

**PROJECT TO DEVELOP SUPPLIERS FOR
MULTINATIONAL HIGH-TECH ENTERPRISES**

(TC-99-01-0-43-CR)

EXECUTIVE SUMMARY

**EXECUTING
AGENCY:**

Fundación Centro Alta Tecnología (FUNCENAT).

BENEFICIARIES:

Costa Rican Small and Medium Enterprises

OBJECTIVE:

The Project's general objective is to help increase national added value in the production of Multinational High-Tech Enterprises (MHTEs) established under Free-Trade zone provisions in Costa Rica, and, as a consequence thereof, increase competitiveness of small and medium enterprises (SMEs). The specific objective is to improve the technological/productive capacity of the SMEs, bringing them up to levels that enable them to supply inputs and/or services for the MHTEs' production and to compete on a global level. (Paragraph 3.1)

DESCRIPTION:

In order to achieve the above-mentioned objectives, three components have been proposed: i) Pilot Supplier Development Program; ii) Integrated Information System; and iii) Establishment of the "Costa Rica - Provee" National Office for Supplier Development. (Paragraphs 3.2-3.16)

The Project will support the development of a minimum of 45 products linking the SMEs to the production network of the MHTEs, thus demonstrating their viability and sustainability. Concurrently, the Project will set up an Integrated Information System that will facilitate these links. For the sake of institutional continuity and in order to give a Costa Rican character to the operation, the establishment of a National Office for Supplier Development is planned, that will continue with this task.

FINANCING:

Method: non-reimbursable – Small Enterprise Development Facility (III-A)

MIF:	US\$	900,000 (60%)
Local Contribution:	US\$	600,000 (40%)
Total:	US\$	1,500,000 (100%)

TERMS: A 36-month term of execution is planned, with a 42-month period for disbursing the MIF contribution. (Paragraphs 4.1 and 5.5)

**EXCEPTIONS TO BANK
POLICIES:** None

**SPECIAL
CONTRACTUAL
CONDITIONS:**

The Agreement between FUNCENAT and the Bank shall set forth that before the date of approval of the Project by the MIF Donors Committee, the participation agreement between FUNCENAT, CINDE, PROCOMER and the CICR was signed and delivered to the Bank, and that in that agreement the participating entities indicated the amount of their contributions to the Project. (Paragraph 4.10)

As prerequisites to the first disbursement of the MIF contribution, the Executing Agency, to the Bank's satisfaction: (i) shall have hired the Project Director in accordance with the Terms of Reference previously agreed upon with the Bank; (ii) shall have submitted the Strategic Project Execution Plan; and (iii) shall have submitted evidence that the Project's Operational Regulations have gone into effect. (Paragraph 8.1)

Once the conditions of Article 2, Subdivisions (i) and (ii) of the General Specifications have been met, up to US\$25,000 of the MIF resources may be disbursed in order to allow the executing agency to contract the international consultant on supplier development, who, among other functions, shall facilitate compliance with the prerequisites for the first disbursement. (Paragraph 8.2)

The creation of "Costa Rica - Provee" shall take place once the Project: (i) has carried out no less than 25 of the 45 networking projects planned as a part of the ultimate objective; (ii) once at least 60% (US\$ 360,000) of the local contribution has been disbursed; and (iii) once the necessary methodologies and manuals are in place. (Paragraph 8.3)

Once "Costa Rica - Provee" has been established and before executing the "Agreement" with "Costa Rica - Provee," the Executing Agency shall submit a proposal to the Bank for its consideration, describing the characteristics of "Costa Rica - Provee" as the new executing agency, along with the "Agreement" for all assets acquired, the balances of the funds pending)

execution, and the income generated by the operation.
(Paragraph 8.4)

**ENVIRONMENTAL
ASPECTS:**

The Committee on Environmental and Social Impact (CESI) approved this operation at its July 12, 1999, session (TRG-26-99). The project takes into consideration the fostering of improvements to meet environmental standards and abidance with international quality conventions and certification processes such as ISO 14000.
(Paragraph 9.1)

I. COUNTRY ELIGIBILITY

- 1.1 The Donors Committee declared Costa Rica eligible for all financing modes of the Multilateral Investment Fund (MIF) on December 3, 1993. The project is eligible for MIF financing within the framework of the Small Enterprise Development Facility (III-A), because it will contribute to the development of non-financial services markets, by promoting the linkage of smaller enterprises to the production networks of multinational enterprises situated in the free-trade zones.

