Gender, social and environmental aspects**

- 4.15 To identify **gender** activities, the PEM will have the indicators of the logical framework, with a breakdown by sex. This will permit measurement of female participation in the program, and determination of whether or not there is a need for specific programs for the region intended to increase the number of women entrepreneurs. In addition, the executing agency will train one of its members in gender issues and the design and execution of appropriate projects.
- 4.16 Analysis of the **environmental impact** of the projects to be financed must be carried out as an integral part of the evaluation process. The Banco do Nordeste has an advanced environmental management system which is an automatic feature of its loan management process. The PEM will characteristically involve activities that in many cases contribute to the improvement or protection of the environment. Any potential adverse effects will be identified early on in the analysis process, which will allow the PCU to either incorporate mitigating measures in the proposals or reject them. The experience of the BN and existing mechanisms together guarantee the environmental feasibility of the program.
- 4.17 This operation does not qualify as a project that promotes social equity as described in the key objectives for the Bank's activities contained in the report on the Eighth General Increase in Resources.
- 4.18 The problem of **child labor** affects labor practices in the Northeast region. This despite the fact that Brazil's Constitution bans from the workplace anyone under 16 years of age. This age limit rises to 18 for jobs that are deemed unhealthy. As well, Brazil is a signatory to all international agreements for the protection of children and young people. The Ministry of Labor has regional delegations in all of the states in the Northeast region, as well as inspectors to verify compliance with current legislation.<sup>25</sup>

## **F. Benefits**

- 4.19 The PEM will help strengthen the ability of the BN to provide support for SMEs. This program is expected to result in increased investment in R&D within the productive sector, as well as the number of innovative and export firms, aspects which will play an important role in revitalizing the economy. In similar fashion, it is expected to improve the quality and quantity of services provided by the institutions that support SMEs and by the private consulting firms. This as a result of those aspects of the program that promote demand and interest among agents in the productive sector of the region in innovation, technological development and globalization.

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<sup>25</sup> In 1996, the Programa de Erradicação do Trabalho Infantil [Child Labor Eradication Program] (PETI) was created with a mandate to eliminate child labor from activities that are unhealthy, onerous or degrading. PETI identified the principal areas in which child labor is still present, noting that these primarily involved activities in the informal and/or rural sector.

- 4.20 Important aspects of this process are reflected in the program's contributions to: (i) creating the habit and instilling methods of strategic analysis; (ii) imparting the practice of reliance on specialized *expertise* from outside the enterprise; (iii) promoting acceptance of inter-firm cooperation in analyzing problems and seeking cooperative solutions; (iv) expanding credit available to SMEs in the Brazilian Northeast; and (v) supporting civil society so that the methods used to form strategic committees, create development areas, etc., give entrepreneurs themselves a more active role in identifying problems and solutions.
- 4.21 The benefits accruing to the intermediary banks relate to two aspects. First, by participating in the program they will expand their business horizons, extending their services to include clients with other than traditional projects, including innovative technologies and the possibility of reaching foreign markets. And second, the program will provide an incentive for financial intermediaries to approve medium- and long-term loans, which are not common with these entities, facilitating the development of the "know-how" necessary for evaluating this type of operation.

#### **G. Risks**

- 4.22 A downturn in the macroeconomic situation—which is not predicted, but cannot be ruled out—would have a dampening effect on the SMEs' willingness to renovate their production facilities. However, the country's economic performance in 1999 exceeded predictions made at the start of the year, and major changes in economic policies are having a significant impact.
- 4.23 Successful coordination of resources administered by various institutions is essential to the success of this program. So long as these institutions continue operating according to their own agendas without reference to the PEM, there will be a risk that the above-mentioned coordination will not be forthcoming. This risk will be lessened when, according to plan, appropriate cooperation agreements are signed under the program setting out working methods, objectives and resources.

#### **H. Sustainability**

- 4.24 Making firms more competitive is the best guarantee of the program's sustainability without, be it added, generating future commitments. Ensuring their financial soundness and introducing best practices in their management will make SMEs more attractive clients for the private banking sector, encouraging a development which is viewed as normal in financially more developed countries. Moreover, the investment nature of all expenditures on development of policies to promote the competitiveness of SMEs, and the high rate of social returns inherent in such expenditures, makes them all the more eligible for long-term support of the type offered by the multilateral lending agencies, for which reason the Brazilian government will no doubt continue to seek the Bank's support in sustaining those

policies. Support for this contention can be seen in the widespread use of public policies to promote competitiveness among SMEs in many of the developing countries and virtually all of the developed countries—policies recognized and accepted by the World Trade Organization.

