

# **ENABLING SMALL ENTERPRISE DEVELOPMENT THROUGH A BETTER BUSINESS ENVIRONMENT**

**Donor experiences in supporting reforms in the  
business environment**

Committee of Donor Agencies for Small Enterprise Development  
Working Group on Enabling Environment

## **TECHNICAL DOCUMENT**

PREPARED BY SIMON WHITE  
AND  
JUAN CHACALTANA

VERSION 2.0  
NOVEMBER 2002

## TABLE OF CONTENTS

Executive summary .....	3
List of acronyms used in the report .....	7
Foreword.....	9
1 Introduction.....	10
1.1 Brief description of Committee of Donor Agencies for Small Enterprise Development and the Working Group on Enabling Environment.....	10
1.2 Policy and legal environment as a mechanism for SME development.....	11
1.3 Description of the review—its purpose and methodology .....	12
1.4 Structure of report.....	13
2 Defining an SME enabling environment.....	15
2.1 Components of the business environment.....	15
2.2 Addressing market failures by reforming the business environment.....	17
2.3 Making the business environment more enabling for SME development.....	19
3 Policy reform interventions by donor agencies.....	23
3.1 General themes of donor intervention .....	23
3.2 Range of donor interventions .....	25
3.3 Intervention tools and processes.....	28
4 Mechanisms for policy reform.....	34
4.1 Mechanisms for donor assistance .....	34
4.2 Mechanisms for donor collaboration.....	35
4.3 Emerging trends in donor interventions: Identifying ‘good practice’ .....	37
4.4 Emerging trends in donor interventions: Identifying ‘bad practice’ .....	40
5 Outcomes from policy reform interventions.....	41
5.1 Measuring the outcomes of donor intervention .....	41
5.2 Issues affecting impact assessment.....	43
6 Key findings and conclusions .....	48
6.1 Lessons learned .....	48
6.2 Future research and information needs.....	49
List of references.....	51
Annex 1 Committee of Donor Agencies for Small Enterprise Development .....	53
Annex 2 Summary review of regional/country reports.....	55
Annex 3 Terms of reference used for the review .....	66

## **EXECUTIVE SUMMARY**

The Committee of Donor Agencies for Small Enterprise Development was established in 1979. Drawing from a diverse range of multilateral and bilateral agencies, the Committee has sought to improve the practice of donors in small enterprise development by commissioning research and sharing information. In 2001 the Committee established a Working Group on Enabling Environment. The Working Group endeavours to learn from experiences in donor-supported efforts to reform the business environment for SME development.

This report was commissioned by the Working Group to review experiences from interaction among donor agencies in small enterprise policy reform in a few selected countries. It was presented at the meeting of the Committee of Donor Agencies for Small Enterprise Development on 16 September 2002 at the International Training Centre, Turin, Italy. This research is expected to contribute to an understanding of the similarities and differences in donor agencies' efforts to help countries improve their policy environments for small enterprise development. It is also expected to contribute to an overall stocktaking of the content, process and outcomes of donor efforts by assessing specific country experiences, and deriving principles of good practice that could help guide future collaboration at the country level.

Five countries or regions were selected for this review. These were: the Balkans (encompassing Albania, Bosnia-Herzegovina and FYR Macedonia), the Caribbean (specifically Dominica, Grenada, Guyana, and Jamaica), Peru, Tanzania, and Viet Nam. In each of these the review was overseen by a Lead Agency representing the Working Group on Enabling Environment. Among other responsibilities, Lead Agencies appointed a National Consultant to carry out this review in each country or region, and prepare a regional or country report. All in all, the work of donor agencies in three countries and two regions are reviewed in the five regional/country reports from which this report has been prepared.

Many donors working in the business environment in which small and medium enterprises (SMEs) operate were found to define the concept of the business environment loosely. As a result, this report draws from a number of donor sources (i.e., donor commissioned research papers) to provide a broad conceptual understanding of the issue. The business environment was found to contain policies, laws and regulations that generally set the 'rules of the game' for private sector activities. Social, economic and political spheres, each of which are interrelated and physically represented by a range of institutions, were found to influence these rules, while the combined effect of these influences, rules and institutions is reflected in the performance of markets.

When defining the business environment, it was important to draw a distinction between business environments that enable private sector development (PSD) and those that enable SME development. Research has shown how SMEs are more vulnerable to biases and constraints in the business environment than larger enterprises. Thus, within the broad thrust of PSD, SME development has a unique position. While PSD encompasses all kinds of private business endeavours, including large enterprises, multinational corporations, etc., SMEs are by definition smaller. Reforming the business environment for SME development can be lost among efforts to reform the environment for PSD. SMEs have a specific set of concerns that need to be addressed in the business environment (e.g., anti-SME bias) and it is important to ensure that reform measures respond to the needs and priorities of smaller enterprises.

The research reported in this document aims to contribute to three critical areas of concern. Firstly, it aims to contribute to an understanding of the similarities and differences in agencies' efforts to help countries improve their policy environments for small enterprise development. Secondly, it aims to contribute to an overall stock take of the content, process and outcomes of donor efforts by assessing selected country experiences. Thirdly, it aims to contribute to the Donor Committee's efforts to derive principles of good practice that could help guide future collaboration at the country level. Each of these contributions is addressed below.

*A The similarities and differences in efforts to help countries improve their policy environments for small enterprise development*

The work of donor agencies in the three countries and two regions reviewed for this study display a high degree of similarity. Donor interventions in the reform process were found to fall into five broad categories (described further below), but the design of these strategies and the packaging of various tools and processes within them were found to vary according to national reform priorities.

In stark contrast to these similarities has been one major area of difference. This relates to the level of donor influence in reform processes. In some countries, government has taken the lead in the reform process, requiring donors to find ways where they can contribute to government-driven processes. However, in other countries, government appears to be less determined, creating a situation in which donors have applied pressure for reform. In these cases, donors have complained about weak counterpart organizations and the lack of government commitment.

Where governments have a clear reform agenda, donors tend to look for a place within this vision or agenda. They can support or complement government's lead. But, where government is less determined and less engaged in the issues of reform, donor agencies face a different kind of challenge. They often need to find other mechanisms to raise awareness among key domestic stakeholders, including government. On the whole, much more can be learned about the processes donor agencies undertake in the design of their interventions. Especially since it is this feature of donor activity that appears to be the most influential in the choice of strategies, tools and processes.

*B The content, process and outcomes of donor efforts*

There were five fields of donor intervention used by donors in the promotion of a more enabling business environment:

- 1 Supporting a stable macroeconomic environment: To create a market-oriented economy in which private sector development (including SMEs) can operate in an efficient manner with the aim of achieving national development goals, such as poverty reduction, employment and wealth creation, etc.
- 2 Direct policy and legal reforms: Private sector development (general): To ensure that policies, laws and regulations governing the private sector did not unduly encumber the private sector. Reforms occurring in this field are not specifically targeted toward the SME sector.
- 3 Direct policy and legal reforms: SME development (specific): To remove anti-SME biases found in policies, laws and regulations and to ensure that the reform of these instruments are responsive to the conditions and capacities of the SME sector. Reforms in this field generally seek to facilitate the promotion of the SME sector.
- 4 Strengthening institutions: Policy design, implementation and enforcement: To ensure that existing and newly created or reformed policies, laws and regulations are properly implemented and enforced in a transparent, equitable and market-oriented manner.
- 5 Strengthening institutions: Representative and advocacy: To ensure that the SME sector is properly represented in policy and legislative reform dialogues, and that representative institutions can advocate for change to government in a consistent and knowledgeable manner that is driven by mandates that come from SMEs themselves.

Within these five fields of intervention, the regional/country reports identified several tools and processes used by donor agencies. These ranged from technical and financial assistance, to the facilitation of high-level dialogue and consultation processes, to training, study tours and demonstration projects. The application of these varied according to national circumstances and reform priorities.

Many donor agencies have made use of broad development strategies, such as Poverty Reduction Strategy Papers, to locate their support for reform efforts. Often government in close cooperation with multilateral and selected bilateral agencies has formulated these strategies, which have provided a framework for a number of donor agencies to identify priorities for reform that they can support, and to work with government in

pursuit of these reforms. They have also helped government agencies take the lead in reform measures.

*C Principles of good practice*

Good practice in donor efforts to support reform in the business environment for SMEs was found to stem from two core principles. The first being the need for donors to recognise the broad strategic role they perform in development efforts in the client country and the role that the SME business environment plays in this. The second principle encourages donors to consider the way they design, package and deliver their support.

In the first instance, effective donor agencies were found to consider their role in the political dynamics of the country and position their reform support interventions in such a way as to promote change, while remaining sensitive to the political domains of local actors. When doing this, donor agencies ensure that domestic actors drive reform processes. Donors themselves should not attempt to force reforms. Instead, they should raise awareness of the need for reform among all actors, support representative institutions to recognise the need for reform and advocate this to others (e.g. to government). Thus, donor agencies should find ways to add-value to domestic reform processes, rather than coming with their own agendas and trying to convince others of these.

It is also important that donors recognise that reforming the SME environment requires an integrated cross-cutting strategy—one that affects policies, laws, and regulations, as well as the institutional framework and the influence of social, cultural and political elements. Thus, donor agencies should stimulate debates on the value of reforms and build open, positive relationships with domestic counterparts.

When designing, packaging and delivering their support, good donor practise recognises that reforming the business environment is a time-consuming process that can take donors well beyond their normal project cycles. Donors need to find ways where they can support a reform agenda over time by extending their project timeframes, engaging counterparts over a long period of time (i.e., building long-term professional relationships), and stabilizing staff and information resources so that donor-counterpart relations can be constant. Good practice in the support of reforms to the business environment also involves supporting social dialogue and strengthening the role key stakeholders can play, especially SME representative organizations. In addition, donor-supported reform interventions were found to be most effective when they add-value to domestic reform processes by offering sound analysis of the business environment (before and after reforms) and by bring international experiences and up-to-date knowledge.

After examining the range of issues that affect the ways in which donor agencies work with domestic stakeholders, as well as how they collaborate with one another, this report considers the way donors assess their support of reform efforts. Donor-to-donor collaboration and coordination was considered to be an important strategy in the support of reforms, but such arrangements were found wanting in many of the regions and countries examined in this study. Measuring changes in the business environment also proved to be a difficult job, made even more difficult when the impact of specific reform interventions is to be assessed. Few donors were found to assess their efforts beyond the measurement of inputs and outputs. Thus, a coherent and relevant framework and approach to impact assessment is necessary.

Finally, a number of future research and information needs are considered. Following from the findings presented in this report, it is clear that the Working Group on Enabling Environment needs to:

- better understand the business environment and its influence on SMEs;
- better understand the influence of international development assistance on the business environment;
- better understanding donor practices;
- design appropriate tools and techniques for measuring the impact of donor-support reforms; and
- identify and promote best practices in donor-supported reforms.

As a first step, the research presented in this report has provided wide-ranging examples of the ways donor agencies are supporting reforms of the business environment in an effort to improve the competitiveness of SMEs and their contribution to national development objectives. But, there are many more steps to take. It is hoped that this report sets a direction and establishes a framework that will guide this future work and contribute to a better understanding of the ways in which small enterprises can be enabled through sustainable and enduring changes to the business environment.

## **LIST OF ACRONYMS USED IN THE REPORT**

AusAID	Australian International Development
BDS	business development services
CAF	<i>Andean Foment Corporation</i>
CARICAD	Caribbean Centre for Development Administration
CARICOM	Caribbean Community (comprises OECS members and Barbados, Belize, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago)
CARTAC	Caribbean Regional Technical Assistance Centre
CDB	Caribbean Development Bank
CIDA	Canadian International Development Agency
DFID	Department for International Development (United Kingdom)
EBAS	EU/ACP Business Assistance Scheme
ECCB	Eastern Caribbean Central Bank
ECEMP	Eastern Caribbean Economic Management Program
ECERP	Eastern Caribbean Education Reform Project
ECTEL	Eastern Caribbean Telecommunications Authority
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDI	foreign direct investment
GTZ	German Agency for Technical Cooperation
IADB	Inter-American Development Bank
ILO	International Labour Organization
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
MSE	micro and small enterprise
NGO	non-government organization
NORAD	Norwegian Agency for Development Cooperation
OECD	Organisation for Economic Co-operation and Development
OECS	Organisation of Eastern Caribbean States (comprises Antigua and Barbuda, British Virgin Islands, Dominica, St Kitts and Nevis, Montserrat, St Lucia, St Vincent and the Grenadines and Grenada)
PHARE	Poland Hungary Aid for Reconstruction of Economy
PRSP	Poverty Reduction Strategy Paper
PSD	private sector development
SAP	Structural Adjustment Programme
SDC	Swiss Development Agency
SEED	Southeast Europe Enterprise Development
Sida	Swedish International Development Cooperation Agency

SME	small and medium-sized enterprise
SOE	State-owned enterprise
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIFEM	United Nations Development Fund for Women
UNIDO	United Nations Industrial Development Organisation
USAID	United States Agency for International Development
WBG	World Bank Group
WTO	World Trade Organization
ZDH	German confederation of craft associations



## FOREWORD

The Committee of Donor Agencies for Small Enterprise Development established a Working Group on Enabling Environment in 2001. This was in response to the growing recognition of the significant and far-reaching impact that the business environment has on the competitiveness of small and medium enterprises and, hence, the ability of this sector to generate wealth, create jobs and reduce levels of poverty.

Over the last decade, international donor agencies have been placing greater emphasis on how they can support reform efforts that make the business environment more enabling to the growth of SMEs. Thus, in the interest of working together, the Working Group on Enabling Environment endeavours to learn from each other's experiences in this field. The Working Group is eager to improve coordination and possibly collaboration among donor agencies at the country level, while creating a better mix of knowledge, experience and partners at both country and international levels.

As a first step in this process, the Working Group on Enabling Environment commissioned the research contained in this report in an effort to review the recent experiences of member agencies engaged in the support of national governments and other counterparts in their attempts to improve their policy environment for small enterprises. A draft version of this report was presented by Simon White and discussed at the meeting of the Committee of Donor Agencies for Small Enterprise Development on 16 September 2002 at the International Training Centre, Turin, Italy. This final version takes into account the comments made by members of the Committee of Donor Agencies for Small Enterprise Development.

I believe this report takes us a long way toward better understanding the issues and dynamics of donor efforts in this field. It shows us how donor agencies approach this work and has given us insights into the kinds of tools, processes and mechanisms they have used. It raises questions about the ways in which donor efforts can be measured and assessed, while giving a range of possible next steps for the Working Group.

Significantly, this report highlights the differences that have been found between donor efforts to support reforms in the business environment, compared to the less political nature of financial and non-financial SME promotion services.

I hope you find this contribution to better understanding the business environment and how it can be made more enabling for SME development both stimulating and a source for further research and information that we can all benefit from.

Johan de Waard

Chairperson

Working Group on Enabling Environment

November 2002

## **1 INTRODUCTION**

The environment in which small enterprises start-up and operate has come under greater scrutiny in the last decade. Following a trend that began in the 1980s in most developed countries, many developing countries have taken steps to reform their business environment through processes that liberalise, privatise and otherwise open their economies to new international markets. This, along with other kinds of microeconomic reforms, has created a new range of pressures on their domestic economies. In addition, the last 10-15 years have witnessed a transition in many formerly socialist countries that have sought to reorient their economies more closely to the dynamic of the national and international marketplace.

Global trade has become a prerequisite for development, requiring all countries that wish to participate to open their markets and face the competition of others. This has largely been a domestic process in which national governments have been required to review their economic strategies so that they can unleash their productive assets in a more market-oriented economy. Thus, private sector development has been raised as a powerful engine for development and there is growing international evidence that governments that are serious about the growth of their economies—as well as equity and poverty—need to develop an environment where everyone has the chance to establish and develop private business.

International development efforts have also undergone a transition in the last decade. A principal part of this transition has been an elevation of the role of the private sector in development efforts. Direct government interventions into development efforts have been questioned, both because of the declining resources of the public sector (as governments become smaller in an effort to curb public debt and achieve maximum market efficiencies), and because of the demand to involve other strategic partners more fully. Thus, international development assistance has encouraged and supported the amendment of public policies to reposition governments in relation to the private sector. Similarly, there has been growing recognition of the unique position of small and medium enterprises (SMEs) within the private sector. Broad private sector development strategies and the business environment in which they operate can be biased against SMEs, reducing their competitiveness and inhibiting their contribution to national development goals. While some development agencies debate the need for specific small enterprise promotion measures, the influence of the business environment on SME performance and the role of international development assistance in this field have become an increasingly pertinent.

By focussing on the role of the business environment for SME development, donor agencies have sought to deliver their development assistance in a more strategic manner, expanding the number of enterprises that benefit from their interventions and creating a more sustainable and enduring change. This has required these agencies to work at a higher level than they have previously when dealing with SME promotion. Drawing from experiences in their own countries, as well as from a broad body of international experience, donor agencies have applied their various skills and resources to assisting developing countries improve their business environments. This report presents the findings of an enquiry into the tools, processes and mechanisms donor agencies have used in this work.

### **1.1 Brief description of Committee of Donor Agencies for Small Enterprise Development and the Working Group on Enabling Environment**

Since the mid-1970s, donors have supported SME development in a variety of ways. Firstly, with the provision of business development services (BDS) and later by the delivery of financial services for SMEs. Since this time, donor interventions in the promotion of SMEs have changed dramatically, reflecting the growing body of knowledge and experience upon which enterprise development programmes are designed.

The Committee of Donor Agencies for Small Enterprise Development was established in 1979. Drawing from a diverse range of multilateral and bilateral agencies (see Annex 1 for a list of current members), the Committee has sought to improve the practice of donors in small enterprise development by commissioning research and sharing information.

This has led to a number of documents that have provided valuable resources for anyone working in the promotion of SMEs—see Box 1.

In 2001 the Committee of Donor Agencies for Small Enterprise Development established a Working Group on Enabling Environment. The interest in working together on the subject of enabling environment and small enterprises stems from the following reasons:

- the importance of knowing what each agency is doing and to learn from each other's experiences;
- the relevance of coordination and possibly collaboration at the country level; and
- co-operation among agencies is likely to give a better mix of knowledge, experience and partners at field/country level.

**Box 1: Key documents produced by the Committee of Donor Agencies for Small Enterprise Development**

Committee of Donor Agencies for Small Enterprise Development (1995) *Small and micro-enterprise finance: Guiding principles for selecting and supporting intermediaries*

Committee of Donor Agencies for Small Enterprise Development (2001) *Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention 2001 Edition* (Known as "The Blue Book")

The Working Group on Enabling Environment subsequently initiated this review of recent experiences resulting from the efforts of member agencies to support national and local governments' attempts to improve their policy environment for small enterprises.

## 1.2 Policy and legal environment as a mechanism for SME development

The Committee of Donor Agencies for Small Enterprise Development has, through previous research into SME promotion, promoted a private sector-led, market economy framework for effective small enterprise development. Within this framework, the State has been assigned the role of 'providing an enabling environment, in correcting or compensating for market failures, and in the provision of public goods, but not in the direct provision of private goods that can be more efficiently provided by the market (Tanburn, Trah & Hallberg 2001, p. 1)

In 1997 the Committee of Donor Agencies for Small Enterprise Development published guidelines for donor-funded interventions into BDS that introduced a number of issues related to the macro-level environment for SMEs. While broadly describing this environment as 'national policy and regulation', the Committee described four pillars to a market-friendly strategy for macro-economic development, which was found to receive broad support from most donors (Committee of Donor Agencies for Small Enterprise Development 1997, pp. 66-67):<sup>1</sup>

- 1 A stable macro-economy: providing financial discipline by governments, a prudent approach to fiscal management, a commitment to low inflation, tax reform, financial sector reform, exchange rates which reflect the true strength of the economy and the privatization of State-owned enterprises.
- 2 A competitive micro-economy: freeing prices and markets so that prices act as key signals to producers and consumers, developing a regulatory framework to ensure competition, including eliminating unnecessary barriers to market entry; developing legal and property rights that facilitate the enforcement of commercial contracts and investment in information and in physical infrastructure, such as transport, to minimize transaction costs.
- 3 Global linkages: opening trade, investment and ideas through a reduction in tariff and non-tariff barriers, encouraging foreign investment and the transmission technologies which may come with it, allowing relatively free movement of people and, on the basis of a realistic exchange rate, encouraging exports.

---

1 These four pillars drawn from the work of Duval and Waterfield (1996) cited in the report.

- 4 Investing in people: promoting strong private and public investment in people's health, education and nutrition, and particularly targeted investment in primary education and preventive health care.

Since 1997, when the Committee of Donor Agencies for Small Enterprise Development first examined this issue in the context of development services for SMEs, the understanding of the business environment and the kinds of reforms that can be made by donors have improved. Individually, many donor agencies have expanded the range of their work in this field. As a result, there has been a growing recognition of the role of institutions in the design, governance and enforcement of policies, laws and regulations. There has also been a better understanding of the ways in which social and cultural factors have influenced the business environment. This report provides the opportunity to document the shifts and improvements in donor efforts to support reforms in the business environment.

### 1.3 Description of the review—its purpose and methodology

The review of experiences from interaction among donor agencies in small enterprise policy reform in selected countries is expected to:

- A Contribute to an understanding of the similarities and differences in agencies' efforts to help countries improve their policy environments for small enterprise development;
- B Contribute to an overall stocktaking of the content, process and outcomes of efforts by assessing specific country experiences; and
- C Contribute to the Donor Committee's efforts to derive principles of good practice that could help guide future collaboration at the country level.