II. FRAMEWORK

- 2.1 During the 1990's, Costa Rica has promoted a clear policy of support for attracting Foreign Direct Investment (FDI). This effort has been focused on areas of high-technology electronics industries and pharmaceuticals. As a result of these efforts, there was an increase in FDI from US\$163 million dollars in 1990 to US\$531 million dollars in 1998, representing 5% of the Gross Domestic Product (GDP). Out of the total FDI, 61% corresponds to industrial activities and of those, 26% to high-tech industries. The results of the policies for attracting FDI, supported by free-trade zone incentives, are further consolidated by the country's comparative advantages in human resources, its political stability, and its strategic geographic location.
- 2.2 The country has 8 free-trade zones with 220 enterprises, of which 20% (44) correspond to Multinational High-Tech Enterprises (MHTEs). Companies in the free-trade zones made 7% of their purchases from local industry in 1997 (US\$52 million dollars out of a total of US\$746 million dollars). Sixteen MHTEs have networked with local suppliers to reduce the costs of production, and transportation; the storage of inputs and packaging; to shorten the time used in developing products; and to increase production flexibility. The MHTEs have a growing interest in acquiring products locally. Thus, the SMEs have an opportunity to occupy this market if they increase their competitiveness.
- 2.3 In 1998, the formal industrial sector was comprised of 4,856 enterprises, of which 45% (2,185) were SMEs, responsible for 32% of the gross value of industrial production. Out of their total production, 74% was earmarked for the local market and the remaining 26% for the foreign market. SMEs are responsible for 34% of the jobs in the industrial sector.
- 2.4 Given the economic relevance of the SMEs and the opportunity for creating provisioning relationships that could become a motor for their business development, various public and private institutions, in an isolated manner, are conducting activities in support of networking. These institutions, including the government, have made mention of how important it is for that effort to be turned into a national program.
- 2.5 There are also numerous institutions devoted to servicing the business and technological development of SMEs. These institutions can contribute to the implementation of a networking program, but they need to be coordinated so that their efforts can reinforce one another and foster the local suppliers' development. They are capable of providing

technical assistance and specialized training in manufacturing processes, improvement and transformation of businesses, quality, productivity, ISO-9000 and ISO-14000 certification, etc. These institutions of support for SMEs have been strengthened by the Small Enterprise Competitiveness Program (ATN/ME-4850-CR), whose principal objective is to “develop a market for specialized business services,” which is conducted by the Chamber of Industries of Costa Rica (CICR).

- 2.6 During its final phase, this competitiveness program, to a marginal extent, based on the capacity developed by business service institutions, started an experimental “Subcontracting Market.” The experiment identified 36 cases of potential links, and 13 SMEs were able to establish small provisioning businesses. These SMEs have required integrated support (training, technical assistance, and investment) for their development. The reduced number of supplier SMEs was principally due to the fact that the links were made in a haphazard fashion. The focus was on supply. What was lacking was a specialized program, as is requested by the institutions that support SMEs.
- 2.7 Other factors limiting the ability of SMEs to make adequate links with the MHTEs are: (i) a lack of familiarity with the procurement practices of the MHTEs, which, in many cases, are of the corporate type, and thus are based on factors of international competition; (ii) low technological levels; (iii) a lack of business management, especially in the areas of quality and risk taking; (iv) limited capacity of their physical installations; and (v) difficult access to credit and/or to venture capital funds.
- 2.8 An operation specialized in supplier development needs to take the following into consideration: (i) the demand for products and/or services expressed by the MHTEs; (ii) a solution to the SMEs’ limitations in order for them to be incorporated into the production networks of these enterprises; and (iii) the existence of business and technological services for local industry. In this sense, the proposed project, designed in such a way that its components facilitate the business of supporting suppliers, is a strategy that is national in scope, and involves institutions related to the development of SMEs. Its results are projected to have a rapid, demonstrative effect, ensuring its institutional and financial sustainability. Furthermore, the operation may mark the beginning of a new industrial model with a technological basis, resulting in the birth of world-class domestic enterprises.

III. THE PROJECT

A. Objectives

- 3.1 The Project’s general objective is to help increase national added value in production levels of the MHTEs established under Free-Trade zone provisions in Costa Rica, and, as a consequence thereof, increase competitiveness of SMEs. The specific objective is to bring the technological/productive capacity of SMEs up to levels enabling them to supply inputs and/or services to the production of the MHTEs and to compete on a global level.

B. Components

- 3.2 In order to achieve the above-mentioned objectives, three components have been designed: (i) Pilot Supplier Development Program; (ii) Integrated Information System; and (iii) Establishment of the “Costa Rica - Provee” National Office for Supplier Development.

