

Donor approaches to improving the business environment for small enterprises

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

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Executive Summary

The Working Group on Enabling Environment, established by the Committee of Donor Agencies for Small Enterprise Development in 1992, has taken a closer look at the work of donor agencies in reforming the business environment for small enterprise development. This report presents the findings of an investigation into the concepts, approaches, and practices donor agencies apply in their efforts to improve the business environment in which small enterprises operate.

While all donors share the common broad goal of poverty reduction—most recently expressed in terms of the United Nation's Millennium Development Goals—many are challenged to find ways to upscale their development programs to produce a greater impact. Small enterprise development has been acknowledged as a useful mechanism for economic development and poverty reduction by both governments and donor agencies. While there have been hard questions asked about the efficacy of financial and business development services in this field (leading to substantial improvements in the way small enterprise development programs are designed and assessed), many donor agencies have turned to the broader conditions in which small enterprises operate in the search for ways to affect a larger number of firms and, hence, expand the benefits of their interventions. Donor agencies are also searching for tools and processes to improve the capacity of small firms to respond to the challenges that advancing globalization and foreign trade brings.

The study presented in this report was based on a comparative assessment of the similarities and differences in donor agency practices in reforming the business environment

for small enterprises. Special attention is given to the way donor agencies define the business environment and the role small enterprises play in it.

It was found that donor agencies have come to this field of work along different paths. Agencies such as the development banks have been involved in supporting macroeconomic reforms for sometime. These agencies have been interested in the business environment in general, but rarely examined the importance of the business environment on small enterprises. In contrast to this situation, there are donor agencies that have a long history of support for small enterprise development programs, but have only recently turned their attention to the broader environment in which small enterprises operate.

Donor agencies and small enterprise practitioners were found to regularly—and often loosely—use the terms 'business environment', 'investment climate', 'business climate' and 'enabling environment'. While avoiding the dangers of a semantic argument, the study has found it useful to unpack the concepts and themes that underlie these terms. A broad range of elements can be contained in the business environment. However, this study found many donor agencies prefer to focus on those elements they believe to be most relevant. These were:

- Macroeconomic strategies
- Governance issues
- Policy, legal and regulatory framework
- Organizational framework

While many donor agencies have not officially defined their view of the business environment, this study cites examples that display great variation.

In addition to these common elements of concern, some donor agencies highlight the role of the broader cultural and value-based

context of economic and social system. Attitudes to enterprise and markets, expectations on the role of the State, the value of hard work and individualism, are broader influences that affect society's institutions, and ultimately the business environment.

This study also examined the approaches donor agencies take to assessing the business environment for small enterprises. What donors measure in the business environment and the changes they monitor reflect their interests. Interventions designed to improve the business environment are based on an analysis that gives priority to some issues over others.

Nineteen tools of assessment are described in this report. Each of these use a different set of information sources ranging from large-scale firm surveys, to gauging expert opinion, to stakeholder consultations. Each of the tools described have a specific area of focus and have been designed to address areas of interest or concern. To varying degrees each of the above tools identify bottlenecks or constraints to private sector or small enterprise development.

Very few tools focus on the plight of small enterprises in the business environment. Some tools attempt to capture information that is specific to small enterprises, but most have been designed with the view that small enterprise data is too difficult to capture, too hard to compare across countries, or unnecessary.

All the tools described generate information that can inform the design of reform interventions. However, not all donor programs are designed on the findings of assessments such as these. Business environment assessments can be used to create a demand for reform and to identify points of concern within the business environment, but the program planning processes of donor agencies are often influenced by a range of other factors.

Reforming the business environment for small enterprise

development brings donors into a number of new (higher-level) domains. Consequently, there are a number of new issues that donors are required to grapple with in this field. These include:

- The need for integrated holistic programs that deal with a number of reform issues, rather than isolated projects
- The time-consuming nature of reform and the demand for longer donor timeframes
- The connection between policy, legal and regulatory reform and the role of markets
- Ways to engage small enterprises as advocates for change and participants in the reform process
- Finding incentives for change, improving governance and building skills
- How a decentralized agency structure can be supported by its head office in this field
- The significance of local-level reforms
- Responding to host government demands and the relevance of fee-for-service reform interventions
- Recognising and respecting the political aspects of reform
- New ways of working with the private sector
- Sectoral approaches to reform

Many donors consulted for this study indicated they would appreciate information on how to improve their performance in these areas. Donors are eager to learn more about the experiences of others in the fields of governance, regulatory reform, policy development and revision, and drawing small enterprises into social dialogue.

The difficulties of donor collaboration are identified. While all donor agencies agree to the importance of better collaboration, many experience internal obstacles. Some of the mechanisms that have

been used to promote collaborative reform efforts are described.

Finally, this report attends to the ways donor agencies formulate the outcomes and impact of their projects and what indicators they use to measure these. The frameworks agencies use to assess outcomes and impact in the reform of business environments is of interest, as are any insights that can be gained into the processes and experiences of turning plans for reforms into actual donor-supported interventions.

While there are many problems experienced by donor agencies in this field, all agencies believe this is a field that deserves careful attention. Most donor agencies are engaged in monitoring and assessing their program interventions, but many are aware of the shortcomings of their efforts.

There are three major problems experienced by donor agencies when evaluating the impact of their interventions. The first comes from the embedded nature of many reform programs. Donor agencies often package their reform efforts within a broader program of development cooperation. This bundling of reform services can make monitoring and assessment of specific reform efforts (i.e., reform components) very difficult.

Secondly, it is difficult to find ways to attribute specific donor-supported reforms to improvements or declines in the business environment when so many other events (both domestic and international) can also affect the business environment. Similarly, it is difficult to prove the counter-factual (i.e., What would have happened if the donor activity had not taken place?)

Thirdly, reforms to the business environment take time. While individual interventions can create short-term outcomes the impact of these outcomes takes a longer period of time to eventuate.

It is clear that individual donor agencies and the Committee of Donor

Agencies for Small Enterprise Development can do much more to improve the practice of donor-supported reforms in the business environment for small enterprises. While the management of reform processes should remain in the hands of host governments and other domestic stakeholders, donor agencies can significantly add value to these efforts.

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List of acronyms

AusAID	Australian International Development
BDS	business development services
BLCF	Business Linkages Challenge Fund (DFID)
CIDA	Canadian International Development Agency
Danida	Danish Ministry of Foreign Affairs
DFID	Department for International Development (United Kingdom)
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDCF	Financial Deepening Challenge Fund (DFID)
FDI	foreign direct investment
GTZ	<i>Gesellschaft für Technische Zusammenarbeit</i> (German Agency for Technical Cooperation)
IADB	Inter-American Development Bank
ICA	Investment Climate Assessment (World Bank)
ILO	International Labour Organization
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
NORAD	Norwegian Agency for Development Cooperation
OECD	Organization for Economic Co-operation and Development
PRSP	Poverty Reduction Strategy Paper
PSD	private sector development
RICS	Rural Investment Climate Survey
SDC	Swiss Development Agency
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
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
WBG	World Bank Group
WTO	World Trade Organization

Chapter 1

Introduction

Small enterprise development continues to challenge governments, donor agencies and practitioners around the world. Responding to these challenges has produced innovations in approaches that improve practices and deepen the understanding of small enterprises and their role in local and national economies. While the advantages of small enterprises and their contribution to national economic and social development are recognised by many, the methods for small enterprise promotion are the subject of debate and revision.¹ In some cases, small enterprises are a symptom of underdevelopment and poverty, but elsewhere they are indicators of a vibrant, entrepreneurial economy. Both developed and developing countries have come to recognise the importance of the small enterprise sector and its relationship to large enterprises and the strategic position that many countries are looking for in the world-economy.

Most governments have come to see that running their own businesses is an inefficient endeavour; there are compelling arguments for the development of a dynamic and competitive private sector as a mechanism for the distribution of resources, goods and services. For the governments of many developing economies, a new relationship with the private sector is being forged. Governments are required to recognise the value of markets and ensure they only interfere with them when they have a clear and good reason. Furthermore, globalisation and the removal of barriers to trade have opened enterprises of all sizes to competition from the world-economy challenging many national governments to find new ways of managing their economies.

1 The term 'small enterprises' is used to describe a wide range of enterprises that are often disaggregated into micro enterprises as well as small- and medium-sized enterprises (SMEs), with the specific definition depending on the purpose or country context.

Governments have taken direct measures to support the development of small enterprises. They have established incubators, launched training programs, encouraged mentors, given out money, guaranteed the money of others, created special councils or taskforces, adopted promotional policies, and even offered tendering preferences to the small enterprise sector. In some cases, these initiatives have been ill informed; they have created or perpetuated market distortions and usually only benefited a handful of enterprises in a sporadic and unsustainable manner. However, there are also cases where governments have promoted small enterprises in a more strategic, market-oriented manner—where they have recognised the role other actors can perform and sought to facilitate the development of markets for business development services.

Donor agencies have endeavoured to work with governments to address these challenges. They have encouraged the sharing of information and experiences, and the learning of lessons that can improve their practices. Over time, donor agencies, along with governments, academics and other actors have established a body of knowledge to build upon these experiences. The Committee of Donor Agencies for Small Enterprise Development, established in 1976, has played a significant role in this regard. Innovations in financial services, the promotion of market-based business development services, and an exploration into ways of improving monitoring and evaluation are examples of the contribution the Committee has made to practice in this field.

This report furthers the work of the Committee of Donor Agencies in an equally challenging and innovative field: the creation of a business environment that is conducive to small enterprise development. Donor agencies have come to realise that the business environment can influence the effectiveness of financial and business development services. Providing support to small enterprises where the business environment dampens entrepreneurship and inhibits enterprise growth undermines the potential of business development services. Moreover, there may be times when certain

financial and business development services are no longer required in a business environment that facilitates enterprise establishment and growth. Thus, donor agencies have begun to pay more attention to the conditions in which financial and business development services are provided and to broaden the scope of their involvement in small enterprise development.

The broader context in which small enterprise development occurs has become better understood by donor agencies. The relationship between small enterprise performance and trade and investment has become a critical concern for many, as has the role small enterprises play in the value chain within specific industry sub-sectors. Assessing and reforming the business environment in which small enterprises operate provides an opportunity to consider these connections and to ensure these interrelationships function optimally. Macroeconomic strategies, labour market policies, legal systems, as well as the systems of governance have all become more relevant to the prospects of successful small enterprise development. Similarly, small enterprise development can be a strategy employed by governments to achieve the dynamism and competitiveness their economies require.

1.1 Study objective and outcomes

The business environment for small enterprise development has been on the mind of the Committee of Donor Agencies for Small Enterprise Development for some time. In 1992, the Committee produced a report, dealing with the ways donor agencies can cooperate in providing support for small enterprise development at the national level (Committee of Donor Agencies for Small Enterprise Development 1992). The report incorporated issues concerning the policy framework for small enterprise development, as well as the organizational framework and the regulation of competition and markets. In 2001, the Committee of Donor Agencies for Small Enterprise Development established a Working Group on Enabling Environment. A first initiative of the Working Group was to commission research into the role donor agencies play in promoting an enabling

environment in five countries/regions.² This resulted in the publication of a report entitled, *Enabling Small Enterprise Development through a Better Business Environment* (White & Chacaltana 2002). The findings of this report were presented during the annual meeting of the Committee of Donor Agencies in Turin in September 2002. The report identified similarities and differences in donor initiatives in this field, while describing the content, process and outcomes of donor efforts. Some tentative suggestions toward good donor practices were also presented. However, the need for further information and a better understanding of the role donor agencies can play in promoting reforms to the business environment was clear. White and Chacaltana specifically referred to the need for further research to:

- Better understand and further develop the business environment concept and its influence on small enterprises
- Assess donor practices and experiences with initiatives to improve the business environment for small enterprises
- Better understand the impact of international development assistance on the business environment, including the design of appropriate tools and techniques for measuring such impacts

Taking these recommendations into account, the Working Group commissioned a new study to look more carefully into these issues. The objective of the study was to better understand the way donor agencies plan and design their initiatives for improving the business environment for small enterprises. It was proposed that this study contribute to the Committee's efforts to derive principles of good practice to enhance future donor collaboration and harmonization at the country level. See terms of reference in Annex 3.

While attention is given in this report to the role of donor agencies in reforming the business environment for small enterprises, it should be recognised that national governments are in fact the main drivers of

² The five countries/regions examined were the Balkans (encompassing Albania, Bosnia-Herzegovina and FYR Macedonia), the Caribbean (specifically Dominica, Grenada, Guyana, and Jamaica), Peru, Tanzania, and Viet Nam.

reform processes. Donor agencies can support reform efforts, but it is the government that must take the lead. Furthermore, it is recognised that private sector representative agencies, including associations of small enterprises, can advocate for change and participate in reform processes—but, again, government usually manages these processes.

Key findings based on a comparative assessment of the similarities and differences in donor agency practices in this field are presented in this document. Special attention is given to the way donor agencies define the business environment and the role small enterprises play in it. As will be shown, donor agencies and small enterprise practitioners regularly—and often loosely—use the terms ‘business environment’, ‘investment climate’, ‘business climate’ and ‘enabling environment’. Semantic arguments aside, it is pertinent to understand the full meaning of these terms. It is especially illuminating to identify the key elements that comprise these terms and which are excluded.

The tools and techniques donor agencies use for assessing the business environment are also given attention in this report. What donors measure in the business environment and the changes they monitor reflect their interests. Interventions designed to improve the business environment are based on an analysis that gives priority to some issues over others. This analysis sheds light on the focus of donor interventions and the source of their interests and concerns.

Finally, this report attends to the ways donor agencies formulate the outcomes and impact of their projects and what indicators they use to measure these. The frameworks agencies use to assess outcomes and impact in the reform of business environments is of interest, as are any insights that can be gained into the processes and experiences of turning plans for reforms into actual donor-supported interventions.

Since the Working Group report in 2002, the speed at which donor agencies have engaged the business environment has been rapid. Not only does it appear that more agencies are now working in this arena, but also those that were previously involved are now more active. Thus, there are more experiences to learn from and, through the

Committee of Donor Agencies, participating agencies have more to contribute.

The following themes of donor agency involvement in reforming the business environment for small enterprise development are addressed:

- Definitions and concepts used to describe the business environment
- Diagnostic instruments and frameworks used to assess the business environment
- Processes for the planning and design of donor interventions
- Programmes and services provided by donor agencies to promote reform of the business environment for small enterprise development
- Monitoring and information systems used by donor agencies in their efforts to promote reform of the business environment
- Collaboration between donor agencies in the promotion of reforms
- Outcome and impact of business environment reforms
- Lessons learnt for donor agency experiences

This study has involved consultations with a number of donor agencies, either in person or by telephone or email. The table below (

Table 1) indicates the agencies that participated.

Table 1: Donor agencies consulted

Agency	Office	Mode
African Development Bank	Abidjan, Cote D'Ivoire	Email
AusAID	Canberra, Australia	Telephone
Commonwealth Business Council	London, UK	Email
Danida	Copenhagen, Denmark	Personal interview
DFID (UK)	London, England	Personal interview
European Union	Brussels, Belgium	Email
Finland Government	Helsinki, Finland	Email
GTZ	Frankfurt, Germany	Personal interview
IADB	Washington, USA	Personal interview
ILO (IFP-SEED)	Geneva, Switzerland	Personal interview
JICA	Tokyo, Japan	Email
Netherlands Government	The Hague, Netherlands	Personal interview
OECD	Paris, France	Email
Sida	Stockholm, Sweden	Email
Switzerland Government	Berne, Switzerland	Email
UNCTAD	Geneva, Switzerland	Personal interview
UNDP	New York, USA	Email
UNIDO	Vienna, Austria	Personal interview
USAID	Washington, USA	Personal interview
World Bank Group: Agriculture and Rural Development Department (ARD)	Washington, USA	Personal interview
World Bank Group: Evaluations	Washington, USA	Personal interview
World Bank Group: Foreign Investment Advisory Services (FIAS)	Washington, USA	Personal interview
World Bank Group: Investment Climate Department (IC)	Washington, USA	Personal interview
World Bank Group: SME Department	Washington, USA	Personal interview

Report structure

This report progresses from a review of the ways donor agencies approach the business environment for small enterprise development to the tools, programs and services they apply in their work, to the way they evaluate the success of their interventions. This progression provides a thread that structures the report and allows the reader to follow the variations that exist between donor agencies in this field.

The following chapter (Chapter 2) begins with an examination of donor agency approaches to the business environment. This explores the terminology used and surveys the elements of the business environment different donors focus on. Some of the contentious issues facing donor agencies are also reviewed, namely, the importance of a broader 'meta-level' element of the business environment on small enterprise development, and the relative importance of enterprise size.

Chapter 3 investigates the tools donor agencies use to assess the business environment for small enterprise development. It compares a collection of standardised tools donors have developed and applied to assess the business environment. It also describes the non-standardised approaches that many donor agencies appear to prefer.

Chapter 4 focuses on the kinds of programs and services donors use to reform the business environment for small enterprises. It recognises that donors bring different competencies and experiences to their work in this field, which influences the way they design their interventions. The assessment tools and processes described in Chapter 3 are shown to be less relevant to the design of programs and services than may have been initially thought. Some of the main approaches donors apply to the reform of the business environment are also examined in this chapter.

The anticipated outcomes of reform are reviewed in Chapter 5, including an investigation of the ways agencies measure success in this field. Although this is an issue that many donors confess to managing

poorly, all agencies stress the importance of getting these matters right and the need for working models and approaches that can be adapted to suit the specific requirements of each program. Some of the problems of measuring the impact of donor-supported reforms are also canvassed in this chapter.

The final chapter is used to draw conclusions from the findings in the preceding chapters and to propose a way ahead. As described above, this report was commissioned to contribute to a further analysis of the influences donor-supported interventions have on the reform of business environments, as well as to the production of a 'toolkit' for donor agencies working in this field. Thus, the final chapter of this report presents some proposals in this regard.

Chapter 2

Describing the business environment

In recent years donor agencies have paid increasing attention to the influence the business environment has on the small enterprise sector's ability to contribute to employment creation and poverty alleviation. Concurrently, interest in the business environment has also been supported by a trend in interventions leading away from the direct provision of financial and business development services—as advocated by the Donor Committee (2001). However, there is still a need for a clear analysis of why and how donors and governments understand the business environment and its affect on small enterprises. Furthermore, the relative importance of an enabling business environment and its place in an overall small enterprises development strategy needs to be more fully understood.

This chapter examines some of the major motivations that were found to underlie the work of donor agencies in this field in an effort to clarify the expectations and overall objectives of donor activity in the business environment. It also examines the range of elements that make up the business environment and the extent to which donor agencies focus on these.

Later in this chapter, the current challenges faced by donors when approaching the business environment for small enterprise development will be identified.

2.1 Donor pathways and motivations for working on business environments

Because donor agencies come to the field of the business climate for small enterprise development on different pathways they bring to this issue a variety of issues for consideration. The World Bank Group, for example, has been involved in macroeconomic interventions for many years. However, the promotion of small enterprises

has rarely been considered at this level; indeed, the relative importance of small enterprises within this context has been the subject of debate. In contrast, a number of bilateral donors and development agencies (e.g., GTZ, Danida, DFID, USAID) have been involved in the promotion of small enterprises on a sectoral basis for some time at the micro and meso levels, sponsoring the use of financial and business development services to improve the competitiveness of small enterprises. Over time, these agencies have shifted their focus toward the macro-level. Some have moved from interventions that once targeted small enterprises directly to the support of meso-level organizations and the development of markets for business development services. Progressing in this direction, greater recognition has been assigned to the role of the business environment in small enterprise development.

Most donor agencies are motivated by impact. They want to be able to show that they have been able to achieve maximum benefit for their target groups for the funds spent. How they assess this impact is the subject of Chapter 5, but it is clear that donor agencies have become more sensitive to questions regarding the results of their work. Many bilateral donor agencies, for example, express the need to be able to furnish their ministers with information on the outcomes and impact of their work; taxpayers in donor countries are demanding more information on what is happening with their contributions to international aid and whether this is justified.

Greater impact is one of the major motivations behind the increasing interest donor agencies are showing in the business environment for small enterprises. There is a trend among donors to raise the level of their involvement from specific small enterprise development interventions—where donor agencies were directly involved in the provision of financial or business development services—toward meso- and macro-level responses.³ This is primarily a consequence of the desire among donor

3 This trend has been documented by the Committee of Donor Agencies for Small Enterprise Development in its previous reports, see (Committee of Donor Agencies for Small Enterprise Development 1997, 1992)

Box 1: Effective markets

Large parts of economic activity are best organized in markets. Markets have proven effective in creating opportunity for citizens to obtain jobs, increasing incomes based on productivity growth, and producing the goods that people want to buy. Functioning markets are thus a critical mechanism to help reduce poverty. Key to effective markets is an investment climate that provides i) sound rules for the market, ii) the expectation that the rules will be adhered to both by market participants and the state, and iii) physical access to the market. Macro-economic stability, well-defined property rights, a sound judicial and contracting system, a reasonable level of certainty about government policy, functioning financial institutions and a good physical infrastructure, such as a transport system, are all ingredients of a sound investment climate.

SOURCE: World Bank (1999, p. 3)

agencies to broaden their influence, thereby increasing the impact of their intervention. It is also motivated by a better understanding of the role of markets in small enterprise development. Donor interventions, like those of government, should not perpetuate the market distortions that disadvantage small enterprises, but should ensure that markets work effectively. Markets can provide a sustained and efficient mechanism for the development of small enterprises and the reduction of poverty. See Box 1 as well as DFID (2000b), UNDP (Commission on the Private Sector and Development 2004) and World Bank (2002a).

Greater efficiency, more investment and broader participation in markets—both international and domestic—are outcomes of improvements in the business environment. Small enterprises within an improved business environment will face fewer obstacles (including biases), while responding to more diverse and competitive markets. Improvements in enterprise competitiveness and the removal of external obstacles to enterprise development will help unleash the potential of the small enterprise sector as a mechanism for employment generation and wealth creation. Thus, donor agencies have come to recognise the causal sequence that links improvements in the business environment to the reduction of poverty and economic growth. Greater attention is being paid to the causal link between enterprise development and poverty reduction (see Ayyagari, Beck et al. 2003;

Beck, Demirgüç-Kunt et al. 2003; Biggs 2002; McKinley 2001). While not established through empirical research, many donor agencies justify their involvement in this field with the view that small enterprise development is a contributor to poverty reduction and economic growth, and this underpins donor efforts to support the reform of the business environment.

Small enterprise development is seen as a mechanism by donor agencies for development in a range of fields (see Committee of Donor Agencies for Small Enterprise Development 1997). Many donor agencies consulted for this study expressed their desire to ensure their programs contribute to the ultimate aim of reducing poverty. Many donors have expressed their support for the United Nations' Millennium Development Goals (MDGs) and have aligned their interventions so as to be able to monitor and assess their programs within this context. Agencies such as Danida, GTZ and the Government of the Netherlands have taken steps to demonstrate the ways in which their interventions contribute to the achievement of the MDGs. The creation of more and better jobs, while a key mandate for an agency such as the ILO, is also an objective shared by many agencies in an overall effort to reduce poverty (i.e., through the promotion of livelihood activities).

