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**Private Sector Competitiveness
Enhancement Program**

PRIVATE SECTOR COMPETITIVENESS ENHANCEMENT PROGRAM

**FY 2009 QUARTER ONE REPORT
OCTOBER – DECEMBER 2008**

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PRIVATE SECTOR COMPETITIVENESS ENHANCEMENT PROGRAM

Quarterly Report

FY 2009 Quarter One (October – December 2008)

EXECUTIVE SUMMARY

USAID launched the Private Sector Competitiveness Enhancement Program (PSCEP)—a three-year, US\$6.6 million program implemented by Chemonics International Inc.—on September 25, 2008. In this initial quarter of operation, Chemonics necessarily focused its efforts on administrative start-up, including establishing the office and recruitment of local staff. Nonetheless, the PSCEP team hit the ground running in a number of key technical areas and began forging institutional relationships, thus demonstrating the program's commitment to delivering results quickly, and providing the foundation for accelerated results later this year.

During the first quarter, PSCEP made important progress in identification of target sectors and local business development service (BDS) providers, as well as association building. Actions included:

- Development of the Work Plan. The work plan serves as the strategic and operational map for PSCEP activities for year one. PSCEP is finalizing the work plan for submission to USAID and MOED.
- Analysis of Domestic Resource Costs (DRC). The DRC analysis will assess the economic, as well as the financial profitability of sector value chains in Azerbaijan's economy. The first phase of the DRC analysis, undertaken in November and December 2008 focused on the 15 non-oil sub-sectors likely to have the greatest potential for growth of income, trade, and employment. The second phase of the analysis, will focus on an additional 15 sub-sectors, and is scheduled to begin in January 2009.
- Qualitative Sector Assessments (QSA) and Action Plans. PSCEP consultants undertook Action Plans for poultry, dairy, manufacturing support services, and food safety in November and December 2008. In the second quarter, the consultants who assessed these sectors will be returning to Azerbaijan to implement the respective action plans. The project will undertake QSAs in additional sectors including: cold storage and warehousing for fruits and vegetables, packaging materials, information and communication technology (ICT), finance and investment, and greenhouses starting in January 2009.
- Local Business Development Service (BDS) Providers. The project identified the leading BDS providers in the northern, southern, central, and western regions of Azerbaijan through a series of site visits. After introducing the program, PSCEP

released a request for expressions of interest to which a total of twelve potential BDS providers— 3 from each region (Guba, Ganja, Lankaran, and Sheki)—responded. The project is currently vetting proposals with the Ministry of Economic Development (MOED), with final selections expected to take place in the second quarter.

- Alliance Building. PSCEP began building strong relationships with the AIC, the Caspian International Investment Company (CIIC), and British Petroleum (BP), as well as the MOED, our key government counterpart. Discussions on program cooperation are ongoing, including development of Memoranda of Understandings (MOUs) to identify common interests and responsibilities. These relationships will provide a solid foundation for program activities in the future.

While there are still some issues that need to be addressed, such as bonus structures for local staff and the regional BDS providers, the program is demonstrating its commitment to deliver results quickly and effectively. As mentioned briefly above, expectations for the second quarter are just as high, with:

- The awaited results of the DRC analysis,
- The analysis of the second round of QSAs and implementation of the Action Plans for the first four sector assessments,
- The expected contracting with local BDS providers in the four regions of Azerbaijan, and
- The finalization and formalization of MOUs with AIC, CIIC and perhaps BP.

I. PSCEP Project Components

The USAID Private Sector Competitiveness Enhancement Program (PSCEP) is a \$6.6 million, three-year program financed by the U.S. Agency for International Development and the people of the United States, designed to promote the competitiveness of select sectors of Azerbaijan's economy in order to create jobs, increase exports, and generate investments. PSCEP is implemented by Chemonics International Inc. Our chief counterpart with the Government of Azerbaijan (GOAJ) is the MOED.