1. Component I: Pilot Supplier Development Program (US\$892.092)

- 3.3 Under this component, a minimum of 45 networking projects will be developed for products of SMEs with the MHTEs over a three-year execution period. In the first year 10 products will be linked, 15 in the second, and 20 in the third. These networking projects will satisfy part of the demand for products currently being imported by the MHTEs. Priority will be given to three industrial activities, without excluding the possibility of including other activities during the projects’ execution: (i) plastics; (ii) metals and mechanics; and (iii) packaging and containers.
- 3.4 The beneficiary SMEs shall be selected using criteria that form a part of the Project’s Operational Regulations, principal among these are the following: (i) capacity to manufacture products or carry out technological processes in the above-identified industries; (ii) a healthy financial situation; (iii) technological capacity and human resources with potential for growth; (iv) minimum levels of productivity in accordance with international standards; and (v) having a business profile and organizational structure suitable for introducing a culture of quality and international certification processes. The Project shall not support SMEs or MHTEs that fail to comply with, or that violate local environmental and labor standards. Compliance with criteria shall be evaluated through a benchmarking methodology that enables the Executing Unit to make an objective determination of the SME’s potential for success. For the development of this methodology, an international consulting body will be contracted, whose terms of reference shall be drawn up by the international consultant on supplier development referred to in Point 4.6. The first pilot projects will make it possible to better understand how to carry out supplier development and will bring to the surface adjustments needed to ensure that this component contributes to the Project’s objectives.
- 3.5 For each provisioning project, two to three candidate enterprises will be selected. The Executing Unit jointly with the MHTE, will conduct an audit of the selected enterprise, with the aim of determining the requirements with which the SME must comply in terms of products, processes, and systems indicated in the MHTE’s manuals on supplier standards. The Executing Unit will facilitate the development of an agreement between the MHTE and the SME for the execution of the provisioning project. Subsequently, together with the SME, it shall proceed to develop a Technical Assistance and Training Plan (“business plan”) focused on developing its technological/productive capacity to satisfy the specific demand of the MHTE.
- 3.6 Technical assistance activities will focus on supporting the SMEs, as applicable, for: (i) solving a specific problem related to products and/or processes; (ii) implanting modern manufacturing systems with clean technologies in compliance with ISO-9000 and ISO-

14000 requirements; (iii) improving business processes, which includes strategic planning, marketing, sales, development of products and processes, etc.; (iv) transforming the business, through strategic planning and reengineering of the enterprise. The training will revolve around short courses: (i) in technical or technological areas addressed to staff personnel; (ii) of the engineering type, with the objective of demonstrating the use of modern manufacturing techniques and their impact on the enterprise's productivity; and (iii) at the executive level, with the aim of making the enterprise's management and ownership personnel aware of aspects involving competitiveness, business management, etc.

- 3.7 For the execution of the Technical Assistance and Training Plan, the Executing Unit shall select the service institutions through a bidding process, in accordance with the areas of competence of each bidder. The payment system to be applied to the SMEs for services received takes a differentiated recovery mechanism into account, so as to provide an incentive for SMEs to participate in the Project. Under this mechanism, the enterprise shall, at a minimum, cover 60% of the costs in the first year, 75% in the second year, 90% in the third year, and, as of the fourth year, 100%. This system shall be applied on a case-by-case basis, taking into account the size and potential of the enterprise, and shall be indicated in the participation agreement to be signed by each SME.
- 3.8 It has been estimated that on an average US\$16,000 dollars will be invested for each linkage. The Executing Unit, through project monitoring, will maintain a suitable accounting of the allocation of these funds, in such a way as to allow the goal of 45 provisioning projects to be met and/or surpassed. If necessary, at the end of the first year of the operation's execution, a limit will be set to prevent a concentration of training and technical assistance resources in a small number of SMEs. This accountability condition with regard to maximizing the impact of the resources is incorporated into the Project's Operational Regulations and shall be the responsibility of the Project Director.
- 3.9 Through a final audit by the MHTE of the selected SME, with support from the Executing Unit, confirmation shall be made of satisfactory compliance with the standards set in the MHTE's suppliers manual, after which the purchase order shall be placed or the contract shall be signed for the sale of the product developed. In the event that compliance is unsatisfactory, a new Technical Assistance and Training Plan shall be developed. The SME shall pay the Project a success commission for each product linkage made, which, depending upon the amount of the contract or purchase order shall range from 5 to 10% of the net sales price. Each SME joining shall sign an agreement setting forth the conditions of its participation.
- 3.10 It is worth mention that, in accordance with the volume of the products to be supplied, the Project will promote cooperation among the SMEs to overcome the capacity limitations of a single supplier's physical installations. The association of various suppliers will provide access for the SMEs to new markets.

