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BRAZIL

**DEVELOPMENT OF A SUSTAINABLE BUSINESS UPGRADING MODEL FOR MICRO,
SMALL AND MEDIUM-SIZED ENTERPRISES IN BRAZIL**

(BR-M1119)

DONORS MEMORANDUM

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PROJECT SUMMARY

DEVELOPMENT OF A SUSTAINABLE BUSINESS UPGRADING MODEL FOR MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES IN BRAZIL

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It is widely acknowledged that today's construction and textile¹ industries have been radically reshaped with new business models- commonly called fast-track construction and fast fashion, respectively - which have been developed by industry-leading firms to respond to rapidly changing market demands and competitive landscapes. They have been spreading globally and are also dominant in Brazil. However, despite much faster growth in construction and clothing compared to other sectors of the Brazilian economy, a vast majority of micro, small and medium-sized enterprises (MSMEs) in these sectors have a great deal of difficulty capturing value through the supply chain as they are unable to adapt their business practices to these new business models. Moreover, they are not meeting the increasingly stringent social and environmental standards expected by anchor firms as a result of changing demands from the global market. Given that the Brazilian MSMEs employ over 60% of the workforce, integrating the MSMEs into these growing industries' value chains is deemed critically important.

The project will support MSMEs in these two high-growth industries to adapt their current business practices to the fast paced demand changes inherent in the construction and apparel business models known as *fast-track construction* and *fast-fashion*. MSMEs' access to markets will be strengthened and opportunities for product, process and business model innovation in the anchor firms' value chains will be identified. At the same time, the project aims to facilitate MSME's compliance with higher social and environmental norms – working conditions, occupational health and safety, use of chemicals, and resources and waste management, among others – which may require MSMEs to adopt new technologies and management strategies.

The expected outcomes for both MSMEs and anchor firms will be improved business performance with better working conditions and increased wages resulting from lower litigation risks, fewer accidents in the workplace, lower employee turnover and related costs, more efficient resource management, improved productivity, and better quality products.

It is worth mentioning that the project has already secured the participation of several key firms (some operating on a global scale) from both sectors: Inditex, C&A, and Pernambucanas in the clothing sector, and Cyrela and at least one more anchor company² in the construction sector. In addition, Banco Santander Brazil will contribute resources to the development of financial management training materials and facilitating the implementation of relevant management tools in all participating MSMEs. Moreover, for qualified MSMEs, Banco Santander would facilitate access to its existing financial programs and products appropriately designed for MSMEs who are in need of investing in innovative management practices and new technologies that will allow MSMEs to be more agile in production in response to rapidly changing demands.

¹ The textile industry includes both natural and artificial fibers as well as the production, industry tissues, clothing industry and fashion retail.

² Yet to be determined but conversations with one major Brazilian construction company are advanced

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ACRONYMS AND ABBREVIATIONS

AOP	Annual Operating Plan
ABIT	Associação Brasileira da Indústria Têxtil e de Confecção
BNDES	Banco Nacional do Desenvolvimento
DIEESE	Departamento Intersindical de Estatística e Estudos Socioeconômicos
DNA	Diagnostic of Needs of the Executing Agency
IBGE	Instituto Brasileiro de Geografia e Estadística
IDB	Inter-American Development Bank
LSFVC	Linking Small Firms to Value Chains
MIF	Multilateral Investment Fund
MSME	Micro, Small and Medium-sized Enterprise
OR	Operating Regulations
PCU	Project Coordination Unit
QED	Quality for Effectiveness in Development
SEBRAE	Serviço Brasileiro de Apoio à Micro e Pequenas Empresas
SENAI	Serviço Nacional de Aprendizagem Industrial
SESI	Serviço Nacional de Aprendizagem
TOR	Terms of Reference

PROJECT INFORMATION

DEVELOPMENT OF A SUSTAINABLE BUSINESS UPGRADING MODEL FOR MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES IN BRAZIL

(BR-M1119)

Country and Geographic Location:	Brazil. Three states: São Paulo, Santa Catarina and Rio de Janeiro		
Executing Agency:	UniEthos		
Access Area:	Access to Markets and Skills Unit (AMC)		
Agenda:	Linking Small Firms to Value Chains (LSFVC)		
Coordination with Other Donors/Bank Operations:	The following partners have confirmed their contribution to the project: C&A, Grupo Santander, and Cyrela.		
Direct Beneficiaries:	240 micro, small and medium-sized enterprises 3,600 MSMEs employees (15 employees*240 MSMEs)		
Indirect Beneficiaries:	14,400 individuals (considering 4 people per family)		
Financing:	Technical Cooperation:	US\$1,000,000	45%
	Investment:	US\$ 000,000	
	Loan:	US\$ 000,000	
	TOTAL MIF FUNDING:	US\$ 1,000,000	
	Counterpart (provided by Anchor Companies: C&A and Cyrela):	US\$ 1,000,000	45%
	Co-financing (From Banco Santander and others):	US\$200,000	10%
	TOTAL PROJECT BUDGET:	US\$ 2,200,000	100%
Execution and Disbursement Period:	42 months of execution and 48 months of disbursement.		
Special Contractual Conditions:	Conditions prior to first disbursement will be: (i) selection of a project coordinator; (ii) commitment letter/agreements from those participating anchor companies and/or execution of final agreements by all the counterparts; and (iii) operating guidelines for the project were approved by the Bank.		
Environmental and Social Impact Review:	This operation was screened and classified as required by the IDB's safeguard policy (OP-703). The proposed category for the project is B.		
Unit with Disbursement Responsibility:	MIF / COF Brazil		