Improving the competitiveness and productivity of the private sector in general and small firms in particular is another objective shared by many donors. Indeed, many donors take the view that the higher-level objective of poverty reduction and economic development can only successfully be achieved through enterprise promotion that enhances competitiveness and productivity.

A list of some of the source documents donor agencies draw from to justify their work in the business environment is provided in Annex 1. These documents reflect a variety of interests and starting points in donor agencies' efforts to reform the business environment for small enterprises.

Donor motivations for engaging in the business environment inform the design of their interventions. Donors have been careful to explain the differences between the

underlying rationale for intervention and the strategies they employ. Poverty reduction, for example, does not necessarily imply a need to work with the poor. Instead, poverty reduction can be achieved through market-oriented interventions that grow the private sector and create a greater demand for local jobs and services. Hence, donor interventions that help medium and large-scale enterprises to grow may contribute more to the reduction of poverty than helping the poor start-up their own businesses.⁴ However, this is a debatable issue. Some donor agencies strive to ensure that the poorer sectors of society are better able to participate in the economy and are not only the final (passive) beneficiaries of development activities in other sectors. Note, for example, the following quote from DFID's Enterprise Development Strategy:

It is useful to distinguish between two different but complementary approaches to enterprise development. On the one hand, there are interventions targeted directly at poor micro-entrepreneurs in the informal sector. On the other hand, there are more leveraged interventions targeted at somewhat better-resourced small and medium-scale enterprises and larger enterprise, that by virtue of their linkages to and impact upon lower income groups can offer significant indirect benefits for the poor (DFID 2000a, para. 3.4.1).

Another reason for donor involvement in the business environment is a consequence of the constraints on other donor-supported interventions. In its assessment of international development assistance, the World Bank found that many of its programs 'focused too narrowly on projects and did not tackle such fundamental constraints to PSD as the appropriate role of the state, financial sector reforms, institutional, legal and regulatory bottlenecks, and the policy environment' (World Bank 2001). Thus, by broadening the scope of interventions to address constraints in the business environment donors can affect the conditions in which all kinds of development assistance

occur. The Netherlands Ministry of Foreign Affairs and the German *Gesellschaft für Technische Zusammenarbeit* (GTZ) also indicated during consultations that they saw the benefits of an improved business environment flowing to other areas of development assistance (de-Waard, Fortuin et al. 2004; Prey 2004).

Thus, donor agencies see the business environment as a means of improving the effectiveness and impact of their work, both in small enterprise development as well as in other fields.

2.2 Models and frameworks for practice

There is a range of models and frameworks donor agencies use when approaching the business environment and to describe the elements of interest or concern. The term 'business environment', used throughout this report, for example, is not used by all agencies. Others use the term 'investment climate' or 'business climate'.

The Working Group set a 'rather narrow' definition of the enabling environment for small enterprises for the purpose of this study. In its terms of reference it indicated that the study should 'focus on initiatives that support legal, regulatory and administrative reforms for small enterprises,' adding that 'aspects regarding the business environment for the private sector in general will be treated in this study only in regard to their relevance for small enterprises'. There are good reasons for this, not the least of which is the wide range of issues that can be included within the term 'business environment'. The *concept* of a business environment may be broadly defined, but for donor agencies dealing with the *practice* of reform, there is a need to clearly demarcate the most relevant factors.

Donor agencies focus their limited resources on the issues they think matter and the ones they can do something about. Because not all elements of the business environment will satisfy these criteria equally, donor agencies are required to prioritise and focus their attention on those elements that do. Thus, this section reports on how donors define the business environment and

4 Many donor agencies distinguish between the needs and capacities of micro enterprises (many of which operate in the informal economy) and those of SMEs.

identifies the elements they consider important.

Some donor agencies are very precise with their use of terms in this field. Agencies such as the World Bank have focussed on the term 'investment climate', principally, because it is investment—both domestic and foreign—that is the end result of a successful or enabling environment. The GTZ claim to use the term 'investment climate' because there is precision when looking at investment; investments can be measured and are, therefore, an indicator of how well the economy is performing (Prey 2004). However, GTZ also uses the term 'enabling environment' to describe its work in this field.

The Danish Government have a particular concern with the use of terms in this field, which is due mainly to their own historical

project formulations. The term 'business sector development' has been used to describe a holistic approach to working with the business sector, just as when working with the health sector or the education sector. This approach involves dealing with both internal and external elements of the business sector, at national, meso and local levels.

The term 'business environment' is used in this report as a generic term. It is less precise than 'investment climate', but certainly includes these elements. Thus, the business environment refers to a wide range of elements that are external to the enterprise.

The table below (Table 2) summarises these terms and indicates the agencies that tend to use them.

Table 2: Review of terms used

Term	Business environment
Used by	ILO, JICA, UNCTAD, World Bank SME Department, DFID
Comment	This term is used to cover a broad range of external elements that affect the growth and performance of small enterprises.
Term	Investment climate
Used by	Government of Switzerland, GTZ, UNIDO, World Bank,
Comment	Those promoting this term emphasise its value in focussing on a key aspect or indicator of the conditions in which enterprises operate, i.e., domestic and foreign investment into the private sector is a bottom-line measure of how well an economy is working.
Term	Enabling environment
Used by	AusAID, Donor Committee on Small Enterprise Development, DFID
Comment	This term appears to be most suited when describing the purpose of donor activities, i.e., interventions that promote an enabling environment. As an adjective, the term enabling describes a quality of the environment. Thus, a 'enabling environment' would be better described as an 'enabling business environment'; the aim is to reform a poor ('disabling'?) business environment into an enabling business environment.
Term	Business climate
Used by	Government of the Netherlands, Government of Denmark (Danida)
Comment	The term 'climate' appears to be synonymous with 'environment'.
Term	Business sector
Used by	Government of Denmark
Comment	This term is used in the same way the 'health sector' is used. It describes a sectoral approach to business development that covers external issues (such as those covered in the terms described above) as well as internal issues (e.g., capabilities and constraints) faced by the business. This term is not synonymous with the private sector because it can include State-owned enterprises.
Term	Private sector
Used by	All agencies
Comment	This term is used to refer to all privately owned enterprises (from very large, multinational or domestic firms, to small, informal ones). Private sector enterprises do not include State-owned enterprises as the 'business sector' does.

It is dangerous to review the terminology used by different donor agencies. It can lead to semantic and theoretical debates that can be both distracting and fruitless. However, just as the Committee of Donor Agencies for Small Enterprise Development has led the way in terms of the use of 'financial services' to small enterprises and 'business development services' to describe approaches to small enterprise development, so too can it facilitate processes in this field. Common terminology aids information sharing and the development of good practices. As shown throughout this report, donor activity in the business environment is a new field of engagement for many donor agencies; it is the newness of these issues

that affect the way donor agencies assess the business environment, design interventions to reform it, and attempt to measure the impact of their work. This demands a consistency by donor agencies in the way they understand and apply their interventions to this field.

The size and variety of divisional interests found within many donor agencies was a problem when attempting to assign 'official' definitions of the business environment to specific agencies. While this is more feasible in bilateral agencies, large multilateral agencies contain a diverse range of views. This problem arose in consultations with the ILO, UNCTAD, UNIDO, and the World Bank Group. Each of these agencies have units,

departments or programs that focus on small enterprises, but other sections of these organizations also work with large enterprises and other constituents, which can affect their approach to this topic. The ILO InFocus Program SEED ('Boosting employment through small enterprise development'), for example, has a particular interest in small enterprises, but the approaches and interests of this program are not necessarily shared by the Bureau for Workers' Activities (ACTRAV) or the Bureau for Employers' Activities (ACTEMP), each of which typically represent large firms and the organized workers' movement. Similarly, the World Bank's SME Department has a view on business environments that, while broadly shared by the Investment Climate Department or the Agriculture and Rural Development Department, is contested at times on specific issues (e.g., the importance of enterprise size); the SME Branch of UNIDO can take a position on business environments that possibly differs from those branches dealing with industrial firms in general, just as the Technology and Enterprise Branch of UNCTAD can take a different perspective on small enterprises and trade than other sections of the organization. Thus, it is difficult to present a 'World Bank View' or 'UNIDO View' on this topic. Whether this is a problem of policy and program coherence within these agencies or a healthy outcome of diversity and dialogue is an arguable point. Scott Kleinberg (2004) described how USAID uses a number of terms to describe these issues: 'Legal and Institutional Reform; the Business Environment; and the Enabling Environment are all used, at times interchangeably. There aren't really formal definitions for these types of programs, and their form may depend as much on the age of the program manager as anything else'.

Box 2: Asian Development Bank

Under the Private Sector Development Strategy, the reform agenda will seek to achieve the following: stable macroeconomic management; investment, trade, and price liberalization; reduced barriers to competition; well-functioning financial and capital markets; flexible labour and land markets; good physical, social, and technological infrastructure; equitable tax systems; and legal and judicial systems that protect property rights, enforce contracts, and provide for dispute resolution. Improving the business environment for SMEs will be part of the reform agenda.

SOURCE: ADB (2000, p. 12)

Defining the business environment was also problematic in bilateral agencies. There are very few bilateral agencies with a clear definition that set parameters for their work in this field. While some agencies take an extremely broad approach (e.g., the business environment refers to any external influence on the enterprise), others have a narrower set of concerns and focus only on a few elements of the business environment⁵. A series of boxes are presented in this chapter containing different examples of how donors view the business environment.

While very few donor agencies have a standard or formal definition of the business environment, they do apply models or tools to this issue, which reflect their understanding of the term and the concepts it denotes. This general understanding of the business environment involves a number of different elements that describe specific components of the broader business environment. Some of the elements that arose in the course of this study included the following:

- **Generic issues:** In some cases, donor agencies indicated that the business environment was a general term used to describe all those elements that are external to the enterprise. Thus, while internal issues such as human, financial and physical resources are internal elements found within the enterprise, the business environment referred to everything that affects enterprise

5 Because most agencies do not have an official definition that clearly defines the business environment and its elements, the analysis provided in this report draws from an examination of donor practices.

performance from outside (e.g., corruption, policies, laws, culture, infrastructure). See Box 2, Box , and Box.

- **Governance issues:** This is a broad term that refers to the ways in which governments administer and manage society and the economy. It includes issues such as the rule of law, government administration, corruption, security, accountability, etc.
- **Policy framework:** This refers to the policies that are used to address the issues of small enterprises, as well as broader macroeconomic policies, sectoral policies, employment policies, etc. See Box 3.
- **Legal and regulatory framework:** This refers to the full range of legal and regulatory instruments governments introduce for small enterprises and for the economy as a whole. Often the concern here is with the costs of compliance with laws and regulations, but the quality and demand for 'good' laws and regulations also emerges in this field. Donors have different interests in the legal and regulatory framework. For example, some

Box 3: OECD and the enabling environment

The term 'enabling environment' refers to the economic, physical, legal, regulatory and institutional framework within which business operates. It encompasses:

- Macroeconomic policies fostering growth and stability
- Legislation and policy reform to facilitate the ability of local people to establish and protect property rights
- The creation of efficient markets in a competitive setting
- The provision of appropriate and efficient infrastructure
- Rational legal and regulatory policies that balance legitimate controls and protection with concerns regarding efficiency, simplicity, impartiality, and legal redress
- Appropriate fiscal policies and effective collection procedures
- A policy and institutional setting that facilitates empowerment, private initiative and risk-taking
- Institutions and distribution systems for disseminating information about markets, enterprises and government policies
- Support services for business

SOURCE: OECD (1994)

Box 4: Danida and the business climate

A favourable business climate is a basic precondition for being able to create positive long-term business development. In this context the term 'favourable business climate' should be understood very broadly as denoting the framework conditions within which actors in the business sector operate.

SOURCE: Danida (2001, p. 15)

are more interested in labour laws and regulations, while others in intellectual property and patenting. There has been a growing interest by donor agencies in the participation of small enterprises in the marketplace, and in particular in international markets. Hence, the need for better trade regimes that can be used to facilitate access to new markets is an important element of the business environment for many donors.

- **Organizational framework:** Sometimes referred to as 'institutional framework', this element concerns the matrix of social, economic and cultural organizations that affect the regulation, promotion, monitoring, representation, and coordination of small enterprises.⁶ This includes the interest in ensuring there are organizations that can represent small enterprises and advocate on their behalf to government. It can also include an interest in ensuring the workers of small enterprises are adequately represented.
- **Organizational capacity:** This refers to the capacity of organizations in the business environment to perform the functions required of them. There are many organizations that can be considered in this element, such as regulatory agencies that are required to enforce specific laws and regulations, judicial authorities, small business representative organizations, etc.
- **Access to infrastructure:** For some agencies the business environment embraces the access small enterprises have to the infrastructure they require to

⁶ The term 'organizational framework' is used in preference to 'institutional framework' based on the distinctions made by North (1989) on this matter. Institutions provide the 'rules of the game' for the business environment, while organizations are the players.

do business. Small enterprises in rural areas, for example, may have inadequate roads to transport their goods to larger markets, which dampens their competitiveness.

- **Cost of infrastructure:** The cost of infrastructure is another element of the business environment that some donors consider important. Thus, the cost of electricity or telecommunications is a factor to be assessed when determining how the business environment affects the competitiveness of small enterprises.
- **Access to finance:** While the demand for finance could be considered an internal character of small enterprises, the access the enterprise has to external sources of finance can be considered an element of the business environment.
- **Cost of finance:** Some donors are less concerned with the availability of finance to small enterprises as a feature of the business environment, and more interested in the cost of finance.
- **Macroeconomic policies and strategies:** The broad economic development strategies adopted by countries is considered an important influence on the business environment for small enterprises. Policies that for example promote competition, privatisation, private sector development, and the liberalisation of domestic markets are often considered a precondition for a business environment that favours small enterprise development.
- **Social conditions and services** (e.g., education, health): The human and social capital contained in the business environment is a broader concept of the business environment that some agencies have considered. Within this view, the potential of small enterprises to compete effectively is supported by social conditions in which the enterprise operates. The better the country's level of literacy, basic and vocational education, health services and even its social safety nets, the more able the enterprise will be to compete in national and international markets.

- **Cultural, attitudinal influences:** Finally, the general attitudes and cultural norms that form the social and economic foundation of the business environment are often considered important. Countries with a strong dependence on agriculture may be seen as being less entrepreneurial than those that have a tradition of trading and mercantilism. Attitudes of government officials towards the private sector and in particular the small enterprise sector are also a consideration here. The table below (Table 3) displays those elements of the business environment that donor agencies consider the most significant; donor agencies either include these elements in their definitions of the business environment or focus specifically on these elements in their work (as the following chapters describe).

Table 3: Key elements of the business environment for donor agencies

Donor agency	A	B	C	D	E	F	G	H	I	J	K	L	M	N
AusAID		✓	✓											
Danida	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
DFID*		✓	✓	✓	✓	✓	✓		✓		✓			✓
European Commission		✓	✓	✓	✓	✓	✓		✓	✓				
GTZ (PSTP)*		✓	✓	✓	✓	✓	✓			✓				✓
IADB*	✓	✓	✓	✓	✓									
ILO (IFP-SEED)			✓	✓	✓	✓								✓
JICA*			✓	✓	✓	✓								
Netherlands*			✓	✓	✓	✓	✓		✓	✓				
OECD	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
SIDA														
Switzerland		✓	✓	✓	✓	✓								
UNCTAD		✓	✓	✓	✓	✓								
UNIDO*	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
USAID*	✓	✓	✓	✓	✓		✓			✓	✓	✓		✓
WBG (ARD)		✓	✓	✓	✓	✓	✓	✓		✓				
WBG (FIAS)		✓	✓	✓	✓				✓		✓			
WBG (IC)		✓	✓	✓	✓				✓	✓	✓	✓		
WBG (SME)		✓	✓	✓	✓	✓								

* Note: the elements identified for these agencies reflect those units that deal specifically with small enterprise development and not necessarily the whole agency's approach to this issue.

Legend:

A	General	H	Access to infrastructure
B	Macroeconomic strategies	I	Cost of infrastructure
C	Governance issues	J	Access to finance
D	Policy framework	K	Cost of finance
E	Legal and regulatory framework	L	Social conditions
F	Organizational framework	M	Cultural, attitudinal influences
G	Organizational capacity	N	Support services

The above chart should not be interpreted as a precise indicator of the elements donors focus on when considering the business environment. Its purpose is to show a range of potential elements and indicate those elements that donors have shown special interest in. Because the business environment covers such a range of elements, donors are required to focus on those elements that are of most interest to them. Many donor agencies deal with a wide variety of issues affecting the business

environment and small enterprise development is usually only one of these issues. Indeed, there is often rigorous debate within donor agencies concerning the importance of small enterprises and the relevance of some of the elements of the business environment presented in the above table.

Using the above table to compare donor agency interests in the business environment, it is possible to identify those elements that are common to all.

Macroeconomic strategies, governance issues, as well as policy, legal and regulatory frameworks are clearly the elements that most agencies focus on when considering the business environment. In addition, the organizational framework used to implement and enforce policies and laws as well as the capacity of these organizations to perform their duties are also elements of interest shared by many donor agencies.

As the following two chapters shows, there are a number of agencies that have focussed on these issues specifically for two reasons. Firstly, these agencies believe that the issues of governance and the policy, legal and regulatory framework are the most relevant to small enterprises. It is in these fields that hold the greatest potential for constraint. Indeed, the impact of the removal of these constraints is considered by many to be substantial. Thus, the reform of governance and the policy, legal and regulatory framework can lead to substantial benefits to small enterprises.

The second reason that many donors focus on these elements of the business environment is because reforms to these elements are achievable. For some agencies (e.g., small bilateral donors), macroeconomic policy reform is too difficult or requires specific instruments that they don't have (e.g., structural adjustment loans) and it is better to focus on specific issues concerning regulatory reform. For others, the provision of infrastructure is a costly and inappropriate element for them to deal with, so it is better to promote policy reforms. Thus, governance and the policy, legal and regulatory framework provide a practical platform for donor intervention and, as a result, donors

Box 3: European Commission on Development of the Business Sector

The Community's actions in this area will aim at creating a policy framework, at the national and regional level, which supports and fosters competitiveness, market economy and good governance. This would encompass technical assistance in support of reforms, particularly in the fields of legislation, banking and finance, taxation, public expenditure, customs procedures and trade facilitation measures, institution building, administrative efficiency.

SOURCE: Schwarz (2004)

Box 4: CIDA and the enabling environment

Critical for private sector development is the creation of an "enabling environment". An enabling environment is defined as the existence of a competitive internal market which is connected to the global economy, guided by a well-defined legal and regulatory framework, and served by a strong and growing human capital base and a viable infrastructure.
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SOURCE: CIDA (1999)

focus specifically on these elements when considering the business environment.

Many donors have expressed the view that because it is such a broad field, working at the level of the business environment is both significant and challenging because it affects all aspects of their agency's work. Many donor agencies believe that the business environment can affect the success of their efforts in the health, education and social services sectors. Thus, those working in the small enterprise promotion units of their donor agencies were eager for others in the agency to recognise how efforts to improve the business environment affected the success of programs in these other sectors (Clemensson 2004; deWaard, Fortuin et al. 2004; Prey 2004).

The World Bank's private sector development strategy recognizes that private sector development "is not a sector, but a crosscutting issue. It is about "a way of doing things" that can have relevance for any sector such as energy or agriculture. And the pursuit of private sector development is not a goal but a means to do things better" (World Bank 1999, p. 44).

For some agencies, the crosscutting nature of business environment work has led them to re-evaluate the need for a specialised small enterprise program; if the business environment is fundamental to enterprise growth and the effectiveness of other development programs, then maybe work at this level is enough. Maybe there is no need to focus specifically on the needs of small enterprises.

There are two notable contested issues that emerged during consultations with donor agencies concerning the business environment for small enterprise development. This first concerned the

importance of a higher level of influence in the business environment, while the second has to do with the relevance of enterprise size and the business environment. These issues are only introduced below. The discussion is taken forward throughout this report because these issues underlie much of the way donors approach the assessment of business environment and the interventions they apply to make business environments more enabling for small enterprise development.

2.3 Beyond the business environment

The first issue concerns the relative importance of the elements of the business environment as presented above. While the table of comparison (Table 3) shows that many donor agencies focus on issues concerning governance and the policy, legal and regulatory framework in which small enterprises operate, there is some debate regarding the greater importance of the broader context in which these elements are located. GTZ, for example, places a great deal of attention on what it calls the 'meta-level' of the business environment. This refers to the basic social attitudes and value systems within which the business environment operates (Prey 2004).

Meta-level influences have emerged within the discussions of industrial competitiveness. GTZ and other German academics and research agencies have promoted the concept of systemic competitiveness, in which meta-level influences are described:

Three elements are important at the meta-level: first, a social consensus on the guiding principle of market and world-market orientation; second, a basic pattern of legal, political, economic, and overall social organization that permits the strengths of the relevant actors to be focused, sets in motion social communication and learning processes, and bolsters national innovative, competitive and growth advantages; and third, the willingness and ability to implement a medium- to long-term strategy of competition-oriented techno-industrial development. Competitive strength calls for high levels of ability in organization,

interaction, and strategy on the part of groups of national actors, who, in the end, will have to strive to realize a systems management encompassing all of society (Esser, Hillebrand et al. 1995).

While not conceptualised in the same way, other agencies refer to this broader element of the business environment as a cultural or social framework in which social organizations operate. In some cases, these social norms are referred to as the institutions that set the rules of the game. Thus, there is a range of social norms that set the framework for the other elements of the business environment. Policies, laws and regulations, for example, are agreed upon and adhered to because (and when) they are consistent with the broader social norms and practices of society, as contained within social and economic institutions (North 1989; Sida 2001).

The promotion of entrepreneurship could be considered a representation of this element of the business environment. The ILO, for example, describes entrepreneurship as 'the attitude and capacity to innovate and take initiative'. Thus, it lies beneath the laws, organizations and other physical elements, reflecting a cultural and attitudinal platform on which other elements of the business environment are built. While the term can be applied to a range of economic and social innovations designed to solve problems, meet needs, or supply products and services, the ILO focuses on entrepreneurship as the 'combination of initiative, innovation and calculated risk-taking associated with identifying market opportunities, mobilizing resources, and managing them efficiently in the operation of productive, viable, and socially responsible enterprises' (ILO 2004).

The Global Entrepreneurship Monitor (GEM) is an annual report that views with business environment through the eyes of entrepreneurship. The primary focus of the GEM is on understanding the impact of entrepreneurship on national economic growth. As shown in the next chapter (as well as in Annex 2), the GEM is interested in a wide range of elements of the business environment and obtains views from many stakeholders and experts (Reynolds, Bygrave et al. 2002).

Of course, donor agencies are free to focus on the elements of the business environment they find relevant. The question this issue raises, however, concerns the way donor agencies understand or conceptualise the business environment, i.e., the way agencies decipher the business environment and its importance. Is the business environment comprised only of tangible policies, laws, regulations, and organizations, or are cultural and attitudinal elements also important? If they are, then what is the connection between the two and how can donor agencies engage in reforms in both these fields?

2.4 The importance of enterprise size

The second contentious issue to arise when considering the business environment is the importance of enterprise size. Because this study focussed on the 'the way donor agencies plan and design their initiatives for improving the business environment *for small enterprises*' [author's emphasis], it was pertinent to investigate the issue of enterprise size. What does an enabling business environment for small enterprises look like? Does it differ from an enabling business environment for any other size class? It was not surprising to find that donor agencies hold different views on this matter.

