

BDS Market Development:

A Guide for Agencies

Draft for discussion only



Widening the circle, moving ahead

MICROENTERPRISE BEST PRACTICES

Development Alternatives, Inc., 7259 Woodmont Avenue, Suite 200, Bethesda, MD 20814, USA



A USAID funded project, implemented by DEVELOPMENT ALTERNATIVES, INC. in collaboration with ACCION International, Foundation for International Community Assistance, Harvard Institute for International Development, International Management Services, Christian Aid, Fairtrade, Grameen Bank, International Labour Office, Oxfam, Rural Finance Program, Community International, and the Business Process Center and Innovation Network



**BDS Market Development:
A Guide for Agencies**

Prepared for the BDS 2000 Training Programme
at the Springfield Centre for Business in Development
Glasgow, Scotland

by

Alan Gibson
Marshall Bear

July 2000

This work was supported by the U.S. Agency for International Development, Bureau for Global Programs, Center for Economic Growth and Agricultural Development, Office of Microenterprise Development, through funding to the Microenterprise Best Practices (MBP) Project, contract number PCE-C-00-96-90004-00.

Alan Gibson is a co-founder of the Springfield Centre for Business in Development. With a background in economic and business consultancy, he has particular expertise in business development services. In 1996-97, he led the consultancy assignment that eventually led to the Committee of Donor Agencies' publication BDS for SMEs: Preliminary Guidelines for Donor-Funded Interventions. This established the basic principles of good practice which have underpinned the recent revival of interest in BDS. He has been responsible for managing and editing seven major case studies on BDS practice, advised many agencies on DBD design and development and has co-facilitated real and virtual conferences on BDS. He is the director of the BDS 2000 Training Programme for which this publication was written.

Marshall Bear has worked in international development for 27 years as a manager, microenterprise specialist, trainer and author. Most recently, he coordinated the MBP Project initiative in BDS where he explored various topics including how to build markets for BDS and how to measure the performance of donor supported BDS projects. His most recent publication explored the use of information and communication technologies for MSE development. Mr. Bear is one of the three core trainers for the BDS 2000 Training Programme.

1. Introduction

After many years' experience promoting business development services (BDS) for SME development, there is increasing recognition of two facts:

1. BDS is an important aspect of wider development efforts aimed at economic and private sector development; and
2. past (and current) approaches have often failed to achieve sustainable, meaningful impact.

Recognising these facts, the last few years have witnessed a major change in development agencies' thoughts and actions emphasising the importance of developing more effective markets of BDS. This *paradigm shift* - as some have coined it - is still an evolving creature that inevitably leaves some questions unanswered. Moreover, there is still a limited amount of hard experience on which to build clear, quantifiable *proof* of success. Nonetheless, the views represented here are much more than development *fad*; they represent the results of a rigorous process of collective analysis and experimentation since the mid-1990s. This is where we - the development community - are in how we think donors should intervene to support BDS.

This document aims to summarise the main content of the key *core skills* sessions in the BDS Training Programme in Glasgow in July/August. It is not an exhaustive trawl through the literature nor does it seek to be comprehensive in its analysis of all factors relating to BDS; it aims rather to be a useful complement to the more detailed issues addressed during the programme. It is structured as follows.

- Section 2 summarises the key arguments for donor support for BDS and for the emphasis on BDS market development and, from this, provides a working definition.
- Section 3 outlines the key design principles, developed on the basis of donor experience, that underpin approaches to BDS market development.
- Section 4 develops an analytical framework for understanding markets and links market analysis to intervention choice.
- Building on this, Section 5 summarises two key market research tools that can be used to analyse markets.
- Section 6 presents a framework for developing an explicit view of sustainability by linking market functions with key market actors.
- Section 7 highlights some core challenges in implementing successful BDS interventions.
- Finally, Section 8 outlines some core distinctive issues relating to monitoring and evaluation in BDS

Appendix 1 outlines some key terms used in describing BDS interventions and this may be a useful starting point in reading the document.

2. BDS market development: the why and the what.

This Section sets out the basic rationale for BDS market development. It summarises its distinctive features compared with previous approaches and, in doing so, offers a new definition of BDS and lays the basis for the remainder of the document.

As with all donor interventions, ultimately development agencies' interest in BDS market development has to be justified on the basis of the contribution it can make to wider development objectives, especially the overarching goal of poverty reduction. At the heart of this linkage between BDS and poverty reduction (Figure 1) are four related arguments (*whys*).

2.1 Why private sector development?

Fundamentally, people are poor because they lack access to income-earning opportunities and the capacity to respond to these. The objective of development agencies is to develop an environment that addresses these causes of poverty. For the last decade at least, the general approach pursued by most agencies¹ in pursuit of this objective has been the so-called *market friendly* strategy based around four related elements:

¹ Summarised in the World Development Report of 1991

1. Stable macro economy: including sound fiscal and monetary management, appropriate taxation policies, reducing corruption and privatisation of non-core activities.
2. Competitive micro economy: including freeing markets to restore the allocative power of prices, reforming unnecessary regulation, enshrining property rights, ending anti-competitive practices and delivering key "public goods" such as infrastructure.
3. Global linkages: including opening domestic markets to international trade and investment in goods and services.
4. Investing in people: including state investment in basic health care, nutrition, family planning and children's education.

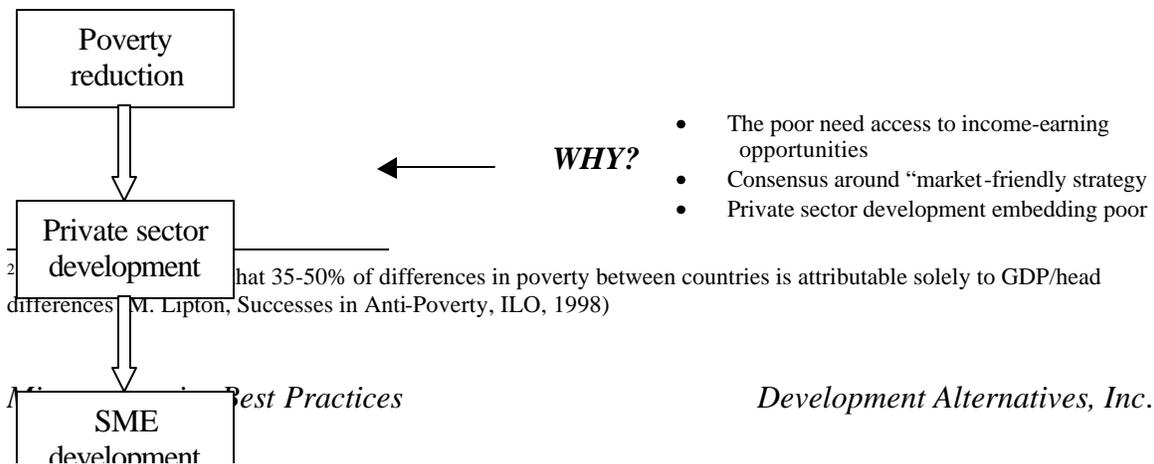
Agencies generally share this view of development and while there may be arguments over the minutiae of each component, aid resources are invariably channelled into the framework created by these four parts. The essence of this view is a more focused role for the state and greater freedom for markets to function properly so allowing more vigorous private sectors to develop. How do the poor benefit from this strategy, especially from private sector development? Benefits should come in a variety of ways but in particular through:

- Opportunities for employment
- Opportunities for self-employment
- Improved access (as consumers) to goods and services

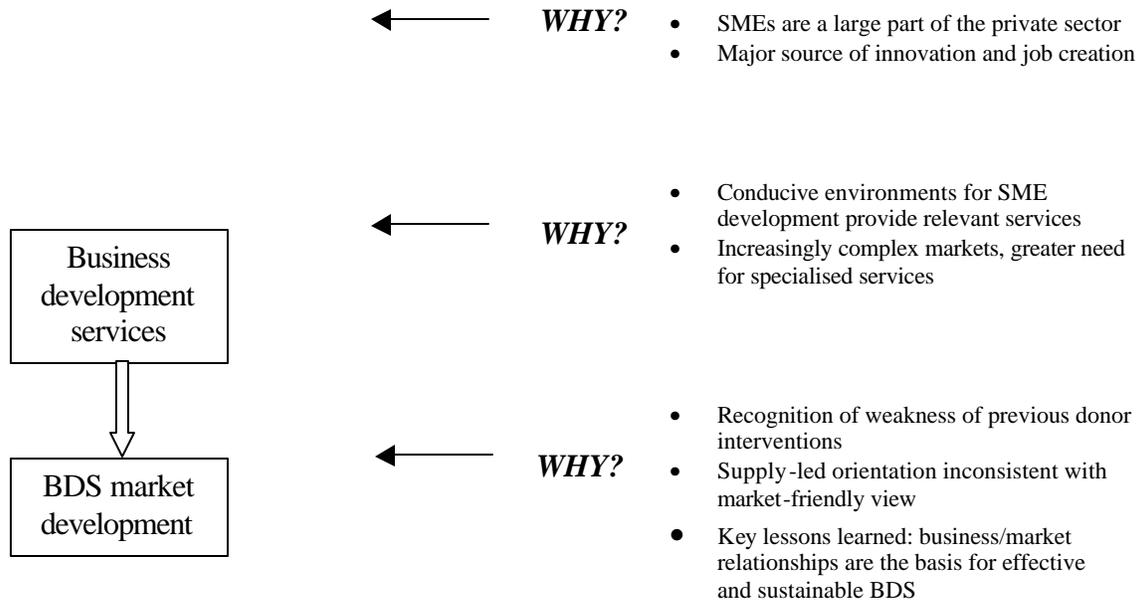
The greatest reductions in poverty in developing economies (in East Asia) have taken place where growth, fuelled by private sector development, has been strongest.²

All of the above empower the poor by embedding them into markets - for labour, for services, for goods - and the opportunities for earning (and for learning) that markets present. This view doesn't underestimate the importance of welfare provision and social protection but it does make clear that the only way for the poor to advance is within an environment where they - like everyone else - are *players* in the market place.