1. BACKGROUND AND JUSTIFICATION

A. Diagnosis of the Problem to be addressed by the Project

- 1.1. MSMEs are a critical component of economic and social development. They represent 99% of all companies in Brazil and are responsible for employing about 60% of the workforce³. The **central problem** is that most of the MSMEs are not able to effectively link themselves to anchor firms, particularly in the construction and clothing industries, because of their limited capacities to meet constantly changing demands for deliveries of products and services, meet quality, social and environmental demands required by the anchor firms in alignment with their new “fast” business models. Construction and clothing are sectors that have been radically reshaped by the new business models – commonly called “fast-track construction” and “fast-fashion” - introduced by industry lead firms. MSMEs’ participation in specific value chain activities is predominant in the construction and clothing sectors. In the latter, for example, global brands’ production depend on multiple small and work-intensive MSMEs. The situation is similar for the former industry where the key players depend largely on small labor contractors. Finally, most MSMEs fail to comply with increasingly stringent social and environmental regulations that are being driven by increasing pressure from conscientious global consumers.
- 1.2. **Fast-track construction** has become the norm in the construction market. The normal process of construction scheduling involves the performance of a series of discrete functions in a predetermined sequential order. The customary logical order of these functions is programming, design, governmental approvals, bidding and negotiation, contract award, construction, and finally, completion. Fast track model compresses the project schedule by running design and construction phases simultaneously to achieve early completion.
- 1.3. Construction companies are developing this new business model in response to the demands for reducing the investment payback period and have more flexibility to market changes. Fast-track construction projects require more complex management structures; since the construction process is contingent on many external factors, most of the MSMEs need to improve their risk management of cash flow addressing potential delays on bidding and contract processes. The best strategy for MSMEs under this less predictable business model involving increased risk in the value chains is the diversification of clients and development of organizational, managerial and operational capacities needed to respond to clients' demands in a more accurate and timely fashion.
- 1.4. **Fast-fashion** was pioneered by Inditex, H&M and other leaders in the clothing and fashion industry. Today, it is the industry’s predominant business model which is based on a constant flow of information forging close links between customers and designers. Product development is an ongoing process and depends on the ability to deliver fast responses to constantly changing fashion trends. According to this model, each

³ <http://www.brasil.gov.br/economia-e-emprego/2012/02/o-mapa-das-micro-e-pequenas-empresas>

collection (up to 8 collections per year) is defined in a very short period of time and suppliers are often contracted without advance notice, thus preventing them from preparing long term plans.

- 1.5. Since the supply chains in the clothing industry are changing from “push” to “pull” strategies, a vast majority of MSMEs need to develop the ability to manage businesses with higher levels of variation in market demands. In other words, diversification of clients, access to information on consumers’ trends, and improvement of production management have become essential business strategies for the MSMEs in the fast-fashion model.
- 1.6. **Impact of the new business models on the supply chain:** As seen above, new business models in these sectors are necessarily modifying the value chains; they pose new risks and opportunities as a result of the changes in the relationships between anchor companies and suppliers. In order for the MSMEs to remain competitive, they need to improve capacity and adapt their business practices to these new market contexts through improved linkages to the value chains, particularly not compromising social and environmental compliance.
- 1.7. In addition to facilitating job creation, the project’s target industries have registered a total average annual growth rate of 6.2% – 2.2% faster than the rest of the Brazilian economy. Compared to the high growth rate of the entire construction and clothing sectors, MSMEs have experienced significantly slower growth (IBGE)⁴.
- 1.8. **Causes of the Problem:** The fast-track construction and fast-fashion are considered dynamic sectors in Brazil. Although each has its own unique characteristics, the MSMEs in these sectors are faced with the following similar challenges:
- 1.9. Low productivity: MSMEs in the construction and clothing industries are often informal organizations with low-skilled labor force, fragile management structures and inadequate financial management capabilities, all of which inhibit them from accessing credit. The MSMEs in these sectors require better business skills, technical knowledge and financial training to respond to the requirements of anchor companies. In both sectors low productivity and high operating costs – mostly related to the inefficient use of resources and high employee turnover – hinder access to competitive markets or integration into dynamic value chains.
- 1.10. Limited capacity to comply with environmental and social standards is becoming a real threat to MSMEs in these value chains. In the clothing industry, fast-fashion shortens lead times and demands error-free execution. Additionally, given the increasing scrutiny of the poor working conditions in the industry, media, NGOs and governments are pressing lead companies to ensure compliance with more comprehensive labor standards. In the construction industry, new technologies and regulations related to sustainable sourcing practices are fostering demand that small companies be able to simultaneously manage contract flows, tax and administrative compliance issues, and business development activities. Some large companies in Brazil are recognizing that MSMEs are strategically important in managing social and environmental risks and

⁴ Instituto Brasileiro de Geografia e Estatística

reducing costs along the value chain. Improving social and environmental compliance, together with business, marketing and management skills, is expected to contribute to increased productivity across the whole value chain. A summary of the standards used by anchor firms is described below