Five countries or regions were selected for this review. In each of these the review was overseen by a Lead Agency representing the Working Group on Enabling Environment. The selected countries/regions and their Lead Agencies are presented in the following chart (Figure 1).

**Figure 1: List of countries, Lead Agencies and authors**

COUNTRY/ REGION	AREA COVERED	LEAD AGENCY	AUTHOR(S)	CITATION*
Caribbean	Dominica, Grenada, Guyana, and Jamaica	DFID	Clare Manuel and Leslie Clark	Manuel & Clark (2002)
Peru	National	ILO	Samuel Machacuay and Ivan Mifflin	Machacuay & Mifflin (2002)
Tanzania	National	Royal Embassy of the Netherlands	Donath Olomi and Mariam Nchimbi	Olomi & Nchimbi (2002)
Viet Nam	National	GTZ	Ray Mallon	Mallon (2002)
Balkans	Albania, Bosnia-Herzegovina and FYR Macedonia	World Bank	Lindita Xhillari (with assistance from Haris Mesinovic)	Xhillari (2002)

Note: \* Refers to the manner in which the country or region report is cited in this report. See Reference List for full details of each report.

Lead Agencies were required to perform the following roles in their nominated country or region:

- Inform all relevant donor agencies, government ministries, and other identified stakeholders of the project, its purpose, approach, and anticipated outputs
- Select a National Consultant to undertake the review in the country/region

- Provide the National Consultant with a list of all relevant donor agencies, government ministries, and other identified stakeholders, with contact details
- Organize national workshop—if required
- Provide comments to the International Consultants (if necessary) on the draft report prepared by the National Consultant

While this review was formulated in the interests of the Committee of Donors, it was recognised (and indeed hoped) that Lead Agencies find value in this exercise at a country or regional level. Thus, the Working Group was eager to ensure that the processes and outcomes of the review have relevance to the Lead Agencies located in the selected countries and regions.

Figure 2, below, provides an overview of the donor agencies that have been reviewed by National Consultants in the five countries or regions studied.

**Figure 2: Range of donor agencies reviewed by country/region**

Balkans	Caribbean	Peru	Tanzania	Viet Nam
ABA-CEELI	CARICOM	AECI	ADB	ADB
CIDA	CARTAC	COSUDE	Com Sec	Asia Foundation
DFID	CDB	FIDA	DANIDA	AUSAid
EBRD	CIDA	EU	DFID	CIDA
EC	DFID	GTZ	GTZ	DANIDA
GTZ	EDU	IADB	ILO	DFID
Italy	EU	ILO	Irish Aid	EC
NORAD	IADE	NOVI	JICA	FES
PHARE	ILO	Swiss Contact	NUFFIC	France
RNE	RNM	USAID	(Netherlands)	GTZ
SDC	UNDP	WB	RNE	IFC
UNDP	USAID		Sida	ILO
USAID	WB		SDC	IMF
WB			UNIDO	JICA
			USAID	JIBA
			WB	Sida
				UNDP
				UNIDO
				WB
				ZDH

## 1.4 Structure of report

Chapter 2 opens the report with a discussion on the use of the term ‘enabling environment’. The Working Group on Enabling Environment initially proposed a general definition, but it appears that many people use this term loosely. Thus, we begin by establishing some frameworks to define the term, without being too academic or semantic. Importantly, the form and content of an enabling environment for private sector development is distinguished from one that is required for effective SME development.

The broad sweep of donor initiatives that focus on improving the business environment for SMEs is presented in Chapter 3. The data presented here draws directly from the regional/country reports commissioned by the Working Group in an attempt to describe the range of donor interventions and to highlight common themes, tools and processes.

Chapter 4 takes the analysis of donor intervention further to examine the kinds of mechanisms donors have used to achieve their purposes. This chapter pays particular attention to the ways donors work with domestic stakeholders (e.g. government, the domestic business community), as well as with other donors. We then try to identify what donor practices appear to be working well (i.e., those that may be defined as ‘good practice’) and those that have been criticised (i.e., may possibly be labelled as ‘bad practice’).

The thorny issue of impact assessment is introduced in Chapter 5. While this study was not designed to assess the outcomes of the policy reform interventions that donors have

embarked upon, this chapter endeavours to open the discussion on the dynamics that emerge when measuring the outcomes of donor intervention.

The last chapter, Chapter 6, summarizes the study findings and presents its conclusions. Included in this discussion is a consideration of the future research and information needs that the Donor Committee on Small Enterprise Development should consider.

The annexes attached to this report contain: A list of institutions that are members of the Committee of Donor Agencies for Small Enterprise Development and the Working Group for Enabling Environment (Annex 1) and summary reviews of the regional/country reports (Annex 2). Annex 3 contains the terms of reference that were used to commission and structure this study.

## **2 DEFINING AN SME ENABLING ENVIRONMENT**

The term 'enabling environment' can be broadly or narrowly defined. Across the regional/country reports there are a wide range of approaches being taken by governments, civil society, SME representative organizations, and international donor agencies to this subject. When reviewing the regional/country reports it was difficult to identify a common understanding among donor agencies as to what elements does the business environment encompass and how these elements affect the competitiveness of SMEs.

It is important to reach an agreed upon understanding of what is meant by the term 'enabling environment', both for the purpose of this report as well as for further research and the development of donor-assisted reform interventions. To this end, we have drawn from a selection of donor-funded research and policy papers to come to a better understanding of the term.<sup>2</sup> As we justify below, this report will use the term 'business environment' to describe an environment in which SMEs can be enabled in their establishment and growth so that they become more competitive. A definition of the business environment and its enabling characteristics requires a two-level explanation. The first level defines the business environment and its components. The second explains how the business environment can be made more enabling for SMEs, i.e., how it can promote SME development.

### **2.1 Components of the business environment**

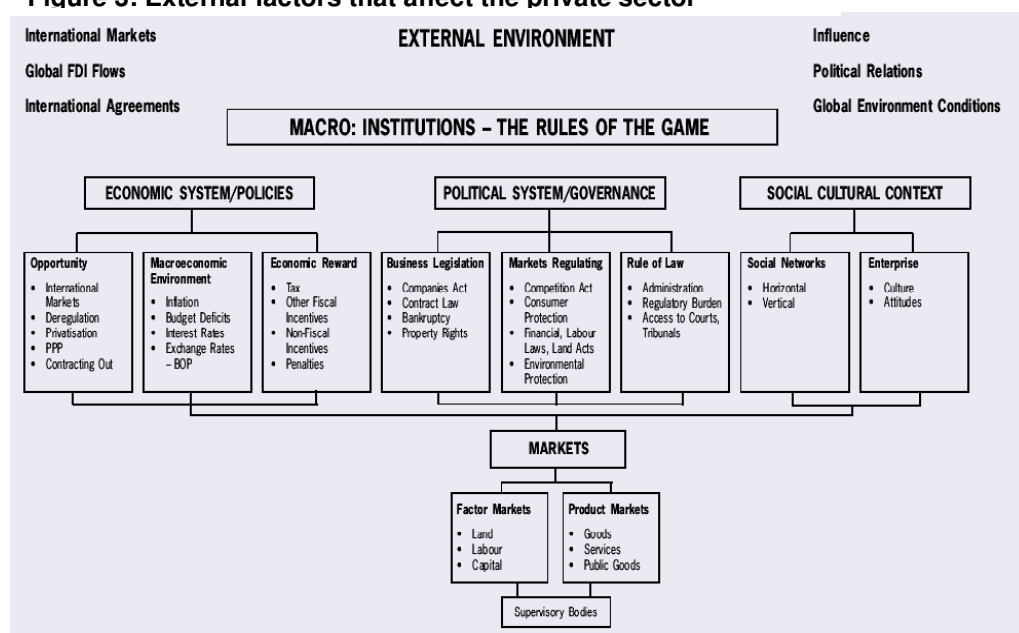
Broadly speaking, the business environment relates to those features that are found outside of the enterprise itself. This includes a wide array of influences ranging from economic, social and cultural systems, to policies, laws and other kinds of rules, to public and private institutions and the affect of other enterprises. These influences can affect the private sector in general, but not always uniformly. SMEs can be face greater disadvantages or biases in the business environment than do large enterprises.

When describing the business environment the Swedish International Development Agency (Sinha et. al. 2001) has grouped the factors that affect the development of the private sector into three levels of economic activity: macro, meso and micro. Factors at the macro and meso level help to form the environment in which enterprises operate, while factors at the micro level impact upon firms directly. Figure 3, below, taken from the Sida report, illustrates the macro level factors that affect the behaviour of firms. These include three spheres of influence: (1) the social and cultural context; (2) the political systems (including the influence of governance); and (3) the economic systems and policies.

Each of these three spheres combines to affect the markets in which the private sector operates. Markets are closely linked to the three spheres of influence described above because they operate according to rules, both formal and informal. These rules govern economic behaviour and, in turn, affect economic behaviour by providing price signals. It is for this reason, that Sida describe the macro environment as 'the rules of the game'.

---

<sup>2</sup> Academic references to the business environment have been avoided because this report focuses on the role of donor agencies. Hence, the perspective of donor agencies when defining the business environment has been our primary concern.

**Figure 3: External factors that affect the private sector**

SOURCE: Sinha et. al. 2001, p. 20.

The three spheres illustrated above express different functions of the business environment. The first sphere concerns the social and cultural context in which enterprises operate. This sphere determines the context in which businesses operate, which includes the level of social cohesion and attitudes towards entrepreneurship. The social and cultural context can create positive attitudes toward entrepreneurship, but it can also lead to negative or suspicious attitudes toward enterprise owner-managers. Thus, the extent to which an entrepreneurial culture is created can affect the activities of firms.

The second sphere of influence concerns the political systems that are in place and the governance of business activities. Instability in political systems can adversely affect small enterprises. The factors listed here work in combination to influence the levels of risk and transaction costs faced by firms, as well as the efficiency of markets.

The third sphere of influence is the economic systems and policies that shape the opportunities and rewards that arise from entrepreneurship. Here the risks of doing business are assessed by businesspeople according to the rewards that are possible. The macroeconomic context in which enterprises operate is included in this sphere.

All three spheres influence markets. Markets are strongly dependent on a range of government policies. Sound macroeconomic policies, for example, can broaden the market base in which firms operate, while innovation and productivity policies can help firms adapt more proficiently to the marketplace. Moreover, competitiveness is directly related to two factors: access to markets and rate of return. The rate of return is, in turn, influenced by productivity and unit costs, which can be determined by infrastructure, access to technology, etc. Thus, the policy and legal environment contributes to the access enterprises can have to new markets.<sup>3</sup>

3 For example, MSEs in Peru it is precisely the lack of access to markets that is the main constraint related to operating outside the regulatory framework (Robles, et al. 2001, pp. 180-181).



Sida's model for understanding the business environment is only one of a number of others. The German Development Institute, for example, have described the concept of 'systemic competitiveness' as a way of understanding the business environment in which SMEs operate, although this is used more frequently in the context of industrial development. This model attempts to capture both the political and the economic determinants of successful industrial development by assessing the ways the state and social actors create the conditions needed to develop systemic competitiveness. There are four levels of investigation contained in this model: The first level is the micro-level of the firm and inter-firm networks. The second level, the meso-level, is concerned with specific policies and institutions. The third level is the macro-level, which deals with generic economic conditions, while the fourth level, referred to as the meta-level considers 'slow variables', such as socio-cultural structures, the basic order and orientation of the economy, and the capacity of social actors to formulate strategies (Altenburg, Hillebrand, Meyer-Stamer 1998).

As cited in Chapter 1, the Committee of Donor Agencies for Small Enterprise Development has given strong endorsement to market-led strategies for SME development. This is because markets provide an extremely effective way of using competition to distribute resources. From the perspective of the business environment, markets are institutions that govern commercial transactions. They provide the 'rules of the game', because they set the norms and standards that affect commercial exchanges. They organize the way in which participants trade in factors of production or in outputs or consumer goods and services. When they work well, markets can provide an efficient means through which commercial activities take place. However, markets can sometimes falter. They can exclude some participants, or favour some over others. They can also work inefficiently and, thus disadvantage many who work in them.

In its recent *World Development Report*, the World Bank (2002) considered the role of institutions in building markets. Institutions, says the World Bank, create the rules, enforcement mechanisms and organizations within which markets operate. Within this context, the relationship between policies and actors in the market place are discussed. Policies can affect markets by determining the legal and regulatory parameters under which enterprises operate, but also by influencing which institutions evolve. In turn, institutions themselves affect which policies are adopted. Thus, institutional structures affect the behaviour of actors in the market, but this behaviour may also be influenced by other institutional structures.

To summarise, the business environment contains a wide range of policies, laws and regulations that generally provide the 'rules of the game' for private sector activities. These rules are influenced by social, economic and political spheres, each of which are interrelated and physically represented in the range of institutions presented above. The combined affect of these influences, rules and institutions is expressed through the performance of markets.

## 2.2 Addressing market failures by reforming the business environment

Private sector development (PSD) has become recognised as a means through which broader development, across social and economic spheres, can be achieved. The OECD (1995) has described private sector development as 'a basic organising principle for economic activity where private ownership is an important factor, where markets and competition drive production and where private initiative and risk taking set activities in motion'. DFID (2000, p. 2) also claims that economic growth is a 'powerful driver of sustained poverty reduction. Vigorous growth and private sector development is strongly associated with poverty reduction, while rising levels of productivity are likely to enhance living standards'.

One of the premises on which PSD has become used as a tool for development has been the understanding that failures in the market place and in the broader business environment have contributed to poverty. These failures have contributed to inequity and the creation and maintenance of poverty. Thus, by improving the environment in which the private sector operates—by making it more *enabling* of PSD—the economy will operate in a more effective and efficient manner, which includes the reduction of poverty.

Within the broad thrust of PSD, SME development has a unique and significant position. While PSD encompasses all kinds of private business endeavours, including large enterprises, multinational corporations, etc., SMEs are by definition smaller. Their smaller size can place them at a disadvantage to larger enterprises—a disadvantage that can be accentuated by the business environment.<sup>4</sup>

The research evidence is clear: SMEs are more vulnerable to biases and constraints in the business environment than larger enterprises. As Beck, Demirgüç-Kunt, and Maksimovic (2002, p. 27) state: 'small and medium sized firms face greater financial, legal and corruption constraints compared to large firms', and, significantly, 'the impact of constraints on firm growth is inversely related to firm size.' Thus, an enabling environment for SMEs will differ from an enabling environment for PSD. These differences (e.g. anti-SME bias) can be considered as failures or distortions of the market.

There are two general causes to market failure, which lead toward reforms in the business environment for SMEs. Each of these is interrelated and each provides a different perspective on the operations of the market and its link to the policy environment.<sup>5</sup> The first way markets can fail is through faults in the enabling framework, i.e., through failures in government policies, laws and regulations. Government policies are interventions in the market and do not exactly belong to the market. However, they affect—by limiting or restricting perfect competition—the operations of markets. At its broadest level, the policy and economic framework in which markets operate—the enabling framework—is affected by the macroeconomic strategy of the country and the extent that it promotes market functions. It is also affected by the political and social culture in which markets operate and the prevailing systems of governance. Good governance provides a sound administrative base for market transactions that demand consistency and predictability.

The enabling framework for market activities is also affected by the legal and administrative systems that govern its operations. Economic courts, the application of commercial standards and the rule of law are examples of legal and administrative systems that can improve the operations of the market. There are many examples to be found where legal and administrative systems fail to meet the needs of smaller enterprises. For example, there can be situations where the cost of establishing and enforcing agreements (transaction costs) is so high that markets cannot operate effectively. Finally, the enabling framework also includes the regulation of market protocols. These may be derived locally, nationally or internationally (e.g. membership to the WTO). Local, national or international restrictions on trade, for example can reduce the effectiveness of the market and constrain its capacity to promote more and better jobs.

The second way markets can fail and affect the performance of SMEs is through the presence of adverse power relations, information asymmetries and market exclusions. Imbalances in power relationships can distort the operation of the market, especially where certain groups (e.g. micro enterprises and women) are excluded from full and equal participation. This can result from biases found in laws and regulations as well as within institutions. Such exclusions or imbalances can also result from prevailing social relations, such as traditional relations that prevent women from owning or inheriting property, or bonded labour situations.

Adverse power relations can contribute to distortions in market power and economies of scale, creating barriers to entry, enabling monopoly rents to be earned and depressing production. They can also lead to asymmetric information—imbalances in the kinds and quality of information held by different parties to a transaction about the nature of the exchange. Each of these practices excludes participants from the market and reduces to effectiveness of the market.

Redressing imbalances in power relationships in the business environment requires a broadening of participation and, hence, the competitiveness and effectiveness of the market.

---

<sup>4</sup> See, for example: Reinecke (2002), Beck, Demirgüç-Kunt, and Maksimovic (2002)

<sup>5</sup> Adapted from Department for International Development (2000).

This may involve reforming those laws and regulations that are biased against small enterprises or groups of small enterprises (e.g. women-owned enterprises) at national, provincial and local levels. It may also require a broader strategy that reforms social relations that perpetuate exploitative, unfair or inequitable practices.

Adverse power relations found in the business environment can also result from inter-market linkages. This is where linkages between markets and the social and political structures and processes in which they operate are found to exclude or disadvantage certain groups. This can occur by limiting the potential of certain groups to manage risk and uncertainty. It can also occur as a result of linkages with other markets and systems where vulnerability or disadvantage in one market system (e.g. financial markets) create or contribute to vulnerability or disadvantage in another market system (e.g. labour markets). Market development initiatives should ensure that linkage between markets and the social and political structures and processes in which they operate don't exclude or disadvantage certain groups. This may require new schemes that help small enterprise owner-managers manage risk and reduce their vulnerability (e.g. local-based social security schemes). It may also involve processes that seek to identify and remove or reduce market linkages that spread vulnerability or disadvantage.

The issue of vulnerability is particularly relevant to the SME sector. While market failures create social and economic risks. While economic risks to small enterprises are most commonly featured in these discussions, social risks, if not properly managed, can cause shocks and contribute to the production of poverty. Shocks produce and perpetuate poverty. All people and enterprises are exposed to risk, but certain groups are better equipped to deal with these risks than others. In response to this, the World Bank has been engaged in designing a Social Risk Management Framework (Holzmann & Jørgensen 2000). See Box 2.

#### **Box 2: SMEs in the Social Risk Management Framework**

The SRM framework indicates that everybody is exposed to risks. Even though the SRM is usually utilised for individuals or households, a straightforward extension can be applied to SMEs. The idea is simple. In economies with high salaried employment, unemployment is a well-known 'idiosyncratic' shock. In contrast, in economies with low salaried employment, unemployment comes in the form of self-employment destruction or SME deaths. SMEs usually use more informal arrangements (e.g., solidarity, family support) when confronted with risk. They usually cope with risk and are usually unable to reduce risk (i.e., prevent risk).

The SRM framework states that there are three strategies to deal with risk: prevention, mitigation and coping. There are also three levels of risk management: informal arrangements, market instruments, and public sector support.

SMEs mostly use informal arrangements when confronted by risks (e.g., community solidarity, family support). Market based instruments are too expensive and in most underdeveloped countries no public support schemes exist. Additionally, SMEs do not usually prevent or mitigate risks. They just cope with it when it appears. Thus, SMEs are less equipped to deal with risks than other firm sizes, indicating that there is room for public intervention in this matter.

Source: Holzmann & Jørgensen (2000)

### **2.3 Making the business environment more enabling for SME development**

Because of its role in setting and enforcing policy, legislation and regulations, government is the main agent involved in the reform of the environment in which private sector development and poverty reduction occurs. However, there are other parties that can contribute to reforms, especially in democratic societies that promote pluralism and the role of civil society in policy making. Each of these institutional actors can be supported in their own ways to contribute to reforms of the business environment that make it more 'enabling' of private sector development and poverty reduction.

- Parliamentary and policy-making institutions: These include national or provincial parliaments, assemblies, or congresses and are the highest level of policy-making. They can be supported through efforts that increase their understanding of the role of government in SME development, while also becoming more aware of the impact on new policies and laws on the operations of small enterprises.

