

**PROGRAM ON COMPETITIVENESS OF SMALL BUSINESS**

**(TC-94-06-366)**

**EXECUTIVE SUMMARY**

**EXECUTING AGENCY:** Cámara de Industrias de Costa Rica [Costa Rican Federation of Industry] (CICR)

**BENEFICIARIES:** Small business in Costa Rica

**FINANCING:** IDB: US\$2,491,000 (MIF window III-A)  
Local contribution: US\$ 701,000  
Revenue: US\$ 148,000

The project is also expected to generate revenue in an amount equivalent to US\$1,283,528.

**TERMS:** Execution: 36 months  
Disbursement: 42 months

**ENVIRONMENTAL CLASSIFICATION:** The Environment Committee, at its meeting of November 23, 1994, classified this as a Category II operation.

**OBJECTIVE:** To establish and develop an active market for specialized business services as a means of improving the efficiency and competitiveness of small business, contributing to export growth and generating stable employment.

**DESCRIPTION:** The executing agency, together with the Centro de Gestión Tecnológica e Informática [Center for Technical and Data Management] (CEGESTI), the Cámara de Exportadores de Costa Rica [Costa Rican Exporters Association], and the Unión Costarricense de Cámaras y Asociaciones de la Empresa Privada [Costa Rican Union of Business and Trade Associations], will be responsible for setting up business extension centers to address and serve the needs of small business. To this end, the performance of small business and the strategies it uses will be evaluated and technical information services will be provided, to encourage business cooperation. In addition, the participating agencies will provide technical assistance of their own or through other agencies hired under subcontract, in the areas of: (i) production and technological innovation, including quality control and standards, environmental regulation, and promotion of the use of subcontracting; (ii) training in business management and technology; (iii) marketing and export

development; (iv) business cooperation and strategic business alliances; and (v) financial advisory services and investment project preparation. To ensure that the project is geared to real demand, resources will be allocated commencing in year two to the different activities depending on the revenue raised in the preceding period. The MIF contributions will be gradually replaced over time by the fees charged to businesses so that the program is able to finance itself by year four.

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

In addition to the general contractual conditions applicable to this operation, the following special conditions are to be included:

(a) As a condition precedent to the first disbursement of the MIF contribution, the executing agency will be required to submit to the Bank:

(i) the agreement, previously authorized by the Bank, with the participating agencies, setting out the rights and obligations of the parties with respect to implementation of the project (see paragraph 2.19) and their acceptance of the operating guidelines (see paragraph 2.22 and Annex 2);

(ii) evidence that a coordinating committee has been formed, showing its membership (see paragraph 2.20);

(iii) evidence that the project director has been hired in accordance with procedures approved by the Bank (see paragraph 2.21);

(iv) evidence that a special account has been opened for administration of project funds (see paragraph 2.22);

(v) a project monitoring system has been set up by the executing agency (see paragraph 2.23).

(b) The executing agency will be required to deposit the revenue from services provided by the participating agencies or other agencies hired under contract in a separate account in order to ensure that project services are continued and expanded (see paragraph 2.28); and

(c) The executing agency will be required to monitor the progress of the program (see paragraph 2.34).

- EXCEPTION:** Given the multiplicity of short-term consulting contracts to be awarded by the business extension centers, it is proposed that the Bank undertake an ex post review of the suitability of the consultants selected and awarded contracts for under US\$20,000 (Annex 2, section VI).
- RISKS:** The MIF will share the risk with the executing and participating agencies in the sense that it is making an initial investment in a business services system that is intended to become financially self-sustaining through the interplay of market forces. The project was prepared on the basis of conservative assumptions as to the increase in demand for these services, and the gradual alignment of fees and operating costs, so that the system will be self-financing by year four. If the assumptions should be wrong, the project can always be redesigned to accommodate the actual level of demand. The risk of one of the participating agencies having problems in coordinating and integrating its activities with the others could always be resolved by reassigning its duties to the other institutions or, ultimately, to the CICR itself.
- ELIGIBILITY OF THE PROJECT:** The project meets all the criteria for eligibility as set by the MIF insofar as it contributes to institutional strengthening and market development, and is an innovative experiment with a significant demonstration effect. The project is also consistent with the Bank's strategy for Costa Rica and complements other operations that are planned and in progress.
- RESPONSIBILITY OF THE MIF:** To make a significant contribution to the start-up capital required to establish an integrated business services system, and to cover part of its operating costs for the first three years. As a result, the revenues generated should exceed the system's operating costs by year four of the program.

## I. FRAME OF REFERENCE

### A. General climate for private-sector business activity in Costa Rica

- 1.1 In Costa Rica, since the mid-1980s, a number of structural adjustment programs have been introduced, the economy has been liberalized, and efforts have been made to overcome the marked anti-export bias of the previous development model in a move towards integrating more fully into the world economy. The IDB has shown its commitment to supporting a deepening of the process of adjustment and economic liberalization in the form of a multisector credit program and an investment sector program.
- 1.2 This shift away from the earlier development model was achieved through comprehensive structural adjustment measures calculated to promote exports as part of an overall development strategy and not as a deliberate attempt to push industrial development. An industrial reconversion program was approved towards the end of the last decade and, brief as it was, it marked an important step towards establishing institutions and introducing initiatives for specialized business services and technology to enhance productivity and competitiveness. Unfortunately, this program was not fully attuned to the problems affecting small business.
- 1.3 Maintaining medium- and long-term economic growth will depend on whether the country presses on with its reforms. Growth will also be predicated on achieving higher productivity and being able to compete in markets that are increasingly open, given the growing internationalization of the world economy and the prospects for economic integration. Against this background, macroeconomic reforms must be supplemented with measures to develop and support technical and organizational innovation within the business fabric, which is understood to embrace the full range of economic relations between businesses in a given system of production. Accordingly, the primary focus should be on assisting the private sector, the principal agent in economic activity, in meeting the challenges posed by stiffer competition in different markets.