Figure 1: The four *whys* linking BDS with market development



within markets



2.2. Why SMEs?

While private sector development overall can be seen to be a key goal for development agencies, why should SME development be a particular focus? Without entering into a protracted debate about the role and characteristics of small businesses, three basic points can be made here:

1. The private sector is mainly SMEs!: depending on the definition one uses, in most economies, most people are employed (or self-employed) within SMEs. We can't look at private sector development without looking at SMEs.
2. Entrepreneurial economies need SMEs: in a changing economic context, SMEs are a strong source of innovation, dynamism and job creation. There does appear to be a close correlation between new business creation, business growth and employment creation - even taking into account high death rates among SMEs. Certainly, in industrialised countries, net employment growth is strongest in small firms (Table 1) - although characteristically, a large proportion of new jobs are created by a small number of fast growing firms. In developing economies, recent evidence from Africa has highlighted the greater sustainability of jobs created from SME expansions rather than often short-lived start-ups.³

³ Liedholm and Mead (1999); Small enterprises and economic development: the dynamics of micro and small enterprises

Table 1: Net employment change by business size in selected countries (average annual change as a percentage of total employment)

		<u>Total</u>	<u>1-19</u>	<u>20-99</u>	<u>100-499</u>	<u>500+</u>
Canada	1983-1991	2.6	2.2	0.6	0.1	-0.3
France	1987-1992	0.9	0.4	0.4	0.3	-0.2
Italy	1984-1992	1.3	1.5	-0.2	-0.2	-0.5
UK	1987-1991	2.7	1.6	0.4	0.3	0.4

Source: OECD

3. But we can't forget the bigger businesses: we need to beware of "romance" over SMEs. Larger businesses - including foreign companies - have access to resources that allow them to play a role beyond SMEs in many sectors. This is not a case of "big is bad; small is good".

2.3 Why BDS for SMEs?

A focus on SME development grows directly from development agencies' overarching poverty-reduction objective and, in pursuit of this, their commitment to an environment promoting the private sector. Key aspects of this environment are, of course, the macro-economic context and public investment in people. However, more immediately for SMEs, access to services is a vitally important dimension in their business environment (Figure 2) and a key factor in determining the competitiveness of economies.

- SMEs have a range of different "needs"⁴ that are critical to their survival and growth. The nature of these will be influenced by sector and stage of SME development but will relate to their ability to, for example, find customers, design products, enhance productivity, improve administration, communicate effectively, and access new technology. The degree to which these needs are met will have a major influence on business success.
- Financial services are a critical part of this immediate environment but cannot meet all business needs.
- Environments that are conducive to SME development provide relevant differentiated services to meet these needs on an informal or formal basis.
- Potentially, a range of providers offer these services to SMEs. In the most entrepreneurial situations, private sector companies and formal and informal networks are the most important players.

⁴ Needs are concerned with inputs to (administration, people, technology, etc.) and outputs from (access to markets, customers, etc.) SMEs.

The importance of BDS for SMEs has been re-emphasised strongly by the explosion in services in industrialised nations in recent years. Lying behind this trend are two key, related factors:

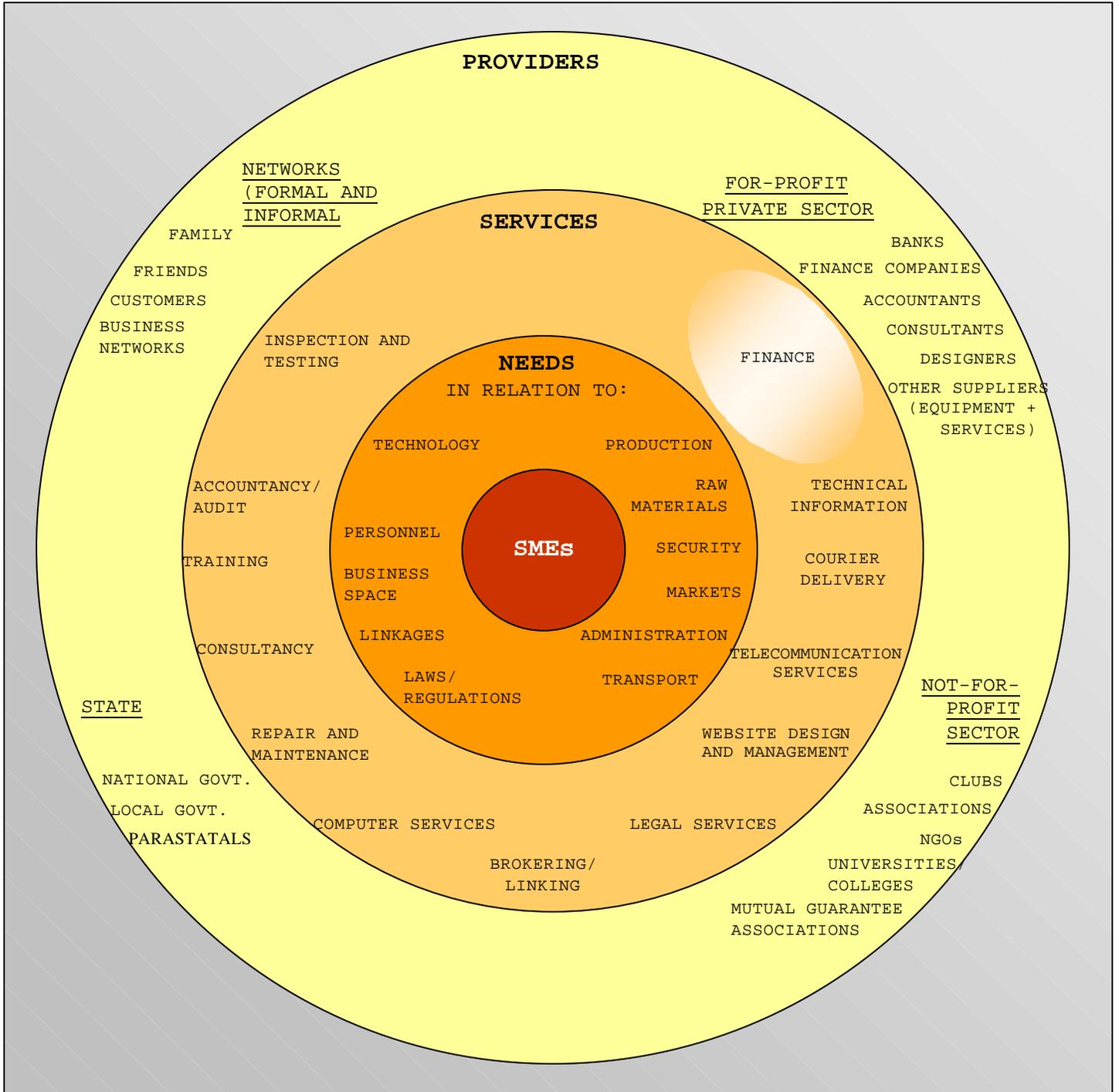
- In a global economy, increasingly complex, specialised and competitive markets;
- In this context, a realisation that to remain competitive, businesses can't be good at everything, need to focus on their own *core competence* and use external specialists for other functions.

2.4 Why BDS market development?

Many donors have long held the view that SMEs need more than finance and have intervened in a variety of ways to support the provision of non-financial services to SMEs. It is our analysis of this experience that has created a new, different focus on market development. In particular there is now widespread acceptance that:

- the results of many interventions in relation to outreach, sustainability and impact have been disappointing;
- a key cause of poor performance has been a supply-led orientation where development agencies decreed what was good for SMEs (rather than listening intelligently to them);

Figure 2: Bringing coherence to BDS: needs, services, and providers



- the key general points in a "market-friendly" environment have not been transferred to BDS for SMEs; the prevailing view has been that many BDS should be an extension of the state. Indeed many donor-supported interventions, especially in low-income countries, have contributed to massive distortion of markets;
- donors failed to learn key lessons from microfinance, notably that poor people (and SMEs) are prepared to pay realistic prices for useful services; they are discerning consumers (just like everyone else), desirous of good services, not charity.