- Political parties: These can play a significant role in setting the social, economic and cultural base upon which SME development occurs. Political parties can be supported through efforts that raise their awareness of the SME sector and the political support that is required to create an environment that maximises the potential contribution the SME sector can make to the achievement of national economic and social development goals.
- Government line ministries: These may be central or provincial government ministries. Their relevance to the small business environment will vary according to their functions and responsibilities; some ministries, such as trade and industry, labour, and taxation, may be directly related to the environment in which the private sector operates, while ministries such as health, women's affairs, and social security can have a less direct, but significant impact on the business environment. The role of the government, say Sinha et. al. (2001, p. 44), is to set the institutional framework for the business environment, the rules of the game, and to ensure that it receives the appropriate incentive to become well functioning as well as to serve as a catalyst and enabler by intervening to improve access, competence and capability. Government line ministries can be assisted in better understanding how the policies, laws and regulations they uphold affect the private sector. They can become more aware of the ways in which programme administration and governance can be improved so that they can act in a manner that facilitates private sector development and poverty reduction, while maintaining standards. They can also be assisted in efforts to consult more effectively with the private sector and to monitor, review, and improve policies, programmes and regulations that affect the SME sector.
- The judiciary: While the role of the judiciary is highly significant, there are often situations found in which few small enterprises are able to make use of the courts to resolve commercial disputes. Cases that do go to court often face major delays in securing decisions with frequent opportunities for corruption. Enforcement of court decisions can also be problematic for small enterprises. The judiciary can be supported in their efforts to ensure that small enterprises have better access to the courts and to information and other mechanisms concerning their rights and obligations within the policy and legal environment.
- Regulatory authorities: These are usually public sector agencies, although some can be parastatals. Their function is usually to enforce specific laws and regulations that govern SME activities. They include taxation authorities, business licensing agencies, customs and excise, auditor general, bureau of standards, consumer protection bodies, central bank, financial regulation and supervision bodies, and competition authorities. Regulatory authorities can be supported through efforts to improve the administration and governance of their programmes and services. They can become better at assessing the impact of their activities on the SME sector, while also improving their dialogue with the sector.
- Local and district government authorities: These perform an important role in setting the local conditions in which the private sector operates. Local government authorities can set local policies and laws, while also being required to enforce policies, laws and regulations that have been established by national or provincial government authorities. Donor agencies can support local and district government authorities in their efforts to create a local environment that is more conducive to SME development. This may include efforts to build the capacity of local government institutions, while improving the skills of elected officials and staff.
- Private sector organizations: As the major participants in private sector development, the private sector itself has a unique and powerful role to play. Quite apart from the role of individual firms, private sector organizations, in the form of chambers of commerce, industry associations, producer organisations, trade federations, and informal sector associations, can represent the private sector and advocate for reforms. Private sector organizations can be supported in their efforts to represent the SME sector and to advocate to government for reforms. They can be assisted through efforts that improve their understanding of the impact of policies and laws on

the private sector (i.e., through research), while also being given support to build their capacity as an organization to service their members and represent them effectively.

- Business development service providers (financial and non-financial): These agencies may be privately owned or government agencies, or a combination of the two. They include business advisers, accountants, lawyers, business support providers, investment promotion bodies, information centres, development corporations, trade promotion boards, commercial banks, and micro-finance providers. Business development service providers can be assisted by donor agencies through interventions that help them provide business-like services that are market-based, while also responding to the development needs of poverty reduction measures. They can also be provided with relevant legal structures to operate within.
- Universities and academic research institutions: Academic institutes are increasingly involved in research on issues that affect the environment for private sector development. Universities and academics can become involved in national policy debates, sometimes at very high levels. They can also undertake strategic and substantive critical studies that address barriers to business development. Universities and academic research institutions can be linked to international research and research institutions. They can be assisted through capacity building efforts that enhance their ability to conduct independent research and provide policy advice.
- Worker organizations: While many unions and other forms of organized labour tend to operate more frequently in the formal sectors of the economy and among larger private enterprises, as well as in the public domain, these bodies can be important agents in the promotion of employment conditions that affect economic livelihoods and the quality of employment. Donor agencies can support worker organizations in their efforts to contribute to poverty reduction and embrace workers in small and informal enterprises.
- Local, community-based and civil society organizations: These entities cover a broad spectrum, but they can perform an important function in mobilising local groups (including those who are poor, in the informal sector, or other kinds of small enterprises), promoting and advocating for local development policies, and facilitating government and community dialogue. Local, community-based and civil society organizations can be assisted through capacity building measures that improve their ability to bring marginalised groups into the policy dialogue, as well as to become agents through which government services and information can be delivered.

There are a number of activities that can be found in reform processes and the selection of these will depend on the need and kind of reforms required to promote SMEs, which will vary from country to country and sector to sector. Because these activities are designed in response to specific reform priorities it is not possible to describe the full range. However, the following examples serve to illustrate some of the more common reform activities. These are presented according to two broad kinds of reform measures that respond to the way in which the business environment has been defined above.

Firstly, there are reform activities that focus on improving the policy, legal and regulatory framework in which SMEs operate. Examples of these kinds of reform activities include the following:

- Filling gaps in the legal or regulatory framework in which the private sector operates (e.g. providing property rights and collateral, contract and commercial laws, bankruptcy laws and insolvency practice, competition laws, company laws, tax laws, laws on financial transactions and labour laws), while ensuring that SMEs are extended the same benefits as large enterprises
- Designing and implementing development policies (e.g. SME development policies, poverty reduction strategies)
- Removing excessive and unnecessary laws and regulations that unnecessarily constrain the private sector or are biased against SMEs

- Simplifying and streamlining regulatory and reporting procedures so that SMEs are more able comply
- Promoting standards and ensuring rights for the private sector in general, as well as for the SME sector in particular (e.g., accounting standards, industry standards in quality, health standards, environmental standards, employment conditions and trade union membership)
- Improving financial regulation and supervision for the private sector in general and ensuring that these benefits reach the SME sector
- Removing any policy, legal or regulatory obstacles that SMEs face when attempting to obtain finances, services, or information, or to access the judicial system

Secondly, there are reform activities that that work within the existing policy, legal and regulatory framework and focus on the reform the institutional arrangements of the business environment. Examples of these kinds of reform activities include the following:

- Improving access SMEs have to information, including market, legal and business information
- Increasing research and knowledge management capacities in government as well as within SME representative and civic organizations
- Enhancing the bargaining power of SMEs through collective or cooperative arrangements, sectoral strategies, and solidarity campaigns
- Reducing corruption and rent seeking among government and regulatory agencies—particularly those involved with the SME sector
- Improving governance and administration, including transparency in public institutions, civil society participation and greater government interaction with business
- Broadening and strengthening the representation of SMEs in dialogue with the government
- Improving government, SME, and community dialogue

A conducive policy and legal environment for small enterprises, says the International Labour Organizations (2002) lowers the costs to establish and operate a business. This includes the use of simplified registration and licensing procedures, appropriate rules and regulations, reasonable and fair taxation. Such an environment increases the benefits of legal registration, facilitating access to commercial buyers, more favourable credit terms, legal protection, contract enforcement, access to technology, subsidies, foreign exchange and local and international markets.

### 3 POLICY REFORM INTERVENTIONS BY DONOR AGENCIES

This study has examined the practices of donor agencies in three countries and two regions. Despite considerable variations in the political, economic and social features of these countries, donor activities are remarkably similar. The targets for reform of the business environment may vary from one country to the next, but there is a common set of strategies employed by donor agencies to support reform processes.

This chapter presents the range of donor interventions that focus on improving the business environment for SMEs, drawing from data contained in the regional/country reports commissioned by the Working Group. This will be done, firstly by briefly describing the general themes that underlie donor intervention in this field. Secondly, by outlining the range of strategies and approaches used by donors to support reforms to the business environment, and thirdly, by describing and categorising the tools and processes used by donors. Finally, some of the features of donor reform interventions are presented.

#### 3.1 General themes of donor intervention

The kinds of interventions that have been undertaken in the countries under study were largely influenced by some general themes behind donor support. While these themes might be simply described as an interest in promoting SMEs, there is a bigger picture that describes the context in which donor interventions occur.

Donor involvement in **the Balkans** has been relatively recent. It was only in 1991 in Albania, for example, that donors first came to the country. There are a lot of similarities found across the countries of the region. All have been undergoing a transition from a socialist, command-economy to a market-economy. This has involved substantial privatisation and market liberalisation reforms. PSD has been a major thrust, as State-owned enterprises (SOEs) have been restructured and privatised. All countries have also experienced varying degrees of social and political upheaval in the last decade. SME development is very new, despite the evidence that almost all employment is found in micro and small enterprises.

In **the Caribbean** donor agency support for SME development seems to be growing in recent years and covering new issues in response to the challenges posed by globalization. In some countries of the region, donors have offered support to overcome the problem of macro instability. The small population of countries in the region makes it costly (in per capita terms) to deliver any kind of support. This is a major concern to many donors and, as a result, there are a number of projects delivered at a regional level as well as at national levels. Because most enterprises in the Caribbean are SMEs, an enabling business environment for the private sector is synonymous to an SME enabling environment.

In **Peru** there is a long history of donor support. However, direct donor involvement in SME related projects only started in the mid-1980s. Most of the initial efforts focused on making some administrative procedures simpler, probably following the de Soto (1984) postulates.<sup>6</sup> Donor agency support has evolved through the years; first by providing considerable support to micro finance schemes in the early-1990's (through pilot or demonstration projects) and more recently, through the support to BDS markets. Donor efforts have also contributed to several important regulatory and policy changes. The existence of a large local network of NGOs and professional expertise, has encouraged donors to concentrate their efforts on coordination and agreements. Donor efforts are now coordinated in the SME Coordinating Table, which is consulted in most SME related activities.

Donor involvement in **Tanzania** has, like the Balkans, come about in response to economic crisis. In this case it was an economic crisis that officially spanned from 1979 to 1985. This transition led to a transition from socialist command-economy to market-economy and the introduction of Structural Adjustment Programmes. Many foreign donors applied

---

<sup>6</sup> Hernando de Soto is the Founder and President of the Institute of Liberty and Democracy in Lima, Peru and is internationally renowned as an authority on the impact of laws and regulations on small enterprises.

pressure to the Government of Tanzania to make these reforms, which included the promotion of the private sector. Subsequently, Tanzania has a substantial private sector, albeit dominated by micro and informal enterprises.

The transition from a socialist command-economy to a market-economy has a special twist in **Viet Nam** where a multi-sectoral economy is being promoted—one that contains a State sector, a direct foreign investment (FDI) sector, and a private sector. From the top down, government has displayed a strong commitment to reforming the business environment, displaying a steadily increasing commitment to PSD since the introduction of *Doi Moi*, largely in response to grassroots pressures to remove barriers to private sector growth and employment. While most donors (including the World Bank, International Monetary Fund and Asian Development Bank) only resumed financial support to Viet Nam in 1993, Sida and the UNDP provided technical assistance on reform and enabling environment issues throughout the whole reform process.

From a global perspective (i.e. one that extends beyond the five regions/countries under study) donor supports for reforming the business environment in which SMEs operate appear to come from two main motivations. The first is the desire for private sector development. Many donors have established strong PSD programmes. As the previous chapter described, PSD has been recognised as a powerful mechanism for economic growth from which all sectors of society should benefit. Examples of donors with a strong PSD approach include the World Bank, the UK Department for International Development (DFID), the German Agency for Technical Cooperation (GTZ), the Swedish International Development Agency (Sida), and the European Bank for Reconstruction and Development (EBRD).

The second common motivation for donor intervention is the reduction of poverty. There are clear links between poverty reduction and PSD. For some donor agencies poverty reduction may more accurately be described as an objective, while PSD is a strategy. SME development becomes relevant as a tool for private sector development and poverty reduction because it broadens participation in the private sector and, because it involves many people who live in poverty, provides a mechanism for their empowerment.

The United Nations Millennium Declaration (55th Session of the General Assembly, 18 September 2000) provided a current focus for UN agencies and others in this field when it resolved to 'halve, by the year 2015, the proportion of the world's people whose income is less than one dollar a day and the proportion of people who suffer from hunger and, by the same date, to halve the proportion of people who are unable to reach or to afford safe drinking water' (Paragraph 19). Almost all the poor pursue some form of private activity to earn their living—either as farmers or small enterprise owner-managers. Consultations with poor people often raise the need for sustainable incomes. The World Bank's study, *Voices of the Poor*, identifies that next to illness and injury, the scope for entrepreneurial activity and the availability of jobs is the most important factor determining the fate of poor people (Deepa et al. 2000, cited in World Bank 2001).

Beyond these two broad themes are a number of specific interests or development themes. United Nations Fund for Women (UNIFEM), for example, has established a programme of activities that endeavours to strengthen women's economic capacity, to encourage women to become key economic players, and to shape the direction of market forces that often ignore gender considerations altogether. The International Labour Organization (ILO), on the other hand, comes to the SME environment with an interest in improving the capacity of the small enterprise sector to create more and better jobs.

Donor support for SME development in the countries under study has displayed a noticeable transition. This is usually from the provision of financial or non-financial (i.e., BDS) support for the SME sector, to the support for meso-level institutions that can be used to represent or promote the SME sector, and to the support for reforms in the business environment. In the Balkans, for example, Xhillari (2002) found that donor support for the SME sector has spanned the provision of financial services, the provision of BDS, the creation of networks of SME promotion agencies, and a focus on the improvement of legal and regulatory framework. Unfortunately, many of these interventions have been interlinked, creating a situation where failure in one field contributes to the failure in others. On the other hand, Xhillari notes that donor experiences in the first three fields of intervention have yielded a better understanding of the needs and dynamics of the emerging SME sector and the



impact the business environment has on the sector's performance. In the Caribbean, Manuel (2002) noted that 'donor initiatives currently tend to address the constraints faced by informal businesses at the micro level', signifying a need to shift their intervention to 'other levels—particularly in relation to legal and regulatory reforms, where the aim should be to encourage compliance'.

### 3.2 Range of donor interventions

The five regional/country reports revealed five fields of donor intervention used by donors to support national efforts in the promotion of a more enabling business environment (see Figure 4: Fields of donor intervention and reform assistance strategies). All these fields of donor intervention were found to have their own areas of focus or concern. These are generally contained in the reform assistance strategies that donor agencies use. Reform assistance strategies were found to vary according to the national context.

**Figure 4: Fields of donor intervention and reform assistance strategies**

Fields of donor intervention	Reform assistance strategies (areas of focus)
<b>1. Supporting a stable macroeconomic environment</b> To create a market-oriented economy in which private sector development (including SMEs) can operate in an efficient manner with the aim of achieving national development goals, such as poverty reduction, employment and wealth creation, etc.	<b>Macroeconomic policy framework</b> <ul style="list-style-type: none"> <li>Providing assistance in the design of transition strategies, often from a command- to market-economy. [Found in Albania, Bosnia-Herzegovina, Dominica, Grenada, Guyana, Jamaica, Macedonia, Tanzania, Viet Nam.]</li> <li>Providing advice in broad-based economic restructuring. [Found in all countries to varying degrees]</li> </ul> <b>Market liberalisation</b> <ul style="list-style-type: none"> <li>Advice in the removal of tariffs and other trade constraints. [Found in all countries to varying degrees.]</li> </ul> <b>Governance</b> <ul style="list-style-type: none"> <li>Providing assistance in the governance of government services and programmes; improving efficiency, accountability and transparency. [Found in all countries to varying degrees and at different levels.]</li> </ul>
<b>2. Direct policy and legal reforms: Private sector development (general)</b> To ensure that policies, laws and regulations governing the private sector did not unduly encumber the private sector. Reforms occurring in this field are not specifically targeted toward the SME sector.	<b>Privatisation programmes</b> <ul style="list-style-type: none"> <li>Providing assistance in the restructuring of SOEs. [Found in Albania, Bosnia-Herzegovina, Dominica, Grenada, Guyana, Jamaica, Macedonia, Tanzania—some time ago—and Viet Nam]</li> <li>Assistance in the restructuring of commercial banks [Found in Albania, Bosnia-Herzegovina, Dominica, Grenada, Guyana, Jamaica, Macedonia, Tanzania, and Viet Nam]</li> </ul> <b>Private sector promotion policies and strategies</b> <ul style="list-style-type: none"> <li>Assistance to create a policy framework for PSD. [Found in Albania, Bosnia-Herzegovina, Dominica, Grenada, Guyana, Jamaica, Macedonia, Tanzania, Viet Nam]</li> </ul> <b>Legislative and regulatory reforms</b> <ul style="list-style-type: none"> <li>Assistance in the analysis and improvement of laws and regulations governing private business behaviour, including institutional reforms. [Found in Albania, Bosnia-Herzegovina, Dominica, Grenada, Guyana, Jamaica, Macedonia, Peru, Tanzania and Viet Nam]</li> </ul>
<b>3. Direct policy and legal reforms: SME development (specific)</b> To remove anti-SME biases found in policies, laws and regulations and to ensure that	<b>SME promotion policies and strategies</b> <ul style="list-style-type: none"> <li>Assistance to create a policy framework for SME development, including defining the SME sector [Found in Albania, Bosnia-Herzegovina, Dominica, Grenada, Guyana, Jamaica, Macedonia, Tanzania, Viet Nam]</li> </ul>

the reform of these instruments are responsive to the conditions and capacities of the SME sector. Reforms in this field generally seek to facilitate the promotion of the SME sector.	<b>Legislative and taxation reforms</b> <ul style="list-style-type: none"> <li>Assistance in the analysis and improvement of laws governing business behaviour and the taxation system as it applies to SMEs [Found in Albania, Bosnia-Herzegovina, Dominica, Grenada, Guyana, Jamaica, Macedonia, Peru, Tanzania and Viet Nam]</li> </ul>
<b>4. Strengthening institutions: Policy design, implementation and enforcement</b> Policy design, implementation and enforcement: To ensure that existing and newly created or reformed policies, laws and regulations are properly implemented and enforced in a transparent, equitable and market-oriented manner.	<b>Capacity building</b> <ul style="list-style-type: none"> <li>A range of interventions designed to improve the capacity and capability of regulatory and SME promotion agencies, including: line ministries, regulatory authorities, public-private sector forums, economic courts, parliaments. [Found in all countries to varying degrees]</li> </ul>
<b>5. Strengthening institutions: Representative and advocacy</b> To ensure that the SME sector is properly represented in policy and legislative reform dialogues, and that representative institutions can advocate for change to government in a consistent and knowledgeable manner that is driven by mandates that come from SMEs themselves.	<b>Creating new institutions</b> <ul style="list-style-type: none"> <li>In the absence of existing institutions, donors have actively supported the creation of new institutions: Examples include national SME networks and promotion agencies [Found in Albania, Bosnia-Herzegovina, and Macedonia]</li> </ul> <b>Capacity building</b> <ul style="list-style-type: none"> <li>A range of interventions designed to improve the capacity and capability of existing institutions that represent the SME sector and can advocate for reform to the business environment. [Found in all countries to varying degrees]</li> </ul>

Interestingly, across all regional and country reports, the issue of gender was absent. Despite the likely need for reforms that redress biases against women that may be found in many societies and, hence in many business environments, no evidence of donor agency support for such reform measures was documented. Regulatory weaknesses that act against SMEs are likely to act against all less empowered interests in society—including women. Correcting government and regulatory failures can do much to empower those with less access to authority or to full economic participation. However, it was surprising to note that none of the countries under study found evidence of a gender perspective among donor agencies in their efforts to address the business environment in which SMEs operate.

The reform assistance strategies employed by donor agencies were found mostly at the national level. However, there were some examples described in the regional/country reports of donors working at sub-national levels, such as in specific provinces or localities. Indeed, there appears to be a growing trend among donor agencies to adopt a two-pronged approach in their reform assistance strategies, combining national-level reform efforts with provincial or local efforts. By doing this, donors are attempting to examine the way national reforms filter down to the local level and how local business environments can be made more conducive to SME development.<sup>7</sup>

Regional approaches by donors to business environment reforms were relatively hard to find. There were a few examples in Viet Nam where the Mekong Region (encompassing Viet Nam, Cambodia and Laos) has been used as a means of designing and delivering donor support. Strangely, in a region such as the Balkans, where there appears to be a great deal of similarity among the member countries, very few regional approaches to reform were found.

<sup>7</sup> This two-pronged approach was cited by both DFID (Boulter, personal interview, written notes 10 May 2002) and GTZ (Prey, personal interview, written notes, 8 May 2002).

By comparison, donors in the Caribbean—a region that exhibits great diversity, but a number of countries with small populations and economies—have sought to reduce the influence of externalities and to lower their transaction costs by applying regional approaches to their work. In Figure 5, we present some of the strategies and tools being used by donors in the Caribbean.

The advantages of a regional approach are that, in some specific small states, there is limited public sector capacity at the national level and some regional bodies or authorities with a greater potential to manage donor funds. Regional strategies reduce transaction costs and help to overcome some constraints that are essentially regional, such as trade barriers, competition, etc. The main disadvantage of a regional approach is that local political agendas might not match regional interests and priorities.

Overall, it is clear that the processes of reform of the business environment are a difficult, multifaceted and time-consuming. This has significant implications on the way in which the business environment is assessed, the design of reform interventions by domestic stakeholders, the design of assistance measures by donors, and the assessment of performance and impact that stems from these efforts.<sup>8</sup>

Donors must recognise that they cannot drive these processes. Instead, they must recognise the necessity for national ownership of reform processes and encourage this. Domestic stakeholders—governments, civil society, SME representatives, and others—are the key drivers of the reform process. It is only through the efforts of these constituents that reform efforts can be legitimised, sustained, and fulfilled.

Consequently, donors need to identify ways they can support these stakeholders in their efforts. They should provide tools, processes and analytical and reform models that add value to domestic reform efforts, while recognising that reform takes time. Thus, in most cases donor planning horizons will need to be extended.

**Figure 5: Region approaches to reform in the Caribbean**

Strategy	Examples
High level agreement on a common agenda	USAID's Caribbean regional programme, World Bank's Country Assistance Strategy for the OECS
Regional funding modality	CIDA's ECEM and CPEC, EU's EBAS technical assistance programme
Partnership with existing regional institution	CARICOM, EU's export development programme with OECS, OECS and ECCB's sub regional approach
Support to new regional bodies	ECTEL - OECS telecommunications authority by World Bank and USAID's, Eastern Caribbean Stock Exchange by IADB and CDB.
Support to regional service providers	CARICAD public sector reform, CARTAC public expenditure

Having surveyed the range of interventions and reform assistance strategies used by donors, we shift our focus to look more closely at the specific tools and processes donors employ to support reform of the business environment.