### B. Small business in Costa Rica

- 1.4 For the purposes of the present project, a small business is defined as a unit with from 5 to 99 employees. Off the bottom of the scale are subsistence microenterprises which are targeted by social projects and off the top are large companies having the wherewithal to access specialized business services. Nonetheless the definition is flexible, since the main purpose of the project is to set up an integrated system of specialized business and technical services to address the needs of businesses within this middle range.

- 1.5 In Costa Rica, production is sharply divided between a few large establishments and an extensive informal sector. The most recent economic census found that in 1990 microenterprises (business units with one to four employees) accounted for 84.4 percent of all businesses and businesses with over 20 employees for just three percent (Annex 8, page 2). The census also found that production was highly concentrated as illustrated by the fact that 85.7 percent of all businesses are established in the central part of the country, where San José, Alajuela, Cartago, and Heredia are located.
  - 1.6 According to data from the Caja Costarricense del Seguro Social [Costa Rican Social Security Fund], there were 4,765 manufacturing companies in 1994. Of this number, 2,193, or 45.7 percent of the total, were small businesses located mainly in the central part of the country and accounting for over one-fifth of all formal employment in industry (Annex 8, page 3). One of Costa Rica's underlying economic problems is that little has been done to assist businesses in the middle range between the two extremes noted earlier. Ideally, this segment should be composed of small companies that make the productive structure more specialized, diversified, and flexible, thereby making it less vulnerable to changing conditions in world markets. This points to the importance of an initiative to develop a market for specialized business services that would help these small companies to be more competitive.
  - 1.7 An IDB-funded study on competitiveness in the producing sectors in Central America and Panama conducted by FEDEPRICAP found that in Costa Rica many small businesses have few links with one another, have limited access to international markets, and generally lack efficient management teams that can draw up and implement new strategies. They are characterized by a high level of technological obsolescence, inadequate quality control, poor product design capacity, and an inability to meet international standards for products and processes. Furthermore, these companies are unfamiliar with international markets and competition, do not have proper distribution networks or marketing methods, and make limited use of subcontracting. Overall, these businesses appear unable to identify clearly the usefulness of the types of business services available which they often confuse with general studies of limited application to their operations or with high risk proposals. All of these shortcomings may be summed up in a general absence of any medium- or long-term strategy on competition and a lack of awareness of the technological and organizational requirements that are needed to meet the present challenges.
- C. Demand for specialized business services by small business in Costa Rica
- 1.8 Demand for outside services by small business is still in an embryonic stage despite the challenges that loom ahead. In recent years, a growing need to compete internationally has kindled more interest in acquiring tools that will help them to modernize,

particularly in the areas of legal and financial advice, training, and, more tentatively, technical assistance for production and quality control. The factors that constrain an increase in demand for these services are: (a) a failure to perceive their importance; (b) problems in identifying reliable suppliers of services to satisfy specific requirements; (c) the cost of services; and (d) an inability to negotiate with consultants and clearly specify requirements in contracts, evaluate results, and implement consultants' recommendations. This project will attempt to deal with all of these factors.

D. Specialized business and technical services now available in Costa Rica

- 1.9 Although a number of qualified private agencies and institutions offering business and technical services do exist in Costa Rica, their products are not tailored to the needs of small business, and the services offered are not coordinated or specialized enough. Management and technical consultants focus on large companies, to the detriment of the development and dissemination of business assessment methodologies and techniques applicable to small companies. This keeps transaction costs up and leads to a lack of transparency in the market place for potential customers. The failure of the education system to adapt to the new demands of competition and the scant concern demonstrated by technological support systems with the problems of small businesses stand in the way of raising the competitiveness and productivity of the sector.

E. Justification of the project

- 1.10 It is apparent, then, that the market for specialized services for small business is insufficiently developed in Costa Rica. Higher demand would increase the supply of these services and improve their adaptation to the needs of business users. As it stands, a higher caliber of service and more effective institutional support are now required, more in tune with the problems of small business. It is essential for resources to be allocated to spur demand and increase the supply of specialized services in management and technical training, foreign trade, technology for products and production processes, quality control and international standards, and information on markets and marketing networks.
- 1.11 Whereas large companies have the means of acquiring services of this kind and microenterprises are targeted as beneficiaries under training and credit programs through NGOs, an adequate supply of suitable services is not readily available to small business. This calls for an effort to develop a market for these services, and the private sector has a significant role to play in planning and implementing programs as part of this process.

F. Consistency with the Bank's strategy in the country

- 1.12 As the Bank's programming paper for Costa Rica notes, the activities scheduled for the 1993-1995 period include export and investment promotion activities. The main feature of the matrix is to consider activities that are relevant to each of the key areas identified in the Bank's programming process, which includes the private sector, together with initiatives to promote investment and exports. In addition, the Eighth General Replenishment of the Resources of the Bank pointed to the importance of modernizing production, stressing the need to ensure conditions conducive to small business. The present project supplements other IDB operations that are planned for the country or now under way, ensuring access by small business to specialized services that contribute to productive, commercial, and structural innovation, a goal consistent with the Bank's strategy.
- 1.13 The project also satisfies the criteria for eligibility for MIF financing insofar as it contributes to the strengthening and expansion of the private sector and small business. It supports institutional and market development and involves an innovative experiment that will have an important demonstration effect not only in the country but in the Central American region through its content and because it calls for coordinating different entities within the Costa Rican private sector.