Sectors	Social standards	Environmental standards
Clothing (fast-fashion)	<ul style="list-style-type: none"> • working conditions legislation • tax legislation 	<ul style="list-style-type: none"> • use of chemicals • pollution control
Construction (fast-construction)	<ul style="list-style-type: none"> • working conditions legislation • health and safety legislation 	<ul style="list-style-type: none"> • green building • waste management

B. Project Beneficiaries

- 1.11. The project beneficiaries will be 240 MSMEs from the construction and clothing sectors (120 MSMEs per sector). The project will directly benefit 3,600 employees and 14,400 indirect beneficiaries. In Brazil in general, almost 50% of small companies' workers have not earned the equivalent of a high-school degree. Labor contracts of up to 30% in the construction sector do not comply with all the legal or industry standards. There is also a high turn-over in employment with low-skilled employees. In addition, more than 40% of the new owners of MSMEs do not have previous professional experience in the sector in which their firms operate. In the clothing industry, workers are predominantly female. It is one of the main female employment generators in the Brazilian economy. According to ABIT⁵, 76 to 90% of the employees in the textiles and clothing industry are women.
- 1.12. In the construction industry, small companies are always threatened by flexible contracts. Male workers are traditionally predominant (93% according to DIEESE⁶) but due to the lack of skilled workers in the sector, companies are starting to increasingly hire women.
- 1.13. To be eligible to participate in the project, the beneficiary MSMEs must: (i) currently (or potentially) belong to the value chain of one of the anchor companies in the two sectors participating in the project⁷; (ii) be microenterprises (with annual sales of up to \$144,000), small businesses (with annual sales between \$144,000-\$1,440,000), or medium business (with annual sales between \$1,440,000 - \$36,000,000); (iii) agree to share the results of introducing the social and environmental measures; (iv) agree to contribute financial and/or nonfinancial resources to cover part of the cost of the technical assistance; (v) be willing to contribute to the cost of the services received (30-60% depending on the size and sophistication of the MSME); and (vi) have individuals with strategic decision-making authority fully involved in the project.

⁵ [Associação Brasileira da Indústria Têxtil e de Confecção](#)

⁶ [Departamento Intersindical de Estatística e Estudos Socioeconômicos](#)

⁷ MSMEs currently working in the value chain will be easier to identify and select as beneficiaries however the project will be open to incorporate other MSMEs that have the potential to be part of the value chain in the near future.

- 1.14. The anchor companies will: (i) undergo an Integrity Check: (ii) contribute with counterpart resources; (iii) commit to source larger volumes from the participating MSMEs (provided that MSMEs comply with social, environmental, quality and volume requirements as a result of the project).

C. Contribution to MIF Mandate, Access Framework and IDB Strategy

- 1.15. The project contributes to private sector development by strengthening the business capacity of MSMEs and improving their opportunities to be sustainably linked to value chains of anchor companies that are key players interested in moving their sectors to more environmentally and socially sustainable practices. As part of the MIF approach to working with large lead firms, this project is centered on capturing value through improved business management and responsible sourcing practices in supply chains.
- 1.16. Link to the Agenda. This project will contribute to the Agenda's results by (i) tailoring socially and environmentally sustainable practices⁸ to a sustainable business upgrading model⁹ for MSMEs that allow them to capitalize on new industry opportunities and respond to the evolving requirements of fast-track fashion and fast-track construction business models and (ii) effectively linking MSMEs to value chains in two dynamic sectors that are improving their environmental and social sustainability. The project will also contribute to reducing the Linking Small Firms to Value Chains (LSFVC) Agenda knowledge gaps, specifically, the project seeks to learn what kind of support MSMEs need in order to be able to meet ambitious environmental and social standards and remain competitive in a changing environment.
- 1.17. Collaboration with the Bank Group. This project is in line with the Country strategy, given that it will contribute to the strengthening of MSMEs in key sectors such as construction and clothing. The knowledge and information to be generated through the project will help companies prevent these degrading working conditions.

2. PROJECT DESCRIPTION

A. Objectives

- 2.1. The objective at the **impact level** is to improve MSMEs business performance (annual sales and growth rates), MSMEs' employee welfare (salaries and improved health and safety conditions), and environmental management of Micro, Small and Medium Enterprises (MSMEs). At the **results level**, the project will strengthen MSMEs linkages to anchor companies in two sectors (construction and clothing).

⁸ Sustainable business practices refer to those developed based on the public and private regulations through multi-stakeholders initiatives, which are often endorsed by large companies or governments.

⁹ "Sustainable business upgrading" in this project refers to customized training, coaching and business advisory services provided to support MSMEs for boosting performance with an emphasis on implementing social and environmental standards compliance. The services are tailored for each firm, taking into account the market structure, sector-specific characteristics, value chains governance, and environmental and social risks. Each MSME would be equipped with its updated strategy and business plan with economic and social indicators. Based on a monitoring system of economic and social outcomes, the process of upgrading is continuously adjusted to provide the most adequate guidance for each company.

- 2.2. MSMEs' improved practices will allow anchor companies meet their own sustainability metrics and regulations, thus strengthening the value chain and levelling the relationship between the two. Creating a solid tie with an anchor company not only increases the appeal of an MSME (client diversification) but could also provide access to new technologies and financing. The adoption of social and environmental sustainability practices will help MSMEs reduce labor costs (by lowering employee turnover and accident rates, for example), increase efficiency (savings in energy, water and input consumption, among others) and reduce legal costs related to noncompliance with national and local regulations.
- 2.3. The project has already secured the participation of key industry leaders in their respective sectors (some of which are global): C&A, Inditex and Pernambucanas (clothing), Grupo Santander and Cyrela in the construction sector. The project will be primarily implemented in the states of São Paulo, Santa Catarina and Rio de Janeiro as those states hold most of the MSMEs in the value chain of the participating anchor firms.