It is not appropriate to review the full scope of this argument in this report.⁷ However, there are some relevant contributions to this debate made by donor agencies consulted for this study.

From an organizational perspective, many donor agencies undertake their work in this field within a broad private sector development framework. Agencies such as DFID, GTZ, as well as the Governments of Denmark and the Netherlands organize their work on the business environment within organizational structures that focuses on private sector development, economic development and investment promotion.

⁷ Readers wishing to examine these issues more fully may find the following useful: (Beck 2002; Biggs 2002; Hallberg 1999).

Many of the World Bank's activities in the business environment are undertaken by departments that are focused on development efforts that extend well beyond the small enterprise sector (e.g., FIAS, Investment Climate Department). In contrast, there are donor agencies with an organizational framework that gives specific emphasis to small enterprises, for example:

- ILO: In-Focus Programme SEED (Boosting employment through small enterprise development)
- Inter-American Development Bank: Micro, Small and Medium Size Enterprise Division, Sustainable Development Department
- UNIDO: SME Branch
- USAID: Micro Enterprise Development Division
- World Bank Group: SME Department

While the range of organizational structures used by donor agencies is interesting, it does not necessarily imply that agencies without an operational unit dedicated to small enterprises do not focus on this sector. Many agencies working in the field of private sector development recognise that, in most developing countries, the private sector *is* the small enterprise sector (Hallberg 2001). The design of programs and services that support the provision of financial and business development services to small enterprises is a major concern for most of the

Box 5 Enhancing the investment climate

Critical features of a sound investment climate include a sensible governance system that allows firms and farms to pursue productive activity without harassment, contracts and property rights to be respected and corruption to be reduced. Equally important is an infrastructure that allows private entrepreneurs and their employees to operate effectively. Competition and, where necessary, regulation are essential to channel private initiative in socially useful directions. A sound financial sector is required to allow firms to enter the market and operate effectively as well as to help restructure failing firms. A stable macro-economic environment and an economy, which is open to trade are also elements of a good investment climate. Overall, enhancing the investment climate is about better public policy for the private sector, including the required supporting institutions.
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SOURCE: World Bank (2002b)

donors surveyed. However, the role of the business environment in small enterprise development creates some more searching responses by the donor community.

The various positions are clear. On the one hand, there are donor agencies that argue for a universal approach to business environment issues: Enterprise size is a distraction, the relative differences in the costs of compliance for a small enterprise compared to large enterprises are minimal and a function of the market. Furthermore, considerations of enterprise size can lead dangerously to a response (i.e., a reform of the business environment) that distorts the market further by making special provisions for small enterprises, which can lead to growth traps.

On the other hand, there are donors that claim that the disadvantages small enterprises experience in the business environment are too significant to be overlooked. Small enterprises are poorly represented in political and legislative processes; they are hampered by artificial (i.e., non-market) biases that make compliance difficult and create an uneven playing field (see Box 6 for some examples). Moreover, small enterprises require special attention *because* they are responsible for so much employment and provide one of the only mechanisms for private sector development. The extremely large size of the informal economy in many countries is seen as symptomatic of weaknesses in the business environment for small enterprises.

Most donor agencies find a position between these two positions. However, this position is not necessarily static and many agencies appear to be reviewing their approach to these debates. GTZ, for example, suggested that if reforming the business environment improved the competitiveness and productivity of enterprises of all sizes, then maybe a special emphasis on small enterprises was no longer relevant.

The importance of enterprise size has been the subject of much debate within USAID. While many technicians tend to follow a universal approach to this issue, those in the Washington headquarters view the entire spectrum more coherently and

promote the value of an 'ecology of firms' most appropriate. USAID is developing arguments on whether one needs to use 'policy analyses that are attenuated to small and micro firms to develop policy programs which treat all sectors fairly and beneficially'. Moreover, USAID is 'shifting its emphasis from the enterprise level to the macro policy level, and have begun to focus more on issues such as trade and WTO accession as critical drivers for economic development' (Kleinberg 2004).

In another twist, the ILO has highlighted the challenges it faces in the field of employment legislation for small enterprises. While many countries report low rates of compliance with labour laws among small enterprises, some countries have created special provisions for small enterprises within their labour legislation. For example, in Pakistan, small enterprises with fewer than ten employees are not required to comply with labour legislation. However, the creation of a special category of laws for small enterprises creates disincentives for

Box 6: Some examples of small enterprise-specific concerns found in the business environment

- | |
|---|
| <ul style="list-style-type: none">• Barriers to entry and non-competitive behaviour in markets where small enterprises are potentially competitive• Expensive and time-consuming regulatory requirements such as licensing and registration• Official and unofficial levies that discourage small enterprises from growing and becoming formal• The legal framework for commercial transactions and the resolution of disputes, that can affect transactions with unknown firms• Laws governing the protection of business and intellectual property, and the use of property as collateral• Tax structures that distort incentives and discriminate against small firms• Government procurement procedures that discourage successful bidding by small enterprises• Zoning regulations that restrict small enterprise operations and entry into high-income markets• Labour market rigidities that make hiring and firing workers difficult and expensive, and limit the flexibility and mobility of the labour force• Infrastructure that opens access to information and markets, particularly transportation, market facilities, and communications infrastructure |
|---|

SOURCE: Hallberg (2001)

enterprise growth. A one-law-fits-all approach to labour legislation doesn't work. There is a need to focus on the employment concerns of small enterprises, especially given the extremely high number of people in the small enterprise sector, mostly in unsafe, insecure and poorly paid employment (Reinecke & White 2004).

Small enterprises hold a strong popular appeal in most countries. Governments that are eager to please the populous will often introduce small enterprise development services to show support for this sector, but such efforts are not always useful in the long term. Donor agencies often fear market distortions and financial and business development interventions by government that perpetuate rather than address this concern. Similarly, the establishment of parallel legal and policy systems that treat small enterprises differently worries many donor agencies. Thus, the challenge is to recognise the variable influence the business environment has on enterprises of different sizes, but to respond to this without creating parallel systems that give undue support or advantages to small enterprises.

While this issue revives some old arguments, it is relevant to the Committee of Donor Agencies. Donor efforts for reform of the business environment have been occurring for some time. What is new is the focus on small enterprises in the business environment. This is the reason the topic has drawn so much interest among small enterprise development practitioners in recent years. There is a need to better understand the influence that changes in the business environment have on the performance of small enterprises. Thus, if the Committee of Donor Agencies is to assist its members and improve the practice of small enterprise development, then it should face this issue directly and identify the contributions business environment reforms can make to small enterprise development.

Chapter 3

Assessing business environments for small enterprise development

This chapter deals with the tools donor agencies apply when assessing the business environment for small enterprises. Naturally, the way donors assess the business environment is in large part a consequence of how they describe it (as reviewed in the previous chapter). Thus, this chapter deepens our understanding of what donors are interested in and how they go about measuring this.

Two kinds of approaches to assessing the business environment for small enterprises have been identified. The first is where donor agencies develop standardised instruments for assessing the business environment. The second is where donor agencies rely on the expertise of their field staff and consultants to undertake assessments, rather than apply a standard instrument. Each of these approaches is examined below.

A number of donor agencies have developed standardised tools and techniques for assessing the business environment. While the World Bank Group dominates this field with the number of standardised tools it has developed and the scale on which many of these tools are applied, there are a number of smaller agencies that have taken initiative in this field.

The decision to design and apply a standardised assessment tool appears to be guided by a various interests. Firstly, a standardised assessment tool reduces the risk of subjectivity in assessments, particularly subjectivity of the personnel who are undertaking the assessment. Tools that provide sampling frames, survey templates and reporting outlines, along with procedural guidelines, provide specialists (whether international or national consultants, or project personnel) with little room for misinterpretation. They promote consistency and encourage quality in a variety of settings.

Secondly, a standardised assessment tool produces results that can be compared across different countries. Tools that apply common sampling frames, indicators and benchmarks encourage comparisons between countries and sometimes between sub-national regions. For many donors, comparative data is useful because it provides the opportunity to assess (i.e., Country A has a more enabling business environment than Country B), but also because this information can be a powerful motivator for reform (e.g., Country B decides it must instigate reform measures so that next time it can score better than Country A).

Thirdly, as implied above, standardised assessment tools can be used to promote comparisons over time so that improvements or declines in the business environment can be measured. As explained more fully in Chapter 5, comparisons over time are considered by some donor agencies as a useful way to measure the impact of reform processes.

The fourth benefit of a standardised assessment tool is the function it can perform in building capabilities among national stakeholders (e.g., enterprise associations, governments). Tools of this kind can help national stakeholders do their job better. Through the use of standardised assessment tools, stakeholders can develop the skills and techniques required to monitor and assess the business environment themselves.

Fifthly, standardised assessment tools encourage assessments to focus on specific aspects of the business environment, rather than be distracted by broader or more general concerns. As the previous chapter demonstrates, the business environment for small enterprises contains many elements, which can lead assessments into generic findings that are limited in their analytical content. Thus, a standardised assessment tool will help assessors focus on the most important elements.

Finally, a standardised assessment tool can be a cost efficient means of assessment. Although an initial investment is required to produce the standardised tools and techniques for assessment, the later cost of undertaking assessments can be reduced because consultants and other assessors

can follow the assessment protocol rather than create a new one every time.

Not all the assessment tools used by donor agencies enjoy these advantages. However, the benefits of this approach are clear. The table below (Table 4) summarises

the range of tools used by donor agencies to assess the business environment for small enterprises. Annex 2 contains a more detailed description of these tools.

Table 4: Standardized assessment tools and techniques

Donor agency	Assessment tool	Brief description
Commonwealth Business Council	Business Environment Survey	A survey of private sector views on the environment for business and investment in 31 countries against 16 key indicators.
European Bank for Reconstruction and Development	Business Environment and Enterprise Performance Survey	The BEEPS is a large dataset providing indicators about the business environment and the performance of enterprises. The business environment is multi-dimensional and includes key aspects of governance provided by the state, such as: business regulation, taxation, law and order, the judiciary, infrastructure, and financial services
	Legal Indicator Survey	A perceptions-based tool used to measure and analyse countries' legal systems. It takes a snapshot of legal reform as perceived by local lawyers. It assesses the extent to which key commercial and financial laws reach international standards, are implemented and are enforced.
Ewing Marion Kauffman Foundation	Global Entrepreneurship Monitor	Endeavours to understand the impact of entrepreneurship on national economic growth. The notion of an entrepreneurial society is used to reflect many of the elements that reflect an enabling business environment.
Gesellschaft für Technische Zusammenarbeit (GTZ)	Assessment of Investment Climate	This tool is currently in development and has not yet been applied.
Inter-American Development Bank	Small Business Policy Assessment Guide	A tool to help consultants review and assess policies affecting small businesses
International Labour Organization	Guide for assessing the influence of the business environment on small enterprise development	Prepared for national consultants and ILO Constituents to assess the influence of policies, laws and regulations on small enterprise employment.
	Survey kit: micro and small enterprises	A generic questionnaire and guide for national consultants and ILO Constituents to assess the influence of policies, laws and regulations on the employment decisions of small enterprise owner-managers.
	Business Climate Assessments	Based on a survey instrument developed by the Swedish Employers Organization, this tool has been tested by the ILO in two provinces of Viet Nam.
Netherlands Ministry of Foreign Affairs	Annual Business Climate Scan	The Ministry has prepared the Annual Business Climate Scan for use by its embassies
World Bank	Investment Climate Assessment (ICS)	Conducted by the Investment Climate Department of the Private Sector Development Vice-Presidency Unit an ICS is a survey of formal firms (mainly companies).
	Investment Climate Assessment (ICA)	Investment Climate Assessments build on the findings of an ICS; they are also run by the Investment Climate Department of the Private Sector Development Vice-Presidency Unit in response to requests from the field structures. An ICA will draw on a wider body of information than the ICS.
	Foreign investment	Conducted by the Foreign Investment Advisory Service of the

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	diagnostic instruments	Private Sector Development Vice-Presidency Unit these instruments are used for a deeper (narrative) assessment of investment constraints.
	Doing Business Surveys	Part of the Private Sector Development Vice-Presidency Unit, these are expert surveys used to collect data for country comparisons and to alert governments of regulatory concerns.
	SME Country Mapping	Conducted by the SME Department in the Private Sector Development Vice-Presidency Unit, SME mapping has been undertaken
	Rural Investment Climate Survey (RICS)	Conducted by the Agriculture and Rural Development Department of the World Bank, the RICS has been developed in collaboration with the Investment Climate Department and focuses on the investment climate for rural, non-agricultural micro enterprises. Thus, between an ICS and an RICS both urban and rural business environments are assessed.
UNCTAD	Investment Policy Reviews	Investment Policy Reviews help countries improve policies and institutions that deal with FDI and increase their capacity to attract and benefit from it.
	Investment Compass	This is a new web-based benchmarking tool, which reveals the competitiveness of each country's taxations system for FDI.
USAID	Investor Roadmap	The main emphasis of the Investor Roadmap assessment is on FDI. Little attention is paid to small, domestic enterprises. However, the issues faced by foreign investors are used to reflect the domestic business environment.

Each of the tools described above have a specific area of focus and have been designed to address areas of interest or concern. To varying degrees each of the above tools identify bottlenecks or constraints to private sector or small enterprise development. While this may not be the specific focus of some tools (e.g., USAID's Investor Road Map or the World Bank's SME Country Mapping) the report these assessment produce contain this information.

All the tools described above generate information that informs the design of interventions that support reform of the business environment. Not all donor programs and services are designed on the findings of surveys such as these, as the following chapter shows, but the data they produce can be used for this purpose.

The range of tools presented above contains huge variations. These include:

- **Sources of information:** There are four kinds of sources of information used in the assessment instruments presented above: (1) firm surveys (e.g., Investment Climate Surveys); (2) intermediary sources such as experts in the field (e.g., Doing Business Surveys); (3) household surveys (e.g., Rural Investment Climate

Surveys); and (4) focus group discussions (e.g., Quick Scan Business Climate).

- **Areas of focus:** The areas of focus taken by assessments vary from governance (e.g., Legal Indicator Survey), to policies, laws and regulations (e.g., FIAS, ILO guide), to organizational arrangements (e.g., SME Mapping), the assessment of attitudes, perceptions and expectations (e.g., GTZ assessment), a reliance on expert opinion (e.g., FIAS), etc. The selection of areas of focus is often influenced by those elements of the business environment the donor agency considers most relevant (i.e., important or influential).
- **Key indicators:** Naturally, there is great variation in the kinds of indicators these assessment tools measure. These usually reflect the elements described in the previous chapter (see Table 3).
- **Assessors:** Who performs the assessment can also vary—from centrally managed assessments involving teams of international and national consultants (e.g., Investment Climate Surveys, Doing Business Surveys), to assessments that are undertaken by local stakeholders (e.g., ILO guidelines), to donor staff

members (e.g., embassy staff in the Government of the Netherlands).

- **Information outputs and use:** There are many different reasons for undertaking an assessment of the business environment and the list of tools above reflect these. In some cases, assessments are conducted for basic research and comparison and without a clear commitment to follow-up with technical support (e.g., Investment Climate Surveys, Doing Business). In other cases, assessments are used to inform program design (e.g., foreign investment diagnostic instruments, GTZ and Netherlands' tools).

Clearly, there are many advantages to the design and use of standardized assessment tools and techniques. However, it would appear that this is a field where the Committee of Donor Agencies for Small Enterprise Development could play a valuable role in the exchange of information and experiences in this field. Many donor agencies are working in isolation from one another, designing tools that suit their own specific needs and interests. While diversity in this field can be valuable and donor agencies often have their own unique interests and concerns that need to be addressed within a standardized assessment tool or technique, there is a danger that many donors spend time and money 'reinventing the wheel'.

Just as there are many donor agencies with an interest in designing and using standardized assessment tools and techniques, many believe they have little need for such an approach. Many donor agencies rely on external consultants to perform assessments on their behalf. These consultants are often well known to the donor agency and have been involved with the agency over a period of time in different countries. In most cases, consultants are brought in from other countries to undertake these assessments and usually from the country of donor origin.

Donor agencies such as DFID, the European Commission, JICA, Danida, and the Government of Switzerland have indicated they make use of the standardised tools produced by other agencies (e.g., SME Mapping, Investment Climate Assessments),

while also commissioning their own research and assessments when required. In this way, donor agencies get the best of both worlds: they draw on the quality of information provided by a standardised tool (i.e., accuracy, comparability, size), while obtaining the unique information they require by undertaking their own assessments.

Some donor agencies make regular use of the tools designed and applied by other agencies. UNIDO, for example, would design and deliver technical assistance that addressed assessments undertaken by FIAS or would invite UNCTAD to prepare an Investment Policy Review as part of an ongoing UNIDO program. UNIDO's financial analysis tool COMFAR is used by other agencies for appraising investment projects.

Agencies such as UNCTAD have a strong analytical component to their work. They commission research and disseminate information that can be used by member states. However, there has been little standardisation of these approaches, at least where small enterprise trade is concerned. Instead, UNCTAD relies on the expertise of consultants and partner organizations (Farinelli 2004).

The approaches donor agencies take to the assessment of the business environment for small enterprises raises a number of contentious issues. As described in Chapter 2, these issues often reflect the values and interests that each donor brings to this work. Just as the definitions donor agencies apply to the business environment reflect their view on this field, so too do the assessment tools and techniques they apply.

One of the constant controversies in this field concerns the importance of enterprise size. Many of the tools listed in the above table have been designed to assess the business environment in general and do not focus specifically on small enterprises. The reasons for this were introduced in Chapter 2. However, there have been some interesting recent developments on this topic within some agencies.

The ILO has produced three tools in the last few years concerned with the influence the policy, legal and regulatory framework has on small enterprise employment. Small

enterprises are an important subject in this case because of the substantial contribution they make to total employment in most countries, in addition to concerns regarding the quality of employment in this sector.

While not considered a standardised tool, UNIDO has applied a 'diagnostic study of the regulatory and administrative constraints' for its work with micro and small enterprises and women entrepreneurs. These surveys are used to analyse the impact of regulation and their implementation on micro and small enterprises in areas such as business licensing, allocation of business land, taxation, inspections or trade regulations (UNIDO 2003b, p. 13).

Most of the World Bank's tools focus on the broader interests of the private sector and foreign investment, but there are a number of recent developments that focus on small enterprise sector. The most interesting of these is found in the Agriculture and Rural Development Department. This Department is currently piloting Rural Investment Climate Surveys (RICS), which will be used to complement the findings of the Investment Climate Assessments (ICAs).

ICAs generally focus on formal enterprises, most of which are quite large. Samples are taken from company or business registration lists and this process often excludes many small enterprises. While the methodology and analysis of an ICA is sound, the Agriculture and Rural Development Department knew it would not capture the dynamics of rural economies and micro enterprises that it is concerned with. Thus, the RICS was designed to be conducted after, or simultaneously with, an ICA. Using household surveys based on random sampling in local areas (to avoid the trap of only surveying formal firms on a registration list), an RICS aims to provide information on the main obstacles in enterprise development and transaction costs in rural economies. A standard RICS instrument is being developed. (See Annex 2 for more information.)

The assessment of the business environment raises the opportunity for political contests. The political dimensions of donor agencies' work in business environment assessment are more

pronounced than in other forms of small enterprise development. While the promotion of financial and business development services can invoke political debates (e.g., market development versus the subsidization of services, the role of small enterprise membership associations), much of this work focuses on technical concerns. In contrast, assessing and reforming the business environment can lead donor agencies into a number of political disputes.

When assessing the business environment, donor agencies need to declare their interests and political biases. Assessments that contain hidden biases that are not shared by host governments have the potential to undermine future reform efforts.

Finally, many donor agencies recognise the need for assessments that go beyond a 'one-size-fits-all' approach. All the tools described in this chapter provide a useful means of data collection and analysis. However, it would be foolish to assume that a singular approach to assessment can be taken in all countries. While surveys such as Doing Business 2004 provide a common format to all countries, their greatest value is in the cross-country comparisons they promote, rather than in identifying specific areas for reform. Indeed, large international assessments such as this can provide a context in which more in-depth and nationally configured assessments are undertaken.

As will be described in the following chapter, assessments of the business environment can be conducted for different purposes. Identifying areas for donor-supported reform interventions is but one purpose for such assessments. Overall, assessments provide a range of interrelated sets of information that can be used to better understand the influence the business environment has on investment or the contribution of the private sector in general and the small enterprise sector in particular to national development. This information can be used by governments, advocates for change (e.g., small enterprise associations, foreign investors), regional development agencies (e.g., African Union, APEC), as well as by donor agencies.

The following chapter examines the issues that affect the way donor agencies

move from assessment to reform and focuses on the specific concerns that donor agencies face when supporting reforms. However, it should be remembered that host governments are the leaders in reform processes. The findings generated by the assessment tools and processes such as those identified in this chapter can be used directly by host governments to support, inform or initiate reform processes without the aid of donor agencies. In this situation, donor-supported assessments perform an important function. However, the concern of this study has been to examine the program cycle that many donor agencies use for reforming the business environment. Thus, the connection donor agencies make between the assessment of the business environment and the design of reform interventions—followed eventually by the assessment of change and impact created by these reforms—is a central concern of this study.

Chapter 4

The practice of reforming the business environment

This chapter examines the progression donor agencies undertake when moving from assessment of the business environment to the design of interventions for reform. Donor interventions directed at the business environment seldom constitute a stand-alone intervention. Increasingly, they are embedded in private sector development strategies or in the frameworks provided by PRSPs, MDGs, ICAs, etc. The collation and subsequent comparative analysis of information about the various approaches, concepts and tools used by different donor agencies will provide further evidence as to what an enabling environment should look like in order to generate business (especially small enterprise) growth. The causal models have to be substantiated by defining adequate indicators that allow for proper impact monitoring.

4.1 From assessment to project design and implementation

Donor agencies provide development cooperation to developing countries to achieve a number of specified purposes. While the generic purposes of donor assistance is described in Chapter 2 (i.e., the reduction of poverty, promotion of competitiveness), here the focus is on the immediate outcomes and subsequent impacts donors wish to achieve.

The survey of donor involvement in reform processes found the following purposes of reform:

- To remove barriers to private sector and small enterprise development (e.g., open markets up for greater competition)
- To remove constraints to private sector and small enterprise development (e.g., reduce the costs of compliance for small enterprises, streamline registration systems)

- To strengthen the involvement of other actors in the design and review of the policy, legal and regulatory framework (e.g., promoting advocacy and representation of small enterprises)
- To improve the knowledge of the business environment and its influence on private sector and small enterprise development (e.g., promoting the use of regulatory impact assessments)

Of course, none of these purposes are exclusive of the others and agencies typically provide assistance to achieve one or more of the above purposes.

One of the interests of the study was to determine the processes donor agencies applied when designing their interventions. Of particular interest was the ways in which donors moved from assessing the business environment to designing their interventions. What processes were undertaken? How did donor agencies use the information generated by business environment assessments?