II. THE PROJECT AND ITS EXECUTION

A. Objectives of the project

- 2.1 The main objective of the project is to develop a market for specialized business services that would help small companies in Costa Rica to become more competitive, thereby boosting exports and generating employment in the producing sectors of the economy.
- 2.2 Specifically, the objectives of the project are:
- (i) To create a demand for specialized business services by small companies through initiatives to identify their needs in the areas of product innovation, technical assistance, quality, standards, certification, training in business management, access to business information, development of intercompany alliances, setting up new companies, and the transfer of technology.
  - (ii) To develop the supply of business services in order to make small companies more competitive. To this end, the capacity of local industrial consultants would be strengthened, support services would be promoted, and methodologies suited to the

needs of small companies would be developed focusing mainly, but not exclusively, on industry and agroindustry.

- (iii) To contribute to the institutional strengthening of associations representing small business in the country.

- 2.3 The project will be based on the principles of joint responsibility by agencies participating in project financing and management. It will be demand-oriented as far as activities and execution are concerned, and designed to become financially self-sustaining upon completion of the MIF assistance. It will support the private sector by making small business more competitive and by broadening the market for private consulting firms.

B. Description of the project and its activities

- 2.4 The following activities will be carried out to accomplish the objectives described in the preceding paragraph:

- (i) The executing agencies will set up an integrated business services system (SISEM) that will be coordinated by Costa Rica's largest business associations and other organizations offering business services. Other existing initiatives may be incorporated in an effort to create a demand for services for small businesses and to supplement and improve the technical and business services available to small companies. To achieve this, a network of business extension centers (CEEMs) or personalized assistance points will be set up to facilitate the task of promoting and disseminating these services as a means of activating demand by small businesses in general. The technical assistance at this initial level will be provided by business extension workers who are qualified to identify and define the specific needs of small business and direct them to consultants providing specialized technical assistance. In turn, the CEEMs will be assisted by documentalists who will use data bases to respond to requests for information that would be useful to business. These data bases will also be upgraded as part of the project. The resources of the MIF will be used to pay the fees of these experts for the initial three-year period and to purchase computer equipment, programs, printers, telephones, and fax machines.
- (ii) Training in business and technology management, foreign trade, and training for industrial consultants. Advanced courses will be offered in these areas and modular programs will be organized in sector technical training and foreign trade. International experts will be hired, from within the region insofar as is possible, to assist with these activities. The MIF financing will be used to pay part of the cost of the training activities on a decreasing basis for a period of three years. The costs covered will include fees for international instructors and local experts.



- (iii) Support for product innovation. Specialized technical assistance will be provided by agencies participating in the project, either directly or by other agencies and individual experts hired under subcontract. Two different levels of technical assistance are planned. General assistance, to be provided by the CEEMs, will identify a business's strengths and weaknesses and determine how consistent its strategies are. Specific assistance, to be provided by the participating agencies or consultants hired by these agencies under subcontract, will begin with an exhaustive assessment of a business in terms of its competitiveness within its market niche, pointing up its strengths and weaknesses as a step towards continuing to develop alternatives for raising production efficiency and competitiveness and culminate with a business project containing a specific plan of action. The proceeds of the MIF financing will be used to pay part of the cost of hiring experienced local and international experts for the intensive technical expertise. This financing will be on a decreasing basis.
- (iv) Marketing and export development. Technical assistance will be provided to strengthen international trade missions. Different mechanisms of business cooperation, particularly between small Costa Rican companies and companies in other countries, will be promoted to encourage the formation of sector networks and arrangements between companies, sellers' associations, strategic business alliances, and other initiatives to enhance the competitive position of small companies in the regional and world markets. The MIF funding will finance, on a decreasing basis, part of the cost of hiring experts and technical services for promoting export development, strategic business alliances, and subcontracting.
- (v) Financial assistance. The purpose of this activity will be to identify financing requirements, develop investment projects, and determine which financial products are most suited to the needs of small business. The MIF financing will pay, on a decreasing basis, part of these technical assistance services until year three of the project.

- 2.5 Information on the project for socioeconomic agents, unions, politicians, and civil society in general will include meetings, forums, seminars, brochures, and advertising in the main media to heighten general awareness of the need to accept the challenge of raising competitiveness as a key element of national development strategy. The information campaign should be directed to all small businesses whether or not they are affiliated with business associations. The purpose of the campaign will be to expand demand for these services, which will in turn result in institutional strengthening for the business sector itself. The MIF resources will be used to pay for preparing audiovisual materials and other

inputs that are needed to promote the SISEM for small business in Costa Rica.

- 2.6 To make the project operative, other initiatives are planned in support of promoting the SISEM and training the human resources involved in the project. This would include training for business extension workers, documentalists, and technical experts working in the CEEMs and the technical staff of agencies that participate in the project indirectly or intend to join it in the future. The MIF financing will be used to pay for these preliminary project activities, and funding is also planned for retraining during the three years of the project.
  - 2.7 The MIF resources will be used to pay the fees of experts hired for management activities for the duration of the project. The experts who will be hired are a general manager, a technical assistant, an accountant, and a secretary. The MIF financing will also be used to pay for three evaluations of the project while it is under way.
- C. Expected results of the project 1/
- 2.8 The project will help institutions in the private sector in Costa Rica to set up an integrated system providing specialized business services of high calibre for small companies. By stimulating demand for specialized services, the project will broaden access to them, thus raising productivity and efficiency and creating conditions conducive to competition in an open economy. The result will be an increase in formal employment, in the form of better paying and more stable jobs. Approximately 1,000 companies, or 15% of the universe considered, are expected to benefit from the project (see Annex 3). The project will also lead to the establishment of new companies in the areas of production and industrial consulting services, and improve the quality of business services available, perfecting and providing information on methodologies for analysis and management, and bringing products and costs into line with the demand generated.
  - 2.9 In the area of business training services, the orientation and content of the SISEM will be adapted to satisfy the actual needs expressed by small businesses in each area receiving assistance from international technical experts. It is hoped that the increased use of the industrial information network, investment and export services, and the industrial subcontracting exchange will lead to closer business cooperation, strategic alliances, and joint ventures.
  - 2.10 Another benefit anticipated is that expertise will be developed in specialized areas serving small business. To this end, the funding