**LOGICAL FRAMEWORK MATRIX**  
**MARKET EXPANSION PROGRAM FOR**  
**SMALL AND MEDIUM-SIZED ENTERPRISES IN NORTHEASTERN BRAZIL**

Objectives	Performance indicators	Means of verification	Assumptions
Goal—Market Expansion Program			
efficiency and competitiveness of medium-sized enterprises (SMEs) and services in the Northeast create an operating mechanism for granting loans to SMEs financial intermediaries.	Increase the contribution of the selected sectors to GDP in the Northeast region	<ul style="list-style-type: none"><li>statistics on the contribution by the SMEs supported to regional GDP</li><li>IBBGE, SEBRAE, SENAI, and SESC reports on performance of selected sectors</li></ul>	<ul style="list-style-type: none"><li>Resources for training and management of technology are used efficiently</li><li>Stakeholders maintain interest in systematic acquisition by non-SMEs of knowledge of science, technology, management, and trade.</li></ul>
	Reduce SME bankruptcies in the region	Number of SME bankruptcies in the region	
Purpose			
ess development, technology and access to international markets for northeastern SMEs through products, production processes, distribution, etc., and loans for investments.	Increase in public and private investment in management technology, innovation, and access to international markets for SMEs	<ul style="list-style-type: none"><li>Reports and accounting statements from public and private institutions</li></ul>	<ul style="list-style-type: none"><li>Governments and private institutions maintain interest in strengthening to support improved technology, management, and international access for SMEs in northeastern</li><li>There is interaction between scientific and technological knowledge and the productive sector.</li></ul>
	Increased productivity in northeastern SMEs	Specific studies for verification (Ministry of Science and Technology, Banco do Nordeste, etc.)	
	Improved SME performance in domestic and international markets	Profitability indicators, increased billings, and market share	
	<ul style="list-style-type: none"><li>increase in number of innovative enterprises</li><li>increased competitiveness of beneficiary SMEs</li><li>increase in number of SMEs investing in research and development</li><li>number of persons trained</li><li>number of SMEs with ISO 9000 and ISO 14000 certification</li><li>increase in number of northeastern SMEs exporting</li></ul>	<ul style="list-style-type: none"><li>specific studies conducted by the Ministry of Science and Technology and Banco do Nordeste</li><li>SME accounting and management reports</li><li>reports by institutions supporting SMEs</li><li>case studies</li></ul>	<ul style="list-style-type: none"><li>SMEs remain interested in business technology development.</li><li>SMEs view innovation as good</li><li>Local financial institutions develop financing services for innovation using various instruments (credit capital, etc.).</li></ul>

Objectives	Performance indicators	Means of verification	Assumptions
	<ul style="list-style-type: none"> <li>increase in number of northeastern SME export consortiums</li> <li>increased access to international markets for beneficiary SMEs</li> </ul>		
<p><b>Technical assistance</b></p> <p>to the following technical services for SME management and innovation</p> <p>on for access to capital markets</p> <p>on of export-oriented business</p> <p>ledge, skills, and positions to SME demand for new management technology</p> <p>basic industrial technology (y, certification, and testing)</p> <p>y training: grants and courses</p> <p>training</p> <p><b>Research and development (R&amp;D)</b></p> <p>by individual SMEs or groups</p> <p>iated with technology centers to</p> <p>cts and processes, resolve</p> <p>problems, and improve quality</p> <p>y platforms</p> <p>ve projects</p>	<ul style="list-style-type: none"> <li>number of SMEs certified</li> <li>number of SMEs with access to capital markets</li> <li>number of business plans prepared</li> <li>number of SMEs participating in training courses</li> <li>number of consultants trained in consultant training programs</li> <li>number of SMEs participating in awareness events</li> <li>number of R&amp;D projects prepared</li> <li>number of technology platforms developed</li> <li>number of cooperative projects carried out</li> </ul>	<ul style="list-style-type: none"> <li>PEM reports</li> <li>specific studies</li> <li>reports by partner institutions</li> </ul>	<ul style="list-style-type: none"> <li>Interested SMEs and institutions participate in the modernization technology innovation process</li> <li>Macroeconomic performance not change substantially.</li> </ul>

Objectives	Performance indicators	Means of verification	Assumptions
<p><b>Industrial infrastructure and technical strengthening</b></p> <p>assess, and strengthen service supporting SMEs</p> <p>laboratories providing services for access to basic industrial technology (BIT—standardization, certification, and testing)</p> <p>financial facilities for support: guarantee funds, venture capital funds, and other</p> <p><b>Trade promotion</b></p> <p>by SMEs on an individual or collective basis to promote trade of their products and services</p> <p><b>Productive investments</b></p> <p>expansion of production and modernization for SME products with financing for purchase and lease of equipment, industrial and other capital goods, and financing for such investments</p>	<ul style="list-style-type: none"> <li>• number of institutions supported, such as metrology laboratories, business incubation centers, technology parks, sector service centers, certification centers, clean technology dissemination centers, and support services for export promotion</li> <li>• number of export consortiums developed</li> <li>• number and value of financial facilities established (such as guarantee funds)</li> <li>• number of SMEs participating in local and international trade fairs and exhibits</li> <li>• number of SMEs that created Internet sites to publicize or market their products and services</li> <li>• number of SMEs that developed specific projects for trade promotion, such as catalogues, information packets, samples, giveaways, and other related items</li> <li>• number and amount of financing operations for which contracts were signed</li> </ul>		



PROPOSED RESOLUTION

**BRAZIL. LOAN /OC-BR TO THE BRAZILIAN NORTHEAST BANK  
Market Expansion Program for Small and Medium Enterprises  
in the Northeast of Brazil - PEM**

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Brazilian Northeast Bank (BN), as Borrower, and the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former a financing to cooperate in the execution of a Market Expansion Program for Small and Medium Enterprises in the Northeast of Brazil. Such financing will be for the amount of up to one hundred and fifty million dollars of the United States of America (US\$150.000.000), which are part of the Single Currency Facility of the Ordinary Capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Financial Terms and Conditions" of the Executive Summary of the Loan Proposal.