Surprisingly, very few donors were able to describe a clear step-by-step process from the assessment of the business environment to the design of programs. Many donor agencies follow processes that connect a demand for donor assistance with the design of program interventions, but these processes are rarely connected to the outcomes of the assessment tools and techniques described in the previous chapter. Assessing the business environment and identifying priorities reform requires a specific approach, which is not always contained by program planning processes. Thus, a distinction should be made between program planning and assessment processes and the tools that are used to assess the business environment.

A process of program development guides most donor agencies whether written in the form of a guide or manual, or incorporated as an agency practice or approach. These processes encourage agencies to take steps that help them assess the need for donor assistance and to design a program accordingly. Many agencies apply a logical framework approach to program design that is based on an assessment of

need; this framework identifies anticipated impacts of the proposed program, and the outcomes, outputs, activities, and inputs required to achieve these. In addition, donor agencies are encouraged to undertake activities that promote dialogue with host governments and other domestic partners, as well as with other donors operating in the country. This dialogue can lead to joint efforts that are formulated between donors and their domestic partners and not necessarily to programs that are donor-driven.

Many donor agencies are guided by procedural rules or practices that, for example, require an official request from government for assistance (e.g., a written request from a relevant minister) before any program can be designed. Thus, donors are eager to respond to demand, rather than present program proposals that are not a response to a mutually perceived need.

In most cases, the nexus between assessment and program planning described above is common to all fields of donor engagement. Whether donors provide assistance with health services, water, sanitation, governance or macroeconomic reforms, these processes can be found. However, this process is not the same as assessing the business environment for small enterprises and identifying specific priorities or targets for reform.

A key concern of this study has been the extent to which business environment assessments—using the tools and techniques described in the previous chapter—have been used to initiate or inform donor-supported reform programs. In general, it was found that most agencies are influenced by a range of other factors in their design of reform programs. Business environment assessments were only one kind of factor in program design. Assessment findings were not the only determinant of program design.

Of the agencies surveyed for this study, the one most likely to use assessment outcomes as a direct contribution to the design of reform programs was FIAS of the World Bank. FIAS assessments are conducted solely on the request of host governments. Governments are required to pay 50 per cent of the total assessment costs

(although often these funds are obtained from other bilateral donors) and a FIAS assessment is typically undertaken with the aim of identifying priorities and areas for reform that might be addressed through technical assistance that was expected to follow. Thus, a FIAS assessment is a prerequisite for technical assistance and the outcomes of the assessment lead directly into the design of FIAS interventions.

In contrast to the FIAS approach, Investment Climate Surveys, as well as Doing Business Surveys (also conducted by the World Bank) are not conducted with an expectation of development cooperation. These assessment tools are used for a variety of purposes, and while the World Bank and other donor agencies may use these findings to inform the design of reform interventions, they are not conducted specifically for this purpose. One of the main purposes for these assessments is to build up a body of data (especially panel data) that can be drawn on and compared when future surveys are undertaken. Thus, these surveys have a broader analytical function than informing program design.

The ILO's tools for assessing the influence of the policy, legal and regulatory framework on small enterprise employment were applied first in the context of a seven-country research project that examined the links between policies, laws and regulations and employment in small enterprises (Reinecke & White 2004). Since this research, these tools have been applied in other countries and have led, or are intended to lead, to the formulation of specific project (e.g., in Nepal and India).

The Government of the Netherlands and GTZ have recently designed assessment tools that will be used by their embassies and country offices. It is anticipated that the findings generated by the use of these assessment tools will feed directly into the process of program planning. Indeed, it is expected that embassies and country offices will conduct these assessments every few years in an effort to ensure that all programs benefit from the information they produce. Within a decentralised organizational structure, the head office of these agencies aims to support their local offices and

encourage the use of tools that are uniform and comparable, with room for adaptation based on specific country circumstances. Thus, these tools and techniques are presented as a guide, rather than a blueprint.

Some agencies indicated that they did not rely enough on the outcomes of the assessment tools their agency uses. UNCTAD, for example, claimed that while its Investment Policy Reviews produced valuable information, this was not always drawn upon in the design of program interventions (Farinelli 2004).

One of the greatest functions of assessment tools is to create a demand for reform. While donors may not use assessment outcomes directly when designing a reform program, they can help set the conditions for program design. Assessments can lead governments to a better understanding of their business environment and, thus, the need for reform.

Officials within the World Bank indicated that the conversion of diagnostic information into donor-supported reform interventions is the greatest challenge facing donor agencies at the moment. There are enough assessment tools available, the challenge is to design programs that respond to the needs, constraints and opportunities that these assessment identify (Aitken 2004).

As described above, most donor agencies have clear guidelines describing the processes for program formulation. These are usually generic; they can apply to small enterprise development programmes as well as to interventions in any other sector. JICA and UNIDO appear to be an exception in this regard. JICA has established guidelines for the assessment of small enterprise needs (including the need for reform in the business environment) and the procedure for program formulation (JICA 2002). UNIDO has produced *Guidelines for the formulation of integrated programmes*. This document provides a step-by-step process from screening and preliminary assessment, to field work and the formulation of a program document (UNIDO 1999, 2000). EUROPEAID has also developed guidelines for private sector development that includes a chapter on business environment (Schwarz 2004).

In most cases, donor agencies commission research to assess the business environment and prepare program documents that respond to the specific needs that have been identified. Usually—even before the assessment is conducted—the donor agency has an idea of the field it wishes to work in. This may be based on previous experience in the country, information taken from other research or assessments, or simply on a hunch that the field of interest needs reform. Previous in-country donor experience is very important and donors need to find ways where they can improve their institutional memory in country offices. Thus, assessments can be used to validate perceived or anticipated needs for reform.

All donors have their stories. Like the program officer who set up a wonderful deregulation program in the banking sector in Central Asia and, after a few years, moved posts to East Africa where he set up a similar project, only to repeat the pattern when moved to Latin America. Such supply-oriented interventions are well known and, naturally, frowned upon. However, they still occur and are not always a disaster. In many countries, reforms are necessary across a wide sweep of fields. Choosing the field to start in can be very difficult. It can be done through thorough objective research, or it can be done through the interests of the donor and, of course, the host government. In practice, the design of projects mostly falls between these two extremes.

DFID, for example, has built up an impressive portfolio of work in the field of regulatory reform and commercial justice. There have been a number of new projects established in the last few years in these fields and, while DFID has not applied a standardised assessment of the business environment in all the countries it is working in and identified these as high priorities for reform in all cases, it has commissioned research and discussed these issues with key national stakeholders before designing these programs. Indeed, the highly decentralised structure of DFID has placed a great deal of decision-making power on the enterprise specialists it has in the field. Rather than direct these specialists to apply a

standard (i.e., centrally approved) model of assessment, DFID staff members are free to find their own approaches to the assessment of need and the design of programs. While the agency criticise their own lack of investment into the sharing of information and experiences across country-based enterprise specialists, they are very conscious of the need for such exchange and an informal sharing of ideas, contacts and project information through email correspondence appears to occur.

In many cases, donor agencies rely on their perceived comparative strengths to inform their design of project. The Government of the Netherlands, for example, claims to have a strong body of competencies in the fields of economic and social dialogue and the organizing of the economy (deWaard, Fortuin et al. 2004). The Government of Germany have a strong tradition in vocational training, 'systemic competitiveness' and institutional development (Prey 2004).

Reflecting their own comparative advantage in this field, the Canadian International Development Agency (CIDA 2003) quotes Malcolm Hatley as follows:

Canada has a comparative advantage in delivering PSD programming in the area of small business development. One reason why there is growth in Canada today, compared to other G7 countries, is just this "small business".

Similarly, the Asian Development Bank indicates its own strength in this field:

One of ADB's strengths lies in conducting policy dialogue with government on needed reforms (ADB 2000).

Japan's International Cooperation Agency presents an unambiguous approach to this issue:

Japan has few experts in this field. In project formulation, attention should be focused on issues in which JICA has a competitive advantage over other donors as well as availability of experts. One option is to prioritise assistance based on Japan's experience (e.g., industrial policy and competitive policy). At the same time, it is important to ensure aid coordination in the projects which overlaps with other donors (JICA 2002, p. 129).

Donor agencies recognise that the business environment for small enterprises spans a broad field and, as a result, they need to keep a sharp focus to their engagement. Martin Clemensson of the ILO described the need for the ILO to carefully assess what it can provide in the field of reforms to the business environment. Why, for example, would governments, employers or workers ask the ILO for assistance in this field? Being clear about the answer to this question and knowing how to respond is critical for all donor agencies (Clemensson 2004).

Finally, there is the political dimension to formulating reform interventions. Some donor-support programs are designed less on determined priority needs or agency strengths, and more on political persuasion. AusAID, for example, has described how security in its region has been a major objective to its involvement in recipient countries such as Indonesia, Papua New Guinea and Fiji. The rationale behind supporting the police force and assisting with macroeconomic policy reform is to prevent lawlessness and the further deterioration of these island economies, thereby protecting Australia from illegal immigration and even the threat of terrorism. However, there are often less obvious influences of the role that politics plays in the design of reform programs. Many donors are very forceful in pursuing the need for democracy, dialogue and pluralism in their work (e.g., bilateral agencies such as USAID, multilateral agencies such as the ILO, and politically-oriented donor agencies such as the Friedrich Ebert Stiftung).

Some donors face more difficult conflicts of interests in their work in the business environment. Bilateral donors, for example, are often lobbied by expatriate businesses in their host countries. There are instances where expatriate business owners (usually owning large businesses providing a source of FDI to the recipient country) wish to lobby the government for reforms. There are many cases where these reforms may work in favour of foreign-owned enterprises against indigenous small enterprises. Thus, the interests of the bilateral donor are divided

and often host governments are suspicious of divided loyalties.

In summary, very little can be said about the process of turning business environment assessments into reform programs. Donors have different processes for the design of their interventions. Some are more decentralised than others, some rely more on external consultants than others, and some draw from external sources of information more than others. However, it is clear that all agencies undertake some kind of an assessment of needs before moving into program planning. The range of needs can be very broad and in their prioritisation of these, donor agencies may fall back on the specific requests of the host government or other social partners, or they may settle on those fields of reform that they have previous experience with and a comparative advantage to share.

4.2 Donor interventions

This section examines a range of issues affecting the interventions donor agencies provide to reform the business environment in which small enterprises operate. It furthers the Working Group's 2002 Report on this topic by reviewing the trends and identifying key areas of interest to donors.

The previous report of the Working Group on Enabling Environment identified five fields of donor intervention in the enabling environment: (1) Supporting a stable macroeconomic environment; (2) Direct policy and legal reforms: Private sector development (general); (3) Direct policy and legal reforms: small enterprise development (specific); (4) Strengthening institutions for policy design, implementation and enforcement; and (5) Strengthening institutions for representative and advocacy. Within each of these five fields, specific intervention tools and processes were described (White & Chacaltana 2002).

Consultation with donor agencies has unearthed a wide range of programs and services provided to improve the business environment for small enterprises. There are a number of influences and trends affecting the kinds of programs and services donor

agencies provide. These are described below.

4.2.1 A higher level of donor engagement

Promoting reform of the business environment for small enterprises has required many donor agencies to work at a higher-level in the organizational framework than they may have previously. Meso-level and macro-level interventions are the domain of the business environment. Thus, donor agencies working in this field engage national government ministries, national regulatory and judicial authorities, small enterprise associations, and chambers of commerce. Donor agencies provide training to legislators, senior policy-makers, and judges; they place advisors at high levels in senior ministries; they draft policies and laws (or advise host governments throughout the drafting process); they promote political debates on business environments and help social partners participate more effectively in these debates; and they participate directly in the preparation of national development plans and poverty reduction strategies while advocating for macroeconomic policy reforms.

For the some agencies, this level of engagement is not new (e.g., ADB, IADB, IFC, World Bank), although a focus on small enterprise development at this level—to the extent that this is undertaken by these agencies—is a relatively recent occurrence. However, many donor agencies with a history of work at lower-levels of the business environment are now moving to higher domains.⁸

4.2.2 Programs preferred over projects

A consistent finding among donors was their focus on program efforts in preference to individual projects. While the terminology

8 AusAID, for example, is a small agency that has not usually worked at the macro-level. In the last few years, however, AusAID has placed personnel and consultants directly into senior line-ministries in PNG and Fiji. While the main rationale for this shift has not been to improve the business environment for small enterprises, it is to promote better governance in order to foster economic and political stability.

may vary between donors, the term 'project' is used to describe a discrete activity of donors with specific outputs that stands alone from other activities. Examples of a project may be a training project or a microfinance scheme. A 'program', on the other hand, refers a collection of interventions (i.e., a collection of projects or components) that are assembled to maximise the impact of donor intervention at a number of levels.

This shift is found in the work of agencies such as GTZ, the Government of the Netherlands and Danida. For example, Danida only works in a small number of countries, but its focus is on an integrated approach to small enterprise development. Danida takes a sector-wide approach to small enterprise development, integrating internal and external fields of influence in Ghana, Tanzania and Viet Nam (Danida 2003a, 2003b, 2003c).

In this new programmatic approach, business environment reform interventions are often bundled with other components within a broader program. In the Danida programs referred to above, for example, reform interventions are a part of a range of interventions to the business sector that include financial and business development services. Similarly, reform programs of the World Bank are often embedded within loan agreements or other broad development efforts.

Because development banks experience difficulties in financing reform interventions they look for ways to insert these activities within a larger set of program interventions. Loans provided by development banks largely focus on activities that have the potential for repayment, which often exclude business environment reform interventions. It is for this reason that development banks are also eager to collaborate with bilateral donors that can finance reform activities and, hence, contribute to a larger package of services.

4.2.3 The demand for longer timeframes

Many donor agencies consulted in this study referred to the need to lengthen conventional timeframes for development cooperation in this field (Aitken 2004; Hallberg 2004; Kleinberg 2004; Llisterri 2004;

Madsen 2004). While many donor agencies typically operate on a two-to-three-year project life for most of their work in other sectors, it has become clear that work in the business environment cannot achieve results in such a short period of time. Thus, donor agencies are looking for innovative ways to increase the timeframes for their interventions.

One of the agencies that have been most successful in lengthening its program timeframes is Danida. In most of its projects dealing with the 'business sector', Danida will engage its partners over a period of 10-20 years. Within this timeframe, Danida will apply a series of five-year project cycles (Madsen 2004).

4.2.4 Strong interest in the policy, legal and regulatory framework

A number of agencies have shown an interest in improving the policy, legal and regulatory framework for small enterprises. This theme has dominated many donor-supported programs. Some examples include:

- DFID has undertaken deregulation programs in Zimbabwe, Uganda, and Tanzania. Among other things, this has involved the use of regulatory impact assessment mechanisms to improve the capabilities of government to understand how laws and regulation affect the behaviour of enterprises. In conjunction with this approach, DFID is also promoting models that focus on 'making markets work better for the poor', which also centres on the role of regulation on markets (Boulter, Way et al. 2004).
- The Governments of the Denmark, Netherlands, Sweden and the United Kingdom are participating in joint projects dealing with regulatory reform and the improvement of commercial justice (e.g., Business Environment Strengthening in Tanzania, BEST). Many of these agencies are also engaged in activities that improve economic courts for small enterprises (Madsen 2004).
- IADB focuses much of its efforts on the assessment of small enterprise policies, while also supporting projects that

improve the regulatory regime for small enterprises (Llisterri 2004).

- ILO has been undertaking assessments of influence the policy, legal and regulatory framework has on small enterprise employment (Clemensson 2004).
- UNIDO has had a strong interest in small enterprise promotion policies.
- UNCTAD focuses much of its efforts on improving the trade regime for small enterprises (Farinelli 2004).
- The World Bank Group supports an extensive range of policy, legal and regulatory reform ranging from trade and investment regulations to lowering the costs of doing businesses.

Donor agencies are developing an extensive body of knowledge on reforms in this field. Thus, the Committee of Donor Agencies could facilitate the exchange of information and experiences. Focussing on the policy, legal and regulatory framework for small enterprise development would provide a stronger focus than the broader business environment. This is not to suggest that other elements of the business environment should be dismissed, but rather to propose that elements such as this have their own specialist skills and experiences that deserve special attention.

An important issue for debate regarding the policy, legal and regulatory framework concerns the relative value of regulation. Some agencies describe the need for deregulation and highlight the high cost and inhibiting functions of regulation. In many cases, 'over regulation' is treated synonymously with 'regulation', i.e., any regulation is treated with suspicion. While this is certainly not a view all agencies subscribe to, many appear to be overly enthusiastic about the need for deregulation.

The ILO is an agency with great concerns about an overly enthusiastic approach to deregulation (Clemensson 2004). Through the International Labour Conference, governments, employers and workers negotiate on all matters concerning employment and set minimum standards of employment. Within this context, regulations are social gains made to protect workers, as

well as employers. While regulation is seen as a mechanism to protect, the ILO also promotes systems of regulation that involve the empowerment or participation of the disadvantaged groups (ILO 2003, p.63). Within this context, the ILO also argues for better laws and regulations:

A policy and legal environment that lowers the costs of establishing and operating a business, including simplified registration and licensing procedures, appropriate rules and regulations, and reasonable and fair taxation, will help new entrepreneurs to start in the formal economy and existing informal businesses to enter it (ILO 2003, p. 48).

The ILO views the lack of compliance with regulations as a governance issue that creates an environment of insecurity, preventing the accumulation of physical, financial, human and social capital. Thus, the ILO argues for 'a strategy for the gradual extension of formal regulations to meet the needs of informal workers and enterprises in the developing world' (ILO 2003, p. 72).

Not all agencies are so clear on their approach to deregulation. When closely scrutinised many agencies recognise the importance of regulations and the need for better regulation rather than none at all, but very few agencies hold a clear position on this. Thus, assessing regulation and its impact on small enterprises should be done with an agreed understanding of the role of regulation. Reducing the time to register an enterprise, for example, may be important, but the original purposes behind registration—if they are sound—should not be lost in the process.

4.2.5 Common concern with representation, dialogue and advocacy

A number of donor agencies consulted for this study indicated their interest in promoting mechanisms that improve the representation of the small enterprise sector in policy-making and review processes. One of the reasons business environments can work against small enterprises is that larger enterprises (as well as State-owned enterprises in some cases) have greater political power and can influence the processes of policy-making. In most developing countries, the small enterprise

Box 7 The Abuja Manifesto

Governments will:

- Set clear targets and realistic plans for investment in and provision of essential services such as infrastructure, education, health and water
- Ensure a legal framework with timely enforceability of all contracts
- Create a good business climate focused on predictability and simplicity of regulations rather than offering elaborate incentives to investors
- Offer transparency of public fiscal affairs
- Implement a continual program to lighten the regulatory burden on business, for example by making it faster and more affordable to start a company, employ staff, register assets or clear customs
- Address constraints on competitiveness in national economies in order that domestic business can compete internationally and benefit from trade liberalization measures
- Improve public access to government services and the efficiency of these services by embracing an e-government strategy
- Set mechanisms for regular consultation between the public and private sector at the highest levels

Business will:

- Implement best practices for Corporate Governance and citizenship to meet high standards for each company and ensure widespread adherence
- Integrate into the business model a work plan for investment in the workforce, local communities, and the supply chain
- Ensure that business activities are sustainable and avoid undue external costs on stakeholders or on society as a whole
- Pay taxes and other revenues to the public treasury in accordance with the provisions of the law
- Invest in ICTs to improve productivity and make increased use of e-commerce
- Organize itself for constructive and cohesive dialogue with government in business policy formulation and assessing priorities

Together governments and businesses should:

- Explore best practice on private sector participation in the provision of infrastructure and other public services
- Implement common standards on Codes of Ethics and systems to eliminate corrupt practices in public and private organizations

SOURCE: Commonwealth Business Council (2003)

sector, while large in number, is poorly organized and without political power. Thus, many donor agencies suggest that sustainable reform of the business environment entails the creation of mechanisms that improve dialogue between government and the small enterprise sector, while building the capacity of small business representative organizations to participate more effectively in reform processes.

The 'representation gap' as they describe it, is a major concern for the ILO. Because the ILO is responsible to a Governing Body comprised of governments, employers and workers from 176 member states, it values the role of organization and representation. Employer organizations in most developing countries tend to represent larger, formal enterprises within the ILO structures. Similarly, worker organizations rarely

represent the workers of small enterprises. Thus, the participation of small enterprise owner-managers, as well as small enterprise workers, in national social dialogue is a major concern to the ILO (Clemensson 2004).

Other agencies such as GTZ, Danida, USAID and the SME Department of the World Bank have also expressed their interest in improving the dialogue between governments and the small enterprise sector.

Agencies such as the Commonwealth Business Council have promoted the role of governments and businesses in improving the business environment both separately and in collaboration. The most recent manifestation of this is the Abuja Manifesto on Business – Government Partnerships for Removing Practical Obstacles to Wealth and Job Creation (see Box 7).

4.2.6 Addressing the human factor in reform processes

Some donor agencies have placed strong emphasis on the importance of changing the attitudes of government officials toward private sector and small enterprise development. Attitudinal change, it is argued, is an important pre-condition for reform.

DFID describe this work as the 'hearts and minds agenda'; changing the hearts and minds of government bureaucrats so that they are more aware of the impact their procedures have on the private sector and are more open to looking for ways to improve this situation.⁹ Interventions to bring this about include training programs and study tours for government ministers, members of parliament, and senior bureaucrats. The use of regulatory impact assessments is also a way of making government officials more aware of the influence they can have on private sector and small enterprise development.

Interestingly, some agencies dismiss this kind of work as being overly romantic and claiming that hearts and minds are less important in reform, than official mechanisms that promote accountability. Frank Sader (2004) from FIAS, for example, says he is less interested with what officials have in their hearts and minds, than he is with the installation of reporting mechanisms that hold bureaucrats accountable for their behaviour. Personnel in government ministries and agencies can change, but the systems of accountability remain. Thus, reform processes should focus on the performance and incentive systems in which government officials work.

While there are differences in the two approaches presented above, they both share a focus on improving the human factor in government administration. Recognising that it is people who drive—as well as block—the processes of reform, donor agencies are devising interventions to change attitudes, improve skills and make officials more accountable.

9 See for example DFID (2003).

The role of training in reform process has also been gaining interest among donor agencies. The World Bank and the ILO have produced training programs related to the business environment. The ILO has produced and tested a training program that raises the awareness of practitioners and policy-makers to the influence the business environment has on small enterprise development. Currently, the ILO, in association with the International Training Centre in Turin, is preparing curriculum for a two-week training program for policy-makers, regulators, and social partners on approaches to the assessment and reform of business environments for small enterprises. It is envisaged that this curriculum will be tested in the second-half of 2004 (Clemensson 2004).

4.2.7 Decentralizing donor decision-making and program development

Another trend among donor agencies is decentralisation. Agencies such as DFID, GTZ, ILO, JICA, and USAID have a broad network of agencies located in developing countries, which have recently been given far greater powers. Even agencies that have been extremely centralised in the past, such as AusAID, have decentralised many of their programs to country offices. However, in the case of AusAID, most policy-based decisions concerning development programs are still made in Canberra. This is in stark contrast to DFID where country offices now play a central role in the design of interventions, the allocation of funds, etc.

JICA described the impact of decentralisation on their programs as follows:

Our field offices used to be expected to merely represent the voices of the recipient country government and/or beneficiaries (small enterprises) but have little voice in actual planning and designing of interventions. However, since a major system change within the Agency is being made, our field offices will have a strong voice and authority in planning and designing interventions in the future (Ueno 2004).