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1/ The different results expected from the project in quantitative terms are described in greater detail in Annex 3.

allocated for training and technical assistance under the project truly represents an investment in human capital. The associations representing small business in Costa Rica are also expected to become stronger institutions as a result of the project. It is hoped that the project will be self-sustaining by year four, financing itself with revenue generated by the services it offers.

D. Cost and financing of the project

- 2.11 The total cost of the project will be the equivalent of US\$3,339,000. The MIF will contribute US\$2,491,000, of which 62% will be used to set up the SISEM, and 38% to cover current expenses. The MIF contributions will gradually decline over the life of the project with the steady increase in revenue from user fees. The local counterpart funding amounts to the equivalent of US\$701,000, of which approximately 76% will be earmarked for operating expenses and 24% for installation of the SISEM. Operating revenue will be used to cover US\$148,000, leaving an accumulated balance of US\$1,135,000 to ensure the continuity of the system.
- 2.12 In preparing the budget, the SISEM installation and operating expenses have been segregated (see Annex 4) to permit comparison between the initial three-year period when the project is receiving MIF assistance for the establishment of a business services market and the project when it has become a financially self-sustaining proposition. The MIF financing of SISEM start-up expenses is essential for consolidating the supply of quality business services for stimulating and organizing demand for these services by small business. Financing earmarked for current expenses will cover fees charged by agents and consultants assisting with the SISEM and part of the administrative costs of operating the system.
- 2.13 In establishing the rates for SISEM services, a step-by-step promotion campaign has been planned, under which the companies will pay an increasingly higher proportion of the costs of services received and the full cost by the end of the third year, thus achieving financial self-sufficiency by year four. For example, the charge for information services would be US\$6 the first year, US\$8 the second, US\$10 the third, and US\$12 the fourth. The revenue from user fees will gradually replace the financing being provided by the MIF and the proposed goals are reflected in the project's budget estimates (see Annexes 1 and 4).
- 2.14 The project budget set out in accordance with IDB standards is itemized below, and Annex 1 contains the criteria used for preparing the budget, the tables of operating revenues and expenses, and sources and applications of funds. Annex 4 lists expenses, the data used for these calculations, the MIF and local counterpart funding, and revenue from services. It is projected that by year four committed expenses will be somewhat less since the start-up phase will be over and revenue should exceed expenses. In addition, there will be accumulated funding available that the parties

will keep to ensure the continued operation of the system upon completion of the project.

PROJECT BUDGET ACCORDING TO IDB ACCOUNTING RULES  
(in US\$ thousands)

CATEGORIES	MIF	COUNTERPART	REVENUE	TOTAL
2. Individual consultants				1,662
2.1 Fees	1,218		72	
2.3 Recruitment	6			
2.4 Other payments and insurance	350			
2.5 Travel	15			
3. Courses and training	475		75	550
6. General support				806
6.1 Offices		103		
6.2 Furniture	7	16		
6.3 Equipment	89	158		
6.4 Supplies	58			
6.6 Support staff	82	225		
6.7 Audit		18		
6.8 Communications	34			
6.9 Other services		16		
7. Publications				126
7.1 Printing	18			
7.5 Distribution etc.		108		
8. Individual consultants for project evaluation				20
8.2 Fees	20			
98. Contingencies	119			119
- Coordinating committee fees		57		57
TOTAL	2,491	701	148	3,339

E. Organization and execution of the project

1. Commitment and responsibilities of the executing agency, the participating agencies, and project management

- 2.15 Seven agencies will take part in the project. The Cámara de Industrias de Costa Rica [Costa Rican Federation of Industry] (CICR) will act as executing agency, with the Centro de Gestión Tecnológico e Informática [Center for Technical and Data Management] (CEGESTI), the Coalición Costarricense de Iniciativas de Desarrollo [Costa Rican Development Coalition] (CINDE), the Bolívar program, the Cámara de Exportadores de Costa Rica [Costa Rican Exporters Association] (CADEXCO), the Unión Costarricense de

Cámaras y Asociaciones de la Empresa Privada [Costa Rican Union of Business and Trade Associations] (UCCAEP), and the Banco del Comercio, S.A., as participating agencies. In its capacity as executing agency, the CICR will report to the MIF on the results of the project and the success in meeting its goals. Annex 5 contains a description of each of the participating agencies.