---

<sup>8</sup> For further evidence of this see Altenburg, Hillebrand, Meyer-Stamer (1998) and Bannock (2002).

### 3.3 Intervention tools and processes

Formatted: Bullets and Numbering

The term 'tools and processes' is used to describe the kinds of activities or practices that donor agencies undertake in their reform efforts. It is sometimes difficult to distinguish between a tool and a process, which is why we have combined them in this discussion. A tool, for example, may describe research or technical assistance, yet each of these tools requires its own kinds of processes when applied. Likewise, a reform process such as facilitation or consultation, requires the use of unique tools.

Depending on the area of focus, donors have applied their own kinds of tools and processes in the support of reforms to the business environment (see Figure 6: Tools and process of reform).

**Figure 6: Tools and process of reform**

Reform assistance strategies (areas of focus)	Specific tools and processes found	Countries or region <sup>9</sup>	Donors <sup>10</sup>
<b>Macroeconomic policy framework</b>	<b>Technical assistance</b> Provided to ministers and parliamentarians, line ministries, and technical or other policy-making institutions. Main focus is at a national level  [Note: Bilateral donors usually only used this tool/process in certain countries]	All countries and regions	ADB EBRD USAID WBG
	<b>High level dialogue</b> Between donor and government, as well as between representatives of the private sector and government  [Note: Bilateral donors usually only used this tool/process in certain countries]	All countries and regions	ADB EBRD USAID WBG
	<b>Policy studies and workshops</b> To improve the knowledge-base and capabilities of policy-makers	Caribbean Viet Nam	ADB EBRD GTZ IADB JIBA JICA USAID
<b>Public administration reform and accountability</b>	<b>Technical assistance</b> Provided to technical, policy-making, and regulatory institutions, at national, provincial and local levels, to improve governance and administration.	All countries and regions	ADB EBRD GTZ JIBA JICA USAID WBG
	<b>Financial assistance</b> Donors will often provide funds to assist line-ministries, regulatory authorities or other kinds of programme delivery agencies in purchasing the resources they require to operate effectively. This can include institutions at national, provincial and local levels.	Balkans Tanzania	ADB EBRD GTZ JIBA JICA USAID WBG

<sup>9</sup> This is not an exhaustive listing. The column is used to illustrate the prevalence of specific tools and processes that were found across the three countries and two regions under study.

<sup>10</sup> This is not an exhaustive listing. The column is used to illustrate the extent to which donors focus on particular tools or processes across the three countries and two regions under study.

	<p><b>Specialist training</b></p> <p>Assistance to improve the capabilities of technical, policy-making, and regulatory institutions, at national, provincial and local levels.</p>	Balkans	<p>ADB EBRD GTZ JIBA JICA USAID WBG</p>
<b>Market liberalisation /strengthening</b>	<p><b>Technical assistance</b></p> <p>Provided to ministers and parliamentarians, line ministries, financial institutions, the judiciary, and technical or other policy-making institutions. Main focus is at a national level, but issues such as decentralisation of government services and the removal of sub-national trading barriers can be included in this assistance.</p> <p>Mapping exercises have also been undertaken to promote investors decisions</p>	All countries and regions	<p>ADB CIDA EBRD IADB JIBA JICA USAID WBG</p>
<b>Privatisation programmes</b>	<p><b>Technical assistance</b></p> <p>Provided to ministers and parliamentarians, line ministries, financial institutions, and technical or other policy-making institutions. Main focus is at a national level.</p> <p><b>Financial assistance</b></p> <p>Donors will often provide funds to financial institutions to increase access new and emerging SMEs have to finance.</p>	<p>Albania Caribbean</p> <p>Albania Peru</p>	<p>ADB DFID EBRD EU IADB JIBA JICA CS-PHARE</p> <p>CAF EBRD GTZ JIBA JICA IADB</p>
<b>SME promotion policies and strategies</b>	<p><b>Technical assistance: policy drafting</b></p> <p>Assistance to line ministries, SME promotion agencies and technical or other policy-making institutions in the drafting of new policies and SME promotion strategies. Main focus is at a national level, but issues such as decentralisation of government services can be included in this assistance.</p> <p>Demonstration projects to validate new practices and strategies.</p> <p>Awareness activities to promote new ideas in SME promotion.</p> <p><b>Facilitation of consultation processes</b></p> <p>Provided to assist governments in their efforts to consult with the SME sector, local communities, and worker organizations.</p>	<p>Albania Guyana Macedonia Tanzania Viet Nam</p> <p>Peru</p>	<p>DANIDA DFID ILO Italy UNDP UNIDO USAID</p> <p>ILO</p>
<b>Legislative and taxation reforms</b>	<p><b>Technical assistance</b></p> <p>Provided to line ministries, financial institutions, regulatory authorities and technical or other policy-making institutions. This intervention is commonly a national effort, but provincial and local governments can also be assisted in this way.</p>	All countries and regions	<p>ABA-CEELI ADB AusAID CIDA DFID EBRD EU GTZ ILO UNIDO</p>

			USAID WBG
<b>Capacity building for institutions involved in policy design, implementation and enforcement</b>	<p><b>Technical assistance: on-the-job training</b> Technical advisers located in line-ministries, regulatory authorities or other kinds of programme delivery agencies. This can include institutions at national, provincial and local levels.</p> <p><b>Specialist training</b> Assistance to improve the capabilities of policy-makers, regulators and other forms of enterprise inspectors. This can include institutions at national, provincial and local levels.</p> <p><b>Study tours</b> Exposure and learning opportunities for policy-makers, regulators and other forms of enterprise inspectors. This can include institutions at national, provincial and local levels.</p> <p><b>Financial assistance</b> Provided to assist line-ministries, regulatory authorities or other kinds of programme delivery agencies in purchasing the resources they require to operate effectively. This can include institutions at national, provincial and local levels.</p>	<p>Albania Bosnia and Herzegovina Guyana Jamaica</p> <p>Albania Viet Nam</p> <p>Balkans Viet Nam</p> <p>Albania</p>	<p>CIDA DANIDA GTZ Italy ZDH</p> <p>ILO Italy ZDH</p> <p>ZDH</p> <p>Italy</p>
<b>Creating new institutions for SME representation and advocacy</b>	<p><b>Financial assistance</b> Provided to assist in the formation of new organizations that can represent the SME sector and contribute to dialogue regarding reforms to the business environment. This assistance usually deals with new national agencies, but can include new institutions at provincial and local levels.</p> <p><b>Capacity building support</b> Such as those provided to existing institutions described in the cells below.</p>	<p>Balkans Tanzania Viet Nam</p> <p>Balkans Tanzania Viet Nam</p>	<p>SDC Sida UNDP ZDH</p> <p>SEED Sida ZDH</p>
<b>Capacity building for new and existing institutions engaged in SME representation and advocacy</b>	<p><b>Technical assistance: on-the-job training</b> Technical advisers located in SME representative and advocacy organizations to assist in the design and implementation of a range of activities, including: membership development, SME development services, analysis of the business environment, reform options and advocacy. This assistance usually deals with national agencies, but can include institutions at provincial and local levels.</p> <p><b>Research</b> Assistance to improve and expand the knowledge base concerning the business environment and its impact on the SME sector for the staff and management of SME representative and advocacy organizations at national, provincial and local levels.</p> <p><b>Specialist training</b> Assistance to improve the capabilities of staff and management within SME representative and advocacy organizations at national, provincial and local levels.</p> <p><b>Advocacy training</b> Assistance to improve the advocacy capabilities of staff and management within SME representative</p>	<p>Albania Guyana Tanzania Viet Nam</p> <p>All countries and regions</p> <p>Balkans Viet Nam</p> <p>Viet Nam</p>	<p>EU CDB CIDA Netherlands Sida UNDP USAID ZDH</p> <p>GTZ ILO UNDP</p> <p>GTZ ILO SEED</p> <p>DANIDA ZDH</p>

	and advocacy organizations at national, provincial and local levels.		
	<b>Study tours</b> Exposure and learning opportunities for the staff and management of SME representative and advocacy organizations at national, provincial and local levels.	Balkans Viet Nam	GTZ UNDP
	<b>Financial assistance</b> Provided to assist organizations that represent the SME sector and contribute to dialogue regarding reforms to the business environment. This assistance can be delivered at national, provincial and local levels.	Balkans Caribbean Tanzania	EU/ACP Netherlands SEED Sida

As this chart above shows, there are a relatively small number of reform tools and processes used by donors—about a dozen are described here—yet, the application of these can vary dramatically according to the reform strategy in which they are framed. Thus, tools and process can be used for a variety of purposes and, as a result, the broader processes in which donor reform assistance strategies are designed plays a critical role.

This brings us to the way in which donors design and implement their interventions. As we saw earlier in this chapter, most donor reform efforts were found to fall into five broad categories. Each of which were found to have areas of focus or concern. Based on the analysis undertaken by donor agencies, these areas of focus are represented as reform assistance strategies.

Very little was found in the regional/country reports regarding the precise processes that donor agencies follow when designing their reform assistance strategies. In general terms, donors engage in a process of research and consultation; they sometimes used local consultants for this work, but often relied on international expert assessments. They consult with government, the private sector and other relevant stakeholders; and they develop strategic relationships with domestic counterparts to design and implement their reform assistance strategies. However, many donor agencies interviewed by national consultants were unable to describe the earlier processes of programme design that were undertaken by their agency. The loss of institutional memory—attributed in part to the rotation of staff in country offices—seems to have inhibited the collection of data on these processes. The mechanisms donors use to design their reform assistance strategies are described more fully in the following chapter.

Although it was found to be extremely difficult to uncover, the processes donor agencies undergo in the design of reform support strategies is extremely significant. Unlike other fields of SME development, such as financial services or BDS, donors are required to accommodate a broader range of concerns. Firstly, and similarly with the design of other SME development strategies, they must address the issues that arise from the capacity of SMEs to respond competitively to market opportunities, as well as the policy, legal, regulatory and institutional framework that surrounds them. Secondly, and in contrast to the design of other SME development strategies, they are required to respond to the political, social and economic systems that influence the options for reform, the kinds of assistance that can support selected reform measures, as well as the speed, quality and partners of reform processes. Thus, donor assistance to reforming the business environment involves the combination of technical responses along with political responses. For this reason, the processes donors engaging in the design of their assistance strategies deserve further investigation.

Donor agencies search for a point of entry to reform processes. In the Caribbean, Manuel and Clark (2002) found that policy reform processes have to be aware of local processes and adopt an opportunistic behaviour. Similarly, in Viet Nam, Mallon (2002) points out, 'opportunities for change can emerge quite unexpectedly, and may be stalled for reasons that are difficult to predict'. For this reason donor agencies need to adopt a flexible approach to their work. In Viet Nam, for example, there have been some good experiences in this

direction. In recent years, donors have adopted a number of different strategies to provide greater flexibility to respond to emerging needs. Examples include (Mallon 2002):

- The Mekong Project Development Facility was developed by several donors to pool their support directly supporting business development planning. While the focus of MPDF activities is on direct support to businesses and strengthening business development services (BDS), it has also funded studies aimed at influencing emerging debate about the enabling environment for business.
- UNDP has moved from planning activities for the life of projects (usually two to four years) to annual planning of activities within guidelines established within a longer-term project design. The recently approved follow-up project on improving the regulatory environment for business is using this approach.
- AusAID recently established a Capacity building for Effective Governance facility aimed at providing the flexibility to respond to emerging demands for technical support to improving governance, including improvements in the private sector enabling environment.
- Some donors (e.g., DFID) have decentralized some decisions to field offices, thus providing more flexibility in responding to emerging opportunities for support.
- Germany is considering the establishment of a Reform Support Fund, to fund short to medium-term support for reform via advisory services, research support and training. The Fund approach would allow activities to be tailored more directly at emerging needs within appropriate partner agency, with continued funding dependent on progress in producing expected results.

Many donor agencies have made use of broad development strategies to locate their support for reform efforts. Often government in close cooperation with multilateral and selected bilateral agencies has formulated these strategies. The most recent of this kind of broad development strategy are the Poverty Reduction Strategy Papers (PRSPs). PRSPs have provided a framework for a number of donor agencies to identify priorities for reform that they can support, and to work with government in pursuit of these reforms. They have also helped government agencies take the lead in reform measures.

While we have witnessed a similarity in the strategies, tools and processes of reform across the three countries and two regions studied, there has been one major area of difference. This relates to the level of donor influence in reform processes. In Viet Nam, for example, Mallon (2002) claims that 'strong national ownership of the reform process has been crucial in successfully implementing change'. Here, government has taken the lead in the reform process, largely in response to domestic pressures for change, requiring donors to find ways where they can contribute to government-driven processes. In Tanzania, as well as the Balkans, the government appears to be less determined, creating a situation in which donors have applied pressure for reform. In these cases, donors have complained about weak counterpart organizations and the lack of government commitment. Here too, governments have taken a different approach to donor agencies when measuring the success of reform efforts.

Where governments have a clear reform agenda, or at least a vision for reform and a commitment toward developing a reform agenda to pursue, donors tend to look for a place within this vision or agenda. They can support or complement government's lead. In some cases, as in the case of Viet Nam as well as other countries, they can help to bring other parties into dialogue with government (such as representatives of the SME sector) to improve the quality of the vision and the chances of success. However, where government is less determined and less engaged in the issue of reform, donor agencies face a different kind of challenge. In such circumstances donor agencies may be required to find other mechanisms to raise awareness among key domestic stakeholders, especially government. This may be done through other development strategies, such as PRSPs, or through exposure visits and regional comparisons. However, it is clear from all five regional/country reports that reforms to the business environment will only succeed where there is national ownership. Donor agencies cannot drive these processes and expect success.



In conclusion, the work of donor agencies in the three countries and two regions reviewed for this study display a high degree of similarity. Donor interventions in the reform process were found to fall into five broad categories within which specific reform assistance strategies, tools and processes were designed. However, the design of these strategies and the packaging of various tools and processes within them were found to vary according to national reform priorities.

More can be learned about the processes donor agencies undertake in the design of their interventions. Especially since it is this feature of donor activity that appears to be the most influential in the choice of strategies, tools and processes.

## **4 MECHANISMS FOR POLICY REFORM**

As we described in the previous chapter, reforming the business environment for SME operations involves more than the application of certain tools and processes. No matter how well designed or relevant these may be, donor interventions require effective mechanisms through which they can apply their support. These mechanisms are used to define the way donor agencies work with domestic stakeholders as well as other international agencies.

This chapter attempts to take the analysis of donor interventions in the reform process further to examine the kinds of mechanisms donors have used to achieve their purposes. Because reforming the business environment has its technical as well as political dimensions, we pay particular attention to the ways donors work with domestic stakeholders (e.g. government, the domestic business community), as well as with other donors. As we described in the previous chapter, reform of the business environment requires national ownership. Therefore, it will be useful to identify any ways in which national ownership can be enhanced. We will also examine the ways donors can collaborate with other donor agencies in an endeavour to ensure coordinated, cooperative and complementary services.

As we will show in the following chapter, measuring the performance and impact of donor-supported reform efforts is a difficult and complex task, which makes it all the more difficult to determine what kinds of donor interventions work and what kinds don't work. Despite the problems of such objective assessments, the regional/country reports have indicated—mainly through anecdotal evidence and stakeholder perceptions—a number of areas where specific donor interventions were found to be more effective than others. Thus, towards the end of this chapter we attempt to identify what donor practices appear to be working well (i.e., those that may be defined as 'good practice') and those that have been criticised (i.e., may possibly be labelled as 'bad practice').

### **4.1 Mechanisms for donor assistance**

As we described in Chapter 2, there is a wide range of actors involved in the business environment in which SMEs operate, each of which may be a potential collaborator with donors. The regional/country reports describe a range of mechanisms that are used by donors to design and deliver their services in the client country. These include:

- Direct relationships with counterpart agencies such as government or private sector representative agencies: these bilateral relationships can be established by the donor or the counterpart; they may be short-lived arrangements designed to achieve a well-defined short-term outcome, or they may continue over a long period of time.
- Participation in project or single purpose committees or taskforces: these mechanisms are established to achieve a specified purpose (e.g., to draft a policy, to conduct research). They may be government structures involving representatives from other line ministries or government agencies, or they may involve a broader cross-section of society, such as government, the private sector, workers, civil society, etc. Donors may promote and support the establishment of these mechanisms themselves, or they may participate in mechanisms that are already in place.
- Participation in standing committees, round tables, councils, or other forums: these are permanent or long-standing mechanisms that may be used to pursue certain reform efforts. Again, these mechanisms can contain a variety of participants representing different sectors of society, depending on their purpose.
- Joint participation with counterpart agencies such as government or private sector representative agencies: although far less common than the above mechanisms, donors can work with other donor agencies to provide a combined package of support for reform. This may involve the 'pooling' of funds or 'basket' funding arrangements, as well as the demarcation of specific technical assistance.

Determining the success of each of these mechanisms requires an assessment that goes beyond the scope of this report. However, the regional/country reports have identified some useful factors that appear to influence the effectiveness of these mechanisms (see Box 3). These factors include:

- Limited range of potential counterparts: Despite the range of actors involved in the business environment (as described in Chapter 2), many donors have complained about the lack of capacity of these actors. This creates any or all of the following outcomes: Firstly, the most capable counterparts for reform become swamped by donor attention. Secondly, donors are required to modify and reduce their reform goals, while giving more attention (including resources) to building the capacity of their counterparts.
- Lack of political clout among reform mechanisms: Some mechanisms—particularly committee structures and weak counterparts—have little sway in the political arena. As a result, donor-supported reforms may be instigated through these mechanisms, but fail to gain the political approval they require for implementation.
- Need for a long-term perspective: Policy, legal and institutional reform is a time-consuming endeavour. Many regional/country reports refer to the necessity to view these developments over at least a five to ten year period. Thus, the mechanisms for the design and delivery of donor interventions need to be long lasting and adaptive to change. Relationships between donors and their counterparts should be mature, professional and based on a common understanding of the need for change.
- Volatility of the political, economic or institutional environment: Where there is a lack of stability in either the political, economic or institutional environment, the possibility for a long-term and consistent approach to reform is challenged. This kind of instability was found to constrain donor efforts in a number of the countries under study.
- The nature of the donor agency: Multilateral donor agencies and bilateral agencies were found to bring different dynamics to donor-government dialogues. In some cases, host governments claimed to be more trusting of multilateral donors because these donors had fewer hidden or alternative motivations to their support for reform.

**Box 3: Barriers to effective relationships between donors and government**

- Inadequate vision, leadership, coordination and ownership on SME reform issues by government
- Lack of transparent and open communication by government toward donors
- Lack of national counterparts, including government champions required for reform processes
- High turnover of donor staff (usually in three-year cycles)
- Frequent changes in donor priorities (donors should design projects that run for 5-10 years)
- Piece meal funding of reform interventions
- Heavy reliance on programmes designed and decisions taken at HQ, thus, a limited capacity among multilateral donor field offices to decide on resources and interventions without HQ approval
- Difference in cultures, values and reform objectives between donors and domestic stakeholders
- Tied aid arrangements, whereby donor support requires the sourcing of advice, equipment, etc. from specified sources (this is particularly an issue for bilateral donors)
- Time taken to approve projects and disburse funds
- Limited trust between government, business associations and donors

SOURCE: Olomi & Nchimbi (2002)

Further research is required to uncover the critical elements of a successful relationship between donor agencies and their domestic counterparts. It is clear that the quality of these relationships has a major impact upon the success of the reform strategies they support.

## 4.2 Mechanisms for donor collaboration

Turning to the second issue that affects the way donor interventions are designed and delivered, the collaboration between donor agencies. We found a high degree of similarity across the five regional/country reports on this issue. Donor collaboration was universally recognised as a critical criterion for enhancing donor intervention in the field of reform. Collaboration among donors was found to lead to (Olomi & Nchimbi 2002):

- Reduced transaction costs for government and donors
- Better harmony and understanding among donor agencies
- Balanced and consistent advice to government from donors
- Better contribution from the donor community to the design and implementation of policies, strategies and programmes

Peru stands out as the country with one of the most effective mechanisms for donor collaboration. The Coordinating Table on SME Development was established in 1994 by the Peruvian Industry Ministry to provide a space for dialogue, coordination and the exchange of experiences. While this group contains members from government, NGOs, the SME sector, as well as donors, it has performed a significant role in donor collaboration and the coordination of donor support—see Box 4.

In Tanzania, too, there appears to have been some results in the field of donor coordination. The Donor Assistance Committee (DAC) Private Sector Development Group Tanzania was established in the late-1990s as an informal forum of like-minded donors interested in supporting the private sector in Tanzania.<sup>11</sup> Since then the DAC has evolved into a larger and more diverse group. It is chaired on a rotating basis and, in addition to donor members, has invited key players in private sector development from government and business associations to join.