2. Component II. Integrated Information System (US\$102,600)

- 3.11 A system shall be established allowing the institutions involved in the support to suppliers or provisioning business to have data that makes it easier for them to meet their objectives. In this sense, the system will have information on: (i) supply and demand for products and networking services; (ii) business and technological service institutions; (iii) the MHTEs and SMEs involved in the Project; and (iv) sources of financing and of venture capital for the SMEs. This system shall incorporate the existing databases of each institution participating in the Project, and its administration shall be the responsibility of the Executing Unit. The information contained in the system shall be of the utmost importance to facilitate the participation of the MHTEs and SMEs in the networking. The MHTEs shall have access to specific, detailed information on potential suppliers. The SMEs shall be provided with information on new business opportunities. Access to all this information shall be restricted and its use shall be subject to pay.
- 3.12 For the execution of this component, a consulting body shall be contracted to: (i) make an analysis of the system's requirements, design, and development, including the database and the Web Page; (ii) hardware and software recommendations, and consultation for their acquisition; and (iii) system startup. Concurrently, the consulting body shall establish the pertinent administrative standards.
- 3.13 The Web Page shall support two types of queries: (i) unrestricted access to information considered to be part of the public domain; and (ii) restricted access to information categorized as confidential. The consulting body, in coordination with the Executing Unit, shall determine the criteria for categorizing the sensitivity of the information contained in the database. This Web Page shall be available for interaction and information queries by direct users, marketing agents involved in the Project, and potential candidates. Similarly, with the aim of maintaining the Web Page's viability, it shall be promoted: (i) through "electronic posters" on shared access pages used by current and potential clients (SMEs, support institutions, MHTEs, etc.); (ii) in specialty magazines; and (iii) through direct e-mail to entities of interest, that comprise a niche in the target market.

3. Component III. "Costa Rica - Provee" National Office for Supplier Development (US\$15,000)

- 3.14 Given that the country does not have an entity specializing in the business of supporting suppliers, a National Office for Supplier Development will be established, named "Costa Rica - Provee," to ensure the Project's institutional continuity and national character. This Office will have its own legal status and capacity to act as an executing agency under the conditions and objectives set forth for this operation.
- 3.15 The creation of "Costa Rica - Provee" shall take place once the Project has carried out no less than 25 of the 45 networking projects planned as a part of the ultimate goal, once at least 60% (US\$360,000) of the local contribution has been made, and once the necessary methodologies and manuals are in place. The first Project evaluation, scheduled at 24 months after commencement of the operation's execution, shall determine compliance with the above-mentioned conditions. If the results are positive, the Executing Unit shall

prepare the terms of reference for contracting a legal/organizational consulting body, defining the attributes that the new entity must possess in order to be able to continue to meet the Project's defined objectives. If the results are negative, the evaluators shall make the appropriate recommendations to improve the operation's execution.

- 3.16 Once "Costa Rica - Provee" has been legally established, the official processing of a change of executing agency shall be commenced. For said purposes, the Executing Agency shall submit a proposal to the Bank for its consideration, describing the characteristics of "Costa Rica - Provee" as the new executing agency, along with the "Conveyance Agreement" for all assets acquired, as well as the balances of the funds pending execution and the income generated by the operation. The creation of "Costa Rica - Provee" shall have no adverse effect on the execution of the Project, given that continuity shall be maintained in the organizational framework and personnel considered for the execution of this operation.

IV. PROJECT EXECUTION

- 4.1 The proposed organization for the Project's execution contemplates an initial executing agency, whose function shall be to receive and administer the operating funds and provide part of the local contribution. Complementing the task of the executing agency, two levels of action have been considered: (i) a superior level for decision-making (Steering Committee); and (ii) an executive level responsible for the development of the Project components (Executing Unit). The Project's duration shall be 36 months.
- 4.2 Executing Agency: The Fundación Centro Alta Tecnología (FUNCENAT), given its institutional capacity and objectives, makes it a suitable recipient to administer the Project funds, be a representative before the Bank, and take charge of the Executing Unit. This private, non-profit institution was created in 1997. Among its objectives are: (i) to promote coordination between public and private entities involved in high-tech development, training, transfers, and applications; and (ii) promote and encourage the development of enterprises of a high technological content and high added value for the country. The operation's Annexes include FUNCENAT's bylaws, which describe its organizational structure in detail. With the aim of consolidating the Project as a national institution, FUNCENAT shall convey ownership of the Project to "Costa Rica - Provee," once the applicable conditions have been met.
- 4.3 The Steering Committee shall have the following responsibilities: (i) supervise the meeting of the Project's objectives and goals; (ii) make sure that the implementation of the budget is proper; (iii) review and approve the annual plan of Project activities and the budget, including the use of the local contribution; (iv) allocate financial resources in order to ensure the continued execution of the Project; (v) select and hire the Project Director; and (vi) approve the contracting of the rest of the Executing Unit's technical personnel and of the international consultants.
- 4.4 It shall be comprised of representatives of the institutions providing local counterpart funds: The Costa Rican Foreign Trade Corporation (PROCOMER), the Costa Rica Investment and Trade Development Board (CINDE), the Chamber of Industries of Costa

Rica (CICR), MHTEs, SMEs, and FUNCENAT. (A description of these institutions is found in the technical annexes of this document). Participation of these institutions in the Steering Committee shall be established through a document reflecting each institution's contributions and commitments. During the first year of the Project's execution, this Steering Committee shall meet at least once every two months, and during the following two years, every six months. The position of Chairman shall rotate among the members of the Committee, who shall provide their services free of charge.