- 2.16 An agreement will be concluded between the executing agency and the participating agencies establishing their responsibilities, especially as to their contributions to the project, joint responsibility for management and continuity of the project, and a schedule of the user fees to be charged. A project coordinating committee will also be set up. As a condition precedent to the first disbursement of the MIF contribution, the executing agency will be required to submit the aforementioned agreement signed with the participating agencies to the Bank for approval.
- 2.17 The project coordinating committee will be made up of the executive directors of the executing agency and participating agencies and the project director. The CICR will chair this committee and the project director will act as secretary. The coordinating committee will meet at least once a month, in order to strengthen the process of interinstitutional coordination and evaluate the progress of the project. Specifically, the coordinating committee will represent the participating agencies' interests in the running of the project; analyze and evaluate the annual objectives and budgets prepared by each participating agency; see to it that each participating agency makes its annual contributions; analyze and issue opinions on the project progress reports; examine and advise the project director on possible initiatives that could be undertaken as part of the project; consider and issue recommendations on the most suitable candidates to be selected by the project director as consultants for the project.
- 2.18 The project director will be selected in accordance with the Bank's procedures. The director's functions will be to administer the project and to ensure that the project objectives are accomplished. He will be responsible for project operations and for preparing the terms of reference for the firms and consultants hired with project resources. The office of the project director will be located in the CICR's headquarters. The director's remuneration will be paid by the CICR out of the MIF financing. A tentative version of the director's terms of reference is given in Annex 7.
- 2.19 Project funds will be disbursed from a project checking account. Checks must be signed jointly by the project director and the executive director or president of the CICR. Prior to the first disbursement of the MIF financing, the executing agency will submit to the Bank a plan of the mechanism that will be used to monitor the project.

## 2. Organization of the SISEM

- 2.20 The integrated specialized business services system (SISEM) will have four business extension centers (CEEMs), located at the headquarters of the CICR, CEGESTI, CADEXCO, and UCCAEP. Each of these institutions will be required to submit to the project director for consideration a list of at least three candidates for the positions of business extension officials and documentalists who will be working at the CEEMs indicating their names and qualifications. The director will select the most suitable individuals and submit their names to the coordinating committee for approval. In addition, CINDE will assist with training, Banco de Comercio with financing, and the Bolívar Program's ENLACE Office with technology liaison.
- 2.21 The staff of the business extensions centers will report to the project director, and their salaries will be paid out of the MIF financing, through the various participating agencies.
- 2.22 To ensure the functioning of the network and performance of the project activities planned, an annual business plan is to be prepared, together with a budget and cash flow chart. The plan will set out the responsibilities and goals of each of the CEEMs. The same approach is to be followed for each of the project activities to be carried out by the participating agencies. The annual plan should show the initial allocation of resources for the different system activities for the CEEMs headquartered in each participating agency. The annual plans agreed on with the coordinating committee will be submitted to the Bank for approval. When the annual plan of operations together with its corresponding budget and cash flow chart are approved, the project director will advance funds to each of the participating entities for the activities planned for the quarter. Subsequently, each entity will be required to account for the use of funding advanced with supporting documentation, in order to be eligible for further disbursements of program resources. The operating guidelines for the project are set out in Annex 2. The acceptance of these guidelines by the participating agencies is considered a contractual condition precedent.
- 2.23 From year two of the project, depending on the results of the evaluations and in light of the progress reports, the coordinating committee will adjust the funding on the basis of the requirements of each activity and its impact on business competitiveness. This will ensure that resources are allocated to each activity and each CEEM in proportion to its revenue generating capacity and the extent to which the goals set by the participating agencies have been met in terms of the services to be provided. Hence, user demand will be the basic criterion for funding.
- 2.24 The revenues from services funded by the project are to be deposited to a project account, within 30 days of the date on which the service is delivered. The revenues will be used to cover project

expenses in year three and any surplus may only be used to fund further project activities. Starting in year four, when the MIF financing has been fully disbursed, the participating agencies will be required to apply any available surplus to maintaining and expanding the integrated business services system.

### 3. Training of project human resources

- 2.25 Given the nature of the project, training programs will be needed for staff assigned to the project. Similarly, there are plans for the project director, once he has signed the contract and the first disbursement authorized, to make a series of visits, in agreement with the Bank and the executing agency, to other programs that are relevant to the specialized services being provided to small business.
- 2.26 The training program for staff assigned to the SISEM will be held during the first three months of the project. Financing has also been earmarked for the ongoing training of this staff as described in Annex 4, to enable them to attend courses or programs of interest, as the need arises during the project.

### F. Requirements for sustainable development

- 2.27 An environmental technical assistance fund will be set up as part of the project to defray the fees of consultants providing guidance to small business on the use of clean technologies. The project services will classify technology upgrading activities based on their potential environmental impact, according to the following categories: (a) environmentally beneficial; (b) environmentally neutral; (c) moderately harmful; and (d) significantly harmful. Appropriate steps must be adopted to neutralize the harmful effects of activities classified in category (d) as a prerequisite for continued access to project services. During the project, information on the potential environmental effects of project activities must be submitted to the Bank together with the progress reports mentioned later.

### G. Promotion of women

- 2.28 In mid-1993, women accounted for 30% of the country's labor force, holding mainly service and administrative positions, with employment being mostly urban, not rural, and in the public, rather than the private, sector. It is projected that by the year 2000, women will account for 40% of the total work force, mainly in service industries. Participation by women entrepreneurs, technical staff, and labor will be encouraged in all project activities, and access to the project will be equally available to both men and women. In this way, it is expected to contribute favorably to promoting participation by women in all activities connected with production in the private sector and to increasing their presence in the formal labor market.