A number of factors inhibiting donor-donor collaboration and coordination were identified in the regional/country reports. These include:

- Differing motivations, definitions and approaches: As described in the previous chapter, there are a variety of motivations behind donor interventions in the SME sector in general and the business environment in particular. These motivations can shape other aspects of donor work in this field, which can inhibit collaboration with other donors. Some donors, for example, promote enterprises in the industrial and manufacturing sector over micro and informal enterprises, typically found in the service and trade sectors. While this may appear to be simply a matter of targeting, such disparities in analysis and the setting of national priorities

#### Box 4: The Coordinating Table for SMEs in Peru

In 1994, the SME Programme in the Peruvian Industry Ministry, proposed a Coordinating Table for SMEs (*Mesa de Concertación Pyme-Peru*) whose goal was to create a space for dialogue, coordination and exchange of experiences, in order to develop the competitiveness of SMEs. The Coordinating Table has four pillars: the State, private SME bodies, NGOs and International Cooperation (donors). Formally it has four bodies:

1. The Presidency, represented initially by the Industry Vice Minister and recently by the Labour and SME Promotion Vice Minister
2. The Assembly, created by institutions closely related to the SME world
3. The working commissions (e.g. the Policies Commission, the BDS commission, Research and Programming)
3. A technical secretary

Among their many advantages, the Coordinating Table is considered successful in the following:

- Generating a friendly and trusting climate among participants, facilitating common knowledge and common attitudes on several specific issues
- Positioning and sustaining a space for dialogue among the public sector, private operators and donors
- Institutionalising a space for common learning and exchange of good practices on SME development
- Helping to complement or even multiply funds coming from donors.
- Providing a technical support for the design of public policies, informing about private sector proposals and comparing it with public sector initiatives.

It is worth mentioning that the new SME Law, to be approved soon, considers this Coordinating Table as the seed for a future National Council on SMEs, an organism similar to the National Labour Council.

<sup>11</sup> The Donor Assistance Committee (DAC) is a part of the OECD in Paris. In late 2000, the DAC established a Taskforce on Donor Practices with the fundamental objective of 'strengthening partner countries' ownership through identifying and documenting donor practices which could cost-effectively reduce the burden on the capacities of partner countries to manage aid, and lower the transaction costs involved (OECD 2002, p. 1). See <http://www.oecd.org/dac/donorpractices>.

can lead to conflicts of opinion regarding the priorities for donor support and the strategies that are employed to pursue these priorities.

- Need for leadership: Donor collaboration and coordination requires leadership. Most regional/country reports expressed a concern regarding donor leadership, claiming that government should manage the coordination of donor support for reforms of the business environment. Government, should identify national priorities and work with the donor community to address these priorities. This would, for example, help to overcome the conflict some donors face over issues of targeting (as described in the above point).
- Problems in local decision-making by donors: The centralised structure of many donor agencies (i.e., the lack of real autonomy of country offices from their headquarters) was cited as a constraint to effective donor coordination. Where such circumstances exist, it was claimed that donor agencies can only share information of their work, rather than plan and decide with other donors on the use of their funds. While some donors contest this view, others suggest that at least sharing information of donor involvement in the business environment is a significant start to donor collaboration and coordination.<sup>12</sup>

Donor collaboration can contribute to the effectiveness of reform efforts. However, it would be wrong to overstate the need for it. In some cases, donors should be encouraged to take a different stance of the needs for reform or reform agendas. Domestic stakeholders do not necessarily need a sanitised 'common donor view' on all reform matters. Like in other fields of development, debate and the clash of values and opinions is an important element in the design of strategies. Although, unfortunately, the winner of these debates sometimes has the most money on offer.

National leadership—particularly government leadership—in the process of reform is essential. Where donors lead, whether in a collaborative manner or not, reform efforts are less likely to succeed. Thus, government leadership should determine the need for donor collaboration.

In light of the above remarks, it is useful to reflect again on the Peruvian Coordinating Table on SME Development. The Coordinating Table provides two critical lessons for the achievement of donor-to-donor collaboration. The first lesson concerns membership and leadership. The Coordination Table is lead by government in the form of the Vice Minister in charge of SME development, while its members comprise public and private sector agencies, as well as representatives of civil society and the donor community. Furthermore, membership of the Coordinating Table is open and current members are continually on the lookout for new experts or representatives who can join it.

The second lesson concerns the procedures of the Coordinating Table. The Coordinating Table has established a series of committees or commissions, each of which are goal-oriented. This ensures that all members are involved in the business of the Table, with the freedom to choose where they wish to participate. Interestingly, members do not necessarily attempt to find a common approach to their work. Instead, they encourage discussion, negotiation and bargaining in their efforts to support SME development.

#### **4.3 Emerging trends in donor interventions: Identifying 'good practice'**

It is beyond the scope of a study of this kind to emphatically deem certain kinds of donor practices 'good' and others 'bad'. However, donor agencies—particularly those participating in the Committee of Donor Agencies for Small Enterprise Development—and other stakeholders in the reform process are eager to consider this issue in an attempt to

---

12 The Viet Nam country report (Mallon 2002) contains some useful and interesting proposals in this regard. It proposes that the existing table on donor-financed projects supporting SME development be incorporated on a web site. This would allow donors to review and update information on their projects as appropriate and submit them to the Web manager. Later this site could be expanded to include project design, study, and evaluation reports. It could also include material on best practices and links to international experiences and best practices.

begin the process of better understanding how donors can improve their support for business environment reforms. Thus, drawing on the findings presented in the five regional/country reports, we have sought to identify those practices that appear to have worked and those whose efficacy has been questioned. In addition, Box 5, contains some examples of good practice identified by the Committee of Donor Agencies for Small Enterprise Development in 1997 in the provision of technical assistance for reforming the business environment.

Good practice in donor efforts to reform the business environment for SMEs appears to stem from two core principles. The first principle requires donors to recognise the broad strategic role they perform in development efforts in the client country and the role that the business environment plays in this. Reforming the business environment in which SMEs operate requires more than a technological fix. It also involves political processes that many donor agencies tend to engage in—directly or indirectly—when pursuing their own interests or those of their constituents. This feature sets reform efforts apart from financial services or BDS. Thus, donor agencies are required to consider their role in the political dynamics of the country and to position their interventions in such a way as to promote change, while remaining sensitive to the political domains of local actors.

The following donor practices that have been captured in the five regional/country reports appear to be considered favourably:

- Donor agencies should ensure that domestic actors drive reform measures. Donors themselves should not attempt to force reforms. Instead, they should raise awareness of the need for reform among all actors, support representative institutions to recognise the need for reform and advocate this to others (e.g. to government).
- Donors should find ways to add-value to domestic reform processes. Rather than coming with their own agendas and trying to convince others of these, donors should consult with and engage local stakeholders in an effort to identify domestic reform concerns and targets. Once identified, donors should determine how they can support and add-value to these processes.
- Donors should stimulate debates on the value of reforms. The World Bank (1998, p. 57), for example, says 'ideas matter more than money' thus, donors should strengthen their efforts for the dissemination of ideas and international experience, train future policy-makers and leaders, and stimulate the capacity for informed policy debates.
- Donor agencies should recognise that reforming the SME environment requires a crosscutting strategy. Thus, not only should SME environment reforms be contextualised into country development plans (e.g. Country Assistance Plans, Comprehensive Development Frameworks) to ensure they are fully integrated and aligned with the broader efforts of donors, they should also be systematically and comprehensively applied.<sup>13</sup>

The second principle that shapes the practice of donors in this field requires donors to consider the way they design, package and deliver their support. Primarily, this concern

#### Box 5: Examples of good practice

Good practices identified by the Committee of Donor Agencies for Small Enterprise Development in 1997 in the provision of technical assistance for reforming the business environment:

- Create permanent pressure for change through a general movement for change (e.g. through high profile publications, targeting influential politicians and not just civil servants)
- Find a 'champion' to advocate for change to the macro environment
- Encourage harmony in business associations to ensure that advocacy issues are not undermined by narrow vested interests
- Establish a statistical base on which reforms can be justified—there is a need for hard evidence to avoid discussions becoming overly-abstract
- Top-level advocacy to achieve success in reform efforts
- Public awareness of the need for reform, especially through the use of the media
- Advocacy performed by business associations often requires external funding

SOURCE: Committee of Donor Agencies for Small Enterprise Development 1997, pp. 69-70):

<sup>13</sup> See World Bank (2001, p. 14).

focuses on the relationship between the donor agency and its counterparts. From this perspective, good donor intervention involves the following practices:

- Formalise assistance programmes with government, the private sector and any other counterpart through written agreements that contain mutual obligations.
- Recognise that reforming the business environment in which SMEs operate is a time-consuming process that can take donors well beyond their normal project cycles. Thus, donors need to find ways where they can pursue a reform agenda over time, such as by:
  - extending project timeframes
  - engaging counterparts over a long period of time (i.e., building long-term professional relationships)
  - stabilizing staff and information resources so that donor-counterpart relations can be constant over time<sup>14</sup>
- Undertake investigative activities to assess the priorities for reform and identify starting points. Sida claims that 'determining priorities for interventions must take account of local conditions, the status of factors, the way they are perceived by the private business sector and the performance and particular characteristics of the private business sector. The aim should be to focus quickly on factors that represent binding constraints and important strengths for the development of the private business sector. Identifying such interventions requires a detailed assessment of the performance and characteristics of the private business sector, through detailed studies of the private business sector' (Sinha et. al. 2001, p. 50).
- Take an integrated approach to supporting reform efforts, which prioritises the needs and spheres for reform across different enterprise sectors and levels of government. In practice, an integrated approach to reform means that donors should:
  - be strategically focussed on achieving an impact on the business environment and not only on narrow programme outcomes
  - engage a range of counterparts including public sector agencies and private sector representatives
  - combine interventions at a national level with local or district level interventions
  - adopt a flexible approach through regular planning, reviews and, where necessary, readjustment of donor interventions
- Sequence reform interventions to build on modest progress as relationships with counterparts are strengthened over time. This may also allow the size and scope of project to expand as local knowledge, contacts and partners increase.
- There can be value in a regional or sub-regional approach to donor intervention—one that promotes the exchange of information and experience across the region/sub-region. However, this requires pragmatism and flexibility so that national needs can be properly accommodated and not lost by being subsumed into a regional strategy.
- Supporting social dialogue and strengthening the role that key stakeholders can play in reforming the business environment can have a substantial, long-term impact on the business environment. Business associations play an essential role in promoting and contributing to reforms of the business environment, especially those that represent the SME sector and not just large enterprises.

---

<sup>14</sup> It is interesting to note that in Tanzania the three-year staffing cycle of donor agencies was cited as an obstacle to effective donor-government relations. As staff from donor agencies came and left, institutional memory was lost and new staff often brought new agendas (Olomi & Nchimbi 2002).

#### **4.4 Emerging trends in donor interventions: Identifying 'bad practice'**

Apart from the objective and quantifiable problems in assessing donors' practices that were referred to earlier in this chapter, it is more difficult to identifying 'bad' donor practices in support of business environment reforms than it is to identify 'good' practices. This is because an ineffective or unhelpful (otherwise referred to as 'bad') practice in one setting may produce a more positive result in another setting. Despite this, the five regional/country reports have at times raised concerns regarding some donor practices, which need to be reflected in this report. In addition, some 'bad' practices of donors emerge as a corollary to some of the 'good' practices described above. With these qualifications, and in an attempt to provoke further discussion and research in this field, a number of critical concerns regarding donor practices are raised.

The first and most common criticism of donor agency practices concerns the short project cycle of many donors. In some countries donor interventions that lasted three to 18 months were criticised for being too short and, therefore, ineffective. It is understood that some specific activities may only require three to six months (e.g., research), but these activities should be contained within a more integrated process of reform that spans a greater period of time. By way of illustration, there were examples of donor efforts in the Balkans that lasted one year and resulted in a detailed SME strategy, but since this time the donor had identified new priorities and moved on to these, leaving the implementation of the strategy completely unsupported.

Conditionality is another practice of some donor agencies that has been criticised as ineffective and bad practice, both by some authors of our regional/country reports as well as by a range of other commentators. The effectiveness of conditionality as a modality for achieving policy reform is contestable (see Beynon 2001, p 33). However, as our claim for 'best practice' above includes the need for domestic ownership of the reform agenda, it would appear that blatant external pressure for change on governments by donors is counter to this position.

Donors have been useful contributors to national strategies (e.g. SME strategies, Growth and Poverty Reduction Strategies), but they need to ensure their emphasis in reform assistance embraces implementation as well as design. There were many cases cited in the regional/country reports where donors had supported the drafting of policies or laws that have been gathering dust for some time since. A commitment to implementation is essential. However, many donors appear to concentrate on 'front-end' approaches and then fail to follow through their reform interventions. Thus, many donor reform measures have been abandoned before fully implemented.

The choice of counterparts by donors has emerged as an interesting issue with regard to the practice of reform. In many cases, the donors consulted in this study complained about the limited capacity and number of counterpart organizations. Where they can be found, many actors in the business environment—potential counterparts for donor-supported reform efforts—were weak both in terms of their organizational capacities and their professional capabilities. For donors, this represents a dual challenge. On the one hand donors should work with these actors to build their capacity and improve their capabilities. On the other hand, donors should promote reform efforts among those who are active and capable.

In conclusion, the chapter has illustrated the importance of strategic relationships if reform efforts are to succeed. These relationships involve governments, business associations, as well as a range of other local stakeholders. They also involve other donors that are engaged in activities that support reform efforts. Donor agencies can enhance their prospects of success by investing in these relationships and by recognising that business environment reforms require political as well as technical interventions.



## 5 OUTCOMES FROM POLICY REFORM INTERVENTIONS

While this study was not designed to assess the outcomes of the policy reform interventions that donors have embarked upon, this chapter endeavours to open the discussion on the dynamics that emerge when measuring the outcomes of donor intervention. This will be done firstly by briefly introducing the issues that challenge the assessment of impact in donor supported reforms of the business environment, and secondly by describing the approaches identified from the five regional/country reports.

### 5.1 Measuring the outcomes of donor intervention

Assessing the impact of donor intervention—whatever the field—remains a controversial topic among donors, as well as within recipient countries. The World Bank's (1998) latest contribution to this topic, entitled *Assessing Aid, What Works, What Doesn't, and Why*, has provoked particular attention, mainly because of its finding that donor aid only works properly when sound policies are in place.<sup>15</sup>

The measurement of impact of donor-supported reforms on the business environment is a complicated issue. So complicated, in fact, that most donors have not undertaken such assessments. Assessing impact implies measuring "additionality", i.e., the additional positive outcomes that the intervention produces. In practice, we need to answer the following question: Would the outcome have been different if the intervention had not occurred?<sup>16</sup> This simple question is extremely difficult to answer in the real world because we do not observe the world in two situations at the same time: with intervention and without intervention.<sup>17</sup>

The Committee of Donor Agencies for Small Enterprise Development has been grappling with ways to measure the impact of donor efforts in financial services and BDS.<sup>18</sup> However, donor interventions into the business environment take these deliberations into a new set of issues. By definition, policy reform affects all people or enterprises in a country or region. For that reason, there is no possibility of constructing a comparison group as a counterfactual; We could use another country as a comparison, but there would be so many other circumstances affecting outcomes that the comparison would be useless.<sup>19</sup> Another alternative would be to use a "before–after" approach, but the problems here are quite the same.

It is likely that the magnitude of the task of measuring impact of policy reform efforts is the reason this topic remains quite underdeveloped among donor agencies. There is a limited amount of experience and expertise regarding measurement of donor contribution to policy reform. When donor agencies describe the impact of their efforts, 'they are mostly referring to implementation of the reforms..... the mere existence of the reforms on paper is perceived as a very significant step' (Olomi & Nchimbi 2002).

---

15 See, for example, World Bank (1998), Beynon, (2001) and Lensink & White (2000).

16 A more difficult question is: Would the outcome have been different had the intervention been different? See Heckman, La Londe & Smith (2000).

17 While we can easily observe, and hence measure, the "with intervention" state; for measuring the outcomes in the "without intervention" state we need the construction of a counterfactual. In other words, we need to estimate a hypothetical state in order to measure what would have happened if the intervention had not been introduced<sup>17</sup>. The most common practice in general, is to use a "control group", similar to the beneficiary group, to act as the counterfactual.

18 Some efforts from the Committee of Donor Agencies for Small Enterprise Development regarding indicators for BDS and credit programs can be found at the following web site: [http://oracle02.ilo.org/dyn/empent/empent.portal?p\\_docid=DONORHEAD&p\\_prog=S&p\\_subpr og=BD](http://oracle02.ilo.org/dyn/empent/empent.portal?p_docid=DONORHEAD&p_prog=S&p_subpr og=BD)

19 There is a lack of information in some countries, like Guyana, in which national statistics are not well developed.

Some of the common approaches taken by donor agencies to measure the outcomes of their efforts are summarised in Figure 7, below.

**Figure 7: Common practice in the measurement of donor outcomes**

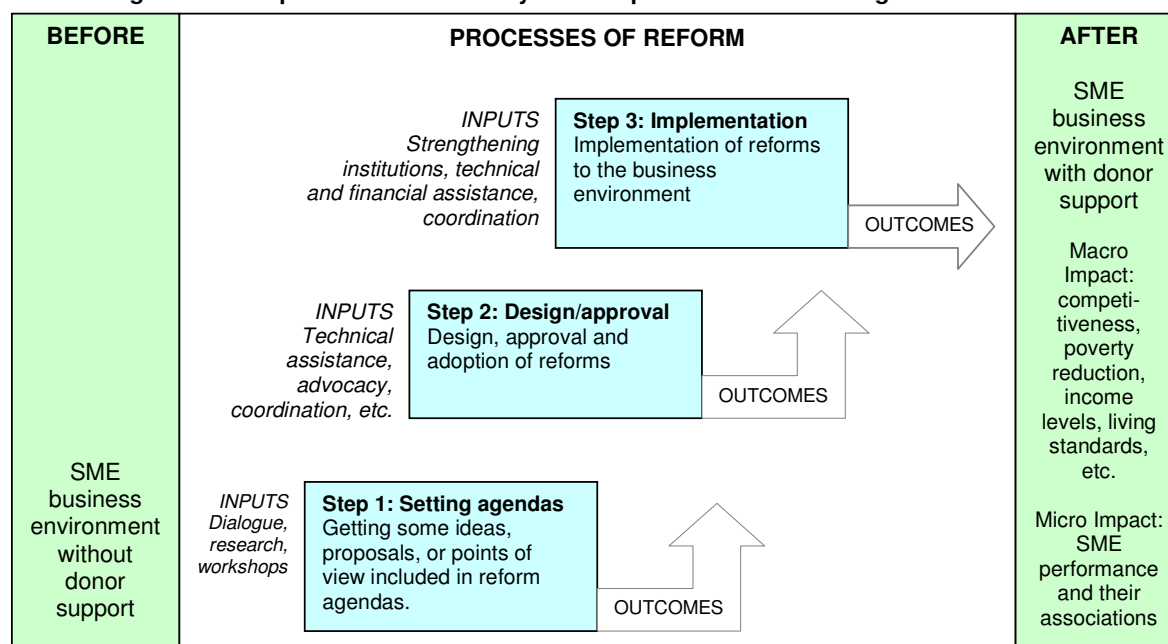
Country/region	Common Practice
Balkans	<ul style="list-style-type: none"><li>• Donors seem to be more interested in the quality of their activities, than the impact</li><li>• Donors have done little to assess the impact of their efforts</li><li>• External evaluators are often brought in, mainly to assess (audit) project inputs and to determine whether objectives were adhered to</li></ul>
Caribbean	<ul style="list-style-type: none"><li>• Regional report claims no experience in performance indicators for business environment reforms</li><li>• Some donors have developed specific performance indicators in relation to particular business environment projects, but many do not</li></ul>
Peru	<ul style="list-style-type: none"><li>• No experience in using performance indicators for business environment reforms</li></ul>
Tanzania	<ul style="list-style-type: none"><li>• A lot of experience in specific project indicators (BDS, credit, etc.)</li><li>• Donors are eager to see implementation as a measure of outcomes, while domestic stakeholders are often content with new or draft policies and laws (i.e. even if not adopted or fully implemented)</li><li>• Some specific indicators of outcome measurement have been used</li></ul>
Viet Nam	<ul style="list-style-type: none"><li>• Mostly qualitative assessments</li><li>• Some specific project indicators mentioned in the Country Report</li></ul>

As we can see, there is an enormous variation in the ways donor efforts are measured. In most cases, donors have developed indicators related to specific project outcomes. However, many donor agencies involved in reform efforts seem to rely on qualitative judgments, such as the opinion the donor staff or the perception of experts that analyzes the project.

How can we classify donor efforts to measure their outcomes? A simple way of doing this is to establish a “cycle” for this kind of support. Figure 8, below, uses a classification of donor intervention reported in the Tanzania report (Olomi & Nchimbi 2002). In this chart we show a typical situation of donor support for reform in the business environment. Before the intervention is agreed upon, we supposedly have a SME environment that needs to be improved through processes that donors can support. So the usual process used by donors, as we have seen in Chapter 3, is to introduce or support some ideas in the reform process—Step 1. Then, donors work with their counterparts to design their proposals and advocate or coordinate in order to get the approval of these reforms—Step 2. Finally, Step 3, donors support specific bodies to implement these reforms.

As the following figure illustrates, all these processes are sequenced and all are important. If some fail then, all can fail. They each require specific inputs and produce defined outputs. The combined effect of these is to create a change to the business environment in which SMEs operate. The impact of donor efforts can be measured according to the changes in the macro environment, such as the competitiveness of the economy, the levels of poverty, income levels and standards of living. The impact of donor efforts can also be measured at the micro level in terms of the effect these reforms have on the behaviour and performance of SMEs.