- 4.5 The Executing Unit (US\$271,600) shall be responsible for developing the Project components, and its principal function shall be to facilitate networking between the SMEs and the MHTEs. Specifically, it shall carry out the following activities: (i) publicity, marketing, and follow up on the services offered by the Project; (ii) ongoing support for relations between the MHTEs and the SMEs; (iii) preparation of the Technical Assistance and Training Plan ("business plan"); (iv) subcontracting of entities bidding on training and technical assistance; (v) identification of possible business alliances; (vi) documentation of the supplier development process; (vii) publicizing of the results through seminars, courses, workshops and conferences on the best practices, and publication of a bimonthly/annual newsletter; (viii) granting of the "Supplier of the Year;" award; and (ix) monitoring of compliance with performance indicators and Project objectives set forth in the Logical Framework (comprising Annex I). The monitoring shall be conducted in accordance with a methodology to be defined through an international consulting body, whose terms of reference form a part of the Project files.
- 4.6 The Executing Unit shall be comprised of a Project Director, a Technical Coordinator, a Technical/Accounting Assistant and a Secretary (the terms of reference for the Executing Unit form a part of the technical annexes). This Unit shall have the support of the international consultant on supplier development, who shall collaborate on: (i) preparation of the prerequisites for the first MIF contribution disbursement; (ii) the selection of the Project Director; and (iii) the startup of the Project activities. For the contracting of this consultant, whose terms of reference form a part of the technical annexes, a special disbursement shall be made in an amount of up to US\$25,000.
- 4.7 The Project Director shall, principally: (i) prepare and carry out the selection and contracting procedure for the rest of the Executing Unit's personnel; (ii) ensure that all mechanisms for the administration and execution of the Project are established; (iii) see to it that the manuals are correctly prepared and that the corresponding methodologies are correctly applied; and (iv) ensure the rational use of the operation's resources, in order to meet the goal of 45 networking projects. The Director shall act as secretary of the Steering Committee and shall be the liaison between the Steering Committee and the Executing Unit.
- 4.8 The Technical Coordinator shall collaborate on the activities described in the "Pilot Supplier Development Program" Component, as a counterpart to an engineer of the MHTEs. He shall be directly responsible for collaborating on the provisioning project, including the search for supplementary financing for investments that require such networking. His remuneration shall be related to his success rate. Thus, it has been anticipated that in the first year 100% of his fees shall be ensured by the Project, 80% in

the second year, and 50% in the third year. The difference shall be made up by an additional payment that, depending upon the case and in accordance with the success-rate commission indicated under Point 3.9, shall range from 2 to 4% of net sales. The number of technical coordinators for the Project shall increase as a function of the volume of linkages, and their fees shall be covered by the profits that those linkages generate or by other contributions.

- 4.9 State of Preparation: The Project is currently in an advanced state of preparation. Together with technicians from the institutions involved, it has developed the majority of the terms of reference for the consulting firms, the draft of the Operating Regulations and model agreements. The institutions that shall form the Steering Committee and be responsible for the local contribution have collaborated in developing the Project, which will facilitate the signing of the participation agreement. The Project has full support from the government of Costa Rica at the level of the Presidency of the Republic and from 7 MHTEs (Intel, Baxter, Isotex, Trimpot, Espion, Conair, and Firestone).
- 4.10 The participating institutions shall contribute at least 50% of the resources comprising the local counterpart in cash. Prior to submitting the Project to the MIF Donors Committee, the participation agreement shall be signed and submitted to the Bank, wherein the participating entities shall indicate the amount of their contributions to the Project.
- 4.11 The Data Banks of CICR, CENAT, PROCOMER, and CINDE shall be made available to the Project as of its commencement, and shall form part of the Integrated Information System. Similarly, the Project will be benefited by incorporating the networking activities that are being prepared by these institutions, such as the molds and dies project.

V. COST, FINANCING, AND SUSTAINABILITY

A. Budget

- 5.1 The total cost of the Project is estimated at US\$1,500,000, of which the equivalent of US\$900,000 shall be contributed by the MIF, and shall be non-reimbursable. The sum of US\$600,000 shall be the local counterpart, in accordance with the distribution of investments shown in the following table. The itemized budget appears in Annex II.