H. Evaluation and monitoring of the project

- 2.29 Three evaluations of the extent to which the project goals and conditions were met will be performed by an outside consultant, in conjunction with the participating entities. The first will be done nine months after the contract is signed with the CICR, the second 18 months into the project, and the third after 30 months.
- 2.30 The evaluations will take into account the information received from the participating agencies, in accordance with the monitoring system that they had proposed and which was previously approved by the IDB. These outside evaluations will assess: (a) the operation of the SISEM and the degree of coordination and cooperation between the participating agencies; (b) the beneficiary companies by size and activity; (c) the quality of the services offered, by means of an analysis of the gains in productivity and competitiveness attained by the companies, and confirming the level of user satisfaction with the services; and (d) the level of fulfillment of objectives with regard to the rates paid by users and the extent to which they contribute to making the activities financially self-sufficient.
- 2.31 If the Bank finds these evaluations to be satisfactory, it will authorize the executing agency to continue committing resources to the project. Otherwise, the executing agency and the other participating agencies will be required to take appropriate steps before the Bank will authorize disbursements to resume.
- 2.32 In addition to the outside evaluations, the executing agency will be required to submit to the Bank an annual report on the progress of the project. Each report will describe the results in each of the areas in which specialized business services were furnished. The reports will also cover the following aspects of the project: (a) the operation of the SISEM and the degree of coordination among the participating institutions; (b) the beneficiary companies by size and activity; (c) the schedule of rates charged to users for the services and whether they are sufficient for the activities to pay for themselves; and (d) information on jobs created, participation by women in the project, and potential environmental impact of project activities, and any other data that may be useful.

I. Feasibility and risks of the project

- 2.33 The feasibility of the project is based on the fact that the funding will be used to finance specialized services for small business, through leading business associations in the country, and key organizations offering services of this kind. This will be strengthened by the fact that the goals of the project are consistent with the guidelines of export development policy and serve as an incentive to the quality and competitiveness of small businesses that are part of the present government's national development strategy.



- 2.34 The choice of a project director is crucial to the success of the project, since he will be largely responsible for ensuring that the basic objectives are achieved. The individual selected for the position must have a high degree of technical expertise and considerable experience working as a member of a team.
- 2.35 The MIF is sharing the risk with the participating agencies insofar as it is making an initial investment in a business services system that is to become financially self-sufficient through market mechanisms. The project reasonably assumes that demand for these services will rise and that rates will gradually approximate operating costs so that by year four the system will be able to pay for itself. Should this assumption be wrong, the scope of the project can always be redimensioned to conform to actual demand. It will always be possible to mitigate the risk of one of the participating agencies having problems in coordinating and integrating its activities with the others by reassigning its duties to other institutions or, ultimately, to the CICR itself.

### III. COORDINATION WITH OTHER INITIATIVES

- 3.1 The IDB has been lending decisive support for strengthening of technological infrastructure within Costa Rica under a science and technology program. One of the goals of this program is to disseminate the findings of scientific research through a network of specialized information centers, making it possible to boost the physical infrastructure capabilities of four national research and service centers. Accordingly, the project proposed here can tap the earlier efforts, which will result in closer links between the national system for scientific and technical research (SINICYT) and production problems, particularly in the private sector.
- 3.2 With financing from the IDB, the Federation of Private Companies of Central America and Panama (FEDEPRICAP) conducted a study on the competitiveness of production in Central America and Panama, developing methodologies to assess competitiveness in production chains and companies in the region. This provides an excellent basis for the work of business extension workers and project technical staff. The Central American system of subcontracting (SCS) of the countries in the region also comes under FEDEPRICAP.
- 3.3 The IDB/MIF have undertaken a similar project in El Salvador. Since 1992, the IDB has been providing financial assistance for the Bolívar program's ENLACE mechanism to promote business alliances and other kinds of specialized services. Initiatives of this kind can be expected to spread throughout the entire region through the linkage of networks of specialized services for small business.

- 3.4 Other programs are being carried out in Costa Rica which contain components that supplement the present project. These projects include the Trainers Instructional Center (CEFOF) set up by the Japanese International Cooperation Agency (JICA), an economic services program for the private sector promoted by the German Office of Technical Cooperation, the technical assistance unit for industry (UATI) under Canada's IDRC, and activities being carried out by FUNDES of Costa Rica. All of these initiatives will be coordinated to avoid duplication of efforts in an attempt to seek complementarity in the overall operation of the SISEM for small business in Costa Rica.

## PROJECT BUDGET

### BASIS OF BUDGET ESTIMATE

The budget was prepared on the basis of a number of working assumptions for each component, and these have been confirmed by the executing agencies. These assumptions have to do with the number of courses, technical consulting services, financial consulting services, and other quantitative assumptions, which are described in detail in Annex 4, and should be confirmed in the annual plan for year one of the project. In addition, during execution and evaluation of the project, measures will be introduced to adjust the allocation of resources contributed by the MIF on the basis of the demand for services by small business in Costa Rica generated by the business extension centers (CEEMs).

The cost of the services has been estimated at market prices, and different sources have been used to confirm the accuracy of the estimates.

### PROJECT OPERATING REVENUE AND EXPENSES

The project will generate revenue through the information, training, technical assistance, business advisory services, business cooperation, and financial advisory services provided.

Table 3 in Annex 4 shows how the commercial rates gradually increase until by year four they will be sufficient to cover the cost of services and administrative expenses.

Outlays for investment expenses will be incurred mostly in year one of the project. These expenses will steadily decline in years two and three and will fall to zero by year four. The participating agencies may apply part of any surplus liquidity to other areas if considered appropriate.

Fixed operating costs are incurred for maintenance of the system in terms of the project and the operation of the CEEMs. As operation of the CEEMs is important for project promotion, they will absorb a relatively high proportion of the expenses during the first three years of the project. Starting in year four, fixed costs could be drastically reduced as the promotional phase is completed and the system becomes operational.

Variable costs relate essentially to the cost of outside consultants and training and instruction for businessmen.

Although an operating loss will be reported for the first three years of the project, a profit will be turned in year four. This is indicative of the ability of the system to finance itself provided it is not required to cover the accumulated loss for the first three years, or to repay the cost of the investment.