During the 1990s, these key points of learning from donor experience became apparent - especially through a major review commissioned by the Committee of Donor Agencies for SME Development (see Section 3). The lesson was clear: the basis for effective and sustainable BDS is business and market relationships between providers and SMEs.

2.5 So what's new about BDS market development?

The above rationale encapsulates four major differences between the new paradigm of BDS market development and previous "conventional" approaches to BDS.⁵

a) What we believe (stated or implied)

	<u>The old</u>	<u>The new</u>
SMEs as:	Thankful beneficiaries of charity	Discerning consumers of services
Key providers:	Government/government organisations	Private sector in functioning markets
BDS as:	Primarily public goods	Private services
BDS financed:	Primarily by the state	Through provider-consumer transactions

b) What BDS is

The old: previously, definitions of BDS, reflecting the above beliefs, emphasised donors' (supply-side) view of what was *good* for SMEs, focusing on training and counselling.

The new: from a market development perspective the definition of BDS is one that reflects SMEs own view (demand-side) and is therefore much broader, in keeping with the breadth of services suggested by Figure 2. BDS is:

⁵ In reality, there have been gradations of change among agencies over a number of years rather than the sudden dramatic shift implied here.

Any non-financial service to business, offered on either a formal or informal basis

Such a brief but broad definition requires further clarification. We need to break it down further to make sense of it.

Included are:

services such as: training/skills development, design, advertising, network brokering, courier delivery, computer services, business consultancy, security services, legal services, commission sales, accountancy/audit, market research, technical information, website design and management, equipment repair and maintenance and conference organising.

These correspond approximately to intermediate or producer services (within the broad tertiary or services sector) as defined in the standard industrial classification; i.e. services that are sold from one business to another (and not to the final consumer).

Included are:

“services” where no formal fee-paying transaction takes place and which are hidden in economic statistics but which, nonetheless, are important. Especially important here are services offered formally or informally from one business to another (e.g. advice, training, introductions, market information)

Excluded are:

- Financial services⁶
- Physical products: manufactured goods or raw materials
- Utilities: water, electricity, and gas
- Government services aimed at the wider community, including but not only for, business such as infrastructure, community and social services and basic health care and education.
- Advocacy: for the business community as a whole (rather than individual businesses)
- Buying services: where the provider buys products from SMEs (rather than the other way around).

Exceptions

While the above provides a basis for understanding BDS, it would be foolhardy to strive for a “watertight” perfect definition of BDS. When services are such a vital component at the heart of economies, linked closely with manufacture and trade, there will always be blurred edges around any definition. For example:

- Some services are part of a trading relationship in physical goods – such as design advice and market information between retailers and manufacturers or the advice and services offered in a managed workspace environment. To *unbundle* services from products in these situations may be pointless.

⁶ These are business services but are the subject of many other guides and are not the focus here.

- Technology development (and privatisation) has allowed a range of new services to be developed associated with utilities.

This element of looseness in definition is inevitable (and to be welcomed) if our notion of BDS is one that has practical meaning in SME environments. This sets the context for donor interventions. However, it is important that this is not interpreted as a *blanket* justification for donor interventions “everywhere”; on the contrary, interventions need to be justified on the basis of rigorous analysis and criteria.

c) The main objective

The old: previously donor-supported approaches to BDS have focused on building the capacity of organisations – partners of donor agencies – to deliver improved services or on delivering services directly.

The new: from a market development perspective, the main objective of interventions should be on improved functioning of BDS markets.

d) The approach

The old: previously, approaches have generally supported organisations – often government-related – in designing and delivering BDS with an implicit assumption of continued subsidy and often standardised BDS.

The new: above all, the BDS market development paradigm demands a different approach to intervention on the part of donors. Most of the remainder of this guide outlines the essence of this approach. It is one that is built on three related ideas:

1. The starting point for intervention design should be a rigorous understanding of BDS markets; market research tools can be a valuable means of achieving this (Sections 4 and 5); i.e., *where are we now?*
2. Interventions need to develop a clear view of how BDS markets will operate in a sustainable manner by linking key market functions with actors (see Section 6); i.e., *where are we going?*
3. In their design and implementation, interventions need to observe, interpret, and give more specific meaning to the BDS principles of good practice (see Sections 3 and 7); i.e., *how do we get there?*

3. Key design principles in BDS

This Section summarises six core principles of good practice in BDS - agreed by major donor agencies - that lie at the heart of the market development approach

Underpinning the move towards a market development approach has been the development of core principles of good practice in BDS. These originated through a detailed review of donor experience commissioned by the Committee of Donor Agencies for SME Development in 1996-97 and, although still preliminary, are accepted by all major donor agencies.⁷

As principles only, of course, these have limited importance. Their real value emerges when they are given practical meaning in the context of specific interventions; this may mean different interpretations in different environments. However, they are broadly applicable - no matter the client group or geographic area. In particular, the whole market development approach in BDS springs from these principles and it is important that anyone involved in BDS has an awareness of them.

3.1 Business-like and demand-led

The design and implementation of any BDS intervention should be driven by business-like concerns, skills, and values. This apparently simple idea has far-reaching consequences for interventions. For example:

- Transactional relationships: conventional development relationships are characterised by a one-way flow of benefits; in contrast, business relationships are based on exchange, mutual benefit and response to demands rather than needs. Applying this idea means, among other points, that providers should charge for services and that facilitators should aim to *incentivise* their relationship with providers.
- Closeness to clients: the best organisations at working with SMEs are themselves like those SMEs in terms of their people, systems and values. Being "close" means developing products that are relevant, having a cost base that is comparable to SMEs and people that understand and talk the language of SMEs. It also increasingly means small for-profit businesses as partners for donors.
- Getting the right people: for donors/facilitators, having people that can deal with profit-oriented providers and understand the market context for interventions is crucially important.

Above all, this principle leads directly to markets as the starting point for intervention.

⁷ The Committee of Donor Agencies for Small Enterprise Development (1998): Business development services for SMEs: preliminary guidelines for donor-funded interventions

3.2 Developing an explicit picture of sustainability

BDS interventions need to be based on a clear view of longer-term institutional sustainability. In this respect, BDS has a considerable amount to learn from microfinance where - at its best - this clarity exists. Typically, microfinance interventions seek to create sustainable microfinance institutions (MFIs). The role of the state is that of regulator. This clarity in objectives provides direction and coherence to interventions and, crucially, defines the role of different parties. Without this broad consensus, drift and inconsistency are inevitable. In BDS, this clarity and direction is usually not evident. Big issues such as the role of organisations, the extent of and rationale for subsidies (if any) and who finances and does product development are left *hanging*, undecided and ambiguous. We return to this point in Section 5.

3.3 Focused with strategic awareness

This principle emerges from the experience of BDS interventions and from the complementary ideas of:

- *core competence*: a key business trend over the last 10-15 years, encouraging businesses to concentrate on their key strengths; and
- *subsidiarity* enshrining a common-sense idea of "who can do what best", meaning that responsibility is delegated to the lowest possible level and that government focus on its own unique role (rather than tread where private sector markets should operate).

In practice this principle poses a number of challenges:

- For providers: what is our distinctive offer; what are we *good at*, relative to other providers? Who are core set of clients and what needs are we addressing?
- For facilitators: what is the specific market constraint that we are seeking to address? What types of intervention can we manage successfully?
- For governments: given our capacity, what are the clear and justified priorities for the role of the state generally and in relation to BDS?

This principle therefore leads BDS in the opposite direction from the "integrated packages" of support that were favoured in the 1970s-80s. It does not, however, imply being strategically narrow-minded. On the contrary, it requires that appropriate networks be created so that key parties know their place within the bigger picture.

3.4 Participation: building on ownership

BDS interventions should build on people's ownership of their organisations and on their ideas. In SMEs, ownership and management are manifested usually in one individual;

this is their distinctive feature and their strength. Similarly, among good BDS providers, ownership is often manifested in one entrepreneurial leader. In their approach to selecting “partners” and in managing relationships with these partners, therefore, facilitators need to offer suitable space and incentives to encourage ownership and avoid the emergence of donor-dependent entities. Facilitators need to model themselves on business investors rather than charitable donors. Among other implications, this principle requires that the role of donors be *facilitative* - working with and reaching SMEs through others - rather than *directive* - doing it themselves.

3.5 Enhancing outreach

BDS interventions need to consciously address the problem of how to reach more SMEs through their interventions. An acknowledged weakness in BDS - especially compared with microfinance - has been the comparatively low levels of outreach achieved. Unlike in microfinance, however, where projects seek to achieve wider outreach through economies of scale in MFIs, in BDS, where repeat, standardised products have a limited market, this is unlikely to be achieved through the development of large organisations. Rather, following this principle through to action requires that BDS interventions (a) first understand why markets aren't working and (b) intervene in a selective and focused manner to address these constraints. Functioning markets, or other mutually supportive business networks, self-propelled by appropriate supply and demand-side motivations and incentives, are therefore seen as the principal means to enhanced outreach.