The project will work in six sectors and at least eight sub-sectors, and possibly as many as twelve. At least two sub-sectors will be in the agricultural-industry: fruits and vegetables (fresh and processed) and animal products. Other possible sectors include manufacturing support services for the oil industry, finance, light industry logistics, and ICT. Most of PSCEP's work in these sub-sectors will be at a more disaggregated level (e.g., fruit juices and concentrates, dairy, poultry, etc.). The project employs a rigorous methodology for sector selection including a quantitative DRC analysis, which aims to identify major distortions impacting these resources, as well as qualitative market constraints, and opportunities analysis, aimed at identifying the most dynamic non-oil sectors. Sectors initially selected will pass through a more rigorous qualitative review to determine final selection.

PSCEP will build on previous USAID and other donor projects that focused on enterprise level assistance and established numerous BDS providers in the regions. PSCEP's strategy, however, envisions enterprise-level assistance as a means to generate greater economic impact at the sector level. That is, activities will be focused not just on assistance to individual enterprises, but how this assistance, as well as other project activities, results in the enhanced competitiveness of the sector or sub-sector. PSCEP's approach focuses on two components:

- Value chain enhancement:
 - Strengthening and effectively utilizing BDS providers
 - Enhancing access to finance and investment capital
 - Promoting food safety and other technical standards
 - Fostering market linkages (identifying buyers and establishing and managing buyer-seller relationships)
 - Addressing value chain constraints such as logistics, distribution, quality, packaging, etc.
- Enhancement of associative relationships:
 - Creating public-private partnership and dialogue
 - Establishing and strengthening clusters and/or associations
 - Supporting outsourcing by larger firms
 - Promoting "social capital" and stakeholder trust

II. Activities and Accomplishments in the First Quarter of Fiscal Year 2009

In this initial quarter of operation, Chemonics necessarily focused its efforts on administrative start-up. Nonetheless, the PSCEP team initiated a number of key technical activities and began forging institutional relationships that are demonstrating the program's commitment to delivering results quickly. The activities undertaken in the first quarter (October – December 2008) are detailed below.

A. Administrative and Project Start-up Activities

October 2008. Chemonics and USAID signed the PSCEP contract on September 25, 2008. Chemonics deployed a three-person administrative start-up team to Baku on September 30th, which conducted local recruitment from October 1-13th.¹ The team quickly contracted an office manager, an accountant, an administrative assistant, and driver, who began working in the second half of October. On October 9, 2008, Chemonics mobilized key expatriate personnel: Chief of Party Danilo Cruz-DePaula, (COP) and Deputy Chief of Party Matthew Weber (DCOP).

During this period, the start-up team also located office space for the project at 10 Mammadaliyev Street. The project signed the lease for the office on October 20, 2008, and subsequently took possession of inventory from former USAID projects and completed office make-ready. Long-term accommodations for expatriate staff were also identified by the end of October. PSCEP also began a dialogue process with the MOED to present and update them on project activities.

November 2008. Following the period of preparation and office make-ready, PSCEP staff began work in the project office on November 10, 2008. Chemonics finalized the documentation to open a bank account on November 25, 2008. Training of local administrative staff continued with the deployment of the Operations Specialist Mary Ross to instruct local staff on USAID compliance. The project also established hard-copy and e-files, as well as procedures for office administration, recruitment, contracts and procurement. Local recruitment continued with hiring the first of the Value Chain Specialists. A TIRSP-PSCEP Joint Emergency Action Plan was also developed by local administrative staff during this period.

December 2008. Local recruitment continued with formal job offers to the remaining Value Chain Specialists. PSCEP also mobilized Field Accountant Marie Elliot to install the Abacus accounting software and to train the local accountant and administrative team to ensure compliance with USAID accounting rules and regulations.

PSCEP finalized the draft of the field office policy manual, and other key documentation including, the approvals matrix to ensure contract compliance and communication. Property was also transferred to PSCEP from TIRSP to provide an office meeting space and additional work stations for staff and short-term consultants.

¹ Given the long time period from the proposal to award, none of the proposal stage local staff remained available.