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			MIF			
	REVENUES	YEAR 1	YEAR 2	YEAR 3	SUBTOTAL	POST-MIF TOTAL
I.	SALE OF SERVICES					
-	Information	14	25	41	79	128
-	Training	124	198	243	565	840
-	Production	44	120	155	318	496
-	Marketing	23	41	48	111	167
-	Business cooperation	15	53	79	146	251
-	Financial advisory services	8	23	34	64	109
	<b>TOTAL REVENUE</b>	<b>227</b>	<b>458</b>	<b>598</b>	<b>1,284</b>	<b>1,991</b>
	EXPENSES					
I.	INVESTMENT EXPENSES	239	61	50	349	349
-	Furniture headquarters	7			7	7
-	Equipment headquarters	58			58	58
-	CEEM equipment	31			31	31
-	Publications	51	39	36	126	126
-	Evaluation	7	7	7	20	20
-	Training for project staff	85	15	8	108	108
II.	OPERATING EXPENSES	935	1,021	1,033	2,990	3,659
1.	FIXED COSTS	607	624	661	1,893	2,223
-	HEADQUARTERS	220	212	223	655	764
-	Individual consultants	139	129	134	402	460
-	Supplies	14	13	14	40	54
-	Support staff	26	27	29	82	106
-	Communications	5	5	6	16	22
-	Offices	12	13	14	40	47
-	Audit	6	6	6	18	18
-	Coordinating committee fees	18	19	20	57	
-	CEEMs	387	412	439	1,238	1,459
-	Individual consultants	230	241	253	724	857
-	Supplies	5	6	6	18	25
-	Support staff	70	75	80	225	255
-	Communications	5	6	6	18	25
-	Offices	19	21	23	64	72
-	Furniture	5	5	6	16	19
-	Equipment	48	53	58	158	187
-	Other services	5	5	6	16	20
2.	VARIABLE COSTS	328	397	372	1,097	1,436
-	Individual consultants	156	196	184	535	719
-	Courses and training	127	160	156	443	599
-	Contingencies	45	40	33	119	119
	<b>TOTAL EXPENSES</b>	<b>1,173</b>	<b>1,082</b>	<b>1,084</b>	<b>3,339</b>	<b>4,008</b>
	<b>OPERATING INCOME</b>	<b>(947)</b>	<b>(624)</b>	<b>(485)</b>	<b>(2,056)</b>	<b>(2,017)</b>

\* Discrepancies may exist between the figures for units and the figures in Table 4 of Annex 4 due to rounding of dollar amounts to the nearest thousand.

## SOURCE AND APPLICATION OF FUNDS

The table below shows the source and application of project funds and the projections for year four of operation.

The MIF contributions decrease over time and will be gradually replaced by the steady increase in operating revenue. The MIF contributions and the local counterpart funding are sufficient to cover project operating expenses in years one and two. Accordingly, operating revenue from the system should generate a surplus. In year three, a portion of the operating revenue will be used for some of the operating expenses. As a result, by the end of year three the project will have generated an accumulated profit of US\$1,136,000, thus ensuring the continuity of the program.

PROJECT BUDGET SOURCE AND APPLICATION OF FUNDS (in US\$000s)*						
SOURCES OF INCOME	MIF			SUBTOTAL	POST-MIF	
	YEAR	YEAR	YEAR		YEAR	TOTAL
I. MIF	955	849	687	2,491	0	2,491
II. LOCAL COUNTERPART	218	233	249	701		701
III. OPERATING REVENUE	227	458	598	1,284	708	1,991
<b>TOTAL</b>	<b>1,400</b>	<b>1,541</b>	<b>1,534</b>	<b>4,475</b>	<b>708</b>	<b>5,183</b>
<b>APPLICATION</b>						
I. INVESTMENT EXPENSES	239	61	50	349	0	349
II. OPERATING EXPENSES	935	1,021	1,033	2,990	669	3,659
1. FIXED	607	624	661	1,893	330	2,223
2. VARIABLE	328	397	372	1,097	339	1,436
<b>TOTAL EXPENSES</b>	<b>1,173</b>	<b>1,082</b>	<b>1,084</b>	<b>3,339</b>	<b>669</b>	<b>4,008</b>
<b>AVAILABLE</b>	<b>227</b>	<b>458</b>	<b>451</b>	<b>1,136</b>	<b>38</b>	<b>1,174</b>
<b>TOTAL</b>	<b>1,400</b>	<b>1,541</b>	<b>1,534</b>	<b>4,475</b>	<b>708</b>	<b>5,183</b>
* Discrepancies may exist between the figures for units and the figures in Table 5 of Annex 4 due to rounding of dollar amounts to the nearest thousand.						

## FINANCIAL SUSTAINABILITY OF THE PROJECT

The statement of source and application of funds, supported by the statement of operating revenue and expenses, shows that the project will be able to pay its way by year four without the need for contributions from the MIF since the project will be generating a positive cash flow.

ANNEX 1

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On the basis of the assumptions, an adjustment in human resources is projected for the project by year four. The project headquarters will continue to be at the CICR, although a full-time international consultant may eventually cease to be required.

The CEEMs will continue to use business extension agents and technical staff, but fewer than in the first three years. Funding for individual consultants and training services will continue at the same level as in year three.

Lower structural costs and increased revenue will make it possible to generate a positive cash flow from operations, which will be enhanced by the surplus built up over the first three years the system is operational.