B. Description of Model/Solution/Intervention

- 2.4. The project will benefit 240 MSMEs (120 in each sector) for which it will identify specific skill gaps – technical and managerial – that the participating MSMEs need to address in order to successfully capture value in the anchor firms' value chains and diversify their clients.
- 2.5. In order to support MSMEs in responding to the current market requirements for sustainability compliance in rapidly growing sectors in Brazil, the project will design and implement a sustainable business upgrading model, enabling MSMEs to adopt pertinent social and environmental measures, thus improve their business performance. The program will establish strategic partnerships with large domestic and multinational companies – representative of each sector and the fast-fashion and fast-track construction business models - that are required by law or industry standards to engaging in socially and environmentally responsible value chain management.
- 2.6. The project will implement a sustainable business upgrading model as follows:
 - (i) Analysis of opportunities and risks at sector level to identify potential for innovation for anchor companies and MSMEs not only in product and processes or technical breakthroughs but also in business practices. This exercise will be conducted jointly with the stakeholders in the value chains - suppliers, clients, employees, communities, governments, financiers, etc. One possible innovation in the clothing sector would be to change the traditional way of doing transactions by shifting from “purchase orders” to more stable “contracts”, which might help MSMEs ensure access to medium-term credit. Other social, environmental and economic issues as areas for possible improvements will be identified by interacting with the stakeholders in the value chain.
 - (ii) Analysis of the business models of each anchor company involved (Inditex, C&A, Pernambucanas and Cyrela) to identify the areas of opportunities in which the MSMEs need to be more systematically involved in the value chain.

Consultants/coaches will design customized business plans for each MSME in order to set economic and social targets.

- (iii) Assessment of their financial needs. Support for financial planning for MSMEs through training (including cash flow management, investment planning, cost control, and finance for social and environmental assets and liabilities). Banco Santander is committed to financing developing the contents for the training and providing resources for its implementation. It is planning to provide also access to finance for those qualified participating MSMEs. MSMEs would be expected to have better access to adequately-tailored financial products (loans, insurance, factoring, etc.) that will be specifically designed for MSMEs in the target industries.
- (iv) Identification of MSMEs' skill gaps in technical, general business, environmental and social management capability to be addressed in order to capture appropriate values in the anchor firms' value chains.
- (v) Development of a minimum standard compliance tool for MSMEs. This tool will include a booklet with all the standards and orientations about management systems, technical information and guidance on social and environmental processes, with a check-list for internal management that MSMEs in each sector should follow, including: (i) organizational culture; (ii) operational efficiency; (iii) human resources management; (iv) innovation management; (v) workplace health and safety; and (vi) environmental management.
- (vi) Implementation of business plans that will be provided through customized, intensive and integrated coaching for MSMEs to implement the drafted plan and use the minimum standard compliance tool developed, with follow-up consultancies in two cycles (6 month each). The coaching will weigh in specific aspects of each sector (risks and opportunities), value chains' characteristics, market conditions and internal management structure. Prior to receiving such customized coaching, each MSME will be required to set economic and social targets in its own strategy and business plan, and based on monitoring of economic and social results, the coaching process will be continuously adapted to maintain the most adequate guidance for each firm.
- (vii) Recognizing that knowledge sharing among peers is important, the exchanges of knowledge will be promoted through creating co-working spaces for MSMEs, networking opportunities among them and with investors and other stakeholders.

C. Components

Component I: Developing and implementing a sustainable business upgrading model. (MIF: US\$258,000); Counterpart: [US\$692,000].

- 2.7. The objective of this component is to design and implement a sustainable business upgrading model to improve MSMEs' business performance that will also facilitate client diversification for MSMEs. This component will create the basis for future expansion of the sustainable business upgrading model to other anchor

companies/value chains. Opportunities for innovation in each sector's business practices will also be identified and tested.

- 2.8. The activities and products of this component are the following: 1. Development of a sustainable business upgrading model (including (i) business plan development for MSMEs, (ii) compliance management tool development; and (iii) implementation plan of the innovation models / processes); 2. Implementation of a sustainable business upgrading model (including: (i) training and consultancy services in the participating MSMEs in the two sectors; (ii) support for the implementation of the compliance management tool; and (iii) monitoring of the business upgrading implementation.); 3. Development of a matrix of social and environmental sustainability dilemmas and potential innovations in the construction and clothing sectors; 4) implementation of the minimum compliance standard management tool for anchor firms and MSMEs; and 5) identification (risk and opportunity assessment) and testing of opportunities for innovation in products, processes and business models.
- 2.9. The expected outcomes of this component are: (i) 300 MSMEs trained; (ii) 3 innovations tested; (iii) 300 MSMEs implementing the compliance management tool; (iv) 300 MSMEs with business plans developed and; (v) 2 social and environmental opportunity matrix developed (one per sector).

Component II: Improving MSMEs financial management and access to finance (MIF: US\$157,000; Counterpart: US\$289,600).