3.6 Tight performance measurement

BDS interventions and BDS providers should rigorously measure their performance. Again, this has been a clear weakness in BDS interventions previously. Among the implications flowing from this principle are:

- Greater use of financial information: providers should allocate costs and revenues to products as the basis for market-based pricing. Facilitators, similarly, measure their own costs and allocate these to partners and/or interventions.
- Greater use of proxy market-based measures for impact: using market research tools, indirect market based indicators can be used as the basis for impact on SMEs.
- A realistic business-like stance on wider indicators: it is counterproductive for facilitators, on the one hand, to urge providers to be business-like and, on the other, burden them with a requirement to measure performance by indicators that are outside the direct concerns of business.

We return to these key principles on Section 6 when we address common implementation challenges in BDS - many of which are concerned directly with applying these principles.

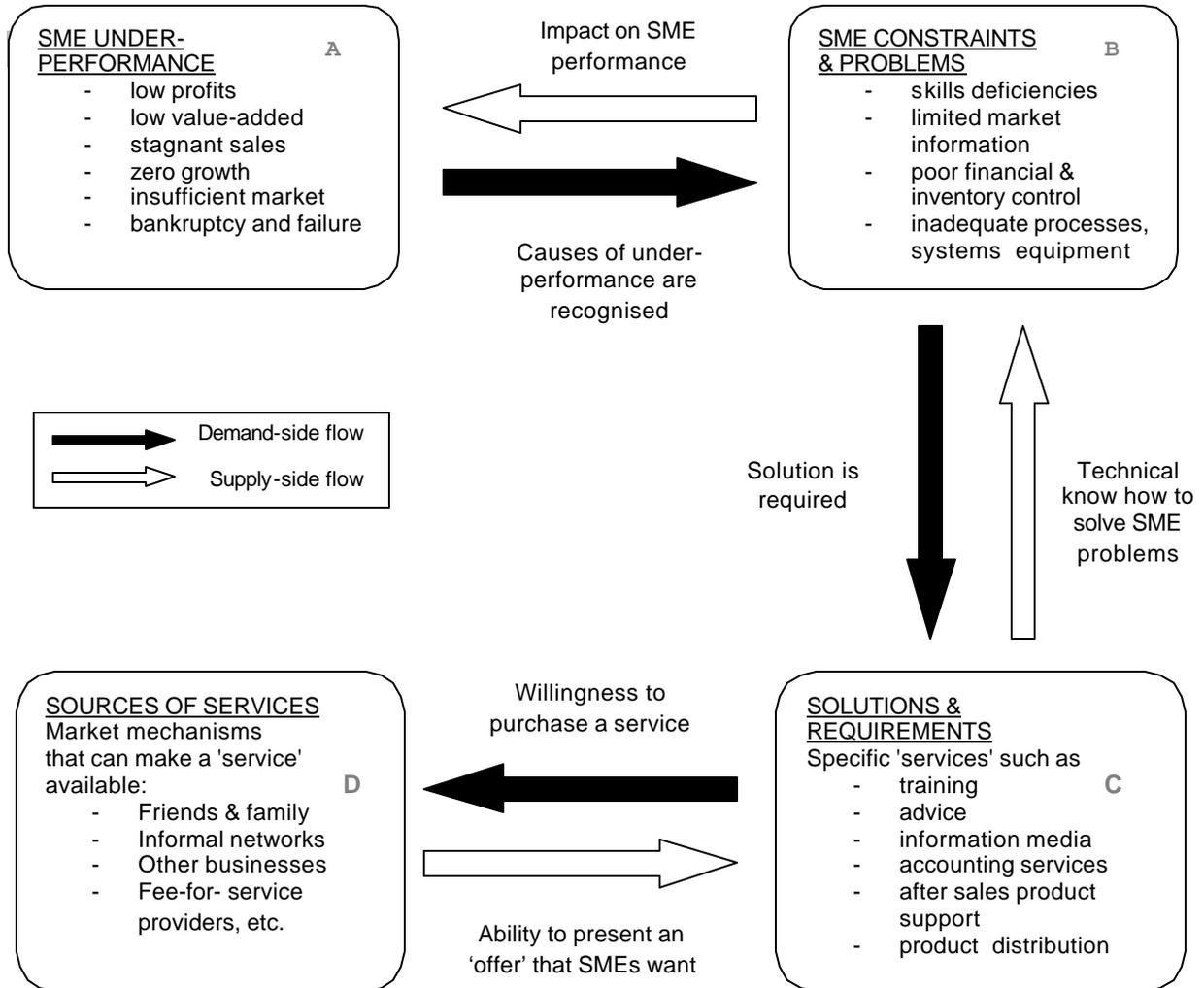
4. A framework for understanding BDS markets and choosing market development interventions.

This Section presents a framework to analyse BDS markets, focussing on demand and supply-side constraints that may prevent effective market operations. Building on this, it concludes by linking market diagnosis to intervention design.

4.1 A framework for BDS market analysis

The starting point for interventions pursuing a market development approach is an understanding of BDS market conditions and the factors preventing markets from working effectively. Markets can be seen to be *effective* when *transactions* take place i.e., when there is exchange between supply and demand at a market price. For this to happen customers must be ready to purchase (*effective demand*) and providers must have something to sell (*effective supply*). Understanding the dynamics of this interaction or transaction is the key to market analysis. Figure 3 shows the anatomy of an effective interaction between a consumer and a service provider.

Figure 3: Anatomy of an effective transaction



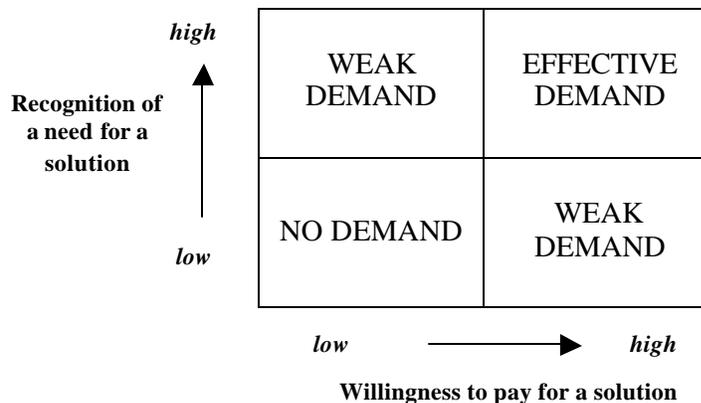
The consumer (the black arrow) recognises the causes of underperformance, concludes that a solution is required and is willing to pay for a problem solving service. The provider (the white arrow) has an “offer” valued by the consumer and has the ability to solve the problem with demonstrated positive impact on business performance. The elements of an effective transaction can also help explain why market mechanisms fail to serve SMEs: consumers may confuse symptoms with causes, they may seek the wrong solutions; providers may not have the right “offer” or may not be able to solve a problem. The core rationale for an intervention is to address the constraint(s) that prevents SMEs from solving their problems by facilitating more effective market provision of BDS.

4.2 Profiling demand and supply

In order to understand the relative strength or weakness of a market for a service, it is necessary to look separately at BDS demand and supply. Based on this assessment of demand- and supply-side weaknesses it is possible to ascertain the overall level of market effectiveness and determine which interventions are consistent with the goal of developing more effective BDS markets for SMEs.

Effective demand, as we define it, is *when recognition of the need* to solve a problem intersects with *willingness to pay* for a solution to the problem (Figure 4). “Recognition to solve a problem” indicates the SME's (the consumer's) readiness to act on a problem; the consumer may not know the best solution to the problem, for example, but knows there is a problem that needs to be solved by outside source(s). Willingness to pay is indicative of the SME's motivation to pay for outside assistance to effect a change. Willingness to pay ranges from no willingness, some willingness (sceptical) to high willingness (has the money and is ready to put it on the table).⁸

Figure 4: Quadrant of demand-side conditions



⁸ Capacity to pay is not tracked separately. Willingness is a better proxy for motivation than capacity and this is a precondition for a successful market transaction. Low capacity to pay is something that can be fixed.

Conditions of effective demand present a strong market opportunity for a BDS supplier. Conversely if both recognition of a need to solve a problem and willingness to pay are very low or absent, then *demand is non-existent*, and market opportunities are negligible. A *weak demand* situation may occur when recognition of a need to solve a problem is well established, but willingness to pay is low or conversely when there is willingness to pay but little or no recognition of a problem. The market opportunity in a weak demand situation is more limited.