BUDGET
(Equivalent in US\$)

CATEGORIES	MIF	LOCAL CONTRIBUTION	TOTAL
I. Component I	603,259	288,833	892,092
Pilot Supplier Development Program			
- Consulting, Provisioning, and Evaluation for SMEs	63,792		63,792
- Technical assistance to SMEs	385,060	127,940	513,000
- Training of SMEs	128,907	78,093	207,000
- Technical Coordinator		82,800	82,800
- Publicity	25,500		25,500
II. Component II	10,000	92,600	102,600
Integrated Information System			
- Consulting, Design, and Development	10,000		10,000
- Software		72,000	72,000
- Hardware		13,400	13,400
- Internet		7,200	7,200
III. Component III	15,000		15,000
"Costa Rica – Provee" National Office for Supplier Development			
- Legal/Organizational Consulting	11,000		11,000
- Registrations	4,000		4,000
Executing Unit	141,000	130,600	271,600
- -Remuneration	126,000	93,600	219,600
- - Internships	15,000		15,000
- - General Support		37,000	37,000
Evaluation	52,864		52,864
- Intermediate and Final Evaluations	40,000		40,000
- Consulting and Monitoring	12,864		12,864
Auditing		15,000	15,000
Contingencies	77,877	72,967	150,844
TOTAL	900,000	600,000	1,500,000
	60%	40%	100%

- 5.2 MIF resources shall finance the totality of the projected consulting, the Executing Unit's cost for the Project Director's fees, publicity activities, and the evaluation. MIF shall partially finance the technical assistance and training projected for the beneficiary SMEs and the contingencies budget item.
- 5.3 The local counterpart resources shall cover the entirety of the fees for the Technical Coordinator, Technical/Accounting Assistant, Secretary, and general support of the Executing Unit; auditing; the acquisition of software and hardware for the Integrated

Information System, and the Internet connection. It shall also partially cover the technical assistance and training projected for the beneficiary SMEs and the contingencies budget item.

- 5.4 The Bank's procedures and MIF eligibility criteria shall be followed for acquisitions and contracting of services planned for the Project.
- 5.5 A 42-month term is projected for disbursing the MIF contribution. At the commencement of the Project a revolving fund shall be created with up to 5% of the MIF contribution, on the basis of a duly supported expense budget.

B. Financial and Institutional Sustainability

- 5.6 The financial sustaining of the Project shall be based on the following revenues: (i) annual membership payments by the MHTEs of US\$2,500 dollars for the benefits of information on potential suppliers, supplier development services, conferences, and publications; (ii) payment by the SMEs for technical assistance and training services received; (iii) payment of the "success" commission by the SMEs; and (iv) payment for use of information.
- 5.7 The above-mentioned revenues shall constitute an independent fund with the aim of ensuring that the services created by the Project shall be maintained and expanded once the MIF resources are exhausted. In accordance with the Project's approach to financial sustainability, MIF and local counterpart contributions decrease over time. Thus, the accrued availability after the third year (approximately US\$700,000) will make it possible to ensure the continuity of the operation. It is important to indicate that the income on the percentage of net sales of the SMEs has been calculated at an average of US\$1,500, but this sum may vary depending upon the amount of the provisioning contract, increasing the accrued availability. The use of the resources shall follow the above-referenced principles of financial sustainability. Thus, the Executing Unit shall develop the corresponding regulations, which need to be approved in advance by the Bank.
- 5.8 The Project's institutional sustainability shall be achieved through the creation of the "Costa Rica – Provee" National Office for Supplier Development, which shall be a permanent structure for providing services and shall serve as an instrument that will continue to facilitate the future training and technical assistance required for this type of business. The existence of "Costa Rica - Provee" shall provide an incentive for entrepreneurs to assume the challenges of the business of provisioning, given that they will have services of effective, reliable support, proven to be successful.

VI. PROJECT JUSTIFICATION AND PROJECT RISKS

A. Justification

- 6.1 The Project will complement national efforts to attract FDI and will facilitate the linkage of the MHTEs to the country's production activities by promoting the transfer of know-how and/or technology. It will offer an additional incentive to the national policy of

attracting FDI, since the country will have an infrastructure of local suppliers. Thus, the MHTEs and later other enterprises (domestic and international) will be benefited.