Figure 8: A simple scheme to classify donor's practices of measuring outcomes



In the above scheme it is clear that most donors are measuring processes as outcomes, under the assumption that reforms actually produce the desired outcomes. However this may not be the case in all situations<sup>20</sup>. Not all good ideas become in such good instruments as to have the desired impact. In this scheme, to measure impact accurately, we would have to make some kind of general or specific before-after comparison.

## 5.2 Issues affecting impact assessment

Regardless of the difficulties associated with quantitative measurement of outcomes from their support to policy reform, donor's reports constantly refer to their impacts or outcomes. Most of the time, the approach used by donors comes from a qualitative perspective (i.e., feelings, perceptions, opinions), either from the donor's staff or experts hired for that purpose. In most cases, these kinds of impact assessments are performed for specific projects. If the reform is about land, then outcomes are related to that kind of goal; if it is about taxes, then indicators about taxes are used. The regional/country reports give clear examples of this kind of approach (see Figure 9).

20 'The SME mapping of Albania, BiH and FYR Macedonia prepared by World Bank Group SME Department could serve as an example of a very good initiative, but with a little impact... This was considered as very good synthetic document that provide important analyses, conclusions and recommendations for the SME Departments in each country. However, there is no evidence of the impact of the document on the policy design process of the governmental institutions or other donors programming.' An indication of this is that 'the related departments' staff have little knowledge about this document' Balkans Report (Xhillari 2002).

**Figure 9: Impact assessments by countries/regions**

Country/region	Impact assessments contained in the regional/country reports
Balkans	<ul style="list-style-type: none"> <li>The establishment of the local business providers network has helped government to become more aware of SME needs</li> <li>The creation of a significant number of business associations and the improvement of their performance</li> <li>The preparation of a SME development strategy for Albania and FYR Macedonia</li> <li>The introduction of some important laws related to the business environment</li> </ul>
Caribbean	<ul style="list-style-type: none"> <li>The GLASP (land titling project) reports indicators such as: enhanced security of tenure and livelihood security for poor people, lands and surveys commission established and meeting annual targets for sustainability, re-established functioning lease registry by end First Quarter 2003, conversion to freehold initiated by 2002</li> <li>Donors have contributed to social capital by supporting the strengthening of formal business organisations and by encouraging business networks and linkages through cluster development</li> <li>Donors support to mapping exercises, have served to highlight constraints to private sector development at a national level</li> </ul>
Peru	<ul style="list-style-type: none"> <li>Donors have played a key role in the simplification proposal of registration procedures, although this was complicated by poor coordination</li> <li>Donors have helped (by demonstration experiences) to introduce a micro finance scheme in the Bank Law.</li> <li>Donors have introduced the idea of developing BDS markets in Peru and the subsidiary role of the State</li> <li>Donors Coordinating Table has become a key institution (for consulting and coordination). The SME Laws are discussed here. The president of this Table is the Vice Minister in charge of SME development</li> </ul>
Tanzania	<ul style="list-style-type: none"> <li>Donor organizations were the main force behind the major macro-economic reforms which took place in the mid-1980s, at the time when the private sector was not only unable to influence change, but could potentially have resisted some of the major shifts in policy</li> <li>Government has since become comfortable with the fact that donors are assisting private sector associations to build the capacity to pressurise it</li> </ul>
Viet Nam	<ul style="list-style-type: none"> <li>Discussants felt that donor support had clearly helped in terms of transferring ideas and international experiences.</li> <li>Donors have helped raise awareness of the important role small enterprises can play in employment creation and poverty reduction.</li> <li>Donor training programmes have contributed to marked improvements in the policy analysis and technical skills of large segments of the central civil service, research institutions, business associations, and business people.</li> <li>Some donor-supported studies had fed into the domestic policy debate and into national planning documents. International experts have contributed to technical improvements in domestic studies and policy and legal drafting.</li> <li>Donor support to education and training has contributed to marked improvements in the professionalism of the civil service responsible for developing and implementing the enabling environment for small enterprise.</li> <li>Another perspective of the impact of donor assistance can be seen by looking at how donors may have affected a number of recent policy initiatives affecting small enterprises in Viet Nam</li> </ul>

The kinds of qualitative assessments contained in the above figure are clearly a way out of the quantitative limitations mentioned previously. However, care must be taken when using this approach. While the use of perceptions and opinions are valuable, they are not systematic. There may be more than one opinion on a particular subject.

There are several reasons why it is so difficult to assess impact in either quantitative or qualitative terms:

- Reforms take long time—sometimes up to ten years—and, hence, it is difficult to track these processes. Thus, it becomes very difficult to assess additionally in these reform processes.
- Most policy reform changes would have happened without donor support, but donor support helped accelerate the process. So the net effect of donors support is difficult to establish
- Some donors are especially careful in attributing outcomes to their efforts. When efforts are done in collaboration among donors as well as with other stakeholders, such as private sector organizations, it is difficult to establish the specific contribution of each donor.
- Local counterparts do not always possess the technical capacities and the necessary information to assess the impact and there are not very many mechanisms of collaboration in place between donors and governmental agencies to carry out joint impact assessments.

In sum, nowadays, most donor projects supporting reforms of the business environment do not necessarily contain enabling environment indicators, and only concentrate on their specific goal indicators. Maybe for this reason, most donor agencies give much more importance to the evaluation of the activities implemented in terms of quantity, instead of the impact. Therefore, a clear message here is that there is a lot of room for developing a framework for impact assessment of donors' support to policy reform. In fact, in the regional/country reports, most interviewed donors share the idea that a system of indicators for assessing outcomes of their support to policy reform is necessary.

In its assessment of six Central European countries,<sup>21</sup> UNIDO (2002) found a constant demand for adequate information for policy development that embraces statistical analysis of SME births, terminations, growth, sectoral and regional performance. In addition, broader indications of SME health covering reactions to the competitive and regulatory environment are necessary, as is information on perceived problems and opportunities. Small enterprise attitudes and reactions to particular policies and programmes were considered important along with evaluation of specific forms of assistance and interventions. Finally, the UNIDO study found that monitoring the views of key stakeholder bodies including business associations, banks, legal services, local authorities and local development agencies was important.

A framework for impact assessment of donors support to policy reform should be based on qualitative assessments but these kinds of assessments need to have a common approach. In general, a clear balance of potential desired and undesired outcomes is required (see Figure 10 on the following page).

---

<sup>21</sup> The Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia.

**Figure 10: General outcomes from donor interventions**

Outcomes	Description
Desired outcomes	<p>Additionality: What specific net effects did the policy reform created?</p> <p>Returns: As measured in economic and social terms. This means that the outcomes should be greater than costs when compared<sup>22</sup></p>
Undesired outcomes.	<p>Displacement effects: SMEs favoured by the reform compete better and probably displace SMEs not favoured by the reform</p> <p>Substitution effects: for example, workers in SMEs favoured by the law generate employment but substituting worker in SMEs that are not favoured by the new policy</p>

Desired outcomes are related to “additionality” and socio economic returns from the interventions. However, undesired effects, such as displacement or substitution effects can also occur<sup>23</sup>. Identifying each of these effects, however difficult should be the priority in a general framework for impact assessment of donor interventions.

Attempts to measure changes in the business environment include the use of scorecards over time to assess change (see Box 6). In addition, diagnostic surveys (e.g. SME Mapping, Road Map Studies) have been used to assess change over time through a before-and-after approach.

Measuring the outcomes and impact of donor supported reform efforts is a complicated exercise, requiring specific instruments and approaches. The difficulty of this task has prevented many donors from undertaking such assessments. However, given the previous success that the Committee of Donor Agencies for Small Enterprise Development has had in improving knowledge and practice in the evaluation of BDS, it would seem that donor efforts in reform processes could be enhanced through a similar programme of work.

#### Box 6: Assessment scorecards

Typically scorecards would show—where relevant and feasible:

- achieved economic rates of return;
- changes in financial performance of the assisted entity;
- changes in indicators of productivity;
- indicators of changes in access to services provided to low income groups;
- information on charges imposed on low-income groups and/or subsidies provided;
- total amount of subsidy provided directly or embedded in financial products;
- indicators of environmental impact;
- indicators of improvement in the investment climate; and
- indicators of the impact on institution building

SOURCE: World Bank (2002b, p.74)

<sup>22</sup> The World Bank (1998, pp. 62-82) assessment of aid highlights the fungibility of aid, stressing that rather than over-emphasising the targeting of aid, donors should endeavour to build government commitment, both in qualitative and quantitative terms.

<sup>23</sup> For example, in Viet Nam there are concerns that the emphasis on using Government subsidized support as a focus of SME promotion policies, coupled with the strong interest by donors in expanding and developing new SME support programs, could lead to the introduction of new distortions, and possibly another source of corruption into the economy.

While it is beyond the terms of reference in which this report has been commissioned, we thought it useful to present at least a tentative outline of criteria that may be used to assess the impact of donor supports toward reforming the SME business environment. These criteria, presented in Figure 11, below, endeavour to promote further discussion on this topic, rather than a definitive statement on this matter.

The figure below follows the conceptual model presented in Chapter 2, by attending to three possible outcomes: (1) policy, legal and regulatory outcomes; (2) outcomes in changes to institutional arrangements and capacities; and (3) outcomes that flow from changes to social, cultural and political systems. However, as we have argued, an assessment of outcomes alone is not enough and the measurement of impact is necessary.

Both the measurement of outcomes and impact requires indicators, some of which may be quantitative or qualitative. The figure below does not present details on possible indicators because it is necessary to give attention firstly to the identification of what must be measured.

**Figure 11: Tentative notes on the measurement of reform outputs and impacts**

<b>Outputs</b>	
1 Policy, legal and regulatory framework	<ul style="list-style-type: none"> <li>• New policies, laws or regulations drafted and adopted</li> <li>• Existing policies, laws or regulations simplified or made more accommodating of SME needs</li> <li>• Unnecessary or restrictive policies, laws or regulations revoked</li> </ul>
2 Institutional arrangements and capacities	<ul style="list-style-type: none"> <li>• Greater awareness of SME needs and experiences resulting from policies, laws or regulations</li> <li>• Improvements in institutional governance</li> <li>• Greater participation of SMEs in private sector associations</li> <li>• Better dialogue between SMEs and government</li> <li>• Better skills and experiences found within all relevant institutions to design, implement, enforce, monitor and reform policies, laws or regulations</li> <li>• Better orientation toward the role of markets</li> </ul>
3 Social, cultural and political systems	<ul style="list-style-type: none"> <li>• More attention given to SMEs by the public, the media, and government</li> <li>• Greater acceptance of SMEs as a desired career option</li> <li>• More open and democratic society</li> <li>• Greater political and economic stability</li> </ul>
<b>Impacts</b>	
Magnitude of the reform	<ul style="list-style-type: none"> <li>• Number of SMEs affected (e.g., less encumbered by policy, legal, regulatory or institutional biases)</li> </ul>
Sustainability	<ul style="list-style-type: none"> <li>• Increased capacity of relevant institutional actors to identify and pursue reform agenda</li> </ul>
Process participation	<ul style="list-style-type: none"> <li>• Number of domestic stakeholders calling for, and participating in, business environment reforms</li> </ul>

While the complexity of this issue has clearly prevented many donor agencies from addressing these concerns, further consideration is necessary. It will help clarify the relationship between outcomes and impact, and give a better focus to the purpose of donor support for reform.

## 6 KEY FINDINGS AND CONCLUSIONS

This chapter pulls together the main findings of the study. Firstly, by distilling the key findings that have emerged from the five regional/country reports into a series of lessons learned. Our intention here is to present the main contributions that this study has made to the broader debate concerning donor support for reforming the business environment.

Secondly, this chapter considers the needs for future research and information. This study has provided a start to a broader process of investigation into donor efforts for reform. It is important, therefore, that some of the future needs taking this investigation further are considered.

### 6.1 Lessons learned

This study has uncovered a wide variety of approaches, tools, processes and mechanisms used by donors to help create business environments that are more conducive to growth in the SME sector. These have been described in the previous chapters. Through the process of identifying and—where possible—assessing these, we have learnt a lot more about how donors approach this work and about the kinds of influences that shape the results of donor efforts. Most prominent among these lessons are the following:

- There appears to be very little common understanding among donors of what constitutes an 'enabling environment' for SME development. Some donors apply a purely pragmatic approach to this issue, by addressing various obstacles in the business environment as they discover them, while others have applied a significant amount of resources to understand this issue more fully.<sup>24</sup>
- Political support for reform efforts is an essential prerequisite. National ownership of reform efforts is essential and donors that pursue reforms without gaining high-level political support do so unadvisedly.<sup>25</sup> National ownership may be assessed by a number of means, but the most common appear to be: (a) the presence of a strong and committed domestic counterpart; (b) the setting of reform agendas by national agencies, possibly with the advice of donor agencies; and (c) coherence of reform agendas with other development policies and directions.
- Reforming the business environment requires a careful balance between the reform of policies, laws and regulations, and the strengthening of institutions that enforce or implement them. Not only is this consistent with the way in which the business environment has been defined in this report (i.e. combining social, economic and political influences, with the 'rules of the game', with the institutional framework), it also accommodates the various needs and priorities for development that can be found from one country to the next (i.e., policies without effective implementing institutions are not policies at all).
- Reforming the business environment for SME development can be lost among efforts to reform the environment for PSD. SMEs have a specific set of concerns that need to be addressed in the business environment (e.g., anti-SME bias) and it is important to ensure that reform measures respond to the needs and priorities of smaller enterprises.
- Donor-to-donor collaboration and coordination can be an important strategy in the support of reforms. However, such arrangements were found wanting in many of the regions and countries examined in this study.

---

<sup>24</sup> For example: Sida, see Sinha et. al. (2001); DFID, see DFID (2000); the World Bank, see World Bank (2000a, 2000b).

<sup>25</sup> This is consistent with the findings of others: 'One painful lesson of experience is that government and community ownership of projects is crucial' (World Bank 1998, p. 79).



- Because the business environment is influenced by a range of social, economic and political factors, effective reform measures may require change in some of these fields. Additionally, the social context to reform is important, including social attitudes to the private sector. Thus, donors need to work with a wide range of groups (e.g. media, business sector, legislators, industry groups) to raise awareness and to build support for reform. However, very little evidence was found of donor involvement with such groups.
- Donor reform interventions are most effective when they add-value to domestic reform processes by offering sound analysis of the business environment (before and after reforms) and by bring international experiences and up-to-date knowledge. Donors can also assist governments in the design, implementation and monitoring of national strategies (e.g. SME strategies, Growth and Poverty Reduction Strategies).
- National reform efforts, while essential and an obvious starting point for many donors, are insufficient on their own. National level reform processes should be complemented by reforms at the local or district level. It is at these more local levels that SMEs often experience the business environment directly. Moreover, there can be a great variety business environments found in sub-national jurisdictions and markets.

## **6.2 Future research and information needs**

Finally, this review has uncovered a range of issues that warrant further exploration, either by the Committee of Donor Agencies for Small Enterprise Development or by individual donors themselves. Some of the more significant and potentially beneficial research and information needs are listed below.

- To better understand the business environment and its influence on SMEs: This review found a range of definitions and concepts used to describe the business environment across donor agencies. While it is a concept that many agencies are increasing their interest in, there is a paucity of practical concepts and models that donors can use. In Chapter 2 we presented a model for conceptualising the business environment in an attempt to establish a base for further discussion. However, more work needs to be done in this field. Thus, the Committee of Donor Agencies could invest some more research into better understanding the way donor agencies conceptualise the business environment and how this concept can be applied.
- To better understand the influence of international development assistance on the business environment: Understanding the business environment is not enough for donor agencies. If their work is to be made more effective, there needs to be a better understanding of the ways in which the broad scope of international development assistance influences the business environment. Before donors focus their attention on the specific demands of SMEs in the business environment, they should recognise the influence their overall assistance programmes can have. In support of this, Beynon (2001) claims that: 'Further research is strongly recommended to better understand the relationships between aid, investment, growth and poverty reduction' (p. 39).
- To better understanding donor practices: This review has found a high degree of similarity in the work undertaken by donors across the three countries and two regions. Donor interventions in the reform process were found to fall into five broad categories within which specific reform assistance strategies, tools and processes were designed. However, much more can be learned about the processes donor agencies undertake in the design of their interventions. Especially since it is this feature of donor activity that appears to be the most influential in the choice of strategies, tools and processes. Thus, the Committee of Donor Agencies could undertake case studies of donor efforts, while also expanding the number of countries in which donor agency efforts are documented.
- To design appropriate tools and techniques for measuring the impact of donor-support reforms: Chapter 4 has clearly laid out the case for further work in this field. Measuring changes in the business environment is a difficult job, made even more

difficult when the impact of specific reform interventions is to be assessed. However, further work in this field is an investment into improved practices by donor agencies.

- To identify and promote best practices in donor-supported reforms: This should build on improvements in measuring impact and, hence, definable success in this field, so that 'good' donor practices can be defined based on objective findings.

The research presented in this report represents a first step by the Committee of Donor Agencies, through the Working Group on Enabling Environment, to examine the role of donor agencies in the support of reforms for the business environment. As anticipated in a first-step of this kind, it has unearthed a range of issues that deserve further attention, but it has also begun to establish a framework and approach to better understand the multifaceted and complex relationship between donor agencies and national governments.

## LIST OF REFERENCES

- Altenburg, T., Hillebrand, W. & Meyer-Stamer, J. (1998) *Building Systemic Competitiveness Concept and Case Studies from Mexico, Brazil, Paraguay, Korea and Thailand*, German Development Institute, Reports and Working Papers 3/1998, Berlin
- Bannock, G. (2002) *Indigenous private sector development and regulation in Africa and Central Europe: A ten-country study*, DFID, London
- Beck, T., Demirgüç-Kunt, A. & Maksimovic, V. (2002) *Financial and Legal Constraints to Firm Growth; Does Size Matter?* Policy Research Working Paper 2784, World Bank, Washington DC
- Beynon, J. (2001) *Policy implications for aid allocations of recent research on aid effectiveness and selectivity*; Paper presented at the Joint Development Centre/DAC Experts Seminar on "Aid effectiveness, selectivity and poor performers" OECD Paris, 17 January
- Committee of Donor Agencies for Small Enterprise Development (1995) *Small and micro-enterprise finance: Guiding principles for selecting and supporting intermediaries*, Washington DC
- Committee of Donor Agencies for Small Enterprise Development (1997) *Business Development Services for SMEs: Preliminary Guideline for Donor-Funded Interventions*, Washington DC
- Committee of Donor Agencies for Small Enterprise Development (2001) *Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention*, Washington DC
- Deepa, N., Patel, R., Schafft, K., Rademacher, A. & Koch-Schulte, S. (2000) *Voices of the poor: Can anyone hear us?* World Bank, Washington DC
- Department for International Development (2000) *Making markets work better for the poor: A framework paper*. Prepared by the Economic Policy and Research Department together with the Business Partnership Department. DFID, London UK
- De Soto, H. (1984) *El otro sendero*, Instituto Libertad y Democracia Lima
- Duval, A. and Waterfield, S. (1996) *Partnership tools: Working with local institutions for micro enterprise development*, CARE, Atlanta.
- Heckman, J. LaLonde, R. & Smith J. (2000) The economics and econometrics of active labour market policies. Handbook of labour economics, North Holland
- Holzmann, R. & Jørgensen, S. (2000) *Social Risk Management: A new conceptual framework for social protection and beyond*, Social Protection Discussion Paper No. 0006, World Bank, Washington DC
- International Labour Organization (2002) *Global employment agenda*, Geneva
- Lensink, R. & White, H. (2000) 'Aid allocation, poverty reduction and the Assessing Aid report', Journal of International Development, Vol. 12, pp. 399-412
- Machacuay, S. & Mifflin, I. (2002) *Intervenciones de la Cooperación para fortalecer un ambiente propicio al desarrollo del sector de la micro y pequeña empresa (Mype) en el Perú* ILO, Lima
- Mallon, R. (2002) *Approaches to support the development of an enabling environment for small enterprises*, GTZ/VCA Project for SME Promotion, Hanoi
- Manuel, C. & Clark, L. (2002) *Review of donor funded enabling environment initiatives for private sector development; Caribbean Region*, DFID Bridgetown, Barbados
- OECD (1995) *Support of Private Sector Development, Development Co-operation Guidelines Series*, Development Assistance Committee, Paris

- OECD (2002) *Donor Practices; Progress Report*, OECD DAC Task Force on Donor Practices, June, Paris
- Olomi, D. & Nchimbi, M. (2002) *Review of experiences from interaction among donor agencies in small enterprise policy reform in the United Republic of Tanzania; Report prepared for the DAC Private Sector Development Group*, Royal Embassy of the Netherlands, Dar-es-Salaam
- Purdon (2002) *Estimating the impact of labour market programmes*, National Centre for Social Research, London
- Reinecke, G. (2002) *Small enterprises, big challenges; A literature review on the impact of the policy environment on the creation and improvement of jobs within small enterprises*, SEED Working Paper No. 23, ILO, Geneva
- Robles, M., et al. (2001) *Estrategias y racionalidad de la pequeña empresa*, ILO Lima, Peru
- Sinha, S., Beijer, A., Hawkins, J. & Teglund, A. (2001) *Approach and Organization of Sida Support to Private Sector Development*, Sida Evaluation Report 01/14, Sida, Stockholm
- Tanburn, J. Trah, G. & Hallberg, K. (2001) *Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention*
- United Nations General Assembly (2000) *United Nations Millennium Declaration*, 55th Session of the General Assembly, 18 September, New York
- United Nations Industrial Development Organization (2002) *A Comparative Analysis of SME Strategies, Policies and Programmes in Central European Initiative Countries*, <http://www.unido.org/doc/331004.htmls>
- World Bank (1998) *Assessing Aid: What Works, What Doesn't, and Why*, Oxford University Press, New York
- World Bank (2001) *Private sector development strategy—Report on external dialogue*, November 15, World Bank, Washington DC
- World Bank (2002a) *Building institutions for markets, World Development Report*. New York, Oxford University Press
- World Bank (2002b) *Private sector development strategy—Directions for the World Bank Group*, April 9, World Bank, Washington DC
- Xhillari, L. (2002) *Experience from interaction among donor agencies in SME policy reform; Regional report for Albania, Bosnia and Herzegovina and FYR Macedonia*, World Bank, Washington