B. Program Activities

Work Plan Completed. The work plan is the key document providing a strategic and operational guidance for PSCEP activities for year one, especially during the first six months of operations. PSCEP mobilized a local consulting firm to support this effort. Three senior experts with expertise in finance, BDS development, and agribusiness assisted the COP and DCOP in this key task. The brainstorming sessions and review of other USAID projects worldwide were key contributions to work plan development and to the inclusion of several innovative approaches in the work plan, such as an incentive-based compensation system for BDS providers. The monitoring and evaluation plan is pending.

DRC Analysis. The DRC analysis estimates the economic, as well as the financial profitability of entire value chains, and the individual segments within these chains. It also calculates the degree to which the chains are subject to positive or negative protection in relation to world market conditions. The analysis identifies major constraints regarding tariffs and subsidies and non-tariff costs that affect the prices of tradable outputs and inputs, as well as variations in benefits and costs associated with location of production, location of markets, scale of activity, and other factors. This comprehensive analysis reveals critical areas which require development of a strategy for targeted assistance. In addition, the analysis covers numerous qualitative dimensions of comparative advantage related to infrastructure, market development, human resource constraints, and other issues that may impact on the sub-sector.

In November 2008, senior economist, Dr. Dirck Stryker, one of the pioneers of DRC methodology, conducted the analysis for PSCEP. PSCEP divided the analysis into two phases consisting of 15 sub-sectors each. The first phase focused on the 15 non-oil sub-sectors likely to have the greatest potential for growth of income, trade, and employment. PSCEP identified the following broad sectors as offering sufficient potential to be screened for further quantitative analysis:

- Fruit and vegetable processing (including nuts and related products)
- Animal husbandry and related products (dairy, meats, others)
- Light manufacturing and non-oil services related to the petroleum industry
- Textiles and carpets
- Construction finishes
- ICT
- Tourism
- Furniture

The DRC team met with local consulting firms and through a competitive bidding process contracted three to lead interviews, field surveys, and data collection in Lankaran, Guba, Ganja, Barda, and Baku.

Ultimately, PSCEP chose these 10 sub-sectors for further quantitative analysis:

- Early Potatoes
- Hazelnuts
- Persimmons
- Greenhouse vegetables (tomatoes and cucumbers)
- Cherries
- Pomegranates
- Pomegranate juice
- Apples
- Poultry
- Dairy

In addition, five other sub-sectors outside of agriculture were identified as offering similar potential:

- Packaging materials
- Trade and transportation
- Furniture
- Construction finishes
- Waste management

The project will finalize the first report and to conduct the second-stage assessment on an additional 15 sub-sectors (detailed below).

Qualitative Sector Assessments and Action Plans. In November and December 2008, PSCEP led the following qualitative sector assessment.

- Poultry. In December, Dr. Tom Fattori arrived in Azerbaijan to conduct a value chain assessment of the poultry sector, including table eggs and broilers. The Action Plan identified the key players in a highly vertical industry. Among its findings, it indicates that even the sectors' leading firms do not fully understand key productivity and income drivers. It recommended the introduction of financial models, geared to assisting firms to generate this information. Furthermore, it showed that the moribund Azerbaijan Poultry Society—a weak industry group—could be strengthened and trained to provide this assistance. The Action Plan calls for:
 - Building customized poultry business models geared to increase productivity,
 - Enhancing the Azerbaijan Poultry Society,
 - Developing strategic plans, and
 - Enhancing access to finance and investment by permitting these companies to be able to demonstrate the impact of an investment on the profitability of their overall business.

The project will begin Action Plan implementation in January 2009.

- Dairy. In December 2008, Mr. Albert Wanous assessed the Azerbaijani dairy sector. The consultant's assessment highlights the weak links in the dairy value chain, specifically the production function. Low milk yields and the large number of small

farms which are geographically scattered increase assembly costs and make it difficult to maintain quality. In addition, the poor quality of raw milk prohibits the production of some value added dairy products and limits the shelf-life of even the most basic products. Poor hygiene on the farm and gaps in the cold chain are major reasons for this quality problem. The assessment concludes that primary effort needs to be focused on the production function of the dairy value chain:

- Improving dairy cattle nutrition and genetics;
- Increasing the productive use of irrigation water;
- Improving raw milk and dairy product quality;
- Supporting human resource development; and
- Developing, supporting and strengthening relevant dairy industry associations and institutions.