Table 2: The implications of different market conditions for interventions

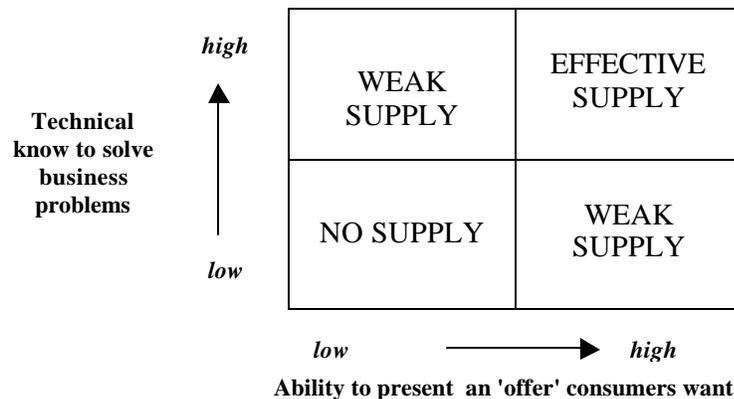
DEMAND		
ANALYSIS	CONSUMER PROFILE (SMES)	IMPLICATIONS FOR INTERVENTION
Effective demand High recognition of problem High willingness to pay	SMEs know what problems are and will pay for solutions. They are looking for a BDS provider to deliver a solution at a reasonable price.	Rationale for demand-side intervention is limited. However may be justified in order to stimulate specific parts of the population where demand is weaker.
Weak demand High recognition of problem Low willingness to pay	SMEs know what the problems are and are looking for solutions but are sceptical about the value of existing services, and are therefore unwilling to pay.	Rationale for demand-side intervention is to increase SME perception or awareness of service benefit and value; e.g., through demonstration, trial etc. Note that unwillingness to pay may be related to existing weak supply 'offer'.
Weak demand Low recognition of problem High willingness to pay	SMEs are seeking some form of assistance to solve a problem and are willing to pay for this. However they are uncertain what the actual problem is often resulting in wrong choice of "solution". This, in turn, can lead to SME dissatisfaction and unwillingness to use/pay for BDS in the future.	The rationale for demand-side intervention is to improve business diagnosis and improve consumer access to information about what benefits specific services can deliver.
Non-existent demand Low recognition of problem Low willingness to pay	This is not uncommon among entrepreneurs. SMEs do not see there is a problem to be solved, and are not prepared to pay for any form of external assistance. Often firms externalise their problems and conclude there is nothing they can do to fix them because it is out of their control.	Rationale for any intervention when demand is entirely absent is limited.

SUPPLY		
ANALYSIS	PROVIDER PROFILE	IMPLICATIONS FOR INTERVENTION
Effective supply High skills to solve business problems High offer to businesses	The service provider has good capacity to solve business problems, and the ability to package that into an offer that consumers want	Rationale for supply-side intervention is limited. May be justified by equity concerns e.g., stimulate expansion into underserved market areas.
Weak supply High skills to solve business problems Low offer to businesses	Despite having sound skills, the service provider lacks marketing know-how; they are unable to demonstrate the value of their service, a common problem for suppliers because of the difficulty of showing the value of a product prior to its use. The offer is not attractive.	Rationale for supply-side intervention is to develop service provider capacity to develop and market appropriate products - develop the offer. Note that weak supply 'offer' might be exacerbated by low willingness to pay on the demand-side.
Weak supply Low skills to solve business problems High offer to businesses	This scenario is not as strange as it seems! BDS providers in many cases promise results but lack the technical capacity to deliver effective solutions. Such a scenario is damaging for service provision as it undermines credibility and damages demand.	The rationale for intervention is to develop provider technical skills. However the question must be asked why support service providers lack the ability to solve business problems in the first place?
Non-existent supply Low skills to solve business problems Low offer to businesses	The service provider lacks any capacity to sell business solutions. Effectively the service provider is nothing more than an empty shell.	Rationale for intervention when supply-side capacity is non-existent is dubious: there is nothing to work with! Intervention <i>may</i> be warranted if demand is particularly strong.

Effective supply is defined by two variables: the technical know how to solve problems and the ability to present an “offer” customers want (Figure 5). Like the demand side of the market equation, these factors must be present, and they are likely to evolve along separate paths. For example, a BDS supplier may be good at packaging an attractive offer, but lacks the know how to solve the customer’s problem. Conversely, a supplier may have the capacity to solve the problem (the know-how) but they lack the ability to package and deliver an attractive offer. Suppliers may sell their service below costs or may not be able to develop repeat clients because the client doesn't perceive the benefit to be worth the cost even though the problem was actually solved.

When service providers have both the appropriate products and the ability to package those skills into business solutions, *supply is effective*. If on the other hand a service provider has appropriate products, but lacks the ability to sell those skills to customers, *supply is weak*. The converse also describes weak supply – suppliers are good at marketing but are unable to solve problems with their products. *Non-existent supply* results from providers lacking both appropriate skills and the ability to make an attractive offer to SMEs.

Figure 5: Quadrant of supply-side conditions



4.3 Using market analysis for intervention design

What are the implications of this market analysis and the demand and supply profiles for what we *do* - for the design of interventions? Table 2 shows in detail the kind of conclusions one might reach on the basis of demand and supply profiles. In general, however, market analysis is essential in finding answers to three critical questions:

- Is there potential for intervention?
- Where should interventions focus?
- What type of intervention is useful?⁹

⁹ A detailed analysis of the efficacy of different interventions is beyond the remit of this paper.

Interventions now can be identified to address market weaknesses. Figure 7 suggests the focus of the intervention: to stimulate demand or to overcome supply constraints. If the market weakness is more on the supply side this suggests the use of interventions designed to remove supply constraints with respect to supplier skills, consumer information and marketing know-how. If, however, the market weakness is more on the demand side this suggests the use of interventions designed to stimulate demand by increasing awareness of business problems or inducing trial of problem solving services. Of course, the depiction is necessarily simplistic. In reality instruments will often effect both supply- and demand-sides and address a variety of constraints.

Figure 7: Matching market analysis to intervention options

BDS Providers

Constrained by:

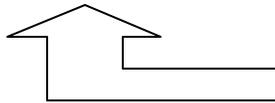
Limited information - about market opportunities

Skills deficiencies - technical or business

Operational deficiencies - resources, systems, structures

Inappropriate products

Environment -distortions and barriers to activity



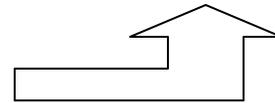
BDS Consumers

Constrained by:

Limited information or awareness - about problems or solutions

Valuation problems - affecting willingness to pay

Limited resources - to assess or purchase services



Intervention options	
<u>Supply-side</u> Product development Venture finance Technical assistance Training	<u>Demand-side</u> Vouchers Matching grants Information
Business linkages	

5. Market analysis tools to identify market weaknesses

This Section outlines two key consumer research tools used in assessing BDS markets and the typical information generated by such tools.

Having developed a framework for market analysis, how do we actually go about doing this analysis? How do we develop the detailed market picture described in Section 4? This is useful for both providers of BDS - who need to find out where there are market opportunities - and for facilitators (our main focus here) - who need to find out where there are constraints preventing markets from working effectively.

Market analysis of this nature lends itself to market research-style tools, rather than more conventional developmental assessments. In practice there are a range of tools that can be used in assessing markets - particularly on the demand-side - and these cannot all be covered here. This document features two private sector market research tools that have been recently adapted by donors and facilitators to analyse demand and supply, identify a service(s) and select appropriate market developing interventions.

5.1 Setting the boundaries of analysis

An important first step before using market research tools is to identify the boundaries of a market analysis. This will determine the nature of analysis and its outcome. For example, if the market is defined narrowly (e.g. small business users of public calling offices) analysis can be much more specific and detailed. It will probably be more manageable too. On the other hand a broader market definition (all BDS consumption nationwide by all enterprises) will generally only yield an overview-level of analysis.

Market parameters are frequently pre-determined by governments or donors and include:

- *Geography* - e.g., a neighbourhood, postal area, town, province, country
- *Products* - e.g., consumers of specific types of service such as telecommunications or newspaper advertising
- *Consumers* - e.g., female-owned businesses, formally registered businesses
- *Sub-sector* - e.g., small scale manufacturing, textile production, agro-processing

The market may also be delineated by the criteria of the intervening agency, based on:

- *Strategic focus* - e.g., priority groups, environmental protection, etc.
- *Capacity of intervening agency* - i.e., what the agency can do; its experience and competence in certain types of intervention (e.g., vouchers) or with specific sub-sectors (metal workshops).

In the latter case, while it is clearly sensible to delineate the market in terms of a facilitators' core competence, there is a risk of shaping the view of the market problem (and thus the intervention) by what we *want it to be*, not what it *really is* (e.g., solutions in search of problems). We need to guard against this risk by looking at both sides of the market equation – what consumers want as well as what providers can do - and developing an accurate market picture on the basis of a more *rounded* view.