The continuity of the SISEM appears to be ensured and it will be left to the participating agencies to decide whether any surplus funds will be used to expand activities in year four, or to do so over a longer period. Although the financing from the Bank will be fully disbursed by month 42, at which time the supervisory role it plays will also end, one of the requirements of the project will be a commitment on the part of the executing agencies to continue with the system.

OPERATING GUIDELINES FOR EXECUTION OF THE PROGRAM  
ON COMPETITIVENESS OF SMALL BUSINESS  
IN COSTA RICA

I. PURPOSE

These guidelines establish the procedures to be followed for administration of the resources contributed by the Multilateral Investment Fund (MIF) for implementation of the Program on Competitiveness of Small Business (hereinafter referred to as the "Program") in Costa Rica.

II. OBJECTIVES

One of the program aims is to develop the market for entrepreneurial services specializing in small business in order to improve its competitiveness. Advisory services and technical assistance in business analyses, preparation of projects to improve productivity, managerial training and consulting services, and marketing and exporting, will help modernize firms and boost their competitiveness in an open economy. The funds contributed by IDB/MIF will be used essentially to hire business outreach consultants and technology experts to serve the business extension centers (CEEMs) located at the headquarters of the program participating agencies. They will also be used to finance the hiring of individual consultants and training services.

III. ELIGIBILITY OF CONSULTING SERVICES

Small firms, of up to 99 employees, in any sector of activity, will be eligible to receive CEEM services which, in turn, will be eligible as long as they are for assessment and identification of the specific needs of small firms, business information, training in business management, technological management, foreign trade, training in business consulting, preparation of specific projects to improve competitiveness, preparation of projects on exports or cooperation among firms, and advice on financial management or preparation of requests for outside financing.

IV. PROCESSING OF REQUESTS FROM FIRMS AND PROVISION OF SERVICES

Applications for financial services through the MIF should be addressed to the CEEMs, the executing agency or any of the program participating agencies. The applications should furnish sufficient information for the CEEMs or the participating agencies to determine the applicant firm's eligibility for the service sought. Once this has been verified, the CEEMs will respond to the request after estimating the number of hours or days of work, informing the

applicant firm of the rate to be charged, and obtaining its agreement to pay that sum.

If the service is to be provided by a third party, the CEEM or, on its behalf, the CEEM or a participating agency acting on its behalf will:

- a. Review the information provided by the applicant firm and, if necessary, prepare terms of reference for the hiring of the outside consulting services.
- b. Ensure that the proposed consultant is suitable, or prepare a list of consultants eligible to provide the service proposed, from which the applicant firm may choose.
- c. Prepare a draft letter for signature by the applicant in which it accepts the consultant selected and the conditions of access to MIF benefits, including: acceptance of the terms of reference of the consulting service; offer of support to the consultants for the performance of the work; and agreement to pay the appropriate cost.
- d. Hire the consultant once the applicant firm has presented a letter of request acceptable to the CEEM or participating agency. This may necessitate negotiations on the terms of reference and other aspects relating to the contract.
- e. Follow up on the consultant's work, accept the final service, or request its extension, and settle any payments pending.

#### V. MANAGEMENT OF REVENUE FROM SERVICES

Each CEEM or the participating agency where it is quartered will be responsible for the collection of fees from the firms using services financed by the MIF, in accordance with the criteria laid down by the Program Coordination Committee, and for their deposit, within 30 days of the provision of the service, in the single project account.

Revenues deposited in the project account will be posted in such a way that it is possible to determine their provenance, the type of service for which they were paid, and the CEEM through which the service was rendered.

#### VI. SELECTION AND HIRING OF CONSULTANTS

The consultants will be selected on the basis of experience, skills, and professional competence qualifying them for the services they are to provide. Eligibility of the consultants will be based on the criteria of nationality and residence in effect in the IDB and the MIF. However, given the multiplicity and variety



of very short-term contracts to be awarded, the suitability of the consultants awarded contracts for under US\$20,000 may be subject to an ex post review by the IDB, thus avoiding delays in the response to applications from small firms.

#### VII. LIMITS ON QUANTITIES

Contracts with outside consultants paid for from the MIF financing for services to small firms may not be for less than US\$500, or more than US\$5,000 per contract.

These limits do not apply to the professionals hired to head the CEEM or to direct the project.

#### VIII. ADMINISTRATION

The MIF resources will be administered by the Bank, through the executing agency, the Costa Rican Federation of Industry. The other participating agencies will administer the amounts they receive for activities specifically entrusted to them in each annual plan of action.

#### IX. REPORTS

Each participating agency will keep up-to-date accounts and information on the use of the funds received, available funds, those committed and disbursed, advances, and revenues in the project account. This accounting will apply to the use of both liquid assets and the human resources hired for management of the CEEMs.

The participating agencies will submit detailed quarterly progress reports to the executing agency and the project director, including data collected for the evaluation of project activities. The executing agency will submit to the Bank annual reports on project execution, on a semi-annual basis if requested to do so.

#### X. FOLLOW-UP AND EVALUATION

The coordinating committee will establish the method of follow-up and evaluation of the program to enable its resources to be realigned in function of demand and to expedite the external evaluations required by the Bank, as well as the annual reports to be submitted to the Bank.

PROPOSED RESOLUTION

COSTA RICA. NONREIMBURSABLE TECHNICAL COOPERATION FOR THE  
PROGRAM OF COMPETITIVENESS OF THE SMALL ENTERPRISE

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 and to take such additional measures as may be pertinent for the execution of the plan of operations referred to in Document MIF/AT-\_\_\_\_\_ with respect to nonreimbursable technical cooperation with the Cámara de Industrias de Costa Rica, for the realization of the Program of Competitiveness of the Small Enterprise.
2. That up to the amount of US\$2,491,000 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.