PSCEP is assessing Action Plan findings with follow-on steps to be implemented in January and February 2009. When they are thoroughly vetted by the program, we will share these Action Plans with key counterparts such as the MOED and AIC.

- Food Safety and Quality Management. In December 2008, Chemonics contracted Dr. Tom Deeb, a consultant with many years experience with USAID programs in the Azerbaijani agribusiness and food safety sectors (including policy-related work in this area under TIRSP), to prepare the value chain assessments for the food safety sector and manufacturing support services (see below). While food safety will not be a sector unto itself within the project, the implications underline many of the sectors with which the program will work, such as: poultry, dairy, juice, selected fresh fruits and vegetables, nuts, processed meats, and catering. This is a key activity for exporting in agribusiness, as well as increasing local sourcing for firms such as BP. Implementation activities will begin in February 2009.
- Manufacturing Support Services. Manufacturing support services (MSS) represents one of the largest and complex sectors within the Azerbaijani economy, in which enablers allow oil, gas, steel, chemicals, and processed food sectors to function. MSS includes a broad range of activities from language courses and translation to the delivery of satellite services, weather forecasting, and high tech repair of equipment and machines. These services in some cases, such a maintenance, repair, and heating, ventilation and air-conditioning (HVAC), provide an opportunity for the creation of highly skilled, higher paying jobs that do not require a university degree, but instead are based on having acquired vocational skills, and the development of highly profitable businesses in Azerbaijan. Activities in December focused on discussions with BP and their suppliers on cooperation with PSCEP. These discussions resulted in a positive response from BP, with implementation to begin in February.

Identification of Local BDS Providers. In December 2008, PSCEP completed a series of visits to the northern, southern, central, and western regions of Azerbaijan. Initial visits focused on better understanding the universe of potential BDS providers across Azerbaijan. Follow-up visits centered on introducing the objectives of the program and

attracting proposals from those BDS providers interested in working on the project. PSCEP published an “Expression of Interest” (EOI) for applications on December 18, 2008, from which PSCEP received a total of 12 proposals – three from each region (Guba, Ganja, Lankaran, and Sheki). PSCEP will evaluate the proposals in January, including input from the MOED and the AIC, to select the finalists for each region.

Alliance Building. A key tenet in PSCEP’s strategy is to leverage funding and know-how by developing strong relationships with key institutions. During the first quarter, PSCEP began building strong relationships with the AIC, CIIC, and BP. Discussions on program cooperation are ongoing. In the second quarter, PSCEP will also establish a more formal process of consultation and coordination with the MOED.

PSCEP worked closely with the AIC in undertaking its first regional “road show” in Guba to educate and inform area entrepreneurs and leading businesses on: “what is private equity,” the AIC mandate, and how USAID through PSCEP and the AIC are working together to generate investments. This was an extremely important event for AIC, which they acknowledged, could not have been undertaken without PSCEP support.

The PSCEP team developed draft MOUs with the AIC and the CIIC to formalize future cooperation between the parties. These MOUs will be signed in the second quarter.

Discussions are also ongoing with BP regarding how PSCEP can work with the Enterprise Development and Training Program (EDTP), implemented by ACDI/VOCA, to localize and develop their supply chain. Specifically, the discussions have focused on:

- Training designed to alleviate key bottlenecks faced by BP suppliers:
 - Quality Assurance and Quality Control
 - Health, Safety and Environment
 - Business Management
 - Project Management
- Tier 1 supplier assistance, to help them localize their supply chains.
- Special projects, i.e.: working with specific sectors like maintenance, repair and overhaul (MRO) at the request of BP.
- Legacy building, i.e.: to work in collaboration with EDPT to build a local organization that could provide these services in the long-term.

Sheki Regional Development. In support of USAID’s commitments and programs in Sheki, the PSCEP team undertook three visits to meet with key stakeholders, including the regional MOED representatives, the Regional Executive Authorities, regional business, civil society, and other stakeholders. The PSCEP team identified several business opportunities, including fresh water fishing, dairy, and agribusiness.