In most cases, the central headquarters of donor agencies are expected to support the work of their country-based offices. This

usually involves facilitating the exchange of information across country offices and providing resources and contacts where necessary. Agencies such as GTZ, ILO and the Government of the Netherlands have been preparing standardized assessment tools that their country offices can use as a resource (rather than a blueprint). A number of donor agencies referred to the role the Committee of Donor Agencies can perform in developing resources and sharing information that can be of use to their country offices.

4.2.8 Local reform processes

Many donor agencies balance their national-level assessment and reform interventions with local-level activities. Agencies such as GTZ, ILO, and the Agriculture and Rural Development Department of the World Bank spoke strongly about the importance of focussing on sub-national areas in their reform processes, whether in small local areas (e.g., within a local municipality) or larger districts or regions.

JICA highlights the need for an integrate regional development approach to small enterprise development in rural areas in its program formulation guidelines (JICA 2002, p. 149). Special attention is also given by JICA to the role of local governments and NGOs at the local level (p. 132).

In some cases, local business environments are considered through programs dealing with local economic development. For example, the ILO's Global Employment Agenda refers to the application of its framework to action at the sub-national level (provincial, district and municipal).

Local authorities can promote entrepreneurship through the adoption of local policies and regulations, as well as through the administration of national laws and regulations. The growing decentralization of government services increases the relevance of local authorities, as do the opportunities for local economic development (LED) and the promotion of local entrepreneurship (ILO 2004, Para. 38).

Similarly, GTZ supports local economic development in a number of countries with interventions that encompass local policy, legal, regulatory, and organizational

frameworks. Small enterprise development is an important feature in these programs.

4.2.9 Fee-for-service reform interventions

Payment for reform services is an issue that arose from time to time during this study. While donor agencies have been eager to promote fee-for-service models in small enterprise development, this has been less of an issue in the business environment.

Fee-for-service is a principle that is promoted by many donor agencies in the field of financial and business development services. Its benefits include the commitment clients have to the use of the service, the promotion of demand-oriented services, and the sustainability of the service. While questions are often raised concerning the capacity of poor clients to pay for services at market rates, the need for clearly defined, time-bound subsidisation is recognised, as is the need to facilitate the development of markets for business development services.

Within the context of reforming the business environment, there are an equal number of arguments that can be proposed to support fee-for-service reform services: It guarantees 'buy-in' from the host government, ensuring that the services are demand-oriented and well focussed; and it offers better value for money because donor agencies are no longer required to fund all or most of the funds required. The argument against fee-for-service is similar to this issue in small business development: the governments of developing countries are unable to afford the costs.

Many donor agencies encourage some kind of cost sharing in the implementation of programs, whether in kind or in cash. However, in most cases this is more symbolic than substantive.

FIAS presented an interesting exception to this approach. Host governments must pay for fifty per cent of the costs of FIAS supported reforms. Thus, FIAS operates more like a consultancy service than a donor agency. However, in reality the host government contribution to a FIAS project is often met by another donor agency simply because the host government is unable to find the funds required for its contribution.

Many technical agencies of the United Nations face similar challenges. They provide technical services that often have to be paid for by a third party donor. However, it is interesting to note that many UN agencies are eager to receive funds from donors to apply to projects, rather than host governments receiving these funds and paying the technical agency (i.e., the UN agency) for its consulting service.

The practice of fee-for-service in the field of business environment assessment and reform deserves more attention. While some donor agencies may find it threatening—because it could threaten some of their own financial resources and place more (possibly too much) responsibility on host governments—it is a principle that has been promoted in so many other fields.

4.2.10 Political aspects to reform

Most donor agencies have a political or values-based agenda to their work, but not all are open about what this agenda is. Some of those who expressed a clear political agenda to their work include: Danida and GTZ—both with a strong emphasis on pluralism and social dialogue—and the ILO—with an interest in employment conditions and social dialogue.

Some agencies, such as AusAID and USAID, described the growing influence national security has in their work. AusAID, for example, has been concerned about the consequences political and economic instability in countries of its region will have on Australia's security. AusAID has been concerned that neighbouring governments are increasingly unable to afford to provide the public goods and services that are expected of them (e.g., policing services). These are major issues affecting governance and stability that have to be addressed before any other issues. From a business environment perspective, these are major concerns, although they have little connection with private sector or small enterprise development per se. Once governance, security and stability issues are addressed, then it will be possible to move on to the business environment (Donaghue 2004).

Three kinds of political disputes are common when donor agencies become engaged in reforming the business environment for small enterprises: The first concerns the fear host governments may have regarding the hidden interests of donor agencies. White and Chacaltana (2002) noted in their previous report that many host governments are more comfortable working with multilateral donor agencies in the field of the business environment because these agencies are considered to be more neutral. Bilateral donors, on the other hand, usually have the interests of their own country. While these interests may be well intended or benign, host governments recognise that bilateral donor agencies are instruments for trade, security, and other political agendas of donor governments. Opening up domestic reform issues to foreign governments can place host governments in a position of vulnerability—whether perceived or real.

The second kind of political dispute donor efforts bring to the business environment, concerns the roles government can perform in the business environment. Sovereign national governments have their own political interests. Some may be one-party states with a tacit interest in pluralism; others may have fierce contests between governments and opposition parties that have the potential to undermine political stability. Donor agencies bring their own views and agendas to these situations, which are not always appreciated. Mallon (2002), for example, described how donor agency attempts to speedup reforms in Viet Nam were sometimes found to be counter-productive. Donor agencies support for business environment reforms are often bundled with political values and interests. For example, private sector development presents a paradigm that goes beyond the desire for a more vibrant private sector. It also comes with a specific understanding of the role of government, the importance of governance and the rule of law, and the importance of competition. Thus, while many governments may want to promote a more vibrant private sector, they may be less enthusiastic about the reduction of industry protection schemes or reducing the size of government.

The third kind of political dispute that often arises is a sub-set of the second. It involves the mediation of stakeholder interests and power. The business environment is the location for a number of disputes between stakeholders, and governments are often required to mediate between them. Foreign-owned enterprises, for example, are often looking for incentives (e.g., taxation incentives) to come to, or remain in, a country and governments are required to balance these demands with those of domestic and indigenous firms. Employers and workers are often in conflict, as are the interests of small and large enterprises. Thus, there is a need to examine the ways in which these contests are mediated, whether through the executive or judicial functions of government.

Reform of the business environment creates winners and losers. In some cases, successful reform will mean that those who have often lost will win, or that those who lose have loud voices. Thus, reform to the business environment will involve conflict and sometimes this conflict will be public and controversial. Those who are potential losers in the reform process will resist change wherever possible.

There is nothing wrong with donor agencies holding a political or values-based agenda in their work. The primary objective of poverty reduction is clearly values-based and shared by all. The main concern in this field is with transparency and the need for donor agencies to declare their values and political interests.

4.2.11 Working with the private sector to improve the business environment

Some donor agencies have expressed a concern regarding their relationship with host governments when reforming the business environment. Some of the contests and conflicts of interests host governments and donor agencies experience have been described previously in this report. As a consequence of this, donor agencies are sometimes reluctant to channel all their funds for private sector and small enterprise development through government. For example, Danida described how it is reluctant to channel its funds through its usual route—

ministries of finance—when implementing its ‘business sector development’ programs. Danida, as with a number of other donor agencies, believes it should use a range of channels to support reform efforts. While the host government is still required to approve all Danida-supported programs, there are other actors in the business environment that Danida will support in an effort to create a more enabling business environment (e.g., business associations, trade unions, judicial structures) (Madsen 2004).

The UK’s DFID has developed a specific private sector mechanism for development cooperation. Challenge Funds were designed in the late 1990s to find creative ways for DFID to collaborate with the private sector and overcome the unsuitability of conventional grant-making processes to many companies and private organizations. In general, Challenge Funds aim to:

- Stimulate innovative approaches to development challenges
- Encourage the private sector to engage in commercially viable business activities that benefit the poor
- Provide a simpler, less costly funding mechanism to build new partnerships between donors and private agencies undertaking such initiatives
- Leverage management and financial resources of the private sector

Two Challenge Funds have been established, each with a specific purpose. These are:¹⁰

- 1 Financial Deepening Challenge Fund (FDCF): A £18.5m fund designed to encourage banks and other commercial institutions such as insurance and leasing companies to develop innovative financial services that benefit the poor. The FDCF covers 15 countries, 12 twelve in Sub-Saharan Africa, plus India, Pakistan and the United Kingdom.¹¹
- 2 Business Linkages Challenge Fund (BLCF): A £18m fund designed to

¹⁰ More details on the Challenge Funds can be found at: www.challengefunds.com

¹¹ A private firm, Enterplan Limited, along with Deloitte and Touche, and Project North East manage the FDCF.

stimulate business linkages between enterprises that generate employment and other benefits for the poor. This fund covers 20 countries in Central and Southern Africa, Rwanda, the Caribbean, and the United Kingdom.¹²

Challenge Funds have been found to provide a valuable mechanism for DFID to strengthen its relationship with private sector players. They keep DFID programs grounded in delivering results for firms. They also create a mechanism for learning from the practical experiences of the private sector, including experiences related to macro and meso policy reform. Although their application in developing countries is still relatively new, there is evidence that Challenge Funds have successfully stimulated investment in innovative business development services and financial products that benefit the poor. They have also leveraged substantial volumes of private funds. However, very few of the projects supported by the Challenge Funds have addressed issues concerning the business environment. In response to this situation the Challenge Funds guidelines were revised in 2002 so that projects of this nature could feature more fully.

Another way donor agencies work with the private sector to improve the business environment is through private sector representative agencies. However, much of this has been addressed above (see 4.2.5).

4.2.12 Sectoral approaches to reform

Another interesting approach taken by some donor agencies in the reform of the business environment has been a sectoral approach. In southern Africa, DFID has established the FinMark Trust to examine the financial sector.¹³ While not focussing specifically on small enterprises, the FinMark Trust contributes to coordination of financial market development activities by working with a wide range of organizations active in promoting access to retail financial services—from government departments and

regulators to banks, non-bank finance companies, and NGOs (FinMark Trust 2004).

Sectoral approaches to the reform of the business environment allow donors to focus on the full range of issues affecting the sector. While this may not be possible when examining all the sectors in which small enterprises operate, a sectoral approach allows for a deeper analysis. The frameworks developed by DFID in this sectoral approach deserve further attention so that they may be replicated by other donor agencies in other sectors.

4.3 Donor collaboration

Finally, donor practices are often influenced by the relationships they have with other donors. Therefore, attention is given to the opportunities for donor collaboration in the reform of the business environment.

All donor agencies consulted for this study agreed that collaboration with one another is important. Collaboration was seen as a way of increasing credibility with the host country and improving efficiency and effectiveness of donor efforts. However, donor collaboration is a 'motherhood' term (i.e., everyone agrees with it and few would want to argue against it), but the difficulties are found in the details. Some donors have indicated that cooperation with others is easier in well-established sectors, such as health and education, because these areas are easily defined and the relative interests and capabilities of donors in these fields are well known. However, the business environment is an emerging issue for many donors; it is less well defined and the capabilities donors bring to this work are unclear. Work in this field also has a highly political character to it, which is not the case in sectors such as education and health (deWaard, Fortuin et al. 2004).

A representative of the IADB suggested that donor collaboration becomes more difficult once political processes intervene (Llisterri 2004). Because business environment reforms require agencies to work at a higher, and therefore, more political level, the challenges to collaboration are greater—but also more crucial than ever. At

12 Deloitte and Touche, in association with Enterplan and Project North East manage the BLCF.

13 FinMark Trust: <http://www.finmarktrust.org.za>

a technical level, collaboration is rather easy; donors can quickly delineate their relative interests and competencies among themselves. Despite this, not all mechanisms for collaboration and information sharing are effective. Llisterra explained how donor agencies spend a lot of time understanding each other because similar terms can be used by agencies to explain different concepts. This is a common problem in the business environment as Chapter 2 described.

One of the most explicit explanations found about donor collaboration in the reform of the business environment comes from JICA:

JICA has little project experience on systems and regulations related to SME promotion. This is in contrast to the vast experience of the World Bank and the IMF, which promote problem solving of systems and regulations as a top priority of SME promotion. JICA has less experience in this area because: a) partner governments rarely request JICA's services for technical assistance related to systems and regulations, b) Japanese experts mainly focus on specific promotion policies targeting small businesses, and c) the improvement of systems and regulations is often a prerequisite for financial assistance required by the World Bank and the IMF (JICA 2002, p. 128).

Collaboration between bilateral and multilateral donors was found to have particular benefits when promoting reforms in the business environment. White and Chacaltana (2002) found that many host governments were suspicious of bilateral donors becoming involved in high-level policy reform; host governments often questioned the motivations and interests of the bilateral agencies. By comparison, multilateral agencies were treated differently. In some cases this was because these agencies incorporated specified reform measures as a condition of financial support (e.g., the World Bank is well know this), but usually it was because multilateral agencies were seen as being more neutral and transparent. Moreover, many host governments directly participate in the governing bodies of multilateral agencies and therefore they have a sense of ownership and trust.

Representatives from agencies such as the World Bank believe they have 'more traction' than most bilateral donors in promoting reform efforts (Aitken 2004; Sader 2004). They claim that donor collaboration on reform agendas is important because it presents a united view and encourages a harmonized approach to reform in which each agency applies its strengths and contributes its comparative advantages.

Business environment assessment has been a field where collaboration appears to have been both active and fruitful. A number of bilateral agencies have supported the World Bank in its efforts to conduct an Investment Climate Assessment, for example. These assessments can be very costly and often the World Bank is unable to find the funds within its own resources to undertake these assessments alone. Agencies such as the Governments of Switzerland and the Netherlands have contributed to these assessments (Grossmann 2004).

Assessment is a field in which the World Bank Group claims considerable advantages and capabilities. It has the capacity to conduct large-scale surveys and reviews that are academically rigorous and internationally comparable. However, due to the way in which its funds are structured (i.e., predominantly focussed on lending programs), it is unable to conduct these assessments in all countries that require them. Thus, bilateral donor agencies could provide financial support to allow the World Bank to conduct these assessments. All agencies would benefit from the outcomes of such assessments (Meer 2004).

A number of donor agencies expressed support for project development facilities as a mechanism for donor collaboration. A comparatively small agency such as AusAID, for example, found value in participating in broader schemes along with other bilateral and multilateral donors, such as the Pacific Enterprise Development Facility and the Mekong Project Development Facility (Donaghue 2004).

Other area-based mechanisms for coordinated development assistance have also proved useful for donors. NEPAD, for example, was cited as a mechanism that

donor agencies could use to collaborate more effectively (Farinelli 2004).

Agencies also referred to the value of PRSPs as a mechanism for donor collaboration, as well as joint participation in Country Strategies. A number of donor agencies (e.g., DFID, Danida) spoke highly of the BEST program in Tanzania as a jointly planned and implemented project, and a successful demonstration of donor collaboration.

The FinMark Trust, referred to in 4.2.12 (above) has also proved a useful mechanism for capturing the support of more than one donor. Established by DFID, the FinMark Trust is incorporated under South African legislation as an independent trust. This structure can be flexibly managed allowing any additional donors to support the work of the trust. While receiving financial support from DFID, the FinMark Trust is positioned as an independent agency that can be supported by any other donors with an interest in reform of the financial sector in Southern Africa (Scott 2004).

While the UN system would appear to be a useful mechanism for the coordination and collaboration of agencies, especially UN member agencies, a number of member agencies described the high level of competition that can be found within the system. Agencies such as the ILO, UNCTAD, UNIDO and the UNDP appear to compete with one another for resources and projects. While some of these agencies have a very specific mandate that would suggest they could avoid such competition, these experiences continue.

Thus, while all shares the value of donor collaboration, most donors experience difficulties. Specific, purpose built mechanisms for donor collaboration in fields that affect the business environment appear to work, including project development facilities, PRSPs, and joint country strategies.

Chapter 5

Creating impact: Outcomes and the measurement of reforms

This chapter focuses on the outcomes created by donor agency reform efforts. As with many issues affecting the measurement of outcomes and the impact of donor efforts, questions surrounding monitoring and evaluation strike at the heart of the reasons for focussing in business environment reforms in the first place.

There is a logical theory behind business environment reforms, which can be hard to demonstrate in practice. The theory is that donor agencies can produce greater benefits from their inputs by improving the business environment; donor-supported reforms will produce conditions that are more conducive to small enterprise establishment and the growth of more competitive and productive small enterprises. Unlike financial and business development services that have been notoriously poor in the number of small enterprises they reach, reforms to the business environment can affect all enterprises—even those operating in the informal economy. However, this theory is difficult to prove in practice. Measuring change in the business environment is possible, but attributing this change to the contribution of a single donor intervention is far more problematic. In an age where donor agencies are facing many more calls for accountability, this issue has become critical. While donors believe they are increasing their sphere of influence (and producing a greater impact) by working to reform business environments, they are unable to demonstrate this.

Donor agencies experience a number of challenges in their efforts to monitor and evaluate business environment reforms. There are three specific challenges that donor agencies face in this field.

The first is the challenge of isolating reform measures in embedded programs: As the previous chapter described, more donor agencies are packaging their reform efforts within a broader program of development

cooperation. As a result, business environment reform measures can be bundled into development loans, or included in an integrated program of support to promote the small enterprise sector. This practice can make monitoring and assessment of specific reform efforts (i.e., reform components) very difficult.

The second major challenge in this field is to deal with attribution and the counter-factual: Attributing a specific reform program to changes in the business environment can be extremely difficult. A donor-supported effort to reduce red tape, for example, can show measurable outcomes (e.g., less red tape), but it is not always possible to show a clear link between this outcome and improvements in the business environment. Maybe the improvement in the business environment was influenced more by the aggressive privatisation program, or growth in the regional economy, or the weakening of the US dollar. Thus, it is easier to attribute specific outcomes to donor programs, but more difficult to say that these outcomes led directly to improvements in the business environment.

Dealing with the challenge of attribution includes addressing the counter-factual argument. This refers to the following hypothetical question: What would have happened if the donor activity had not taken place? The outcome would not have been produced (i.e., there would be no reduction in the amount of red tape), but would the business environment changed? If improvements to the business environment were a result of regional influences or foreign exchange, then clearly a reduction of red tape would not have mattered much.

The real impact of donor effort often lies somewhere between the extremes of attribution and the counter-factual. A reduction in red tape is very likely to have contributed to an improvement in the business environment, but it is unlikely to have been the only reason for this improvement; there are other factors that this improvement can be attributed to. Similarly, without a reduction of red tape, it is very likely that the business environment may not have improved so much, but exactly how much

less this improvement might have been is very difficult to determine.

The third challenge is a result of the problem of timeframes: Reforms to the business environment take time. While individual interventions can create short-term outcomes (e.g., training judges or policy-makers), the impact of these outcomes takes a longer period of time to eventuate. Long timeframes enhance the problem of attribution, described above, as other contributors to changes in the business environment have time to take effect.

The World Bank Group is currently undertaking an assessment of its work in reforming the business environment over the last ten years. Led by Ms. Kristin Hallberg, Lead Evaluation Officer, Sector and Thematic Evaluation, in the Operations Evaluation Department, this work involves a review of project assessments undertaken for all projects. While the results of this assessment are still to be finalised and released, the problems of assessment described above are common. Many reform interventions have been found to perform less well than other project functions. This is largely because of the timeframes required for assessment were too short (i.e., assessing impact directly after the completion of a project is too soon) and because reform activities have often been bundled into broader programs, which makes reform efforts more difficult to isolate and assess (Hallberg 2004).

Despite the problems described above, most donor agencies agree that concerted efforts must be taken to deal with the issue of monitoring and evaluation. Some donors take a pragmatic approach to this challenge and simply do whatever they can to monitor and assess outcomes and, where possible, impact. Others appear tormented by this

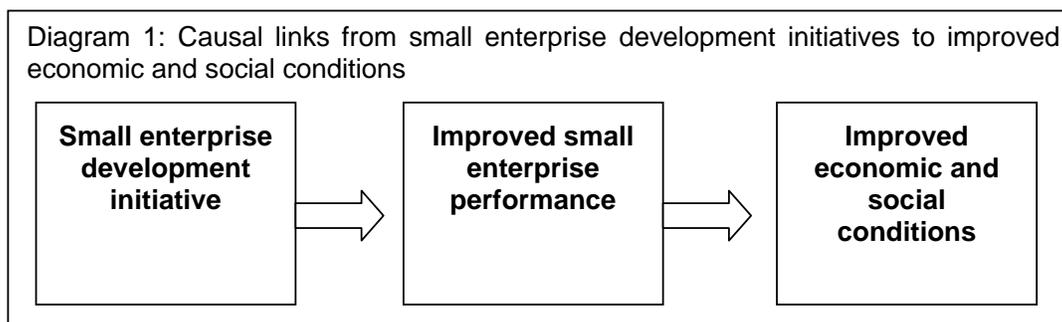
issue and search for different methods. A number of donor agencies refer to the current work of the Committee of Donor Agencies on this issue.

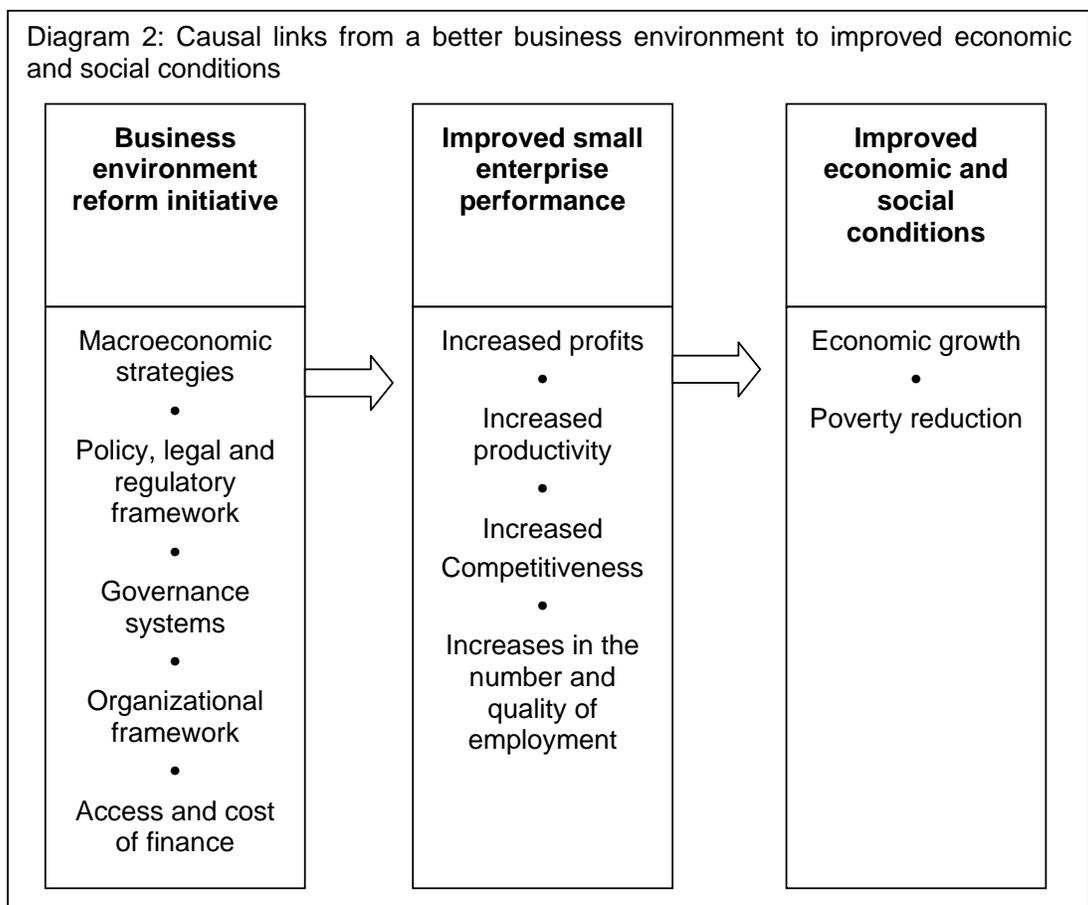
Donor agencies undertake measures to support reforms in the business environment for small enterprises to achieve specific outcomes. This is usually related to broader development objectives such as the reduction of poverty and the achievement of development outcomes such as those contained in the MDGs. Small enterprise development contributes to this objective by, for example, promoting a more productive and competitive small enterprise sector.