- 2.10. The objective of this component is to facilitate access to finance for the participating MSMEs. The activities and the products of this component are the following: (i) identification of MSMEs' financial needs in value chains (financial plans); (ii) identification / development of suitable financial instruments; (iii) training and support for MSMEs implementing their financial plans; and (iv) development of public-private-partnerships¹⁰ by sector to expand financial instruments availability.
- 2.11. Banco Santander is committed to financing the contents for the financial training and providing resources for its implementation. Banco Santander will also provide access to finance for those qualified MSMEs, and the financial products (loans, insurance, factoring, etc.) will be specifically designed for MSMEs in the clothing and construction sectors.
- 2.12. The expected outcomes of this component are: (i) 215 MSMEs with financial diagnosis developed; (ii) 215 MSMEs with financial plans developed; (iii) 100 MSMEs with financial plans in implementation and; (iv) 3 (additional) financial institutions participating in the project.

Component III: Knowledge Management and Communications Strategy. (MIF US\$109,100; Counterpart US\$134,400).

- 2.13. The objective of this component is to systematize, document, and disseminate the experience and knowledge generated in this project, with the objective to: (i) share a sustainable business upgrading model and a minimum sustainability compliance

¹⁰ Potential partners include *O Banco Nacional do Desenvolvimento* (BNDES) and the anchor companies.

management tool and (ii) replicate the proven model through partnerships with public institutions, the participating anchor companies (two of which have operations on a global scale), and other anchor companies, thus presenting potential to expand to other countries of Latin America and the Caribbean.

- 2.14. The strategic audiences of the project are: (i) companies interested in improving social and environmental sustainability along their value chains; (ii) public sector agencies and; (iii) other civil society organizations, multilateral organizations and networks of experts interested in developing similar projects.
- 2.15. In order to meet these audiences' knowledge needs, the following knowledge products will be developed: (i) 2 case studies (one per sector) that systematize and document the sustainable business upgrading model ; (ii) 1 video and; (iii) communication strategy, including national and regional events in order to disseminate the case studies, encouraging replication. On an annual basis, the Executing Agency will update the Project Fact Sheet (template provided by the MIF), which contains basic information on the project, its challenges, the intervention strategy.
- 2.16. The expected outcomes of this component are: (i) 2 case studies developed; (ii) 1,500 downloads of the case studies; (iii) 3 workshops organized; (iv) 350 participants in the workshops from relevant organizations; (v) 1 monitoring and evaluation system working (including baseline); (vi) 1 communication strategy developed and; (vii) 1 promotional video developed.

D. Project Governance and Execution Mechanism

- 2.17. Executing Unit. The executing agency will establish a project execution unit (PEU) consisting of a Project Manager, a Financial and Administrative Assistant and an administrative/accounting support.
- 2.18. Recognizing that the social and environmental challenges faced by the anchor firms involved in the project are common to other firms, the project will also catalyze the creation of a Steering Committee with relevant stakeholders for each sector, representing the MIF, MSMEs, companies, consultants and business agencies, with diverse expertise and of a consultative nature, to ensure that the PEU has feedback and advice from experts in the different project areas. The committee members will also be engaged in searching additional resources in order to replicate this process.

E. Sustainability

- 2.19. The project's sustainability is contingent upon the presence of three to six anchor companies committed to purchasing products and services from beneficiary MSMEs that meet volume and quality while complying with social and environmental requirements. The existence of private and public funding (from C&A, Inditex, Pernambucana, Cyrela and Banco Santander among others) is expected to facilitate leveraging resources from other sponsors during and after the project. The project will also create the conditions to expand the sustainable business upgrading model to other anchor companies through the creation of a Sector Steering Committee so that the

methodology created and the lessons extracted from the project can be applied by potential future anchor firms and key organizations in each sector.

- 2.20. SEBRA and SENAI have national scope and a strong presence in the majority of Brazil's regions. By securing the participation of these institutions, the project is ensuring the participation of business owners and technical experts which in turn will increase the project's potential for scaling up and replication. To facilitate dissemination and maximize the project's impact, implementation will be done through sector associations. Finally, it is expected that those successful beneficiary MSMEs will play a leadership role and produce a demonstration effect among other enterprises in their employer organizations and sector associations.
- 2.21. One year before the project ends, a **sustainability workshop** will be held with all key stakeholders to identify specific actions needed to ensure the continuity of the project's activities as the project funding has been expended.

F. Experience and Lessons Learned from MIF or other Institutions

- 2.22. The MIF has previous experience in linking MSMEs to anchor companies' value chains in a socially and environmentally responsible fashion. A specific example for Brazil is "Expanding opportunities for corporate social responsibility among small and medium enterprises in Brazil (BR-M1023)". In another project "Sustainable Working Conditions for Better Micro and Small Enterprise Performance" (BR-M1066), the MIF has developed a sector competitiveness analysis which could be used in this project when analyzing the sectors (Component 1). Also, in this same project, the Social Service of the Industry (SESI) developed a diagnosis tool that would help MSMEs identify their priorities and help develop action plan. Those tools will also be made available to UniEthos - the project's executing agency.
- 2.23. One important lesson learned from the project "Pilot program for MSMEs competitiveness through the implementation of sustainable practices" (ME-M1077) executed by *Instituto Tecnológico y de Estudios Superiores de Monterrey (ITESM)* is related to the ability of anchor companies to attract MSMEs, especially when requesting that MSMEs share their financial information. To avoid this problem Uniethos should make sure that: (i) there is a communication plan prepared by each anchor company to clearly state their interest in the project and in their commitment to the linkages with MSMEs; (ii) each involved MSME receives a participation contract with detailed information on confidentiality and that all sensitive information will be only shared in a consolidated format.
- 2.24. To avoid the creation of unrealistic expectations among MSMEs, UniEthos will carefully plan the development of the sustainable business model before contacting each participating MSME. MIF experience in project BR-M1066 suggests that the executing agency must be flexible when selecting participating MSMEs given the expected drop out rate that will happen at the implementation phase. In this regard, UniEthos will have to select a higher number of MSMEs than the final target.