- 6.2 The operation is a means for generating synergy between the various institutions that currently provide isolated support for SMEs. It will allow them to channel their efforts in a focused manner, eliminating the waste incurred by duplicate activities that attempt to individually solve the problem of the lack of linkage between the SMEs and MHTEs. Likewise, the operation will incorporate the results of the Small Enterprise Competitiveness Program (ATN/ME-4850-CR), utilizing the experience in subcontracting and business services developed by that operation. Furthermore, it will serve as an opportunity for micro and small entrepreneurs of the metal/mechanics and industrial maintenance sectors currently benefiting under the Social Entrepreneurship Program (SP/EM-98-20-CR and ATN/EM-6327-CR). Finally, this operation creates an opportunity for the Inter-American Investment Corporation (IIC), to participate directly or through local financial entities in the financing of the beneficiary SMEs.
- 6.3 The development of the Project will ensure that the key players meet their objectives: (i) MHTEs: lower costs, increased purchasing flexibility, shortened production times, etc.; (ii) SMEs: increased productivity and sales to the MHTEs; (iii) CINDE: promotion of FDI through an industrial infrastructure attractive to the MHTEs; (iv) PROCOMER: a promotion of and increase in exports from domestic SMEs; (v) CICR: support for the business development of the SMEs; (vi) business services institutions: development of institutional capacities for the technological development of the SMEs; (vii) FUNCENAT: support for the development of high-tech SMEs; and (viii) government of Costa Rica: national economic development, through increased investment, job creation, and expanded exports.
- 6.4 The Project is designed to become a growth opportunity for local industry within a new model, characterized by business activities with a technological foundation, encouraging the birth of new world-class domestic enterprises, which can be duplicated in other Latin American countries.

B. Risks

- 6.5 The fact that the financing and/or venture capital required by the SMEs for their investments in equipment and technology is lacking constitutes a risk for the operation. The design of the Project has minimized this risk. On the one hand, the search for supplementary financing for the networking has been defined as a part of the Technical Coordinator's functions. On the other, the Banco Nacional de Costa Rica and other financial entities have taken an interest in establishing special lines of financing for the beneficiary SMEs. Likewise, the MIF is expected to approve the SME Centroamericana-CASEIF's participation in the Investment Fund, before the end of this year, which could complement this national initiative. At the same time, the IIC has shown an interest in collaborating on the project, with the intention of promoting financing for the Beneficiary SMEs. The Integrated Information System will contain data on accessible financing sources for the SMEs.

- 6.6 A change in the tax incentives incorporated into the policy for attracting FDI will affect the continued presence of the MHTEs in the country. Their continued stay in the country could also result from external factors such as technological changes and situations of world recession. In order to lessen this risk, the Project has been designed with a national approach and with participation from PROCOMER and CINDE, institutions with a direct relationship to the incentive policies for attracting FDI. This will ensure the stability of said policy. Furthermore, the Integrated Information System will make it possible to detect trends in technological changes with sufficient advanced notice, making it possible to offer timely solutions for reconversion by local suppliers and allowing them to expand their portfolio of clients to international markets that are not affected by economic crisis.

VII. PROJECT REPORTS AND EVALUATION

A. Reports

- 7.1 Within 30 days following the end of each semester, the executing agency shall submit a progress report. Likewise, 30 days after the end of the term of execution of the technical cooperation, the Executing Agency shall submit the final Project report. In writing these reports, which shall principally cover qualitative aspects of the operation's execution, the Logical Framework of the Project shall be taken into consideration as input.
- 7.2 These reports shall pay special attention to: (i) the degree of progress in the development of the components and compliance with the Project's performance indicators; (ii) aspects of institutional coordination required by the Project; (iii) the contracting of consultants and services rendered in support of the Executing Unit's intermediary work; (iv) collaboration on the Project risks; (v) problems encountered and measures adopted to solve them; and (vi) any adjustments and scheduling of activities contemplated for the subsequent period. Based on those reports, the Executing Agency, the Steering Committee, and the Bank shall meet annually to discuss the Project's quantitative results (achievement of goals), with the purpose of determining whether the operation should be continued, suspended, or canceled.

B. Evaluation (US\$40,000)

- 7.3 At 24 months of the Project's execution, the first evaluation shall be made of qualitative aspects, covering: (i) the performance of the Executing Unit and the role played by the Steering Committee and other institutions involved in the Project; (ii) component achievements in accordance with the "Strategic Project Execution Plan;" (iii) the degree or probability to which the Project's objectives have been met; (iv) the effectiveness of the networking methodologies and of Project monitoring; (v) the Project's financial sustainability; and (vi) compliance with the conditions set by the Bank aimed at determining the benefits and timeliness of establishing the "Costa Rica - Provee" National Office for Supplier Development.
- 7.4 The final evaluation, which shall be made 3 months after the end of the term of execution, shall measure the impact of the Project, incorporating recommendations and lessons learned for future reference. Likewise, the performance of "Costa Rica - Provee" shall be

examined, along with the progress made toward achieving its financial and institutional sustainability . The evaluations indicated shall be contracted by the Bank.

C. Audit (US\$15,000)

- 7.5 Within a term of 60 days counting as of the end of each year of execution, the Executing Agency shall submit a financial report to the Bank audited by independent auditors who are acceptable to the Bank. The last of these reports shall be submitted 3 months following the date on which the last disbursement of the MIF contribution was made. These reports shall include the statement of Project expenses financed with funds from the MIF and the local contribution.