Table 3: Market Information -- Key Questions and Why they are Important

Objectives	Key Questions
<p><u>Profile of Users</u> <i>To define a profile of users of services.</i></p> <p>This data permits segmentation of users by different characteristics.</p>	<ul style="list-style-type: none"> • Who (what type of SMEs) are using the service? (may include sector, size, gender, ethnic group, geographical location etc.)
<p><u>Awareness/Understanding</u> <i>To determine how aware SMEs are of the service(s).</i></p> <p>SMEs may have heard of but may not understand the service and its benefits. Lack of understanding inhibits trial and use and can be overcome with better market information.</p>	<ul style="list-style-type: none"> • How aware are SMEs of the service? (awareness) • Do SMEs understand the business benefits of the service and how the service delivers those benefits? • How do SMEs find out about suppliers?
<p><u>Use (non-use) of services</u> <i>To understand users' current purchase and use habits and future intent.</i></p> <p>The data helps quantify market size, segments and penetration and evaluate suppliers success in reaching SMEs. Purchase habits can explain why SMEs turn to markets for a service and what other alternatives are used.</p>	<ul style="list-style-type: none"> • What is the market penetration for the service? (i.e. what percent of SMEs have ever tried the service.) • What are consumers' purchase habits? frequency? volume? amount spent? • Is use increasing or decreasing? (trends, adoption rates) • Why do SMEs use the service? (e.g. my business is growing, colleague recommended it, etc.) • Why don't SMEs use the service? (e.g. – don't need it, do it in house, don't know of any suppliers etc.)
<p><u>Perceived Value and Satisfaction of Services</u> <i>To gain a broad understanding of how users of services perceive their value in solving business problems.</i></p> <p>It provides customer feedback to suppliers on the strengths and weaknesses of their offers in meeting customer demand. Mismatches between expectations and offers can provide an indication as to why the market is not working.</p>	<ul style="list-style-type: none"> • What benefits do SMEs expect to get from the service? What benefits are they actually getting from the service? • Are SMEs satisfied with the services they are getting? What features are they satisfied/dissatisfied with?
<p><u>Availability of Suppliers and Offers</u> <i>To gain an understanding of the universe of the suppliers that serve and could serve the market.</i></p> <p>It provides a supplier's perspective on market problems and possible responses. Mismatches between customer expectations and supplier offers may provide indications of unrealistic customer expectations of how the market can address demand.</p>	<ul style="list-style-type: none"> • Where do SMEs go to use the service? (where are suppliers?) • What type of suppliers do SMEs use? What type of suppliers exist? • How are offers delivered? To what extent is the market fee for service? embedded services? free/subsidized from the state or non-profits? or other mechanisms? • What is the market orientation of suppliers? (E.g. turnover from private sector) • What are substitutes for the service? e.g. informal or other mechanisms for getting the same business benefit (e.g. from media, from friends/family/ colleagues, from business association etc.) • Who are potential new suppliers?

5.2 Consumer research tools

There are a variety of tools that potentially may be used in developing a detailed picture of the demand-/consumer side of BDS markets. These include, for example, product concept tests, price sensitivity tests, user studies, and customer satisfaction surveys. Two of the more important of these - now beginning to be used to shape BDS interventions - are Usage, Attitude and Image (UAI) surveys, and focus group discussions (FGDs).

UAI surveys are a consumer research tool that permits a broad look at the current market for few or many services from known suppliers. A UAI market survey offers a picture of the market from the perspective of SME consumers and helps facilitators to learn about: overall market size and segments; service features consumers want; and satisfaction with services from competing suppliers.

By gathering information from users (and non-users) of a service, a facilitator can identify services in most/least demand by SMEs, identify market problems that could constraint demand and select the best intervention that stimulates demand (e.g., overcomes lack of understanding of service benefits) and/or removes supply constraints (e.g., supplier lacks the know how to serve SMEs).

This is a quantitative tool that follows a structured research method. Table 3 summarises the learning objectives when using a UAI for a BDS market survey, the key questions to get information against each objective and data tables that can be used to summarise the data collected.

FGDs are a qualitative market research tool used to better understand how consumers experience the use of services by exploring with “qualified respondents” how they perceive, choose, evaluate and value BDS. Table 4 offers a set of questions that can be used when conducting focus groups with purchasers and non-purchasers of services. The objectives of the FGD with either group is gain insight on:

- how consumers differentiate among and make their choice of service providers;
- what motivates repeat purchase of business service;
- how to improve services to make them more appealing to existing consumers;
- why people who recognise the importance of services don't actually buy them; and
- what needs to be done to convince non-purchasers that they will get value for money if they become future purchasers.

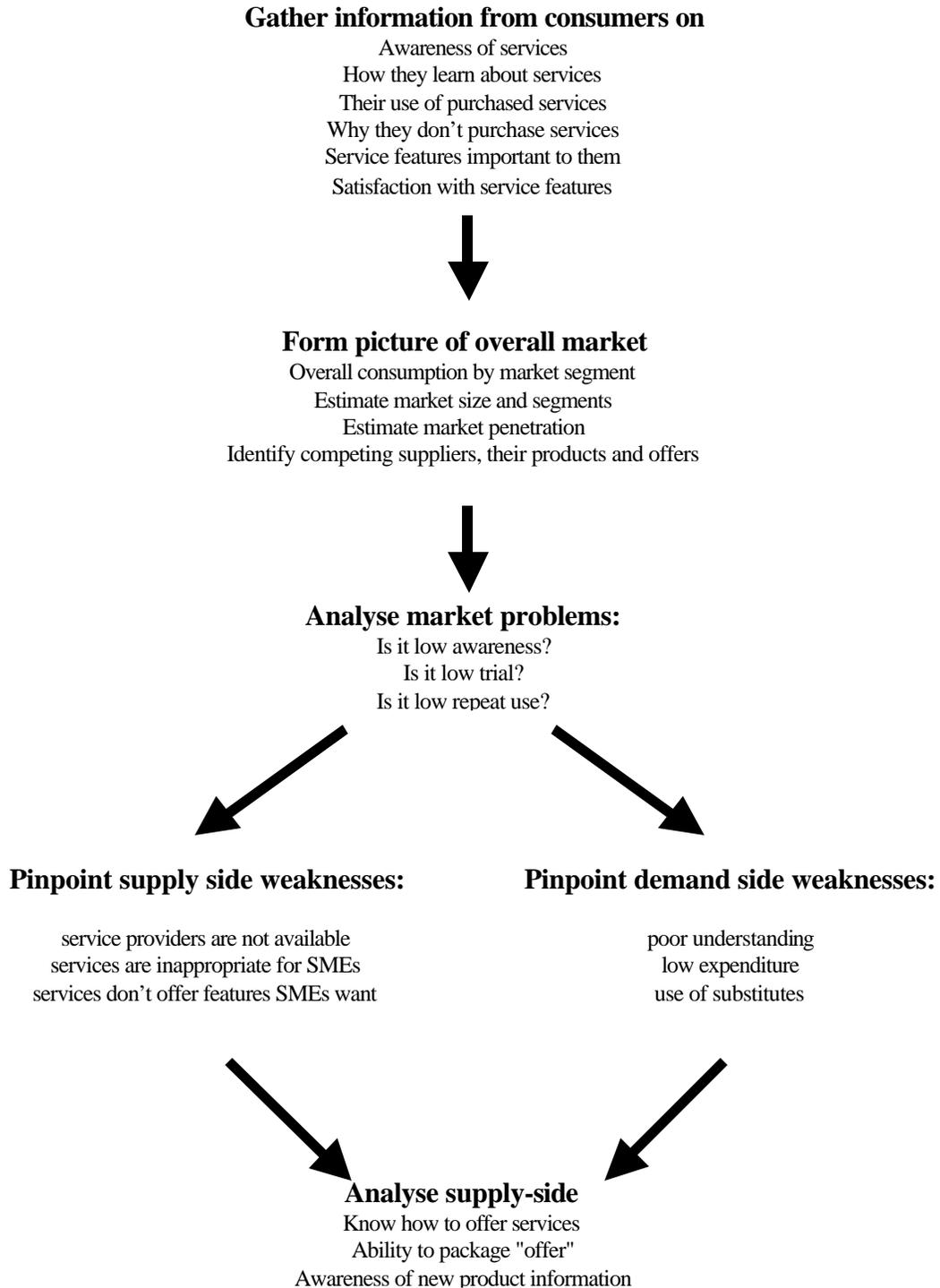
Table 4: Interview Guidelines for Focus Group Discussions

Purchasers of Services	Non-Purchasers of Services
<ul style="list-style-type: none"> • Decision factors behind first time purchase • Service features that differentiate various suppliers when making the purchase • Service features that led to multiple purchases • Expected and actual results from the purchase on the business • Expected and actual result from the purchase on individual recipient • Level of satisfaction from the purchase (value for money) • What sort of tailor-made services can be provided which will make them invest their money and time • What factors will prompt them/hinder them to purchase other types of services • What improvements are required to match the needs of their business, including quality, quantity, and reach 	<ul style="list-style-type: none"> • Despite recognising their importance, what are the reasons behind non-purchase • Whether non-purchase of BDS is effecting business performance • Expectations from BDS if purchased in the future • How can be done to allow them to make the purchase • What sort of tailor-made services can be provided which will make them invest their money and time • What general improvements are required which will match the requirements of their business, including quality, quantity and reach

Whether using these UAI surveys or FGDs or other techniques, consumer research tools can be used to form a picture of the market and to better pinpoint market weaknesses. The information permits an analysis of SME consumer demand but it also offers an SME perspective on supply by looking at sources of services, satisfaction by different providers and the use of substitutes. These tools set the basis for a closer look at the supply side of the market using tailored institutional assessment tools (not covered here). Figure 8 below shows the typical information flow developed when using market research tools.