## **ANNEX 1 MEMBERS OF THE COMMITTEE OF DONOR AGENCIES FOR SMALL ENTERPRISE DEVELOPMENT**

### **BILATERAL AGENCIES**

Austria:	Ministry of Foreign Affairs
Australia:	Australian Agency for International Development
Belgium:	Belgian Administration for Development Cooperation
Canada:	Canadian International Development Agency (CIDA)
Denmark:	Ministry of Foreign Affairs
Finland:	Ministry for Foreign Affairs (FINNIDA)
France:	Ministère des Affaires Étrangères
Germany:	Federal Ministry for Economic Cooperation and Development (BMZ)  German Agency for Technical Cooperation (GTZ)*  Kreditsanstalt für Wiederaufbau (KfW)
Italy:	Ministry of Foreign Affairs
Japan:	Japan Bank for International Cooperation (JBIC)  Japan International Cooperation Agency (JICA)
The Netherlands:	Ministry of Foreign Affairs*
Norway:	Norwegian Agency for Development Cooperation (NORAD)*
Sweden:	Swedish International Development Cooperation Agency (Sida)*
Switzerland:	Swiss Agency for Development Cooperation (SDC)*
United Kingdom:	Department for International Development (DfID)*
USA	United States Agency for International Development (USAID)

### **MULTILATERAL AND OTHER DEVELOPMENT AGENCIES**

African Development Bank (AfDB)*
Asian Development Bank (ADB)*
European Bank for Reconstruction and Development (EBRD)
The European Commission (EC)
Food and Agriculture Organization (FAO)
The Ford Foundation
Inter-American Development Bank (IADB)
International Development Research Centre (Canada)

International Fund for Agricultural Development (IFAD) \*

International Labour Office (ILO) \*

International Trade Centre (ITC)

Organisation for Economic Co-operation and Development (OECD)

Organization of American States (OAS)

Soros Foundation

United Nations Conference on Trade and Development (UNCTAD)

United Nations Development Fund for Women (UNIFEM)

United Nations Development Programme (UNDP)

United Nations Industrial Development Organisation (UNIDO)

The World Bank Group (WBG) \*

## ANNEX 2 SUMMARY REVIEW OF REGIONAL/COUNTRY REPORTS

1	Country/Region	Balkans Regional Report for Albania, Bosnia and Herzegovina and FYR Macedonia
2	Lead Agency	World Bank
3	National Consultant(s)	Lindita Xhillari
4	Methodology	<ol style="list-style-type: none"> <li>1. Review of secondary data</li> <li>2. Consultations with donor agencies and government stakeholders</li> <li>3. Circulation of draft report to donors for comments (i.e. no workshop)</li> <li>4. Submission of final report</li> </ol>
5	Country context	<p>There are a lot of similarities found across the countries of the region. All have been undergoing a transition from socialist, command-economy to open market. This has involved substantial privatisation and market liberalisation reforms. PSD has been a major thrust, as SOEs have been restructured and privatised. All countries have also experienced varying degrees of social and political upheaval in the last decade.</p> <p>Donor presence in the region is relatively recent (e.g. in Albania before 1991, there were no donors present. It was closed to outside agents). SME development is very new, despite the evidence that almost all employment is found in micro and small enterprises. Some countries have still not officially defined SMEs. There are 12 donors involved in SME development, five are bilateral donors.</p>
6	Categorisation of donor interventions	<p>Donors have often applied a multi-pronged approach to their work in the region. This has encompassed four kinds of interventions, each of which have been linked and, therefore, influence one another:</p> <ol style="list-style-type: none"> <li>1. Financial support for SMEs—this mainly involves the provision of: <ul style="list-style-type: none"> <li>• Credit lines for SMEs</li> <li>• Micro-finance funds</li> <li>• Equity and guarantee funds</li> </ul> </li> <li>2. Reforming the business environment—this mainly involves assistance in: <ul style="list-style-type: none"> <li>• Policy and strategy design</li> <li>• The design of SME promotion strategies</li> <li>• Legislative and taxation reforms</li> </ul> </li> <li>3. Institutional capacity building—this mainly involves: <ul style="list-style-type: none"> <li>• Institution building (i.e. creating new institutions such as national SME networks and local and regional business advice agencies)</li> <li>• Establishing information systems</li> <li>• Building and supporting business associations</li> </ul> </li> <li>4. Business development services—this mainly involves assistance to: <ul style="list-style-type: none"> <li>• SMEs in business planning</li> <li>• Commercial banks to provide advisory and financial services</li> <li>• SMEs for restructuring</li> </ul> </li> </ol> <p>Policy reform interventions have focussed on four issues:</p> <ol style="list-style-type: none"> <li>A. Broad strategic issues (particularly focussed on PSD)</li> <li>B. Promoting business support through: <ul style="list-style-type: none"> <li>• National networks of SME support</li> <li>• Support of local agencies</li> </ul> </li> <li>C. Improving the legal and regulatory framework through the drafting of new laws and regulations</li> </ol>

		<p>D. Policy and strategy formulation (e.g. drafting SME strategies)</p> <p>This spread of intervention reflects the lack of a strategic focus by donors that have sought to cover all issues.</p> <p>Most donors are not applying a regional approach, except SEED (World Bank/IFC)</p>
7	Tools or processes used	<ol style="list-style-type: none"> <li>1. The provision of technical know-how was the most common form of assistance provided. This included: <ul style="list-style-type: none"> <li>• Technical assistance to line ministries and other government institutions</li> <li>• Workshops and training seminars for government officials</li> <li>• Training of trainers for regional business agencies</li> <li>• Study tours to western countries</li> </ul> </li> <li>2. In some cases, equipment support to various organizations was provided.</li> <li>3. SME Mapping of the World Bank was conducted in the three countries and provided a useful means for donors to identify starting points in the design of EE reform interventions. (Used to identify gaps, duplications, and priorities.)</li> </ol>
8	Charts/Diagrams	<p>Table 5 provides a good overview of donor support efforts.</p> <p>Charts 1, 2 and 3, illustrate the range and complexity of institutional actors.</p> <p>Annex 1 provide a useful and interesting inventory of the main donor projects in the region, covering the following items:</p> <ul style="list-style-type: none"> <li>• Country</li> <li>• Donor</li> <li>• Project title</li> <li>• Implementation period</li> <li>• Project status</li> <li>• Impact in the sector</li> <li>• Lessons learned</li> </ul>
9	Highlights: Critical issues	<ol style="list-style-type: none"> <li>1. By combining four different kinds of interventions (see Row 6, above) donors have sought to create efficiencies across all, but in fact this has tended to confuse matters and distort a clear understanding of what is required. (For example, many donors have provided funds for SME development, even though there is a surplus of funds available to SMEs. The real concern for access to finance by SMEs is a legal and regulatory one and not one of supply.) It has also lead to situations where the failure of one component has compromised the effect of other components.</li> <li>2. Donor-government relations have been a problem: Poor donor coordination. Leadership by the government in donor-supported reforms is necessary, but donors are frustrated by government's lack of engagement in donor coordination issues, and government dislike donors taking a lead. These relations need to be formalised.</li> <li>3. Ministry of Finance is a powerful ministry in terms of the business environment, but it has no interest in the SME sector.</li> <li>4. Many donor interventions have been supply-led by donors themselves. Very few donor efforts were found that respond to the demands of the private sector.</li> <li>5. Lack of political consistency in reforms has made it hard for donors to work in a consistent manner with government. There is little evidence of a consistent donor involvement, except with GTZ.</li> <li>6. Evidence of donor intervention that has lacked participatory or effective consultation measures (e.g. an international consultant works in isolation to key domestic stakeholders).</li> <li>7. Need to improve the coordination between government institutions and to improve the capacity of the main line ministry responsible for SME development (e.g. in Albania this ministry has two people addressing all SME issues).</li> <li>8. Government does not have a vision for SME development and donors can't</li> </ol>



		<p>fill this void on their own. How can donors help government develop a vision for SMEs?</p> <p>9. Frequent changes of government personnel have made donor-government dialogue and cooperation more difficult.</p>
10	Highlights: Good practice	<p>1. Donors should establish formal agreements with national governments</p>
11	Indicators of performance and impact	<p>1. Donors have done little to assess the impact of their efforts.</p> <p>2. External evaluators are often brought in, but mainly to assess (audit) project inputs and to determine whether objectives were adhered to. Often donors seem to be more interested in the quality of their activities, than the impact.</p> <p>3. Reforms to the business environment take a long time before their impact can be measured (generally 5-10 years).</p> <p>4. Corruption is a common concerns for the business environment, but difficult to measure improvements.</p> <p>5. Joint (i.e. collaboration among donors and with government) impact assessments can be a useful approach to measuring impact.</p>
12	Lessons	<p>1. Political support for reform efforts is an essential prerequisite that appears to be missing in the region. Many policies, laws and strategies have been drafted with donor assistance, but have not been passed by the parliaments.</p> <p>2. Reforming the business environment for SME development, appears to be lost among efforts to reform the environment for PSD.</p> <p>3. EE reforms should be balanced across the reform of policies, laws and regulations, and the strengthening of institutions that are required to enforce these.</p> <p>4. Can be value in a sub-regional approach to donor intervention—one that promoted exchanges of information and experience.</p> <p>5. Many local counterparts to donor efforts are weak, thus, there needs to be investments into capacity building.</p> <p>6. Donors have been useful contributors to national strategies (e.g. SME strategies, Growth and Poverty Reduction Strategies), but they need to shift their emphasis in reform assistance from design to implementation.</p>
1	Country/Region	Caribbean
2	Lead Agency	DFID
3	National Consultant(s)	Clare Manuel and Leslie Clark
4	Methodology	<p>The emphasis is on the business environment as a whole (not only for SMEs). Field work in Barbados, Guyana, Saint Lucia and Jamaica, but inference on the 15 Caribbean states. Tools: Interviews with key actors, review of 80 projects, interviews of government stakeholders; review of key literature/documents.</p>
5	Country/Region context	<p>Size and geography are relevant constraints for PSD ( Small size countries and multi island region). Globalisation is affecting these small states and its PSD. Social, political and fiscal instability is becoming an increasing issue in the region, as is poverty. There are national and regional efforts to overcome small size and high costs of interventions.</p>
6	Categorisation of donor interventions	<p>Four levels of donor intervention:</p> <ul style="list-style-type: none"> <li>• Global factors, example. support to regional bodies</li> <li>• Work on "Rules of the game", example: support to social and political stability fiscal stability, business legislative framework, public sector reform</li> <li>• Support to Access to markets: example: support to transport/communication, business support infrastructure, social capital and structure of the private</li> </ul>

		<p>sector</p> <ul style="list-style-type: none"> <li>• Support to Competence and capacity of firms: example: Access to sustainable capital and managerial/business skills</li> </ul>
7	Tools or processes used	<p>Modalities of donor intervention identified:</p> <ul style="list-style-type: none"> <li>• Donor strategies at the regional level</li> <li>• High level donor-government agreement on a common agenda</li> <li>• Common donor regional/sub regional approach and funding modality</li> <li>• Partnership with existing regional governmental institution</li> <li>• New regional bodies</li> <li>• Regional service providers</li> <li>• Learning lessons across the region</li> <li>• Donor strategies at the national level</li> <li>• Finding the right govt. Interlocutor</li> <li>• Influencing public sector reform programmes</li> <li>• Building on a poverty reduction strategy</li> <li>• Responding to govt. or private sector identified priorities</li> <li>• Being opportunistic</li> </ul> <p>Tools identified:</p> <ul style="list-style-type: none"> <li>• Mapping exercises</li> <li>• Advocacy</li> <li>• Government-private sector workshops/focus groups</li> <li>• Government-donor working groups</li> <li>• Legislation</li> </ul>
8	Charts/Diagrams	<p>Box 5.1 contains useful information describing donor interventions in an interesting dimension: a regional approach, with different levels. In Box 6.3 the authors suggest the advantages and disadvantages of a regional approach to donor support. Useful annex with information of individual reviewed projects.</p>
9	Highlights: Critical issues	<ol style="list-style-type: none"> <li>1. Small size of countries means limited capacity of government/counterparts</li> <li>2. Informal sector could limit donors efforts for PSD</li> <li>3. Attitudes and structures of government do not reflect a priority for private sector led growth</li> <li>4. Lack of sufficient donor/ private sector interaction</li> <li>5. Many EE initiatives do not form part of donor private sector programmes: <ul style="list-style-type: none"> <li>• Probable suboptimal performance of efforts</li> <li>• No EE performance indicators included</li> </ul> </li> </ol>
10	Highlights: Good practice	<ol style="list-style-type: none"> <li>1. Governments are taking the lead in promoting a strategic approach</li> <li>2. Business road map in Jamaica and Guyana</li> <li>3. Donors support to regional/sub regional bodies (strengthening, coordination)</li> <li>4. Specific projects (such as the Cluster competitiveness project-DFID) for institutional strengthening of formal private sector organizations</li> </ol>
11	Indicators of performance and impact	<p>A. Enabling environment indicators: Donors have developed specific indicators in relation to particular projects:</p> <ul style="list-style-type: none"> <li>• Example: Land project (enhanced security of tenure and livelihood security, lands and surveys commission, annual targets, lease registry, etc)</li> <li>• Proposed in the paper:</li> <li>• Surveys of the investment climate</li> <li>• Roadmap studies</li> <li>• International credit ratings about country risk</li> <li>• National statistics (not well developed in all countries)</li> </ul> <p>B. Performance indicators. Donors have developed indicators in relation to particular projects (example: USAID project)</p>

12	Lessons	<ol style="list-style-type: none"> <li>1. It is necessary to be flexible and pragmatic about a regional approach. It may be possible when the following conditions are present: strong policy environment, commitment to EE reform, and institutional framework to take reform forward</li> <li>2. A sound regional approach must have support of appropriate national interventions</li> <li>3. Integrated approaches are more effective than individual goal oriented ones</li> <li>4. Interventions are more likely to be effective if they are appropriately prioritised and sequenced. For this, it is necessary a govt strategy for PSD. PRSPs in some countries are mentioned as good examples of this</li> </ol>
1	Country/Region	Peru
2	Lead Agency	ILO
3	National Consultant(s)	Samuel Machaccuay and Ivan Mifflin
4	Methodology	Interviews to donor agencies, government stakeholders. Review of specific literature and documents
5	Country context	<p>Peru is a middle-income country, mainly with primary sector production (mining, fishing). This year is the 4th of a recession that started in 1998 with the international crisis. Although 85% of labour is explained by SMES, low productivity of SMEs are a concern</p> <p>Last year, the Labour Ministry has been transformed to include SME development (before there was a SME direction in the Industry Ministry)</p>
6	Categorisation of donor interventions	<p>Two broad categories:</p> <ul style="list-style-type: none"> <li>• Structural Factors for SME development (FEED)</li> <li>• Direct SME Environment Factors (FEDEE).</li> </ul> <p>The report concentrates in the FEDEE level and finds three levels of donor intervention:</p> <ol style="list-style-type: none"> <li>1. Support to the legal framework</li> <li>2. Coordination efforts</li> <li>3. Competitiveness improvement</li> </ol>
7	Tools or processes used	<p>Modalities of donor intervention identified:</p> <ul style="list-style-type: none"> <li>• Institutional <i>concertation</i> on SME</li> <li>• Partnership with the State or private sector to develop markets of services for SMEs</li> <li>• Partnership with private sector to strengthen service providers institutions</li> <li>• Accompanying regulatory initiatives of the Government</li> <li>• Direct cooperation agreement with State to support programmes or institutions in favour of SME</li> </ul> <p>Tools of intervention identified:</p> <ul style="list-style-type: none"> <li>• Advocacy</li> <li>• Technical assistance for legislation</li> <li>• Coordination groups among government/donors/SME bodies</li> <li>• Dialogue and concertation spaces</li> <li>• Experience sharing events</li> <li>• Participative planning</li> <li>• Studies and diagnostic on SME</li> <li>• Funding pilot experiences</li> <li>• Promotion of new technologies for service provision</li> </ul>

8	Charts/Diagrams	<p>Several figures in chapter 2, concerning the magnitude of donor intervention in Peru. They show that donor's aid to SMEs is a small fraction of all aid. Also that most of the donor's support comes from multilateral agencies (World Bank and IADB)</p> <p>Chart 8, indicates priorities of donor agencies</p>
9	Highlights: Critical issues	<ol style="list-style-type: none"> <li>1. Promotion of SME does not appear as a priority in the agendas for most donors. Some of them include SME actions in their strategy to reduce poverty.</li> <li>2. Multilateral agencies work in the Structural Factors dimension (FEED). However all actions in this level seem to be disperse and heterogeneous</li> <li>3. Most bilateral agencies efforts concentrated on BDS and credit experiences, very few in EE support. However a growing interest in EE actions is perceived</li> <li>4. Multilateral agencies (main donors in monetary terms) are perceived as vertical institutions (they are not members of the coordinating table for example), while bilateral cooperation (key to SME development) are considered a more horizontal institutions</li> <li>5. In most cases, donors interested in SME development are following the local stakeholders' lead. However, the authors consider that there is no good interlocution yet in the state (leading to concentration of efforts or superposition). There used to be a government office in charge of coordination with donors disappeared (SECTI) but disappeared</li> <li>6. In all cases, a gender approach or interest is mentioned but there is no evidence of further actions.</li> <li>7. Little private sector involvement in SME policy reform</li> </ol>
10	Highlights: Good practice	<ol style="list-style-type: none"> <li>1. There are many local institutions and capacity. For this reason, donors' strategies have been concentrated on dialogue among institutions.</li> <li>2. Donors build upon local initiatives for reform</li> <li>3. Good donors experiences with pilot projects have had a "second floor" approach in the state, oriented to the market development. In some cases (credit for example) this approaches became the basis for institutional reform</li> <li>4. In 1997, the SME Coordinating Table was created. The idea was to articulate the work of the State, donors, local NGOs and private bodies. 4. In 2000, a Policy Commission was created inside of this coordinating table: the mission is to dialogue and coordinate on policy reform related to SMEs</li> <li>5. The emphasis in competitiveness has evolved from a SME specific centred approach, to the development of a framework in which SMEs are inserted in productive sectors, competing or cooperating with other enterprises classes with different behaviour</li> </ol>
11	Indicators of performance and impact	<p>Donors have supported and strengthen some local initiatives. Their technical assistance has been key to the promotion of laws (like the SME law or the micro finance law). They are coordinated in the SME coordinating table that has a Policy Commission. Author's impact assessments:</p> <ol style="list-style-type: none"> <li>1. Support to the legal framework <ul style="list-style-type: none"> <li>• Awareness on the importance of administrative simplification</li> <li>• Important regulations such as the Simplified Regime for administrative formalization, the SME Law, reform in the municipal tax system</li> <li>• Support to the creation of important bodies such as the Guarantee Fund for SMEs (FOGAPI), the Municipal Program to SME support (PROMDE) and recently the new Vice ministry for SMEs</li> </ul> </li> <li>2. Coordination efforts <ul style="list-style-type: none"> <li>• Support to the SME Coordinating Table</li> <li>• Information sharing and analytical tools exchanged</li> <li>• Support to the creation of COPEME a consortium of all local NGOs working with SMEs</li> <li>• Formulation and policy reform proposals</li> </ul> </li> </ol>