This relationship is usually described in the following manner (Oldsman & Halberg 2002)—see Diagram 1, below.

Donor agencies that support the reform of the business environment for small enterprises can apply the same causal links. However, there are different kinds of donor-supported interventions (i.e., reforms) that are used to create these changes. Diagram 2 on the following pages illustrates how reform of the most common elements of the business environment contributes to broader development outcomes.

Diagram 1: Causal links from small enterprise development initiatives to improved economic and social conditions





By describing how reform can be supported by donor agencies and the potential impacts this support can have, donor agencies can define more precisely the purpose of their interventions.

Diagram 3, on the following page, illustrates the causal links between improving the business environment for small enterprises and achieving broader development. Specific indicators can be formulated for each of these interventions to determine how successful donor support has been and whether it has contributed to a positive change in the business environment and the attainment of specific development goals. A series of possible indicators are presented in the annexes (Annex 4) to help donor agencies think about these when designing their programs.

A framework for the monitoring and evaluating donor efforts to support reforms of the business environment for small enterprise development would describe causal links

between reform interventions and improvements in the business environment for small enterprises; as well as between improvements in the business environment for small enterprises and poverty reduction and economic growth.

Of central concern to donor agencies is the way they articulate and measure the relationship between supporting reforms to the business environment for small enterprises and the attainment of broader development objectives, such as those articulated in the UN's Millennium Development Goals.

The annexes contain an explanation of the ways reforms to the business environment can contribute to achievement of the UN's Millennium Development Goals (see Annex 5).

The Committee of Donors is already examining issues affecting the measurement of impact in business development. While the issues of monitoring and evaluation raised in

Diagram 3: The causal links between improving the business environment for small enterprises and achieving broader development

	INTERVENTIONS	OUTPUTS	OUTCOMES	IMPACT
<i>The private sector in general</i>	Removal of obstacles to private sector investment Improving organizational capacities and governance	Fewer obstacles and bottlenecks to private sector activity Government is more aware of the influence of policies and laws on the private sector Improved governance—in general as well as regulatory authorities	Greater investment in the private sector More signs of growth from micro to small to medium to large sized enterprises More partnerships between the public and private sector Government interventions are more precise	More competitive, efficient and functioning markets More diverse, resilient and entrepreneurial national and local economies Bigger private sector with more demand for employment
<i>The small enterprise sector in particular</i>	Removal of anti-small enterprise biases Improving the advocacy and representation of small enterprises	The policy, legal and regulatory framework is 'size-neutral' (without parallel frameworks for small enterprises) Fewer obstacles to small enterprise activity Small enterprises participate more effectively in policy, legal and regulatory	Greater participation by small enterprises in domestic and international markets Improved competitiveness among small enterprises Growth and improvement in small enterprise employment Greater participation by the poor in markets (through	Economic growth Poverty reduction

this report are similar, donor agencies require frameworks that specifically address the dynamics of reform processes. Rather than measuring the impact of a specific service, this field of work is more easily diffused.

Most donor agencies undertake one or more of the following monitoring and evaluation procedures:

- Recording program inputs and activities: As indicated in previous reports (White & Chacaltana 2002), this kind of information is commonly used by donor agencies, but of little use in the search for objective impact assessment.
- Recording outputs based on donor interventions (e.g., drafting and adoption of a policy or law, removal of unnecessarily regulations)
- Stakeholder perception surveys: Before and after donor intervention

- Enterprise surveys: Before and after donor intervention
- Participatory impact monitoring: Used by GTZ to obtain the views of the target group, implementing partners, and program staff
- Anecdotal information: While this is a poor substitute for 'hard' monitoring and evaluation data, many donor agencies have indicated that good anecdotal information on the contribution of donor efforts to reform and the benefits these reforms have wrought upon the target group is very useful. In some cases, this kind of information meets the evaluation demands of taxpayers and other constituents very well.

Some donor agencies highlight the role that monitoring and evaluation can play in building national capacity and creating incentives for change. Two examples can be

used to illustrate this function. The first concerns the role of monitoring and evaluation as an internal mechanism for measuring staff performance and promoting incentives for reform. Middle management government officials can easily become obstacles to reform. Whether it is their potential to earn additional money through petty corruption, or their interest in exercising bureaucratic power over others, or their desire for a quiet government job, these people can resist change and, because of their position within the bureaucracy, such resistance can thwart reform processes. In response to this rather common situation, donors have described the value of introducing new performance appraisal systems that establish a new set of incentives for government bureaucrats. Such a system would apply monitoring and evaluation systems that focus on reducing bureaucratic red tape, lessening the time required to obtain licenses, permits, etc., and improving the facilitation functions of government offices. This new set of indicators can be used for human resource management purposes within government structures, as well as by donor agencies wishing to track changes in the business environment (Sader 2004).

The second example concerns national benchmarking. By regularly conducting assessment of the business environment and recording improvements or declines (e.g., Investment Climate Assessments, Doing Business Surveys, baseline enterprise surveys), donor agencies are able to stimulate debate and create greater enthusiasm for change. This kind of assessment has clear benefits in terms of creating better conditions for reform, but does little to demonstrate the performance of donor programs or their specific contributions to reform.

Making this kind of information public is an important consideration. Often these assessments are treated confidentially for fear of negative consequences (e.g., foreign investors will be less interested in investing, or opposition political parties will use it to their political advantage). However, many donors suggested that regular assessments of the business environment should be made

available to the public and even discussed in the media. Public scrutiny and discussion are important contributors to the process of reform.

Many donor agencies refer to the importance of considering monitoring and evaluation in the process of program design. Hallberg (2004) stressed the importance of designing program outcomes and inputs first. She also highlighted the need for assessment indicators to reflect specific program characters as well as national and cultural features. It is wrong to expect that one set of indicators can be applied to all reform programs in all countries. Getting donor agencies to think about these issues in these early stages of program design is essential.

This kind of approach has been promoted by UNIDO in its draft *Guidelines for the evaluation of projects and programmes*. This document defines key terms and lays out a framework for evaluation (UNIDO 2003a). JICA has also taken this approach to program design (JICA 2002).

Officials at the Inter-American Development Bank described how donor agencies struggle with considering monitoring and evaluation in the process of program design because they are generally poor at defining objectives. Thus, the difficulty is not in monitoring and assessing programs and impact on the business environment, but the skills of program designers (Llisterri 2004).

Discussions on monitoring, evaluation and impact return donor agencies to the models and frameworks used to define the business environment for small enterprises. The progression from conceptualising the business environment and its influence on small enterprise development, to assessing the business environment and designing reform programs, bring donor agencies back to the issue of measuring their influence on change. The connections between these different processes deserve greater attention.

Chapter 6

Conclusions

This chapter provides a brief synthesis of the issues raised in the preceding chapters. It examines the critical issues raised in this report and proposes measures that may be taken by the Committee of Donor Agencies and donor agencies themselves to improve donor practices in the assessment and reform of business environments for small enterprise development.

6.1 Models and frameworks

Chapter 2 presented some of the pathways that have led donor agencies to working on the business environment for small enterprises. It also identified a broad range of elements that are contained in the business environment, but found many donor agencies prefer to focus on those elements they believe to be most relevant. These were:

- Macroeconomic strategies
- Governance issues
- Policy, legal and regulatory framework
- Organizational framework

While many donor agencies have not officially defined their view of the business environment, some of the samples cited in Chapter 2 show great variation. Some donor agencies embrace a very broad approach to the business environment and others focus on a handful of concerns, such as those listed above. In addition to this list, some donor agencies highlight the role of the broader cultural and value-based context in which the above elements are found. Attitudes to enterprise and markets, expectations on the role of the State, the value of hard work and individualism, are broader influences that affect society's institutions, and ultimately the business environment.

The challenge for the Committee of Donor Agencies is to determine whether there is value in taking a position on these issues and

proposing a definition. This study has shown the value of a conceptual model that lays a foundation for the sharing of information and experiences. A common language is required before such an exchange is possible and the subsequent challenges of monitoring and evaluation can be addressed more productively once a common model or understanding has been reached. Thus, rather than trying to create a model of the business environment that forces compliance by all donors, the Committee of Donor Agencies could propose a definition that encourages the use of common terms and purposes.

In addition to the value of a common language, this study has shown that donor agencies are developing a significant body of knowledge and experience in reforming particular elements of the business environment. For a body such as the Committee of Donor Agencies, it could be important to clarify specific elements of the business environment in order to facilitate the exchange of relevant information. For example, regulatory reform is a field within the business environment that has specific requirements (e.g., training in the role of regulation, regulatory impact assessment, the promotion of regulatory best practices). These requirements differ from reform efforts in other fields of the business environment, such as macroeconomic reform or the design of small enterprise promotional policies, or the drafting of labour legislation. Thus, defining the business environment and the challenges that exist within it can promote the improvement of donor practices.

One of the contested issues raised in Chapter 2 concerns the importance assigned by donor agencies to the size of enterprises in the business environment. This is an issue that can be debated by donor agencies and academics. While the Committee of Donor Agencies should contribute to this debate, it should also take care not to be distracted by such issues. Small enterprises are the central concern of the Committee of Donor Agencies and it is important that the impact the business environment has on small enterprises is kept in focus.

6.2 Tools of assessment

Chapter 3 examined the approaches donor agencies take to assessing the business environment. While only a few of the assessment tools reviewed focused on small enterprises, there were quite a few tools identified, each with its own areas of concern and method.

Chapter 2 showed that while many donors do not have official definitions of the business environment, the use of assessment tools indicates those elements of the business environment donors find most relevant. There is a connection between the way donor agencies conceptualise the business environment for small enterprises and the tools they use to assess it.

Many of the tools provided by the World Bank have proved useful to bilateral donor agencies, and a number of agencies are interested in further sharing of these and other diagnostic tools. As useful as they are, one of the difficulties with many of the World Bank tools is the cost of conducting such large-scale assessments. Thus, some donor agencies are looking into producing their own tools, or identifying and modifying other tools.

The Committee of Donor Agencies could help member agencies address these challenges in three ways. Firstly, it could facilitate the exchange of information and experience in the design and application of assessment tools. Secondly, it could offer guidance to donor agencies on the variety of tools that can be used and which tools are appropriate in particular circumstances. Thirdly, it could build upon agreed definitions of the business environment by describing the procedures for assessment of each of the most relevant elements.

6.3 Donor-support reform practices

A number of new trends and common approaches to donor-supported reforms were presented in Chapter 4. As donors shift a greater amount of their program activities to reforming the business environment there is a larger body of experience that can be drawn upon. This chapter showed how donor agencies are influenced by a number of

different factors when designing their reform interventions and that objective assessments of the business environment do not necessarily dominate the nature of the program that is finally prepared. However, it is clear that donor agencies appreciate guidelines suggesting how assessment information can be used more effectively to inform program design. In particular, there is an interest in demonstrating the links between reforming the business environment for small enterprises and broader donor agency objectives, such as the reduction of poverty and economic growth.

Reforming the business environment for small enterprise development brings donors into a number of new (higher-level) domains. Many donors would appreciate information on how to improve their performance in these areas. There is also a demand for information on a number of program challenges, such as timeframes, creating incentives for reform, and engaging the private sector in reform processes. In addition, donors are interested to learn more about the experiences of others in the fields of governance, regulatory reform, policy development and revision, and drawing small enterprises into social dialogue.

The Working Group on Enabling Environment plans to conduct further research in 2004 on study on the impact of donor reform interventions. This would include issues affecting the extent and relevance of donor coordination and collaboration. This study would be based on a case study approach.

6.4 Monitoring and evaluating donor impact

Chapter 5 presented a number of issues affecting the measuring of impact by donor agencies. While there are many problems experienced by donor agencies in this field, all agencies believe this is a field that deserves careful attention. Most donor agencies are engaged in monitoring and assessing their program interventions, but many are aware of the shortcomings of their efforts.

Monitoring and evaluating donor impact requires the design of indicators and

frameworks that are tailored specifically for each program and country. However, there are a collection of principles and approaches that are common to all monitoring and evaluation procedures that can be shared. Moreover, there are specific issues within business environment reform programs that donors need to address in all their programs.

The Committee of Donor Agencies is already examining issues affecting the measurement of impact in business development. While the issues of monitoring and evaluation raised in this report are similar, donor agencies require frameworks that specifically address the dynamics of reform processes. Rather than measuring the impact of a specific service, this field of work is more easily diffused.

One way of taking this issue further is to build upon the model of the business environment and its reform, describing how reform can be supported by donor agencies and the potential impacts this support can have. A series of possible indicators could be presented to help donor agencies think about these when designing their programs.

6.5 Challenges to the Committee of Donor Agencies

This study has unearthed a strong demand among donor agencies for assistance from the Committee of Donor Agencies in this field of work. As donor agencies refocus their interventions in this field, they are eager to learn from the experiences of others and to contribute their own, often hard-won, lessons and experiences. While each agency has its own idiosyncrasies and varying capacities to collaborate with other agencies, all those that participated in this study were looking to the Committee of Donor Agencies for assistance.

The Working Group for the Enabling Environment is encouraged to take this work further and to help the Committee of Donor Agencies develop better conceptual and practical frameworks for assessing the business environment, designing reform programs, and measuring the success of these.

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Annex 1: Key donor publications

The following documents are cited by donor agencies as providing a rationale for working on business environments for small enterprise development. In some cases these documents provide a policy basis for donor intervention in the business environment, in other cases these documents provide an analysis for donor intervention and a strategic outline of involvement.

Donor agency: Canadian International Development Agency (CIDA)
Publication (Author Year) Private sector development policy
Comment The objective of CIDA's private sector development policy is to create more, better, and decent jobs and sustainable livelihoods by helping markets to function well and by stimulating the growth of the local private sector in developing countries and countries in transition. Particular attention is given to the role of the business environment and how CIDA can promote improvements.
Availability http://www.acdi-cida.gc.ca/index-e.htm

Donor agency: Asian Development Bank
Publication (Author Year) Private Sector Development Strategy (ADB 2000)
Comment An overview of the ADB's work in private sector development with lessons from the past and directions for a way forward. Contains a number of references to the business environment for private sector development, including the needs of small enterprises.
Availability http://www.adb.org/Documents/Policies/Private_Sector/default.asp

Donor agency: Australian Agency for International Development (AusAID)
Publication (Author Year) Private Sector Development Strategy (AusAID 2000)
Comment Despite the limited work AusAID undertakes in private sector development, this Strategy highlights the importance of an enabling environment for small enterprises. Strong emphasis is given to the role and improvement of governance.
Availability http://www.ausaid.gov.au/publications/pdf/privsectordevel.pdf

Donor agency: DFID
Publication (Author Year) DFID enterprise development strategy (DFID 2000)

Donor Approaches to Improving the Business Environment for Small Enterprises

Comment

This document outlines the range of interests and approaches DFID takes to enterprise development. It includes a description of the policy, legal and regulatory barriers to growth and gives specific attention to micro enterprises.

Availability

<http://www.dfid.gov.uk/>

Donor agency:DFID

Publication (Author Year)

White Paper on International Development: 'Eliminating World Poverty: Making Globalisation Work for the Poor' (2000)

Comment

This White Paper deals with a wide range of issues concerning the fight against poverty in the context of globalisation. Specific references are made to small enterprise development and reforming the policy framework.

Availability

www.globalisation.gov.uk

Donor agency:Inter-American Development Bank

Publication (Author Year)

Strategy for Microenterprise Development (IADB 1997)

Comment

This document puts forward the rationale, objective and main components of the IADB's micro enterprise strategy. It outlines the problems that the Bank is seeking to address, the strategic directions for Bank investment and other activities in the sector, and presents a concrete program of action. It includes references to the business environment for micro enterprise development.

Availability

<http://www.iadb.org/sds/doc/MIC%2D103E.pdf>

Donor agency:Inter-American Development Bank

Publication (Author Year)

Enterprise Development Strategy: Small and Medium Sized Enterprises (IADB 1995)

Comment

Most countries in Latin America are undergoing reforms that are opening their economies to greater international competition. However, domestic factor markets are not adequately developed to ensure the successful adaptation of SMEs to this new competitive environment. Unlike larger firms, which can more easily absorb the transaction costs, SMEs are at a disadvantage and require specific compensatory assistance. This report presents the Bank's strategy for supporting the development of small and medium enterprise in Latin America and the Caribbean.

Availability

<http://www.iadb.org/sds/doc/759eng.pdf>

Donor agency:International Labour Organization

Donor Approaches to Improving the Business Environment for Small Enterprises

Publication (Author Year)

Small Enterprise Development; the Policy Challenge (ILO 2003)

Comment

This 32-page booklet, which expands on the Guide to Recommendation No. 189, introduces the policy and regulatory environment as an important external influence on the capacity of small enterprises to create more and better jobs.

Availability

Available in English, French, Spanish, Arabic, Russian and Vietnamese

Email request to: IFP-SED@ilo.org

Donor agency:International Labour Organization

Publication (Author Year)

Recommendation 189: Recommendation concerning general conditions to stimulate job creation in small and medium-sized enterprises (International Labour Conference 1998)

Comment

This is an official recommendation of the International Labour Conference (ILC) in Geneva. The ILC sets the policy and directions for the ILO and is comprised of representatives of 176 Member States, each of whom is represented by government, employers and worker. Recommendation 189 describes a series of fundamental elements in the promotion of SMEs and outlines functions that should be performed by governments, employer and worker organizations.

Availability

Email request to: IFP-SED@ilo.org

Donor agency:International Labour Organization

Publication (Author Year)

Guide to Recommendation 189

Comment

A synopsis of the issues and strategies contained in Recommendation 189 for the benefit of government ministers, senior ministerial and departmental officials, policy-makers, programme administrators and other enterprise development specialists.

Availability

Available in English, French, Spanish, Arabic, Russian and Vietnamese

Email request to: IFP-SED@ilo.org

Donor agency:International Labour Organization

Publication (Author Year)

Global Employment Agenda (ILO 2003)

Comment

The Global Employment Agenda sets out a framework for responding to the globalisation of employment. Its main aim is to place employment at the heart of economic and social policies. The policy environment in which small enterprises operate and the policy, legal and regulatory constraints to small enterprise employment are given particular attention. This document was submitted to the Governing Body of the ILO in March 2003.

Availability

<http://www.ilo.org/public/english/standards/relm/gb/docs/gb286/pdf/esp-1.pdf>

Donor agency:International Labour Organization

Publication (Author Year)

Promoting decent employment through Entrepreneurship (2004)

Comment

Also a part of the Global Employment Agenda (see above) this paper presents the case for the review of policy, legal and regulatory constraints to entrepreneurship. It recognises that an enabling environment for enterprise development requires a national policy framework that recognizes the contribution of business to economic development, and responds to the particular features of different kinds of enterprise. This document was submitted to the Governing Body of the ILO in March 2004.

Availability

<http://www.ilo.org/public/english/standards/relm/gb/docs/gb289/pdf/esp-1.pdf>

Donor agency:Japan International Cooperation Agency (JICA)

Publication (Author Year)

Approaches for Systematic Planning of Development Projects (JICA 2002)

Comment

This guide deals with a number of key themes in the JICA program. Chapter 3 deals specifically with the promotion of SMEs. A key objective within the JICA program outlined in this chapter is the Development and Operation of a Conducive Business Environment to Growth of SMEs.

Availability

<http://www.jica.go.jp/english/publication/studyreport/topical/spd/index.html>

Donor agency:OECD¹⁴

Publication (Author Year)

Guidelines in Support of Private Sector Development (OECD 1994)

Comment

These guidelines suggest broad policy outlines and practical donor strategies for promoting the private sector in developing countries. They take account of the evolution of thinking in this field and of current 'best practice' in related assistance efforts. Many aspects of private sector development, however, are new to the development community and thus present special challenges. Accordingly, these orientations are considered by Members of the DAC to constitute a "work in progress". Special attention is given (p. 12-15) is given to 'fostering an efficient and hospitable enabling environment' for private sector development.

Availability

<http://www.oecd.org/dataoecd/33/56/1919794.pdf>

14 The OECD's Development Co-operation Directorate has only undertaken limited work in small enterprise development in developing countries. However, it is currently preparing a background report on SMEs development to be presented at an OECD Ministerial Meeting on SMEs in Istanbul in June 2004 (Gabyzon 2004). In addition, the Development Assistance Committee (DAC) has issued guidelines from time-to-time dealing with different issues affecting development assistance by member countries. Key documents include: guidelines on private sector development (1994), guidelines on poverty reduction (2001), and guidelines on trade capacity building (2001).

Donor agency:OECD
Publication (Author Year) Guidelines on poverty reduction (OECD 2001)
Comment The Guidelines represent an emerging international consensus and a shared commitment and understanding of how to work together more effectively to help developing country partners reduce poverty. They refer briefly to private sector development and the role of micro enterprises in rural economies, but focus mainly on the need for policy coherence by donors in efforts to reduce poverty.
Availability http://www.oecd.org/document/1/0,2340,en_2649_201185_1885953_1_1_1_1,00.html

Donor agency:OECD
Publication (Author Year) DAC Guidelines on Strengthening Trade Capacity for Development (OECD 2001)
Comment The trade, aid and finance communities are developing more coherent strategies to help developing countries integrate with the global economy. These guidelines provide a common reference point for these efforts. They also show how donors can help developing countries build their capacity for trade. Attention is given to formulating and implementing a trade development strategy that is embedded in a broader national development strategy, as well as to strengthening trade policy and institutions.
Availability http://www.oecd.org/document/31/0,2340,en_2649_34665_1886111_1_1_1_1_37413,00.html

Donor agency:UNDP
Publication (Author Year) Unleashing entrepreneurship; making business work for the poor (Commission on the Private Sector and Development, 2004)
Comment This is a report to the Secretary General of the United Nations from the Commission on the Private Sector and Development. It provides an analysis of the role the private sector can play in development and makes a series of recommendations. A lot of emphasis is given to the conditions for entrepreneurship and the role of markets.
Availability http://www.undp.org/cpsd/

Donor agency:UNIDO
Publication (Author Year) Development of clusters and networks of SMEs (UNIDO 2001)
Comment Describes UNIDO's approach to cluster development and includes methodologies and tools. While not a clear business environment issue, UNIDO argues that effective cluster development requires a proper policy and legal framework.