- 2.25. The project will have into account the findings of the study commissioned to the London School of Economics and Political Science (LSE) by the MIF's Access to Basic Services and Green Growth Unit "Best Practices in Environmentally Sustainable Supply Chain Management" (March 2014) which includes the Case of Inditex.

G. MIF Additionality

- 2.26. Non-Financial Additionality. MIF's past experiences and accumulated technical expertise are fundamental when the project deals with more than one sector. The MIF's ability to understand MSMEs challenges and coordinate with anchor companies so that effective solutions can be elicited requires not only knowledge but credibility which MIF has been able to solidify through its works with numerous private and public sector partners. MIF can also leverage its existing network to enhance the quality of the intervention in areas that are not the core strength of the Executing Agency.
- 2.27. Financial Additionality. While the anchor companies will commit their participation with counterpart funding, MIF financial support is key for: (i) developing a solid methodological basis (value chain analysis, tailored sustainable business model) that can increase the likelihood of achieving the results and impact desired; and (ii) attracting additional support and resources from other partners who may become interested in joining the project later on.

H. Project Results

- 2.28. At the results level, the project will strengthen MSMEs linkages to markets in two sectors (construction and textiles) through the design and implementation of a "socially and environmentally sustainable business methodology". The result indicators are:
- 240 MSMEs sustainably linked to anchor companies [CRF 230200]
 - 120 MSMEs linked to new anchor companies (MSMEs client diversification, disaggregated by sectors)

I. Project Impact

- 2.29. The objective at the impact level is to increase MSMEs' business performance such as annual sales, growth rates and improved environmental indicators. For the MSMEs' employees, the project will improve working conditions including: average salaries increase and better health and safety conditions.
- 30% average sales increase for MSMEs [CRF 330100]
 - 30% average salary increase by the MSMEs employees (disaggregated by sex and sector)
 - 30% accident reduction in the work place (disaggregated by sex and sector)
 - 300 net jobs created annually (average, total cumulative 1,200) [CRF 330300]
 - 30% Waste Reduction (disaggregated by sector)

- 20% Energy Consumption Reduction [CRF 330400]

J. Systemic Impact

- 2.30. The proposed project could create systemic impacts through scale, replication and influence. The overall systemic impact of the project could be measured by (and contribute to) indicators identified in the Corporate Results Framework: Number of MIF-supported models scaled or replicated [CRF 450100] and; number of key public or private actors or institutions changing or applying new practices based on MIF-sponsored projects or knowledge [CRF 450300].
- 2.31. By developing more sustainable business models, the project will contribute to catalyze innovations in three sectors with relevance in Brazil's economy. There will be tools developed by the Project that will allow incorporating social and environmental issues in business models. The project will also contribute to improving sustainability practices in key anchor companies and their two sectors,
- 2.32. The project involves the public and private sector (at least 2 global anchor companies) that could result in wide-scale buy-in and replication in other countries of the region. Partnerships with anchor firms and other partners would help achieve wide scale adoption of social and environmental sustainable business models, and resulting implementation of good practices, and dissemination of tools and these practices that could lead to wider adoption among Brazilian businesses. By motivating anchor firms to ensure that their suppliers and other stakeholders adopt good social and environmental practices, the Project could result in these practices being adopted by others not directly participating in the project.

3. MONITORING AND EVALUATION STRATEGY

- 3.1. Baseline: A baseline will be established in line with the Logical Framework indicators. UniEthos and the anchor companies will collect baseline data of each participating MSME through a survey tool to be developed and through a measurement process developed at the initial phase of the project implementation. All indicators will be collected yearly or every semester (depending on the information) and up-loaded into MIFs semester report system, the Project Status Report. The indicators will also be in line with the Corporate Result Framework so as to be able to have aggregated data from all beneficiaries. These indicators will also be disaggregated by gender (for employees) and size of firms.
- 3.2. Monitoring: The program will establish a Monitoring and Evaluation system and define the appropriate monitoring methodologies by using: (i) business reporting (sales/revenue (existing and new business), levels of productivity by sector, access to financing, technological innovation); (ii) social impact reporting (labor accidents, environmental policies implemented, household income for farmers, etc.); and (iii) market access endorsed by formal alliances between small producers/small firms and anchor companies. These monitoring methods will be implemented every semester and/or annually to assess and measure financial, operational, social, skills results and impacts obtained from the program.