VIII. SPECIAL CONTRACTUAL CONDITIONS

- 8.1 As prerequisites to the first disbursement of resources from the MIF contribution, the Executing Agency, to the Bank's satisfaction: (i) shall have hired the Project Director in accordance with the terms of reference, as previously agreed upon with the Bank; (ii) shall have submitted the Strategic Project Execution Plan; and (iii) submitted evidence that the Project's Operational Regulations have gone into effect.
- 8.2 Once the conditions contained in Article 2, Subdivisions (i) and (ii) of the General Specifications have been met, up to US\$25,000 of the MIF resources may be disbursed to allow the executing agency to contract the international consultant on supplier development, who, among other functions, shall facilitate compliance with the prerequisites for the first disbursement.
- 8.3 The creation of "Costa Rica - Provee" shall take place once the Project: (i) has carried out no less than 25 of the 45 networking projects planned as a part of the ultimate goal; (ii) once at least 60% (US\$ 360,000) of the local contribution has been disbursed; and (iii) once the necessary methodologies and manuals are in place.
- 8.4 Once "Costa Rica - Provee" has been established and before executing the "Conveyance Agreement" with "Costa Rica - Provee," the Executing Agency shall submit a proposal to the Bank for its consideration, describing the characteristics of "Costa Rica - Provee" as the new executing agency, along with the "Conveyance Agreement" for all assets acquired, the balances of the funds pending execution, and the income generated by the operation.

IX. ENVIRONMENTAL AND SOCIAL IMPACT

- 9.1 The CESI [Committee on Environmental AND Social Impact] approved this operation at its July 12, 1999 session (TRG-26-99). The project takes into consideration the fostering of improvements in compliance with environmental standards and abidance with international quality conventions and certification processes such as ISO 14000.

X. EXCEPTION TO POLICIES AND PROCEDURES

- 10.1 No exception to the Bank's policies and procedures is contemplated.

Annex I. Logical Framework of the Project

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
AIM			
To help increase national added value in the production of Multinational High-Tech Enterprises (MHTEs), established under Free-Trade zone provisions in Costa Rica, and, as a consequence thereof, to increase the competitiveness of small and medium enterprises (SMEs).	5% increase in sales of inputs and/or services by the SMEs to the MHTEs during the first year, 10% during the second year, and 15% during the third year.	Project-Monitoring records and system PROCOMER's local sales records.	The government will continue its policy of incentives for attracting Foreign Direct Investment (FDI).
PURPOSE			
To improve the technological/productive capacity of the SMEs, bringing them up to levels that enable them to supply inputs and/or services to the production of the MHTEs and compete on a global level.	SMEs' productivity rate increases 10% the first year and 15% the second and third years (measured by sales per employee)	Project-Monitoring records and systems	The MHTEs remain in the country
COMPONENTS			
1. Component I.- Pilot Supplier Development Program	45 successful production linkages 10 products the first year 15 products the second year 25 products the third year	Project-Monitoring records and systems	The pace of technological changes will allow the SMEs to adapt and continue in the business of provisioning.
2. Component II.- Integrated Information System	System with information on supply and demand, MHTEs, SMEs, and support institutions, operating at 6 months of execution of the Project	Monthly review of system operation	
3. Component III.- National Office for Supplier Development	"Costa Rica – Provee" legally established, with Project ownership status as of the third year of execution	Registration of legal status with the National Public Registry Conveyance Agreement on the ownership of the Project	
ACTIVITIES			
COMPONENT I	892,092	Accounting Records of the Executing Unit	The MHTEs gradually demand more local products.
1.1 Consulting firms on Provisioning and Evaluation of SMEs	63,792		The SMEs have sources of financing for acquiring equipment and technology
1.2 Technical assistance for SMEs	513,000		
1.3 Training for SMEs	207,000		
1.4 Technical Coordinator	82,800		
1.5 Publicity	25,500		
COMPONENT II	102,600	Accounting Records of the Executing Unit	Participating institutions share their Databases
2.1 Consulting, design, development, and execution of the system	10,000		
2.2 Hardware, software, and Internet	92,600		
COMPONENT III	15,000	Accounting Records of the Executing Unit	
3.1 Consulting, legal/organizational for the establishment of Costa Rica - Provee	11,000		
3.2 Registrations	4,000		

PROPOSED RESOLUTION

**COSTA RICA. NONREIMBURSABLE TECHNICAL COOPERATION FOR
THE DEVELOPMENT OF SUPPLIERS FOR HIGH TECHNOLOGY MULTINATIONALS**

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Fundación Centro de Alta Tecnología of Costa Rica and to take such additional measures as may be pertinent for the execution of the project memorandum referred to in Document MIF/AT- with respect to a technical cooperation project for the development of suppliers for high technology multinationals.
2. That up to the amount of US\$900,000, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the resources of the Small Enterprise Development Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.