		<ul style="list-style-type: none"> <li>Development of a methodology to promote concentration</li> </ul> <p>3. Competitiveness improvement</p> <ul style="list-style-type: none"> <li>Development of specialized services, methodologies, human resources for work with SMEs.</li> <li>Promotion of the importance of policies for sectoral competitiveness</li> <li>Information about competitiveness cluster</li> <li>Development of Entrepreneur Development Centres</li> </ul>
12	Lessons	<p>1. Initially donors were interested in administrative simplification and deregulation. However, it has become clear that SME problems do not go necessarily through the regulatory framework but through compliance of rules or information of them to everybody.</p> <p>2. The national lead in policy reform is perceived as a key element in order to the sustainability of the dialogue and coordination process. Donors have supported the development of leadership in their local counterparts and the institutionalisation of their responsibilities. A local institutional network is considered important for donors support sustainability</p> <p>3. SME competitiveness can not be promoted isolated from the sectoral interrelations they have (cluster approach). Key elements are: coordination between private and public bodies and the development of quality standards, BDS, etc.</p> <p>3. A flexible approach is better to get specific reforms (example: USAID's support to administrative simplification)</p>
1	Country/Region	Tanzania
2	Lead Agency	Royal Netherlands Embassy
3	National Consultant(s)	Donath Olomi and Mariam Nchimbi, Entrepreneurship Centre, University of Dar-es-Salaam
4	Methodology	<p>1. Tried to use the templates developed in Viet Nam, but these proved too time-consuming for donors. So a modified (simplified) template was used.</p> <p>2. Personal interviews with donors and government were held.</p> <p>3. National donor meeting to discuss findings contained in a half-completed draft.</p> <p>4. Preparation of final report.</p>
5	Country context	Transition from socialist command-economy to open market. Economic crisis (1979-1985) spurred many reforms, including the later introduction of Structural Adjustment Programmes. Many micro and small enterprises are found with a 'missing middle' of medium enterprises—even a missing top (i.e. large enterprises). Tanzania has been in a broad transition for sometime from SMEs experience difficulties arise at all levels: macro, meso and micro.
6	Categorization of donor interventions	<p>Two broad kinds of donor intervention are described in the report:</p> <p>1 Direct interventions to government on the design of policies, laws, strategies and programmes, mainly through the provision of technical assistance.</p> <p>2 Capacity building of institutions (private sector representative agencies and District authorities), particularly through:</p> <ul style="list-style-type: none"> <li>Policy research</li> <li>Strengthening associations of businesspeople</li> <li>Strengthening government institutions</li> <li>Facilitating public-private dialogue</li> </ul>
7	Tools or processes used	<p>Processes used for donor assisted reforms were:</p> <ul style="list-style-type: none"> <li>Standing forums and committees (government, private sector and</li> </ul>

		<p>combinations of the two)</p> <ul style="list-style-type: none"> <li>• Temporary committees used for specific purposes (e.g. drafting a policy, strategy, or programme)</li> </ul> <p>Analytical tools used in donor-supported activities were:</p> <ul style="list-style-type: none"> <li>• Roadmap Studies—two were conducted: USAID first, then ILO/UNDP.</li> <li>• Various surveys and research studies</li> </ul>
8	Charts/Diagrams	<p>Table 5 provides an interesting overview of key agencies involved in reform processes. This table addressed:</p> <ul style="list-style-type: none"> <li>• Agency or activity undertaken</li> <li>• Composition of agency or participants in the activity</li> <li>• Roles performed</li> </ul> <p>Table 7 provides a summary of capacity building efforts by donors.</p>
9	Highlights: Critical issues	<ol style="list-style-type: none"> <li>1. Donors have been engaged in providing external pressure on government for policy reforms in Tanzania (referred to a 'bitter pill').</li> <li>2. Conditionality, especially through SAPs has played a large role in donor supported policy reforms over the years, but these are mainly associated with PSD and not SME development.</li> <li>3. Donor coordination has involved the sharing of information, agreeing on common priorities and perspectives, and sharing costs.</li> <li>4. Donors don't share a common definition on the SME sector; sometime this is confused with target groups and motivations for reform efforts.</li> </ol>
10	Highlights: Good practice	<ol style="list-style-type: none"> <li>1. The local DAC is a good local model for donor collaboration</li> </ol>
11	Indicators of performance and impact	<ol style="list-style-type: none"> <li>1. Donors and domestic stakeholders appear to have differing opinions on the impact of reform efforts; donors are more eager to see implementation, while domestic stakeholders are content with new or draft policies and laws (i.e. even if not adopted or fully implemented, these reforms are steps in the right direction—they show something is happening).</li> <li>2. Some practical instances of improvements in the business environment resulting from donor efforts are documented in the report (e.g. tax reforms, food sector reforms, creation of National Business Council, cross-border trade), although the questions remain regarding the actual impact these outcomes have had on the SME sector.</li> </ol>
12	Lessons	<ol style="list-style-type: none"> <li>1. Collaboration among donors leads to: <ul style="list-style-type: none"> <li>• Reduced transaction costs for government and donors</li> <li>• Better harmony and understanding among donor agencies</li> <li>• Balanced and consistent advice to government from donors</li> <li>• Better contribution from the donor community to the design and implementation of policies, strategies and programmes</li> </ul> </li> <li>2. Role of business associations in promoting and contributing to reforms of the business environment is increasing. Previously, most reform processes were a result of external donor pressures.</li> <li>3. Barriers to effective relationships between donors and government: <ul style="list-style-type: none"> <li>• Inadequate vision, leadership, coordination and ownership on SME reform issues by government</li> <li>• Lack of transparent and open communication by government toward donors</li> <li>• Lack of national counterparts, including government champions required for reform processes</li> <li>• High turnover of donor staff (usually in three-year cycles)</li> <li>• Frequent changes in donor priorities (donors should design projects that run for 5-10 years)</li> <li>• Piecemeal funding of reform interventions</li> <li>• Heavy reliance on programmes designed and decisions taken at HQ, thus,</li> </ul> </li> </ol>

		<p>a limited capacity among multilateral donor field offices to decide on resources and interventions without HQ approval</p> <ul style="list-style-type: none"> <li>• Difference in cultures, values and reform objectives between donors and domestic stakeholders</li> <li>• Tied aid arrangements, whereby donor support requires the sourcing of advice, equipment, etc. from specified sources (this is particularly an issue for bilateral donors)</li> <li>• Time taken to approve projects and disburse funds</li> <li>• Limited trust between government, business associations and donors</li> </ul> <p>4. Barriers to effective donor-to-donor collaboration</p> <ul style="list-style-type: none"> <li>• Donors have too many differing views (i.e. on defining the SME sector and the priorities for SME development)</li> <li>• Limited knowledge and experience in donor collaboration</li> </ul> <p>5. Barriers to donor-private sector relationships:</p> <ul style="list-style-type: none"> <li>• Lack of national counterparts in the private sector, creating problems with representation of the SME sector and overloading some counterparts</li> <li>• Undeveloped culture of association and group action</li> </ul> <p>6. Time should be invested into the relationships between donors and their domestic counterparts in order to build acceptance and local ownership of reform efforts.</p>
1	Country/Region	Viet Nam
2	Lead Agency	GTZ
3	National Consultant(s)	Ray Mallon
4	Methodology	Templates distributed to all donors, followed by interviews with government and private stakeholders
5	Country context	Transition from a Socialist economy with a high degree of State Intervention. Strong commitment to policy shifts from the top down. PSD has become a major theme in this transition, which has included SMEs (although SOEs are also included as SMEs). High degree of EE reform work going on, mostly due to domestic grassroots pressures for change. Many donors are involved.
6	Categorisation of donor interventions	<p>Three levels of donor intervention found:</p> <ol style="list-style-type: none"> <li>1. Supporting a stable macroeconomic environment</li> <li>2. Direct improvements to the policy and legal environment for SMEs</li> <li>3. Strengthening institutions and policy implementation to promote SMEs</li> </ol>
7	Tools or processes used	<p>Modalities of donor intervention identified:</p> <p>A. Joint donor dialogue with the government on EE issues Involving the following tools of intervention:</p> <ul style="list-style-type: none"> <li>• High-level donor-government dialogue</li> <li>• Facilitation of business-government dialogue</li> <li>• Policy studies and workshops</li> </ul> <p>B. Direct support to new policies and regulations Involving the following tools of intervention:</p> <ul style="list-style-type: none"> <li>• Provision of experts to draft policies, laws, regulations</li> <li>• Training and workshops on policy and regulatory issues</li> <li>• Study tours</li> <li>• Financing costs of consultative processes</li> <li>• Studies on policy and regulatory issues</li> </ul> <p>C. Institutional capacity building Involving the following tools of intervention:</p>

		<ul style="list-style-type: none"> <li>• Provision of experts for on-the-job training</li> <li>• Training and workshops on policy process and issues</li> <li>• Specialised post-graduate staff training</li> <li>• Policy and research workshops</li> <li>• Collaborative research</li> <li>• Study tours</li> <li>• Advisory support</li> </ul> <p>D. Policy-based lending Involving the following tools of intervention:</p> <ul style="list-style-type: none"> <li>• Technical assistance in the design of action plans</li> <li>• Policy reforms tied to loan or grant funding</li> </ul>
8	Charts/Diagrams	<p>Appendix 2 contains a chart describing donor interventions under the following categories:</p> <p>A. Major reform (Policy Regulatory Decision: Number and Date)</p> <p>B. Major domestic agencies involved</p> <p>C. ODA support provided</p> <p>D. Outcomes</p> <p>E. Outstanding issues</p>
9	Highlights: Critical issues	<ol style="list-style-type: none"> <li>1. Donors can add-value to domestic policy reform agendas.</li> <li>2. Strong national counterparts are in short supply.</li> <li>3. National ownership to reform efforts is essential</li> <li>4. EE reforms should recognise and work with different levels of government (i.e. sub-national governments)</li> <li>5. Need for greater transparency in their relationships with government.</li> <li>6. Need for donors to understand the national context for reform (i.e., to recognise that consensus building efforts are essential)</li> <li>7. There are substantial benefits that stem from learning from regional experiences, such as through the use of case studies</li> <li>8. Need for flexibility in project design, and for careful selection of the right mix of consultants</li> </ol>
10	Highlights: Good practice	<ol style="list-style-type: none"> <li>1. Donor interventions that build upon and add-value to domestically driven reform efforts (rather than external attempts to initiate reforms, i.e. donor-driven). National ownership of reform processes is necessary.</li> <li>2. Design of donor interventions should involve a sustained effort over time. Need for a 'protracted dialogue' as well as to better understand the national context before designing programmes. This can be achieved by consulting widely, a phased approach to programme design, case studies of what has worked, and sustained dialogue with officials.</li> <li>3. Consultative processes, involving many stakeholders (e.g. in workshops and training), disseminating studies to the media, using domestic institutions/consultants to undertake most research, longer-term, flexible programs aimed supporting reform processes are all good practices.</li> </ol>
11	Indicators of performance and impact	<p>Tangible, direct outputs of donor intervention identified:</p> <ol style="list-style-type: none"> <li>1. Increased awareness of the potential benefits of SMEs in creating employment and incomes, reducing poverty, and promoting balanced debate.</li> <li>2. Stronger capacity to analyse issues relating to business development</li> <li>3. Increased awareness of international approaches to improving the EE for SME development.</li> </ol> <p>Other issues:</p> <p>A. It is likely that most reforms would have occurred without donor support, but donors helped accelerate these reforms, whilst bring international experience and up-to-date knowledge to the process.</p> <p>B. Impact can be enhanced by better donor coordination.</p> <p>C. EE reforms appear to have had a greater impact on the SME sector than any BDS or financial services. (However, these other services help government and other stakeholders better understand the SME sector.)</p>



12	Lessons	<ol style="list-style-type: none"><li>1. National ownership of reform efforts is essential.</li><li>2. Donors need to work with a wide range of groups (e.g. media, business sector, legislators, industry groups) to build support for reform.</li><li>3. Value in combining interventions at a national level with local or district level interventions.</li><li>4. Donors can bring the following benefits to reform processes:<ul style="list-style-type: none"><li>• Quality analysis of the situation</li><li>• International experience and up-to-date knowledge</li></ul></li><li>5. Multilateral agencies and bilateral agencies bring different dynamics to donor-government dialogue.</li><li>6. Flexibility in donor interventions is necessary. This can be achieved by:<ul style="list-style-type: none"><li>• Pooling of donor resources</li><li>• Regular planning, reviews and readjustment of donor interventions</li></ul></li><li>7. EE reforms take time (often 5-8 years), while donors often work in 3-18 month project cycles.</li><li>8. The social context to reform is important, including social attitudes to the private sector. Thus, the need to work with media and other social institutions.</li><li>9. Need for a mixed and strategic use of consultants in EE reforms, including a commitment to the use and development of domestic consultants.</li><li>10. Improvements in donor coordination are necessary (Appendix 1 provides an interesting proposal to use a web site to collate information of donor interventions).</li></ol>
----	---------	---

## **ANNEX 3 TERMS OF REFERENCE USED FOR THE REVIEW**

This version was agreed upon in a meeting of the Working Group on Enabling Environment on 13 March 2002. It incorporates the comments received on the January 2002 version.

### **Background and justification**

The Committee of Donor Agencies for Small Enterprise Development has established a working group (WG) on SME enabling environment. The WG is chaired by the Netherlands and the following institutions have participated in various ways in proceedings relating to SME policy and regulatory environment: ADB, AfDB, DFID, GTZ, IFAD, ILO, Norad, SDC, Sida, USAID and WB/IFC.

Following WG discussions in London (August 2001) and Stockholm (September 2001), it has been concluded that there is widespread interest in undertaking an inventory of recent experiences from the member agencies' efforts to support national and local governments' attempts to improve their policy environment for small enterprises.

The interest in working together on the subject of enabling environment and small enterprises stems from the following reasons:

- the importance of knowing what each agency is doing and to learn from each other's experiences;
- the relevance of coordination and possibly collaboration at the country level; and
- co-operation among agencies is likely to give a better mix of knowledge, experience and partners at field/country level.

In preparation for the Stockholm WG meeting, the ILO drafted terms of reference for an inventory of experiences from interaction among donor agencies in SME policy reform. After a round of consultations and a WG meeting in Geneva (March 2002), the present proposal is a suggestion for how this joint activity can be carried out.

### **Objective**

The review of experiences from interaction among donor agencies in small enterprise policy reform in a few selected countries is expected to:

- Contribute to an understanding of the similarities and differences in agencies' efforts to help countries improve their policy environments for small enterprise development;
- Contribute to an overall stocktaking of the content, process and outcomes of our efforts by assessing specific country experiences; and
- Contribute to the Donor Committee's efforts to derive principles of Good Practice that could help guide future collaboration at the country level.

The term "enabling environment" or "policy environment" is used here to refer to the policies, laws and regulations that affect small enterprise operations. This includes both specific small enterprise policies and overall economic policies. The review does not focus on specific programmes or projects (e.g. in the fields of finance or BDS).

### **Strategy**

The review is foreseen to contain the following elements:

- Five selected review countries;
- The review will be carried out in each country based on the common guiding questions;
- The WG appoints one or two international consultants to coordinate the review, to analyse the national review results, to compile the aggregate report and to present

the findings at a meeting of the Committee of Donor Agencies for Small Enterprise Development, planned for September 2002 in Turin (draft TOR attached, Annex II);

- Five WG members have chosen 1 country each in which they will take responsibility for the national reviews. The country review responsibility ("lead agency") entails:
  - Recruiting and financing a local consultant;
  - Providing an operational budget, e.g. for local transport to conduct interviews;
  - Organising and raising funds for a workshop in the country.

The findings from the reviews will be presented and discussed in a meeting of the Committee of Donor Agencies for Small Enterprise Development, planned for September 2002 in Turin.

Based on the results of this exercise, the members of the WG may want to plan the next stages in terms of (i) any follow-up studies required, (ii) further activities of dissemination of the findings, (iii) development of guidelines for policy interventions, and (iv) joint policy activities in selected countries.

The possibility of setting up a website to share existing conceptual frameworks and tools for policy work, as well as the report from this exercise, is being explored.

It is assumed that each member of the Donor Committee with policy activities in these countries will participate in the review. To that end, the corresponding field offices will be informed by the lead agencies in each country. WG members may also directly inform the field offices in these countries.

Consistency across country reviews will be ensured as follows:

- In the early stage of the country reviews, a list with main relevant policy areas will be shared across countries.
- The international consultant(s) will visit several countries to learn more about the country cases and "benchmark" the assessment of the national consultants.
- National consultants will be required to use a similar reporting format by addressing the guideline questions.

## **Scope of review**

In order to limit and focus the review, the study should only aim at interventions that have had an intended and explicit focus on policies for, and those affecting, small enterprises. The review should address processes where donor agencies have been involved in support interventions at either the national, provincial or local level. This includes past interventions that are now completed (over the last two to three years), current interventions, and planned interventions.

The views and experiences of Government and the private sector as recipient and counterpart of agency support will be part of the review exercise.

## **Guideline questions**

### *Objectives of the intervention*

- What were the formulated and/or underlying objectives of the donor-supported policy intervention(s) (e.g. making the environment more conducive to private sector development, to employment creation, etc)?

### *Focus and target groups*

- Did the intervention(s) focus on a particular policy or piece of legislation or did it involve a comprehensive change of the environment for small enterprises?
- Did the intervention(s) focus on specific size classes or economic sectors of enterprises?

Partners and demand for the intervention

- With which national agencies and stakeholders did the donor work directly (direct counterpart) and indirectly (participants and policy processes)?
- How was the need for the intervention(s) first detected and how was the response initiated? (e.g. agencies' own diagnostics, national counterpart's request, convenor for policy activities)

*Process*

- What was the role of the intervention(s) (e.g. providing resources, giving legitimacy to the process, providing technical know-how, providing logistics, etc.)?
- What were the mechanisms of cooperation between (a) the agencies and their national counterpart(s) and (b) between national stakeholders?
- What were the main tools provided or used by the agencies to analyze the policy environment and to facilitate policy reform?
- What was the level of commitment of the government and other stakeholders throughout the process (e.g. political support, time, money)?

*Themes and topics covered*

- Which policy areas were covered in the policy process - e.g., specific MSME policies, registration, licensing, and permits at start-up/formalization, various economic and financial policies, taxation, labour laws, property rights, and provision of services during operation, and/or bankruptcy and related laws at exit?
- Were the following aspects systematically taken into account?
- Gender aspects
- The division of responsibilities between different levels of government (national down to local)

*Outcome and impact*

- Which policies, laws and regulations were enacted or changed as a result of the policy process? (or to which stage did they get if they were not enacted or changed?)
- Which institutions were created or upgraded as result of the policy process?
- Which steps have been taken to implement new or improved policies, laws and regulations? Is there any evidence at the local level of actual implementation?
- Is there any evidence on the impact of the new or modified policies, laws and regulations on micro, small and medium-sized enterprises, or on poverty alleviation, employment generation or other development objectives?

*Collaboration among donor agencies*

- With which other donor agencies or international agencies were there any kind of collaboration?
- What was the character of the collaboration among donor agencies, e.g. awareness of each other's initiatives, information sharing, joint planning or joint activities?
- Was the collaboration based on local initiative or due to head office expectations?
- What were the motivating factors for the collaboration, e.g. pooling of resources, demanded by local stakeholders, building synergistically on each other's mandate and expertise?
- Did the collaboration among donor agencies increase the effectiveness of the process or did it confuse and/or duplicate efforts, (e.g. along principal themes or topics, to what extent was the policy advice consistent? Were the reform processes consistent, or competitive? Did the agencies provide conflicting policy advice or work in parallel?)
- What were the impeding/key factors that made collaboration among donor agencies difficult/successful?

*Lessons learnt*

- In summary, were the interventions successful, and were the objectives of individual agencies reached? What are the main factors of (partial) success and (partial) failure?
- What can be learned from this case study (a) for future interventions by Governments, donors and agencies and (b) for the national set-up of future policy formulation processes?
- What can be learnt from the attempt to collaborate among donor agencies? What can be learnt from the views and experiences of Government and the private sector? What can be gleaned from this case for good practice guidance for future donor collaboration?

Ensure that the summary covers the existing concepts and approaches in work on the business enabling environment, notes the most interesting projects, lists the best and worst practices, and signposts towards good practices

**Terms of Reference for international consultant(s)**

The role of the international consultant(s) is to ensure methodological consistency among the five country-level reviews to enable comparisons, and to draft a synthesis report based on all national reviews. It is envisaged that the international summary report will be presented to a regular meeting of the Donor Committee in September 2002.

There will be two international consultants to share the work, one of which will be the lead consultant. The lead consultant will visit the national review work in China, Tanzania and Viet Nam, and make the presentation to the Donor Committee. The second international consultant, who needs to speak Spanish, will visit Peru and the Caribbean region.

The attached Review Outline provides further information on the scope of this exercise and the specific procedures.

The Chair of the Working Group will coordinate the international review.

*Contract period*

The contract period for the consultants shall be from 15 April 2002 to 30 September 2002. The lead international consultant assignment will entail 50 working days and the second international consultant's work will entail 30 working days.

*Services to be provided*

The Working Group (or the individual member agencies) will contract the services of the consultants to review the activities of international agencies and donors in the field of policy reform for small enterprise development. Specifically, this involves the tasks indicated below. The lead international consultant will carry out tasks 1, 2, 3 (three countries), 4, 5, 6, and 7, whereas the second international consultant will carry out tasks 1, 3 (two countries), 4 and 5:

- Prepare for the assignment by participating in a briefing in the Hague, collecting background documents and concept papers from donor agencies and by scrutinizing the TOR for national consultants and their work plans to ensure methodological consistency.
- Contact the Headquarters of the international agencies and donors participating in the Working Group to obtain information on their general policies of policy intervention for small enterprise development.
- Visit the countries where the reviews take place, to monitor the national consultants' work and to become familiar with the country-specific issues related to donor agencies' interaction with regard to the policy and regulatory environment for SMEs.
- Edit the national review reports provided by the national consultants, and contact the national consultants to obtain additional information where necessary.
- Draft a report that synthesizes and analyses the findings for the countries under review and that provides answers to the attached guiding questions.

- Present the draft report to the Donor Committee in Turin in September 2002.
- Draft the final version of the report, incorporating the feedback from the September Donor Committee meeting.

*Expected outputs*

One draft and one final report not exceeding 30 pages, excluding a two-page executive summary and annexes, submitted in hard copy and in electronic form.

A presentation to the Committee of Donor Agencies for Small Enterprise Development in Turin, September 2002.