C. Progress against Program Components

PSCEP will begin reporting on progress against program components in the second quarter of 2009 when program activities are underway.

III. Activities Scheduled for the Second Quarter of Fiscal Year 2009

A. Administrative/Management Activities

- Select monitoring and evaluation specialist and grants managers to complete local staffing.
- Submit the Policy Manual to USAID

B. Program Activities

Activities planned for the second quarter (January – March) 2009 include:

Work Plan Submission. The project will deliver the edited, final version of the work plan in January. We will share and discuss the work plan with key Azerbaijani counterparts, especially the MOED.

DRC Analysis – Part 2.

- Dr. Stryker will arrive in mid-January to finalize the first DRC analysis (detailed above) and to begin with the assessment of the second set of sub-sectors.
- The preliminary selection of the 15 sub-sectors include:
 - Wheat
 - Apple juice (for European markets)
 - Feed corn
 - Feed mills
 - Processed meats
 - Carpets
 - ICT (specific area to be identified)
 - Catering services
 - Bee keeping
 - Tomato Paste
 - Freight Forwarding
 - Waste management
 - Spare parts
 - Transshipment trade
 - Citrus
 - Possible Alternatives: Olives, Cotton, Construction Services

Sector Value Chain Action Plans. As detailed above, PSCEP prepared the first four value chain assessments in quarter one. In January and February 2009, these consultants will be re-fielded to begin Action Plan implementation, solidify MOUs with enterprises and

associations in the specified sectors, and begin capacity development activities. In addition, the second round of value chain assessment will begin with cold chain and warehousing for fruits and vegetables, packaging materials, ICT, finance and investment, and early potatoes.

BDS Provider Selection. PSCEP will finalize the selection of BDS providers in Guba, Ganja, Lankaran, and Sheki, once comments and ratings on the proposals have been received from USAID, MOED and AIC. Activities will include final interviews and selections in January and February, and contracting in February.

Alliance Building.

- Azerbaijan Investment Company.
 - Finalize MOU;
 - Develop and begin implementation of training program;
 - Continue implementation of road shows in Ganja, Lankaran, and Sheki; and
 - Begin assistance to target companies in order to catalyze investments.
- Caspian International Investment Company.
 - Finalize MOU;
 - Assess products and discuss new product development;
 - Continue implementation of road shows; and
 - Begin due diligence on and provision of assistance to target companies.
- British Petroleum.
 - Formalize MOU,
 - Develop Action Plan,
 - Begin delivering assistance in key areas.

Sheki Regional Development. PSCEP will develop a formal implementation plan for Sheki, in conjunction with the USAID Sheki Regional Development Team, and begin delivering assistance to firms.

IV. Issues

A. Administrative Issues

- BDS bonus structure needs to be formalized and approved.
- Local salary bonus structure needs to be approved.
- Have experienced difficulties in obtaining VAT-exempt letter from government to ensure that PSCEP does not pay local taxes for procurements.

B. Programmatic Issues

- The relationship with the chosen providers needs to be developed carefully. Undoubtedly, by far the strongest BDS providers in the country are those that USAID

previously supported through the Azerbaijan Business Assistance Development (ABAD) program, Rural Enterprise Competitiveness Project (RECP) and other efforts. Still, some of these providers will require institutional support. This will have to be incorporated into the PSCEP work plans with these BDS providers, while they generate concrete results. Given the project's limited budget for BDS strengthening, this will be a major challenge.

- The DRC analysis is a resource (time and budget) intensive activity much greater than originally anticipated or budgeted. It is generating strong interest from the part of the Government of Azerbaijan, the private sector, donors and other stakeholders and will serve as useful tool not only for PSCEP, but for USAID to dialogue with the government on investments and subsidies. Accordingly, we are fully committed to delivering a top-notch analysis. Nonetheless, it is consuming a significant part of our technical assistance budget.

ANNEX A: PSCEP HIERARCHY OF OBJECTIVES AND YEAR 1 BENCHMARKS