Donor Approaches to Improving the Business Environment for Small Enterprises

Availability

<http://www.unido.org>

Donor agency: UNIDO

Publication (Author Year)

Supporting private industry (UNIDO 1999)

Comment

Produced by the Investment Promotion and Institutional Capacity Building Division, this document outlines UNIDO's approach to private industry development and includes details on the requirements of an SME policy framework.

Availability

<http://www.unido.org>

Donor agency: World Bank Group

Publication (Author Year)

Private sector development strategy; directions for the World Bank Group (World Bank 1999)

Comment

Provides an overview of the World Bank's approach to private sector development. Includes a review of the purpose of, and instruments for, PSD. Describes the 'primacy of the investment climate' for private sector development.

Availability

<http://www.worldbank.org/privatesector/whatwedo.htm>

Annex 2: Inventory of diagnostic tools

Donor agency	Commonwealth Business Council
Instrument	Business Environment Survey
Status	The Commonwealth Business Council (CBC) has conducted three Business Environment Surveys: 1999, 2001 and 2003. The 2003 survey covered 31 Commonwealth countries, a wider range than in previous years. Business Environment Surveys have been supported by DFID with technical assistance from by Oxford Analytica.
Information sources	There are two main information sources used in the Business Environment Surveys: (1) enterprise surveys and (2) in-depth interviews carried out with business representatives. The interviews complement survey questionnaires to produce a fuller understanding of the perspectives of the private sector as a basis for dialogue with governments on the policy framework for business and investment.
Main focus	The CBC encourages private-public dialogue on trade and investment issues in order to build a shared understanding of the challenges facing business and governments and contribute to better policy formulation and more private sector investment activity. The survey provides information for the future development of national action plans through the CBC's COM-PAC 16 Point Investment Program, which was endorsed by Commonwealth Heads of Government at their 2002 Summit. The COM-PAC provides an action-oriented program for governments and business jointly to address key areas to strengthen the investment climate. Work on the COM-PAC has commenced in three countries in Africa, with ambitious plans to extend this to other Commonwealth countries. The Survey also provides a valuable resource for dialogue with governments at the Commonwealth Business Forum and the CBC's series of national investment conferences. Through these activities the CBC will continue its work to help mobilize investment in Commonwealth countries and to strengthen the role of the private sector in that process.
Comments	No specific attention given to small enterprises.
Availability	www.cbcbglobelink.org/cbcbglobelink

Donor agency	European Bank for Reconstruction and Development (EBRD) and World Bank
Instrument	Business Environment and Enterprise Performance Survey
Status	BEEPS was initiated in 1999 covering 4,104 firms (excluding farms) in 25 countries in central and eastern Europe and the Commonwealth of the Independent States. In 2002, survey covered 6,153 firms in 26 countries of the region.
Information sources	The BEEPS samples enterprises from a range of industry and service sectors to be as representative as possible of the population of firms, subject to various minimum quotas for the total sample in each country. The minimum quotas of the samples for each country were: 1 At least ten per cent of the total businesses in the sample should be small in size (two to 49 employees), 10 per cent medium-sized (50 to 249 employees) and ten per cent large (250 to 9,999 employees). Firms with only one employee and 10,000 or more employees were excluded from the sample.

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	<p>2 At least ten per cent of the firms should have foreign control and ten per cent state control, where control is defined as an ownership share of more than 50 per cent.</p> <p>3 At least ten per cent of the firms should be exporters, meaning that at least 20 per cent of their total sales are from exports.</p> <p>4 At least ten per cent of the firms should be located in a small city (population under 50,000) or the countryside.</p>
Main focus	<p>The BEEPS is a large dataset in terms of both the sample size and the measures it provides about the business environment and the performance of enterprises. The business environment is multi-dimensional and includes key aspects of governance provided by the state, such as:</p> <ul style="list-style-type: none"> • Business regulation • Taxation • Law and order • The judiciary • Infrastructure • Financial services <p>The survey also examines closely the issue of corruption – both administrative corruption that is often associated with arbitrary application of existing laws and regulations and “state capture” through which firms seek to influence the content and application of specific laws and regulations to the benefit of a narrow private interest rather than the broad public interest. The behaviour and performance of firms also has many dimensions. The BEEPS focuses in particular on the growth of firms, including the decisions to invest and to innovate, and the growth of revenues and productivity.</p>
Process	MEMRB Custom Research Worldwide implemented the 2002 BEEPS on behalf of the EBRD and the World Bank. MEMRB followed the ICC/ESOMAR International Code of Marketing and Social Research Practice (for more details, see the Website www.esomar.org and click on codes and guidelines).
Comments	The BEEPS is an initiative of the EBRD and the World Bank to investigate the extent to which government policies and practices facilitate or impede business activity and investment in central and eastern Europe and the Commonwealth of the Independent States. The purpose of the BEEPS is to alert both policy makers and business people to the opportunities and obstacles in the business environment of the region. (Fries, Lysenko et al. 2003)
Availability	http://www.ebrd.com/pubs/econ/workingp/84.pdf

Donor agency	European Bank for Reconstruction and Development
Instrument	The Legal Indicator Survey
Status	Launched in 1995
Information sources	Lawyers, academics and law reform agencies
Main focus	<p>A perceptions-based tool used to measure and analyze countries' legal systems. It takes a snapshot of legal reform as perceived by local lawyers. It assesses the extent to which key commercial and financial laws reach international standards, are implemented and are enforced.</p> <p>The objective of the sector specific assessments is to benchmark the development of key legal sectors in each country against international or harmonized standards, and to provide a clear analysis of gaps in the existing legislative framework while identifying future legal reform needs. With this information, countries can pinpoint legal reform opportunities and undertake reforms on their own or with the assistance of others. Results are also used to</p>

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	help measure the level of legal risk related to each country and to specific investment activities.
Process	An extensive questionnaire is sent to lawyers, academics and law reform agencies annually. Responses are analyzed to provide a numerical rating system for each country. Ratings range from one to four for the extensiveness and effectiveness of commercial and financial laws. The indicators are based on respondents' perceptions rather than on an objective assessment of the laws. The EBRD reviews and compares these perceptions with its experience as a user of the legal system. To arbitrate among competing views of respondents, the EBRD sometimes relies its own experience as a user of the legal system.
Comments	No specific focus given to small enterprises
Availability	http://www.ebrd.com/country/sector/law/index.htm

Agency	Ewing Marion Kauffman Foundation
Instrument	The Global Entrepreneurship Monitor (GEM)
Status	GEM was developed in 1998. 2003 saw the fifth annual GEM assessment of entrepreneurship. The program has expanded from ten countries in 1999 to over 30 in 2002 and 2003—a total of 41 countries have been involved for one or more years. National teams have been in operation in 39 of these countries; their host institutions, membership, and sponsors are listed below. The Ewing Marion Kauffman Foundation are global sponsors of the GEM, with support from Babson College and the London Business School.
Information sources	The annual GEM assessment involves four major types of data collection: (1) Surveys of the adult populations are completed in each country. This involves locating a representative sample of the adult population to determine which are active in entrepreneurship, either by starting a new firm or as the owners of an existing firm pursuing an entrepreneurial strategy. (2) Firm surveys. (3) Interviews with national experts, including the completion of a 10-page questionnaire by experts to provide a standard measure. (4) Existing data on national features assembled by a variety of international research organizations (e.g., World Bank, International Monetary Fund, UN, International Labour Organization). These harmonized surveys—for 2003 over one hundred thousand interviews were complete in 31 countries—are the basis for harmonized comparisons of national entrepreneurship. The primary data collection is the adult population surveys. In 2003 the GEM covered 101,738 respondents across 31 countries.
Main focus	The primary focus of the GEM is on understanding the impact of entrepreneurship, broadly defined, on national economic growth. Given the value of having a reliable empirical base for this assessment, data collection is harmonized cross national measures of entrepreneurial activity, the national consequences of entrepreneurship, those factors that distinguish the countries that are more or less entrepreneurial, and the implications for public policy.
Process	GEM is a collaborative effort, in terms of financial resources, intellectual advancements, as well as design and analysis. A GEM consortium assessment and planning meeting is held early in January of each year. Over 150 scholars from the various national teams assist the coordination team.
Comments	The focus on a broadly defined approach to entrepreneurship is a unique aspect of the GEM, in addition to its use of a range of information sources, including small enterprises.
Availability	www.gemconsortium.org

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Donor agency	Gesellschaft für Technische Zusammenarbeit (GTZ)
Instrument	Assessment of Investment Climate
Status	Still in development; not yet tested
Information sources	Existing literature, stakeholder consultations, previous GTZ experiences
Main focus	Identification of bottlenecks Formulation of policy recommendations
Process	Four-step assessment: (1) factors that contribute to the investment climate; (2) theoretical analysis of bottlenecks in the investment climate; (3) review of GTZ in-country project experience; and (4) formulation of policy recommendations.
Comments	Private sector in general; no special provisions for small enterprises.
Availability	Email request to: joachim.prey@gtz.de

Donor agency	Netherlands Ministry of Foreign Affairs
Instrument	Annual Business Climate Scan
Status	This tool was developed in March 2004 and is yet to be applied. Government embassies in Partner Countries will use the tool on an annual basis.
Information sources	Primary sources of information are consultations with local businesspeople and other stakeholder (e.g., government, business organizations, and civil society), and existing literature
Main focus	Private sector in general; no special provisions for small enterprises. However, attention is given to the experiences of women entrepreneurs.
Process	The Annual Business Climate Scan is prepared by local embassies of the Government of the Netherlands in Partner Countries. A guidance note has been prepared by the Sustainable Economic Development Department of the Ministry of Foreign Affairs in The Hague, which describes process that embassies can follow when conducting the scan. The process involves a series of interviews, meetings or workshops with the informants identified above to obtain an overview of the strengths and weaknesses of the business climate.
Comments	The Annual Business Climate Scan is an essential input for the annual plan that embassies prepare, as well as for their multi-year strategic planning processes. It provides a track record and helps to identify options for donor intervention. It also encourages the integration of all embassy programs.
Availability	See Government of the Netherlands (2004) Email request to: johan-de.waard@minbuza.nl

Donor agency	International Labour Organization
Instrument	Assessing the influence of the business environment on small enterprise development – an assessment guide
Status	Developed in 2002; applied in ten countries
Information sources	Review of policies, laws and regulations in defined policy fields, stakeholder consultations, review of existing literature
Main focus	This guide offers a step-by-step approach to rapid yet systematic assessments of the policy and regulatory environment, which can support constituents' efforts to advocate for an enabling environment.

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Process	Mapping of policies, laws and regulations in specified policy domains; assessment of influence on small enterprises; assessment of markets
Comments	Focus on the influence of the policy and legal framework on small enterprises, particularly on small enterprise employment
Availability	Email request to: IFP-SED@ilo.org

Donor agency	International Labour Organization
Instrument	Business Climate Survey
Status	Based on a survey instrument developed by the Swedish Employers Organization, this tool has been tested by the ILO in two provinces of Viet Nam.
Information sources	Local stakeholder consultations: Through an exploration of government officials' and small-scale entrepreneurs' perception of the business environment the survey is a first step in identifying constraints for small enterprise growth and ways to make local business climates more enabling for small-scale enterprises. The results from the survey are presented in a policy dialogue event in the location that is a region or province. The findings are then discussed between authorities and the business community who jointly identify the actions to be taken that will lead to a more enabling environment.
Main focus	The business climate survey is a participatory exercise that contributes to economic growth, employment creation and poverty reduction by improving local business climates through dialogue strengthening between government authorities and small-scale businesses.
Process	<ol style="list-style-type: none"> 1. A short and simple survey questionnaire is developed informed by local conditions of the small business sector. The questionnaire is purposely kept short to around twenty questions for it to be answered quickly and easily. The same questionnaire can be used in different locations to allow for comparison. 2. The questionnaire is then distributed to both small businesses and to local government officials. The same questionnaire is used for both groups. Ideally the survey should be distributed to all officials and enterprises, but if the population is very large, a sample can be selected. 3. The survey data is then processed and analysed. A short report is written with a quick introduction explaining the purpose of the business climate survey; the responses given by enterprises and government officials to each question are presented. At this stage the report should not attempt to interpret and comment the findings, rather the findings should be presented objectively and no conclusions about the business climate should be made. 4. Dialogue between authorities, local institutions and the business community. Local authorities and businesses are invited for a dialogue event in which the report is distributed and a short presentation about the findings is given. The survey results are debated and authorities and the business community are encouraged to agree on items that will lead to an improvement of the local business climate. The outcome of the meeting is a report with decisions made and an action plan with issues that realistically can be addressed can be addressed in the coming year. <p>The ILO provides technical assistance to the development of the business climate survey from questionnaire design, data analysis, report writing as well as facilitation of the dialogue between authorities and small-scale businesses.</p>
Comments	The Business Climate Survey takes a stakeholders' analysis of the business environment and uses this as a tool for dialogue and the setting of reform activities. It is a quick, easy to administer process that does not rely on detailed

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	statistical analysis.
Availability	Email request to: IFP-SED@ilo.org

Donor agency	International Labour Organization
Instrument	Survey kit; how to measure the influence of national policies, laws and regulations on employment in MSEs
Status	Developed in 2002; applied in eleven countries
Information sources	Micro and small enterprises
Main focus	To assess the influence policies, laws and regulations have on the employment decisions of micro and small enterprise owner-managers
Process	Survey of around 350 micro and small enterprises older than two years and employing two or more people. An equal-split sample frame is used covering micro and small enterprises, male- and female-owned; trade, service and manufacturing enterprises; and rural and urban enterprises. Random local area sampling is used in preference to lists of registered enterprises.
Comments	The kit contains a generic questionnaire that can be modified to suit the conditions of the survey country. It also contains guidelines for designing a sampling frame, along with recommendations for the organization, management and quality control of the survey.
Availability	Email request to: IFP-SED@ilo.org

Donor agency	UNCTAD
Instrument	Investment Policy Reviews
Status	IPRs have been undertaken in 14 countries (reports available on the website)
Information sources	UNCTAD evaluation missions; investors' surveys; and workshop/round-table meetings
Main focus	Investment Policy Reviews help countries improve policies and institutions that deal with FDI and increase their capacity to attract and benefit from it.
Process	The IPR team comprises UNCTAD staff and international and local experts. The IPR team conducts the review over a period of six months. It culminates in the presentation of the findings and recommendations to the UNCTAD intergovernmental Commission on Investment, Technology and Related Financial Issues and in other appropriate forums, as well as in follow-up technical assistance.
Comments	No specific attention given to small enterprises.
Availability	http://www.unctad.org/Templates/Startpage.asp?intltemID=2554

Donor agency	UNCTAD
Instrument	Investment Compass
Status	This is a new web-based benchmarking tool, which reveals the competitiveness of each country's taxations system for FDI.
Information sources	Investment promotion agencies complete two questionnaires, one on the investment regulatory framework the other on taxation. Once the questionnaires have been validated by national authorities, UNCTAD completes the data collection and compiles an Investment Compass.

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Main focus	<p>Investment Compass is an interactive tool for analyzing the main economic and policy determinants that affect the investment environment. The Investment Compass permits comparisons between countries, between a country and a region, and between a country and a best performer. The tool comprises 60 indicators based on international statistics and on special national surveys conducted by UNCTAD.</p> <p>The Investment Compass is organized around six major areas:</p> <ol style="list-style-type: none"> 1. Resource Assets 2. Infrastructure 3. Operating Costs 4. Economic Performance and Governance 5. Taxation and Incentives 6. Regulatory Framework
Process	<p>The Investment Compass has selected and developed indicators considered to have an influence on the investment environment. These indicators provide comparative measures to benchmark foreign direct investment. The Compass makes comparisons on a "horizontal" basis (one country compared to another country, or to a region, or to a 'best performer'), as well as on a "vertical" basis (comparison between indicators for a given country).</p> <p>Through a multi-stage process, the Investment Compass provides results in terms of areas, which are broken into groups of variables. These variables are also broken into key indicators. Values of areas, variables and indicators range from 1 to 100. These values are obtained through a 'normalization' technique, where each indicator has been assigned minimum and maximum values. Through a simple arithmetic average, the relevant normalized indicators are aggregated to give the value for each variable, and the relevant variables are aggregated to provide the value for each area.</p>
Availability	http://compass.unctad.org/

Donor agency	USAID
Instrument	Investor Roadmap
Status	<p>The Investor Roadmap, an in-depth examination of the steps required of a foreign investor to become legally established in a country, addresses the administrative and procedural barriers facing foreign direct investment. To determine readiness for foreign direct investment – and to formulate plans to enhance that readiness - USAID and other worldwide donor agencies have conducted Investor Roadmap studies in more than a dozen countries worldwide since 1995, including Ghana, Namibia, Kenya, Zambia, Tanzania, Uganda, Mongolia, Dominican Republic, Latvia, Bolivia, Jordan, and South Africa. The Investor Roadmap has proven effective in mobilizing government efforts to improve investment landscapes in the respective countries.</p>
Information sources	Information is gathered largely from the perspective of a foreign investor, because foreign investors are required to undertake some steps not required of local investors (e.g., immigration permits, repatriating profits).
Main focus	The main emphasis of the Investor Roadmap assessment is on FDI. Little attention is paid to small, domestic enterprises. However, the issues faced by foreign investors are used to reflect the domestic business environment.
Process	Investor Roadmap assessments are composed of 13 core processes divided into four process groups. The four process groups are: (1) Employing procedures, including obtaining temporary and permanent residency permits for investors, securing employment permits for expatriates, and handling local labour relations. (2) Locating processes, including purchasing land, transferring

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	<p>deeds, developing a site, and complying with environmental laws. (3) Reporting to government, including registering a business, acquiring incentives, applying for specialized licenses, and registering for and paying taxes. (4) Operating, which includes importing, exporting, acquiring foreign exchange, and repatriating profits.</p> <p>Consultants are commissioned by USAID to conduct the assessments.</p>
Comments	<p>USAID believe this makes the assessment more comprehensive than if it were to focus just on the local investment perspective. The foreign investor's perspective allows public sector officials to understand how an individual agency's policies and practices affect a broader, multi-agency process. This perspective also casts government operations as an exercise in customer service, with the foreign investor the user of public services. Nonetheless, the Investor Roadmap is still relevant to local investors, who are subject to the vast majority of steps outlined in most countries around the world.</p>
Availability	<p>www.usaid.gov</p>

Donor agency	<p>World Bank Group</p>
Instrument	<p>Investment Climate Assessments (ICAs) and Investment Climate Surveys (ICSs)</p>
Status	<p>ICAs were begun in July 2002, although this was preceded by eight pilot studies. Since this time, 45 surveys have been conducted and ICA reports have been prepared; eight of these are available on the web site (see below).</p>
Information sources	<p>The ICS uses large samples of firms (i.e., 1,500 firms), while the ICAs supplement this with information from key informants.</p>
Main focus	<p>Investment Climate Assessments (ICAs) are designed to systematically analyze conditions for private investment and enterprise growth.</p> <p>Underpinning all ICAs is a standard core investment climate survey instrument (the Investment Climate Survey, or ICS), which allows the comparison of existing conditions and the benchmarking of conditions to monitor changes over time. The survey is administered to managers of firms and consists of a core set of questions as well as several modules that can be used to explore in greater depth specific aspects of the country's investment climate and links to firm-level productivity. The core survey has 11 sections:</p> <p>General information about the firm: ownership, activities, location.</p> <p>Sales and supplies: imports and exports, supply and demand conditions, competition.</p> <p>Investment climate constraints: evaluation of general obstacles.</p> <p>Infrastructure and services: power, water, transport, computers, and business services.</p> <p>Finance: sources of finance, terms of finance, financial services, auditing, land ownership.</p> <p>Labor relations: worker skills, status and training, skill availability, over-employment, unionization and strikes.</p> <p>Business-government relations: quality of public services, consistency of policy and administration, customs processing, regulatory compliance costs (management time, delays, bribes), informality, capture.</p> <p>Conflict resolution/legal environment: confidence in legal system, resolution of credit disputes.</p> <p>Crime: security costs, cost of crimes, use and performance of police services.</p> <p>Capacity, innovation, and learning: utilization, new products, planning horizon, sources of technology, worker and management education, experience.</p>

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	<p>Productivity information: employment level, balance sheet information (including income, main costs and assets).</p> <p>To date, eight ICAs have been posted on the ICA website. Most are conducted at the national level, although the India ICA compiled state-level indicators. The number of firms in the sample has varied widely: from 1,032 in India to 659 in Bolivia, 576 in Peru, 223 in Nepal, 193 in Mozambique, and 98 in Bhutan.</p>
Process	<p>The process of conducting an ICA can be long: Up to 12 months. Consulting teams are usually formed comprising of international and international consultants. Survey findings are initially prepared. This should be followed by an Assessment Report containing recommendations for improvement of the investment climate, but only a small number of these have been prepared.</p>
Comments	<p>While the Investment Climate Department of the World Bank claim that 90 per cent of respondents to its ICSs are SMEs, they are mostly large, formal enterprises located in urban centres. Most, but not all respondents, are companies and samples are usually taken from business or company registers.</p> <p>A specific SME Module has been added to the ICA (found in the website at the address below).</p> <p>The national and sub-national comparisons of ICA reports are very interesting and can lead to competition and a subsequent desire among governments for reform. There is an intention to repeat an ICA every three to five years to monitor change.</p>
Availability	<p>http://www.worldbank.org/privatesector/ic/ic_ica_tools.htm</p>

Donor agency	World Bank Group
Instrument	Doing Business Survey
Status	<p>The data set covers 133 economies. The sample includes 22 high-income OECD economies as benchmarks, 25 economies from Europe and Central Asia, 33 from Africa, five from South Asia, 21 from Latin America, 14 from the Middle East and North Africa and 13 from the East Asia and the Pacific region. In 2004 the sample will be expanded to 140 economies, covering every economy with a population greater than 1.5 million, except for six economies that are not members of the World Bank or are inactive International Development Association borrowers. Inclusion of economies with less than 1.5 million population may be considered on a case by case basis upon request by governments or World Bank departments.</p>
Information sources	<p>Review of existing laws and regulations in each economy; targeted interviews with regulators or private sector professionals in each topic; and cooperative arrangements with other departments of the World Bank, other donor agencies, private consulting firms, and business and law associations. Standard templates/questionnaires have been developed for all topics.</p>
Main focus	<p>Main topics covered include: starting a business; firing workers; enforcing contracts; getting credit; and closing a business.</p>
Process	<p>The World Bank headquarters in Washington DC runs these surveys. They involve a large sample size of enterprises, drawn from a national register of companies. Teams of international and national consultants conduct the survey.</p>
Comments	<p>The Doing Business Survey provides compelling data that is comparative across countries and over time. However, small enterprises are not well represented in the sample because only enterprises that are registered as companies are included. Thus, sole proprietors, partnerships and, of course, enterprises in the Informal Economy are excluded.</p>
Availability	<p>http://rru.worldbank.org:80/doingbusiness/default.aspx</p>