- 3.3. **Evaluation:** The project will have at least two external evaluations: a mid-term evaluation which will evaluate areas of improvement of the project and the type of results that can already be extracted at that stage. The focus of this evaluation will be both on the process of the project and on initial results and will be used to correct any original misconception or implementation flaws. The second evaluation, which will take place at the end of the project, will evaluate the project’s impact, including aspects such as: (i) knowledge generation, management and dissemination; (ii) direct impacts toward beneficiaries (income, business performance, innovation, etc.); (iii) access to markets and finance; and (iv) potential for replication. Specifically this evaluation will seek to answer the following questions: Does participation in value chains provide enough incentive for MSMEs to comply with social and environmental regulations? Can the tools developed through the project provide sufficient institutional strengthening to allow MSMEs to comply with social and environmental regulations? Do anchor firms and MSMEs achieve better business performance by complying with social and environmental regulations?
- 3.4. **Closing Workshop.** The executing agency will organize a closing workshop at the appropriate time to assess along with other key stakeholder the outcomes achieved, identify additional tasks to guarantee sustainability and identify and disseminate lessons learned and best practices.

4. COST AND FINANCING

- 4.1. The project has a total cost of US\$2,200,000 of which US\$1,000,000 (45 %) will be provided by the MIF, US\$1,000,000 (45 %) will be local counterpart and US\$200,000 (10%) co-financing. Counterpart resources will come primarily from the participating anchor companies. Cyrela and C&A confirmed similar contributions of up to US\$500,000 in cash resources. Santander will contribute to the co-financing with up to US\$50,000 and the rest will be contributed by the anchor companies as in-kind contribution (managers’ time dedicated to the project, support services and use of facilities for training and events). The execution period will be of 42 months and the disbursement period will be of 48 months.

PROJECT BUDGET	MIF (In US\$)	Counterpart and co- financing (In US\$)	Total (In US\$)
Project Components			
Component 1: Develop and Implement a Sustainable Business Tool.	258,000	692,000	950,000
Component 2: Improve MSMEs Financial Management	157,000	289,600	446,600
Component 3: Knowledge Management and Communication Strategy	109,100	134,400	243,500
Execution and Supervision Components			
Baseline and Monitoring System	35,000	-	35,000
Executing Agency/ Administrative	304,500	84,000	388,500
Mid-Term and Final Evaluation	24,000	-	24,000

Ex post reviews	25,000	-	25,000
Contingencies	17,400	-	17,400
Sub-total	930,000	1,200,000	2,130,000
% of Financing	44%	56%	100%
Impact Evaluation Account (5%)	50,000		50,000
Agenda Account	20,000		20,000
Grand Total	1,000,000	1,200,000	2,200,000

5. EXECUTING AGENCY

- 5.1. UniEthos will be the Executing Agency of this project and will sign the agreement with the Bank. UniEthos is an innovative nonprofit organization (NGO) that provides advisory and executive education services to companies that want to sustainably develop their businesses. It is the executing and advisory branch of Instituto Ethos, which objective is to raise awareness among enterprises and mobilize and help them manage their businesses in a socially responsible manner, developing partnerships to build a more just and sustainable economy. It has an extensive network of public and private partners that contribute to strengthening companies' competitiveness and generate added value to society. UniEthos and its sister organization, Ethos Institute¹¹ (a well-known institute that works on public policies), share a common strategy for promoting economic changes and improvement of business practices. Instituto Ethos executed a MIF project from 2006 to 2010, "Expanding opportunities for corporate social responsibility among small and medium enterprises in Brazil" (BR-M1023), commonly known as "TEAR program", which created a methodology to implement corporate social responsibility measures in SMEs, with the support of 7 anchor companies from different sectors. The TEAR methodology showed positive results for the MSMEs and is still being implemented by some anchor companies with the support of UniEthos as a regular reference product.
- 5.2. UniEthos's mission is aligned with MIF's strategy since their core business is to develop competencies, innovative managerial best practices and business models with new sustainability standards. Traditionally UniEthos analyzes the characteristics of the company it supports, verifies their potential for changes and the relevance of the project the company wants to implement and its utility for the society. It identifies standards and/or suggests improvements for the company's sustainability standards, opportunities, risks, trends and innovative practices to suggest action plans for each of their clients/members. For the MIF it will be a good opportunity to work with UniEthos since major corporations in the country are UniEthos clients, such as Natura, Caixa, Citi

¹¹ In 1998, a group of prominent Brazilian businesspeople came together to form *Instituto Ethos de Empresas Responsabilidade Social*, as a non-profit organization intended to assist companies with understanding and incorporating social and environmental sustainability in the everyday operations of the company. Ethos was a pioneer in this area, not only in Brazil, but also in Latin America in general. Starting with 11 founding large company members, Ethos now has over 800 company members, representing more than 30% of the Brazilian GDP and approximately 1.3 million workers. Moreover, Ethos membership also includes eight industry federations, 33 associations and NGOs, seven media entities and 45 institutions of higher education.

Group, Cargill, Fiat, GBarbosa, among others. Through those corporations, the sustainable business model developed in this project will possibly be transferred to a greater number of MSMEs, achieving the intended systemic impacts. This project will have two types of partners: (i) Anchor companies, which will participate with counterpart and (ii) Supporting Organizations, which will not provide counterpart but will support MSMEs in some specific activities such as business training and entrepreneurship. Anchor companies will be involved in two phases. Phase one will start in the first three months of execution, and phase two will begin after the first year of implementation. Some identified partners for both phases are:

- 5.3. Phase One: Cyrela: Founded in 1969 Cyrela Brazil Realty is the largest homebuilder and real estate company by revenue and market value in Brazil. Considered one of the most solid of the civil construction sector, currently operates in 17 states and 55 cities in Brazil and Argentina. It has 35,000 customers and 7,250,000 square feet (674,000 m²) built. The company is headquartered in São Paulo and listed in the BM&F Bovespa.
- 5.4. C&A: International clothing retail company C & A is an international clothing retail company that has completed 37 years of presence in Brazil. C&As network implemented a fashion business model that made clothing accessible to lower income populations around the world. Currently C&A has over 220 stores in 101 Brazilian cities, more than 18,000 employees and receives approximately one million customers per day. In recent years the company implemented important sustainability actions such as the using 40% recycled material in the total volume of raw material in the production hangers and a volunteering program that involves more than 5600 employees.
- 5.5. Phase Two: Inditex: This Spanish retailer (Inditex) started its operations in Brazil in 1999 and has over 40 stores in the country. Characterized by working with networks of sewing cooperatives and workshops, it is vital for Inditex's own value chain to partner with solid MSMEs with proper managerial, social and environmental safeguards. For the project, Inditex will work with a selected set of its intermediaries' current suppliers to develop action plans to strengthen these MSMEs working conditions.
- 5.6. Pernambucanas: With more than 100 years in the textile industry, Pernambucanas is a renowned Brazilian company with four business lines (textiles, clothing, appliances and financial services). The project will focus on the textile and clothing lines where Pernambucanas holds a leadership position (ranked as number one in the textile industry and among the top-three retailers in the clothing sector). In this project, its value chain will be assessed to design and implement new management practices that the company has committed to adopting in order to improve its relationship and value proposition (particularly in terms of the environmental and social standards) with suppliers / subcontractors. The company is also open to integrating into its value chain those MSMEs that comply with Pernambucanas' requirements.
- 5.7. Grupo Santander: It will provide funding for developing and implementing the financial training for the participating MSMEs. Santander will also provide access to finance for those qualified MSMEs through appropriate financial products (loans, insurance, factoring, etc.).

- 5.8. Anchor companies will be contributing to the counterpart with cash and in-kind resources. Grupo Santander will contribute with co-financing in in-kind resources (content for trainings) as well as cash resources to implement trainings. In the construction and textile sectors the anchor companies have a commitment of maintaining at least 2 business transactions with each MSME.
- 5.9. Other Partners: SENAI, SEBRAE and SESI are part of the “S” system in Brazil, a private network of services, not for profit and for public interest. These three organizations will sign agreements with the executing agency regarding their contribution to the project. SENAI is the national service for training the employees of the industry. They will be key partners to multiply the experience and later adapt the methodology for other sectors. SEBRAE is responsible for the strengthening of MSMEs in Brazil and will provide specific training on entrepreneurship and business management when needed. SESI is also a national service for the industry focused on social issues for the industry employees. SESI will be instrumental when defining the social and environmental standards that the construction and clothing industry have to follow. SESI will also provide training for MSMEs in those standards.
- 5.10. UniEthos will establish an executing unit and the necessary structure to effectively and efficiently execute project activities and manage project resources. UniEthos will also be responsible for providing progress reports on project implementation. Details on the structure of the execution unit and reporting requirements are in Annex 7 of the project technical files.

6. PROJECT RISKS

- 6.1. Lack of commitment from MSMEs: the impact and success of the project is contingent upon MSMEs' commitment, which will be affected by its capacity and understanding of the strategies that will be designed. To mitigate this risk, the process will be coordinated with the anchor companies, establishing clear criteria for selecting the strongest candidates.
- 6.2. Changes in the social and environmental regulations: may affect both anchor companies and MSMEs. To mitigate this risk the project will incorporate the most demanding requirements in the industry in the compliance tool and the methodology so that MSMEs will be well prepared for further regulatory requirements.

7. ENVIRONMENTAL AND SOCIAL EFFECTS

- 7.1. Given the nature of the proposed program, adverse environmental and social impacts are not expected. The project will contribute to positive social and environmental performance of participating companies by assisting in the implementation of socially and environmentally sustainable practices, including those related to improving environmental management and workplace health and safety and environmental impact.
- 7.2. The project will not finance activities that may negatively impact the biodiversity of areas of intervention. In terms of environmental impacts, the project will contribute to

the compliance of regulations. As for social impact, the project will develop multiple capabilities in small businesses for social compliance. Additionally, gender equity will be promoted by ensuring women's equal access to the project's activities. In this regard, supporting companies' competitiveness is expected to benefit directly from better working conditions for women. Female workers in construction are developing new working environment and increasing the positive perception about diversity at the work place.

- 7.3. The nature of the project will ensure that socially and environmentally responsible practices are implemented in the two sectors in order to avoid negative environmental impacts. In terms of occupational health and safety related to the activities in the clothing and construction sectors, the IDB's guidelines will be applied.

8. COMPLIANCE WITH MILESTONES AND SPECIAL FIDUCIARY ARRANGEMENTS

- 8.1. **Disbursement by Results and Fiduciary Arrangements.** The Executing Agency will adhere to the standard MIF disbursement by results, procurement and financial management arrangements specified in Annex 8.
- 8.2. Despite the low institutional risk rating, an allocation of resources is considered necessary to provide training in financial management and procurement that may be needed. This will ensure maintaining the expected standards of quality, and streamlining the preparation of basic documentation.

9. INFORMATION DISCLOSURE AND INTELLECTUAL PROPERTY

- 9.1 **Information Disclosure.** This project is categorized as public for the purpose of the Bank's information disclosure policy.