A final caveat is required with respect to market research tools. Ultimately, what matters in any intervention is knowledge of the BDS market situation. While we can always learn from the information gained by these tools, people with experience and a good, practical feel for a market situation may not need such extensive investigation of the market through these techniques.

Figure 8: Typical information flow from using market research tools



6. Sustainability: getting the strategy right

This Section defines sustainability in BDS and sets out the reasons why an explicit view of sustainability in BDS is so important. It sets out a framework for sustainability linking key actors with supply-side functions and, briefly, summarises what this sustainability picture might look like.

The starting point in any intervention is therefore an understanding of the market in which we're interested and, in particular, of the constraints that inhibit market development. Parallel with this analysis, however, it is important to develop a clear view of where an intervention is going; of how it is envisaged BDS markets will operate in a sustainable manner in the longer-term. While sustainability has long-held a prominent place in development vocabulary and is generally seen to be "important" it is seldom defined tightly or operationalised into tangible objectives and activities; this has been especially so in BDS interventions.

6.1 What does sustainability mean in BDS market development?

In order to make sense of sustainability, we need to think through the implications flowing from a general definition. In general, sustainability is:¹⁰

*the **capacity** to ensure that **benefits** continue **beyond the period** of an initial intervention.*

Capacity is concerned with the supply-side capability to continue to offer services and this is likely to be a combination of different actors performing different supply-side functions.

"Capacity" can include a wide range of factors – skills, motivations, systems, finances etc. – but in a simplified way can be reduced to two issues:
 ⇒ the ability *to do* and
 ⇒ the ability *to pay for/finance* services.

Beyond the period of an intervention: usefully, this reminds donors and facilitators that they are there to be transient facilitators of change and not permanent fixtures on the BDS landscape.

Benefits: for SMEs are implied by their demand for services from providers (i.e. demand/transactions is a proxy measure for benefits).

Since SMEs need change and become more differentiated, for benefits to continue services must also change; they cannot simply be a standardised, unchanging product offer.

From the above, a more specific definition of sustainability in the context of BDS market development is:

"The supply-side capacity to ensure that relevant, differentiated BDS continue to be offered to and consumed by SMEs beyond the period of an intervention.

¹⁰ From *Sustainability in NGO development projects*; ODA, 1995

A transparent view of long-term sustainability in BDS therefore is one that defines supply-side capacity in more depth, linking market players with market functions by addressing the core questions of 'who does and who pays' ".

6.2 Why is clarity in sustainability so important?

Development agencies¹¹ are interested generally in generating longer-term change and benefits through their short-term interventions. If, however, the nature of this longer-term picture is not clear it can permit inconsistency between what projects do and what they are trying to achieve. A clear view of sustainability imposes discipline and direction on interventions. Conversely, a vague and ill-considered view allows interventions to drift aimlessly.

The contrast with microfinance is instructive. Whereas in microfinance the drive towards financially sustainable MFIs is consistent with tight cost control, positive real interest rates and rigorous repayment collection, in BDS, imprecise views about payment for services (from SME clients) and subsidies (from under-resourced governments) in the longer-term allow interventions to:

- Develop products that are too expensive/inappropriate for SMEs;
- Let the cost base of providers rise so that they become *out-of-tune* with SMEs (and *in-tune* with donor money);
- "Corrupt" SMEs with the expectation of large subsidies and BDS as a donor creation rather than a "normal" product in a market;
- Lure governments into involvements that are beyond their capacity.

6.3 Why has it been so difficult to develop clear views of sustainability in BDS?

This characteristic problem of lack of clarity about sustainability in BDS interventions stems from a number of factors:

- **Not a neat organisation, an unruly market:** whereas in microfinance, our focus is usually on specific organisations and this provides real boundaries for analysis, in BDS we are dealing with markets which, inevitably, are more elusive, being characterised by many more players, multiple relationships and loose boundaries.
- **The breadth of the term:** BDS as defined here covers a wide magnitude of services. This means that, as mentioned in Section 5, interventions need to be clear about what kind of services are being considered.

¹¹ As opposed to relief agencies whose goal is inherently more short-term

- **The (unhelpful) public goods argument.....:** some services are sometimes termed public goods since society as a whole is the main beneficiary rather than the specific consumer of the service. Pure public goods - non-rival and non-excludable - are very few in number. There are many more goods that may have some public goods characteristics - such as training - where there may be positive externalities but the case is hardly clear. Moreover, theorising about whether or not BDS have/have not some public goods character is a diversion from the more pressing reality of governments with limited resources focusing on priority core functions. Public goods arguments can easily be used to ease government into active continuous roles in BDS markets that they can ill-afford and are unnecessary. Most BDS can be and should be provided and consumed in a private market context.
- **.....and some areas of "legitimate" government involvement:** of course there are some services and functions that are likely to remain within the legitimate remit of governments. For example, basic research and development and some types of information provision are close to the education and knowledge base justifying state involvement. More capable governments may see themselves as the only actor capable of wider cluster development or network co-ordination and brokering. However, the list is not especially long.
- **A history of messy government involvement:** partially stemming from public goods arguments but more often for other social and political factors, governments have been (and are) involved in BDS as subsidisers or organisers. The often troubled history of interventions that have supported government in this role has been a key factor in leading agencies to market development. However, it is the case that governments in industrialised nations do often intervene extensively in BDS and this is sometimes used as an argument for continued efforts to raise low-income country governments' capacity to provide BDS directly (rather than facilitate BDS markets). Three points refute this argument:
 1. Despite the efforts of governments, for most businesses in most industrialised economies, BDS is provided through the market place;¹²
 2. The quality and effectiveness of much officially supported BDS in these countries is highly questionable and, at its worst, is akin to a welfare state for struggling enterprise.¹³
 3. The resource base of industrialised nations dwarfs that of low-income countries and the practices that have developed are those of "rich" states where sustainability concerns press only lightly;

¹² In the UK for example, one recent study showed that only 14% of business advice is provided by "official" government-supported agencies (*The market for external business advice services in Britain*; R. Bennett and P. Robson, ESRC Centre for Business Research, 1999)

¹³ Also in the UK, there was a negative correlation between usage of public sector sources of advice and profitability; meaning that government subsidised advice was focused on badly performing SMEs (many of whom were actually seeking financial assistance).

The above factors complicate the BDS context but none excuse failure to develop a sustainability picture for BDS. On the contrary, it is precisely because of this prevailing complexity that striving for a transparent view of the future in BDS is so important.

6.4 A transparent framework for sustainability in BDS

In order to overcome these problems, it is necessary for interventions to develop explicit, transparent views of sustainability in BDS. Figure 8 offers a simple framework for a transparent sustainability picture. This builds on the earlier definition in BDS and has three key elements:¹⁴

1. Main potential actors on the supply-side of a market (i.e. not SME consumers themselves)

- Government and government organisations: this can be broken down further (local or regional government, etc.) but is essentially the public sector;
- For-profit businesses, of any size or ownership form, ranging from self-employed to substantial corporations;
- Networks: formal or informal, business networks can be a powerful source of “services” – advice, contacts, skills, etc.;
- Business membership organisations (BMOs): sector associations, chambers of commerce and employers’ organisations whose principal role is advocacy;
- Not-for-profit business: this could include NGOs but also universities and educational institutions that may have some autonomy from government.

Donor agencies are not included here; their role is perceived to be facilitative and short-term without a valid longer-term rationale.

2. Key supply-side functions

In approximate order of priority, the main supply-side functions that need to be undertaken in any market are:

- Delivery of services to SMEs;
- Product development: ranging from adaptation of products to existing markets to new products for new markets;
- Skills/capacity enhancement: for providers of services;
- Research and development (R & D): this is more basic work to develop new insights into market mechanisms, underlying market trends and changes in SMEs that may eventually be useful in applied product development work;
- Regulation and policy-making: the overarching framework of rules and policies within which markets operate.

¹⁴ There are some parallels here with mapping exercises in sub-sector analysis.

In addition there are other functions that are possibly less important generally but may be useful in some situations. These include:

- Basic information provision that, for example, supports the development of markets generally rather than specific products (and providers);
- Advocacy that, it could be argued, is important to ensure appropriately balanced government involvement in markets; and
- Co-ordination: for some BDS, initial co-ordinating work might be necessary to develop the supply-demand relationship.