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Donor agency	World Bank Group
Instrument	Foreign Investment Assessments: Administrative barriers
Status	The Foreign Investment Advisory Service (FIAS) was established in 1985 and has undertaken assessments on administrative barriers in some 120 countries.
Information sources	In addition to a survey of firms and stakeholder consultations, FIAS takes a 'self-assessment' approach to reviewing administrative barriers to investment in client countries. Under this approach, a counterpart team in the Government will use FIAS templates to collect the basic "institutional" information on administrative procedures for business establishment and operation in the country, following the existing norms and regulations. Assessment also relies on the expert opinions of the consultants.
Main focus	FIAS helps governments obtain foreign investment and its assessments are steeped in this direction. The main focus of an assessment is to define the requirements for improvement and the need for technical support.
Process	<p>FIAS assessments are run from Washington using national and international consultants. Governments must request FIAS support and co-fund (50%) its cost. An assessment report is produced, as is a report outlining priority recommendations for reform. These recommendations are then used to inform a FIAS support project, which is also co-funded by the host government.</p> <p>Four phases of assessment and assistance: (1) identifying the problem areas, analysis and recommendations; (2) prioritization of recommendations and preparation of Action Plan; (3) implementation of agreed reforms; and (4) monitoring of impact of reforms</p>
Comments	<p>Where Investment Climate Surveys identify legal, regulatory and administrative barriers, FIAS aims to look more closely at specific problems. There is no attention given specifically to small enterprises. However, small enterprises are seen to benefit through these efforts by their linkages with large foreign and domestic firms.</p> <p>FIAS assessments focus mainly on administrative barriers, but its response to these assessments can include the following:</p> <p>Investment incentives: Support to analyze incentives to ensure they are competitive and cost effective.</p> <p>Investment promotion: To assist countries design promotion institutions, formulate promotion strategies, and adapt models that have proven effective elsewhere.</p> <p>Building linkages: To help governments design programs that foster supply and other relationships between foreign-owned and domestic companies</p> <p>Foreign direct investment data systems: To help governments design systems of collecting data about investment flows for governments and investors.</p> <p>Multi-agency technical assistance program: To assist in the design and implemented of coordinated efforts among four international agencies (FIAS, UNCTAD, MIGA, and UNIDO) to promote FDI flows.</p>
Availability	http://www.fias.net/index.html

Donor agency	World Bank Group
Instrument	Rural Investment Climate Surveys
Status	Rural Investment Climate Surveys (RICS) are a new initiative of the Agriculture and Rural Development Group of the World Bank and are currently being piloted in four countries. The RICS has been developed to complement the findings of

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	an ICA (see above), by focussing on rural sub-national economies.
Information sources	Household surveys based on random sampling in local areas; targeting a sample size of approximately 1,000 households.
Main focus	<p>RICSs aim to provide information about, the main obstacles in enterprise development, and transaction costs in market linkages. They will shed light on the optimal availability of rural infrastructure services and business development services (BDS), given the level of development. They will show possible improvements in competitiveness and help to derive priorities for public interventions.</p> <p>The analytical work will process data specific for rural economy for comparison with rest of economy. The results will contribute “rural content” of ICA reports. The data and analytical results will be made available for PRSP processes; they will be in particular useful for developing country-level rural and private sector strategies, and for strategies for rural towns and rural infrastructure services. Findings will enable policy dialogue, prioritizing policy reform and investment, and CAS preparation.</p>
Process	<p>A standard RICS instrument is being developed. This includes rural issues and rural-urban interactions. The survey sample includes unregistered enterprises. Key methodological questions still be considered are:</p> <ul style="list-style-type: none"> •What should be included in the questionnaire? •What sampling gives a cost-effective coverage of issues? (e.g., should all rural enterprises be included, or only selected groups with presumed dynamic characteristics?)
Comments	RICS are an exciting innovation to watch. It applies a proven formula (the ICA) to a different context (i.e., rural economies, micro enterprises) and includes enterprises operating in the informal economy.
Availability	Email request to cvandermeer@worldbank.org

Donor agency	World Bank Group: SME Department
Instrument	SME Country Mapping
Status	SME Country Mapping has been undertaken in 12 countries. Reports are available of the web site below.
Information sources	Consultations with key stakeholders
Main focus	<p>There are three main areas of focus to SME Mapping:</p> <ol style="list-style-type: none"> 1 Overview: The overview section of the map provides a one-page, quick view of the issues related to SMEs in a given country. It includes quantitative data, such as the host-country definition of SMEs, with respect to employees and sales, as well as macroeconomic data on the country. 2 Snapshot: The snapshot section of the map summarizes the material from the different Gap Analysis sections to provide a summary of each aspect of the four pillars. The section also identifies potential initiatives to confront the constraints identified in the Gap Analysis. 3 Gap Analysis: The Gap Analysis section is a compilation of all of the information included in the country map. It provides information on specific aspects of the four pillars, recognizes institutions or organizations that play a role in SME activity, and identifies potential initiatives to confront any identified constraints.
Process	A team of international and national consultants usually undertake an SME Mapping assessment, led by the SME Department. The assessment involves an analysis of the key factors and constraints affecting the small enterprise sector

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	<p>in a particular country, including:</p> <ul style="list-style-type: none"> • The demand side: the needs of enterprises for inputs such as information, advisory services, training and technical assistance, and financial services • The supply side: public and private programs, including services that the World Bank Group, local institutions, governments, NGOs, donor agencies, and others can offer small enterprises • Deficiencies in the legal structure, administrative framework, and government policies relating to small enterprise development
Comments	<p>The World Bank Group's SME Country Mapping is one of only a handful of tools that deal specifically with the small enterprise sector. It deals specifically with some key business environment elements, while encompassing demand and supply side issues.</p> <p>SME Country Mapping is used to enhance program planning, as well as to provide a database of the business environment for small enterprises for the purposes of knowledge management and benchmarking.</p> <p>The SME Department has been involved with other departments of the World Bank in a number of other initiatives concerning the business environment. These include:</p> <ol style="list-style-type: none"> 1 Early Warning System used by the World Bank Private and Financial Sector Development Department in Europe and Central Asia Region. 2 IFC Private Enterprise Partnership for the Former Soviet Union has developed and been carrying out a business environment surveys (http://www.ifc.org/pep) 3 World Bank Institute is leading the Knowledge Economy Assessment, which is very relevant to work on the business environment (http://info.worldbank.org/etools/kam2004/)
Availability	http://wbln0018.worldbank.org/sme/countryhomepage.nsf?OpenDatabase

Annex 3: Terms of Reference

Background and justification

In 2001 the Committee of Donor Agencies for Small Enterprise Development established a working group (WG) on SME enabling environment. The WG is chaired by the Netherlands and the following institutions are at the time permanent members: EU, DFID, GTZ, IADB, ILO, Royal Danish Ministry of Foreign Affairs, WB/IFC. However many more institutions have expressed their interest in working together with the WG on SME policy and regulatory environment, e.g. IFAD, Norad, OECD, Sida, UNIDO and USAID.

The efforts of the Working Group in 2002 resulted in the publication on “Enabling Small Enterprise Development through a Better Business Environment”, prepared by Simon White and Juan Chacaltana (Nov. 2002). The findings of this report were presented during the annual meeting of the Committee of Donor Agencies in Turin in September last year. The report focuses on the following three areas:

- The similarities and differences in donor initiatives to help countries improve their policy environments for small enterprise development;
- The content, process and outcomes of donor efforts;
- Principles of good practice.

The study also made clear that further research was necessary, in particular to:

- Better understand and further develop the business environment concept and its influence on SMEs,
- To assess donor practices and experiences with initiatives to improve the business environment for SMEs;
- Better understand the impact of international development assistance on the business environment, including the design of appropriate tools and techniques for measuring such impacts.

Taking the above into account, the Working Group decided to follow up these recommendations and commission further research divided into three steps.

As a first step a study is commissioned to better understand and assess how donor agencies plan and design their initiatives to improve the business environment for SMEs.

A second and separate study on impact (including the extent and relevance of donor coordination/collaboration) through a selected case study approach using programs which appear to show good practice will be carried out between February and May/June 2004.

In a third step and related to the outcomes of the earlier steps a “toolkit” based on an adequate methodological framework will be developed which allows donors and practitioners to get access to tools like strategies which have worked, good practices and information about how to define indicators about outcome and impact, etc.

Objective of the study

A better understanding of how donor agencies plan and design their initiatives for improving the business environment for SMEs will contribute to the Donor Committee's efforts to derive principles of good practice that could help enhance future donor collaboration at the country level.

Rationale

In recent years donor agencies have paid increased attention to the influence that the policy and regulatory framework have on the small and medium-sized enterprise (SME) sector's ability to contribute to employment creation and poverty alleviation. Concurrently, interest in the policy and regulatory environment has also been supported by a trend in interventions leading away from direct BDS support – as advocated by the Donor Committee.

However a clear understanding is needed as to why and how the enabling environment was identified by the donors/governments as a barrier to growth and which specific characteristics in the business environment may amount to a barrier. Furthermore, the relative importance of an enabling business environment and its place in an overall SME development strategy needs to be analysed.

Donor interventions directed at the business environment seldom constitute a stand-alone intervention. Increasingly they are embedded in private sector development strategies or in the frameworks provided by PRSPs, MDGs, ICAs, etc.

The collation and subsequent comparative analysis of information about the various approaches, concepts and tools being used by different donor agencies will provide further evidence as to what an enabling environment should look like in order to generate business (especially SME) growth. The causal models have to be substantiated by defining adequate indicators that allow for proper impact monitoring.

Sharing and disseminating this knowledge between the participating agencies and the wider community of the Donors Committee will allow further discussion on how to improve implementation of such programs and promote better cooperation between donors.

Strategy

The study will focus on the planning and design phase of projects and not on implementation. Therefore it will collate and analyze information on what diagnostic tools, concepts and internal processes donor agencies apply when designing new projects and programs in this field.

After collating and analyzing the information, a comparative assessment should be done with the aim of describing similarities and differences in the practices of the participating donor agencies. Special attention should be given to how donor agencies formulate outcomes and impact of their projects and what indicators are used to measure these. At this point it might be helpful to use a life cycle concept, which defines entry, operations and exit levels as decisive stages in enterprise development.

Based on these findings the study then should develop ideas of how to promote better coordination and cooperation at field level when it comes to implementation. It is also expected that best practices or successful examples will be identified which in later stages might be investigated further as case studies.

Scope of review

For the purpose of this study the definition of enabling environment for SME will be a rather narrow one. The study will focus on initiatives that support legal, regulatory and administrative reforms for SMEs. Aspects regarding the business environment for the private sector in general should be treated in this study only in regard to their relevance for SMEs.

Although identifying and categorizing diagnostic tools is an important prerequisite, the main focus of the study will be on identifying, assessing and comparing the concepts and approaches that donor agencies apply when designing their programs.

The study will focus on actually used tools, concepts and processes and not on the ones not used anymore or planned for a more distant future.

The challenge is not so much the methodology itself, but how in different programs inputs, outputs, outcome and impact this been defined as well as indicators identified and defined at each stage of the causality chain.

The above study will be carried out mainly by visiting relevant HQ. At this stage the following visits to HQ are proposed:

- Washington: WBG WB, IFC, MIGA, including relevant combined departments and specific projects (for instance FIRST); IADB, USAID, FUNDES. It is estimated that this will involve five full working days (Monday through Friday);
- Europe. Visits to ILO, UNCTAD, UNIDO, DANIDA, DFID, GTZ and EC. In addition some agencies like for instance ADB, AFdB, CIDA, and SIDA may need to be contacted by phone and e-mail. It is estimated that this will involve a total of up to 10 working days.

Allowing 3 days for preparation, 6 days for the preparation of draft report, 1 day for discussion with working group (proposed is second half January 2004 in Geneva with ILO as host) and 3 days for finalization, the total number of days, including two days for overseas traveling would amount to: 30 days.

The terms for the consultant are based on the understanding that he will receive considerable help by the participating agencies when compiling the necessary information in their headquarters. Given the tight timeframe it will not be possible for him to gather and assess the situation in each agency without proper preparation.

Guideline questions

Themes and topics covered

At the beginning it should be repeated that for the purpose of this study the definition of enabling environment for SME would be a rather narrow one. The study will focus on initiatives that support legal, regulatory and administrative reforms for SMEs in respect of entry, operations and exit requirements. Aspects regarding the business environment for the private sector in general should be treated in this study only in regard to their relevance for SMEs.

However we should be aware of the fact that it is not really feasible to agree on one common definition of the enabling environment, as many agencies have a different view on what an enabling environment is. These differences should not be glossed over. For example, some agencies consider an enabling environment is one that is "size-neutral", while others would want to see a greater emphasis given to the problems of smaller enterprises. It would be good to document the definitions that each agency has and then to compare these at the beginning of the inventory. In the "White Report" of 2002, we found that even within agencies it appeared that the field offices had a different idea of what an enabling environment is compared to their head offices.

The study will analyse and assess the planning and design process, the preferred modes of delivery and instruments, the diagnostic tools used and the expected outcome of such interventions as seen by the donor agencies.

1. Definitions and basic understanding of the terms related to enabling environment

In a first step it should be clarified how donors define the relevant subjects and terms of this study. What definitions are used for:

- Enabling environment versus business environment?

- Business sector and private sector?
- Business culture, business climate or investment climate?

2. Planning and design process

The analysis of donors' practices and approaches should cover the following aspects:

- Inventory of diagnostic tools and instruments (with attention also to size neutral respectively SME specific diagnostic work);
- The role and function of such tools in the design of programs or projects;
- The internal process of project design and planning (with attention to the extent of participation of other stakeholders);
- Internal guidelines, quality standards and frameworks to be considered;
- The main conceptual elements of programs or components (for instance process or content orientation, basic strategies and concepts; role of other actors, monitoring systems and impact orientation, etc.)
- Relevant program activities in regard to
 - Legal/regulatory/administrative reforms
 - Improvements in the business environment
 - SME level and economy wide performance outcomes.
- Responsibilities at headquarters and field level as well as internal approval procedures

3. Modes of delivery and instruments

It is evident that there are considerable differences between donors in the modes of delivery and the preference of certain instruments. Some concentrate on specific content related interventions, others prefer a process orientation focussing on capacity building. Another differentiation could be made between stand-alone and embedded interventions as well as between short term and long-term programs.

A list of such instruments includes:

- i) Consultancy advice
- ii) Training programmes
- iii) Consultation processes
- iv) Organising stakeholder workshops and cross-sector dialogues
- v) Supporting business associations with advocacy work
- vi) Capacity building for Government bodies and civil society organizations
- vii) Donor collaboration: In what areas were donors collaborating with one another? Who were the collaborating partners? Does donor collaboration work better in some kinds of interventions than in others? Did donor collaboration prove effective? Why?

The study should assess the preferred modes of delivery and instruments (stand alone or embedded) and ask how agencies view its relative advantages and disadvantages.

4. Diagnostic Tools

We have to be aware that although the Working Group uses quite a specific definition for enabling environment many diagnostic tools will be of a more general character (investment climate at large, private sector development, etc with perhaps some specific references to the SME business environment). Examples are ICAs, FIAS's ARC surveys, UNCTAD's IPRs and EBRD/WB's BEEPs, sector work/studies, PRS elements, FIRST type assistance, etc.

We are not immediately aware of tools designed to specifically look only into the business environment (adversely) affecting SMEs. It would be a major step forward if the study could identify such tools.

5. Outcome and impact as seen by the donor agencies

Here the focus will be on outcome specified in project objectives and indicators. An example could be if a respective Government passed a specific law, or changed an existing regulation to reflect an understanding and adoption of recommendations made. We need to be aware here to distinguish as far as possible if this is an outcome of a donor-supported effort or would it have happened anyway. It is to be expected that there will be few hard evidence to that; mostly the information will be on what donors expect as outcome of their ongoing projects.

Specific guiding questions might be:

- Is there any evidence at the local level of actual implementation or actions towards implementation?
- At which Government level is action towards implementation happening, central, regional, local?
- Were any institutions created or existing ones upgraded in the policy process?
- Did donors support any civil society organizations (e.g. business associations) to participate in the process? Were stakeholder workshops and dialogues facilitated through donor interventions?
- Is there any evidence on the impact of the new or reformed policies, laws and regulations on SME development, on business growth, on poverty reduction and employment generation?
- Have there been any changes made to the government's understanding of the small enterprise sector?
- Have there been any changes made to the government's attitude toward the small enterprise sector?
- Have small enterprises become more central in the government's national development plans?

Lessons learnt

- In summary, were the approaches and tools/instruments used by donor agencies successful (or can some success be seen so far)? To what extent were the individual projects' outputs achieved? What are the main reasons for a good and a bad project? What projects have worked and which have not?
- What would the respective donor agency have done different (which different approaches and tools would it have used) if they had to redo the process with the aim of most effective and visible impact (including quick wins) for SME growth and thus poverty reduction?
- What can be learnt from various approaches and tools/instruments in their attempt to help establish new policies and reform existing ones? Which specific approaches and tools can be recommended from this case for good practice guidance for future project implementation?
- What should be changed to allow for a better cooperation and coordination between donor agencies in the field?

Terms of Reference for international consultant

The role of the international consultant is to visit those key multi- and bilateral donors and agencies identified, in order to carry out the assessment and to compile the report.

It should be clear from the beginning that this study is expected to provide rather specific information about what donors are doing in relation to the guideline questions. This information should be presented adequately in the report and if necessary in annexes. Based on such specific information the assessment and comparative analysis of the different approaches will then be carried out.

The Chair of the Working Group on Enabling Environment will coordinate the international review, with help from the Working Group members for the respective Agency Headquarter visits and for contacting those agencies identified who are non-members of the Working Group.

The international consultant will:

1. Compile the information provided, and contact the multi- and bilateral agencies to obtain additional information where necessary
2. Draft a report that synthesizes and analyses the findings and that provides answers to the guideline questions
3. Present the report to the Coordinator of the Working Group on 15th of January 2004
4. Draft the final version of the report, incorporating the feedback from the Working Group until 31st of January, 2004

Annex 4: Toward a framework for monitoring change and assessing impact

The following chart is an attempt to describe the relationship between donor interventions that aim to reform the business environment for small enterprises; the instruments that are used for this purpose; the indicators of change that may be used to measure the outcomes of donor assistance; and the indicators of possible impact.

Focus of donor intervention	Donor-support reform instruments	Indicators of change (outcomes)	Indicators of possible impact
Macroeconomic policies and strategies			
Private sector development strategies	TA for reviewing and drafting strategies Bench-marking of investment climate Study tours for ministers and senior bureaucrats	New or revised private sector development strategies prepared and adopted by government Improvements in investment climate ratings Greater understanding among policy-makers for the role the private sector can play in development and poverty reduction	Increased investment in private sector
Privatization strategies	TA for reviewing and drafting strategies	Decline in the number of State-owned enterprises	Decline in government funds lost through SOEs Increased investment in private sector

Donor Approaches to Improving the Business Environment for Small Enterprises

Focus of donor intervention	Donor-support reform instruments	Indicators of change (outcomes)	Indicators of possible impact
Policy, legal and regulatory framework			
Small enterprise promotion policies	TA for policy drafting	New or revised laws prepared and adopted by government	Greater precision in government efforts to promote, govern and monitor the small enterprise sector Fewer undesired market distortions created by government Better synergies forged between small enterprise development and national development strategies Reduced marginalisation of the small enterprise sector
Business regulations	Regulatory impact assessment	Improved understanding among policy-makers and regulators of the impact of regulations on business behaviour	More efforts are taken to reduce the undesired impact of regulations on small enterprises Less regulatory bias against small enterprises
	TA for improving regulations	New or revised regulations prepared and adopted by government	Fewer obstacles or constraints on small enterprise activities (e.g., fewer procedural steps for compliance)
Property rights and contract enforcement	TA for improving property laws and regulations	New or revised property laws and administration procedures prepared and adopted by government	Fewer disputes involving claims over property
	TA for improving contract laws and enforcement mechanisms	New or revised contract laws and enforcement mechanisms prepared and adopted by government	Shorter times for small enterprises to obtain a judgement from commercial courts
Tax, trade and labour issues	TA for improving specific policies, laws and regulations	New or revised policies, laws and regulations	

Donor Approaches to Improving the Business Environment for Small Enterprises

Focus of donor intervention	Donor-support reform instruments	Indicators of change (outcomes)	Indicators of possible impact
Governance systems			
Improving the performance of government ministries	Organizational capacity building (training, organizational development)	Government ministries have clear implementation strategies and work plans	Greater responsiveness by government to the current needs and opportunities of the small enterprise sector
Improving the performance and accountability of regulators	Organizational capacity building	<p>Staff have been trained and are better equipped to perform their functions effectively</p> <p>Regulators operate in a more transparent and accountable manner</p> <p>Staff have been trained and are better equipped to perform their functions effectively</p>	<p>Less corruption and rent-seeking by regulatory authorities</p> <p>Fewer regulatory obstacles and constraints to small enterprise activities</p> <p>Greater involvement of the private sector (especially small enterprises) in regulatory activities (e.g., self-reporting, business associations involved in self-regulation and managing regulatory functions)</p> <p>Greater efficiency within regulatory authorities</p>
Improving the representation and advocacy of small enterprises	<p>Supporting the development of business representative organizations</p> <p>Support for public-private dialogue</p>	<p>Increase in the number of small enterprises participating in chambers of commerce and other forms of business organization</p> <p>Chambers of commerce and other forms of business membership organizations have a clear advocacy agenda</p> <p>Increase in the number of formal and informal consultations between government and chambers of commerce and other forms of business</p>	<p>Improved representation of small enterprises in chambers of commerce and other forms of business organization</p> <p>Improved benefits for small enterprises to join chambers of commerce and other forms of business organization</p> <p>Stronger 'voice' for reform within the small enterprise sector</p>

		membership organizations	
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Annex 5: Reforming the business environment to achieve MDGs

How reforms to the business environment for small enterprises can contribute to achieving the UN Millennium Development Goals:

- 1 By removing the constraints and barriers to enterprise growth the business environment can enable small enterprises to contribute more to economic growth and, hence, to the first goal of the MDGs (i.e., the eradication of extreme poverty and hunger).
- 2 By removing the constraints and barriers to participation by the poor in the private sector, a better business environment will contribute to the first goal of the MDGs (i.e., the eradication of extreme poverty and hunger).
- 3 By removing the constraints and barriers to women's participation in markets and female-owned enterprises, reforms to the business environment can contribute to the third MDG (i.e., the promotion of gender equality and empower women).
- 4 By improving financial flows into poor households, a better business environment for small enterprises will help poor households gain access to maternal health care (MDG Number 5) thus reducing child mortality rates (MDG Number 4).
- 5 By improving compliance rates among small enterprises, the business environment can be reformed to ensure that sound environmental laws and regulations are enforced to promote environmental sustainability (MDG Number 7).
- 6 By integrating national business environments with global trade and investment opportunities, reforms to the business environment can contribute to a global partnership for development (MDG Number 8). Specifically, this is achieved through the:
 - Promotion of an open, rule-based, predictable, non-discriminatory trading and financial system, and a commitment to good governance, development, and poverty reduction
 - Development and implementation of strategies for decent and productive work for youth
 - Transfer of new technologies, especially information and communications

The diagram on the following page illustrate the above.

Specific business environment reforms and their contribution to the UN MDGs