3. Linking actors with functions

In developing a transparent picture of sustainability for the future¹⁵ the core task for each main function is to develop – in as much detail as possible – a clear view of:

- Who will undertake this function? (who does?) and
- Who will pay for this to happen? (who pays?).

Considered responses to these deceptively simple questions provide a transparent basis for rational analysis of the future of particular BDS and for the development of a consensus – between donors, with government and other players – over longer-term objectives. Currently, neither the transparency nor the consensus is often in evidence.

6.5 What would a sustainability picture look like?

Given the above framework for developing transparency in sustainability, what should this picture look like for BDS market development interventions? First, it is important to point out that it won't always be the same. There are a number of factors that might lead to legitimate differences between countries:

- BMO traditions: in some countries BMOs have considerable strength and may be able to play a role in, for example, information provision as well as the more traditional advocacy function. In others (more), they have a limited but important advocacy-focused role.
- Government capacity: wealthier governments (say in middle-income countries) with a stronger human resource base can potentially play a more active role in supporting functions such as R & D or "co-ordination". For most low-income countries however, governments' priority should be to focus on core roles only.

¹⁵ The period of time to be considered will clearly vary from one situation to another but the end of a project period is the obvious time horizon to consider.

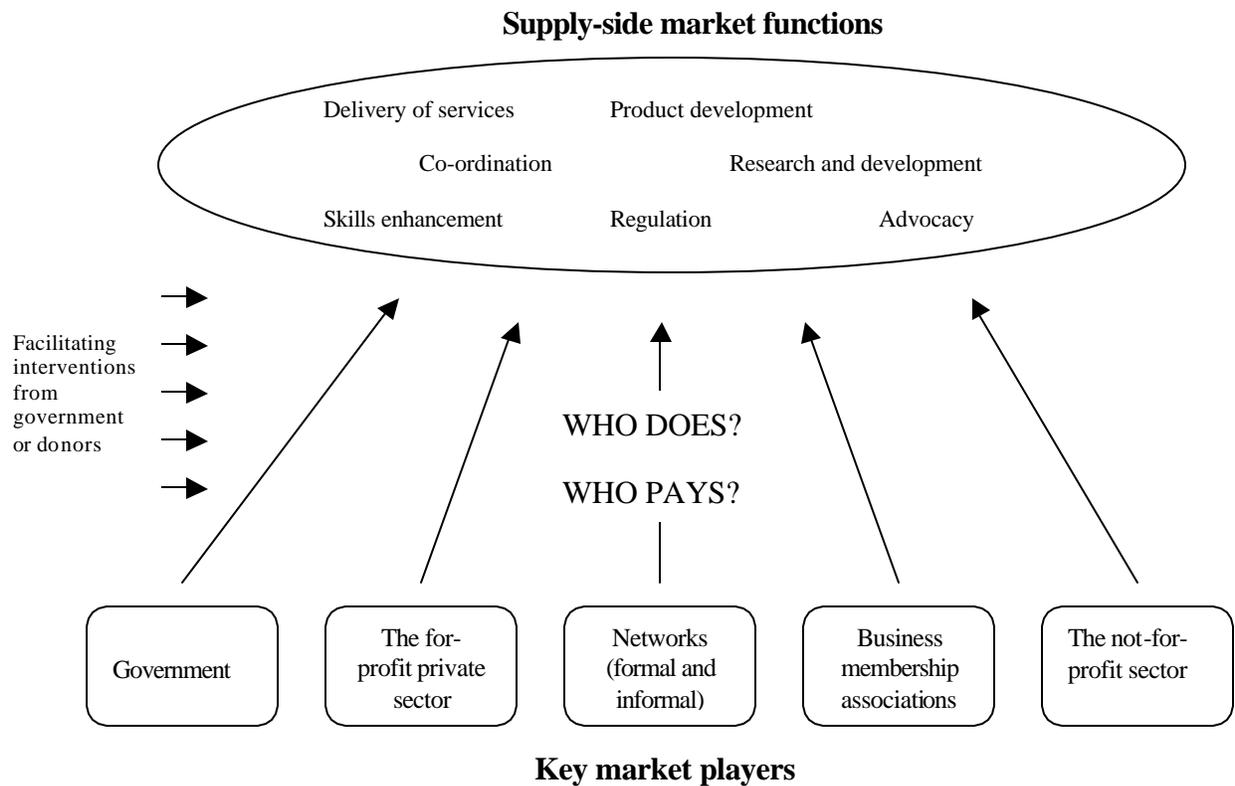
- Entrepreneurial character of NGOs: business-like NGOs have developed in some countries that, in their culture and capacity, are similar to competent for-profit players. In other cases, they continue to be loaded with a welfare legacy and anti-business sentiment and have few relevant skills.
- The strength of networks: more entrepreneurial economies often have networks of businesses (SMEs and larger firms) that have higher potential for an active role.

Second, notwithstanding these differences, the general shape of BDS in the future will be characterised by:

- **The for-profit sector:** the key providers of BDS and responsible for product development financed directly from revenues from fee-paying SME clients.
- **Government:** policy-maker and regulator, financed by the state (government therefore should essentially not be a provider of BDS).
- **BMOs:** providers of an articulate advocacy voice for the business community

In other functions - skills enhancement, R & D, information - there is more potential for overlap and local factors may be most important in shaping the desired picture.

Figure 8: Sustainability in BDS



7. Core Implementation Challenges

This Section outlines many common issues that need to be confronted in designing and managing interventions. It focuses particularly on the selection and management of partner relationships and the challenge of implementing core principles of good practice and concludes by listing some key implications for donors and facilitators emerging from the BDS market development approach.

The overall shape of interventions in BDS is guided by:

- (1) analysis of the market in which we are interested and the constraints to market development revealed by this (Section 4 and 5) and
- (2) our view of sustainability in the longer-term (Section 6).

Clearly, interventions built on these foundations may take a number of different forms and each of these raises its own distinctive problems. However, there are a number of more general issues that commonly need to be confronted in BDS interventions if they are to be successful. These fall under three broad categories:

1. Who should we work with?
2. How should we work with them?
3. What are the implications for the capacities of donors and facilitators?

7.1 Who should we work with?

The move towards BDS market development often means that agencies (donors and facilitators) need to work with different kinds of organisations (or partners). In particular, agencies may need to consider working with for-profit private sector companies as the main providers of BDS. In practice, three sets of issues need to be considered: what selection criteria should be used, the process of selection (how), and how many partners to work with.

What criteria should be used in selecting partners?

Criteria for selection should draw on the key design principles in BDS identified in Section 3 and formulated as questions or, if possible, as specific indicators. For example, among the key questions might be the following:

1. Do the people have the right skills and motivations, personal ownership and working culture to enable them to work in a business-like manner?
2. Is the structure – legal and operational - one that allows organisations to behave in an entrepreneurial way?
3. Are internal systems – for example payment structures, systems of performance assessment and cost control – appropriate?
4. Do partners have transactional relationships with their clients, manifested, for example, in their approach to pricing and client selection?
5. Is the cost base of the organisation consistent with the client group it seeks to serve?

6. Are partners' current approaches to product pricing fed by accurate cost information and consistent with longer-term sustainability?
7. Do partners allocate costs to their products/activities to allow a clear view of the *real* costs of delivering products?
8. Is the client base clearly defined?
9. Is there consistency between the product offer and the client base?

Although developing clear and specific criteria for selection is essential, it is important to recognise that - as with any business investment - this is not a full-proof process and, like business investors, personal factors (such as belief in the individuals running providers) play an important role in selection, even if they are difficult to capture in a list of criteria.

How should we select partners?

As important as selection criteria is the *process* through which partners are selected. Choices here include personal knowledge or recommendation, identification through market research or competitive tendering processes. While there is no universal right or wrong over these, there are a number of factors that do need to be taken into account in using them:

- The selection process guides expectations over the eventual relationship: if partners don't have to do *much* to gain selection (for example, being given rather than having to pay for tender documents in open tender situations) it may be difficult to develop the desired transactional relationship with them.
- Opening donor eyes to new partners: often the challenge in BDS is to reach to different types of partner who may be outside "normal" donor circles. Market research and tendering processes may help to expand this circle of potential partners.
- Expanding partner choice versus achieving partner quality: ultimately successful relationships need to be negotiated between donors and partners and this requires in-depth knowledge of partners rather than simply a wide choice.

How many partners?

Conventional approaches to development have often emphasised working with one partner organisation in a relatively intensive manner. Two key problems with this approach is that (a) this intensive focus of resources is potentially distorting and (b) it places all an agencies' efforts in one (sometimes precarious) organisation. Working with a number of partners - sometimes referred to a *portfolio approach* - in a less intensive manner (intervening lightly and broadly rather than intensively and deeply) can help to reduce the risk of distortion and spread risk.

7.2 How should we work with partners?

In assessing how we should work with partners a collection of related issues need to be considered. Again most of these grow directly from the principles of good practice referred to in Section 3. Some of the more important points are outlined below.

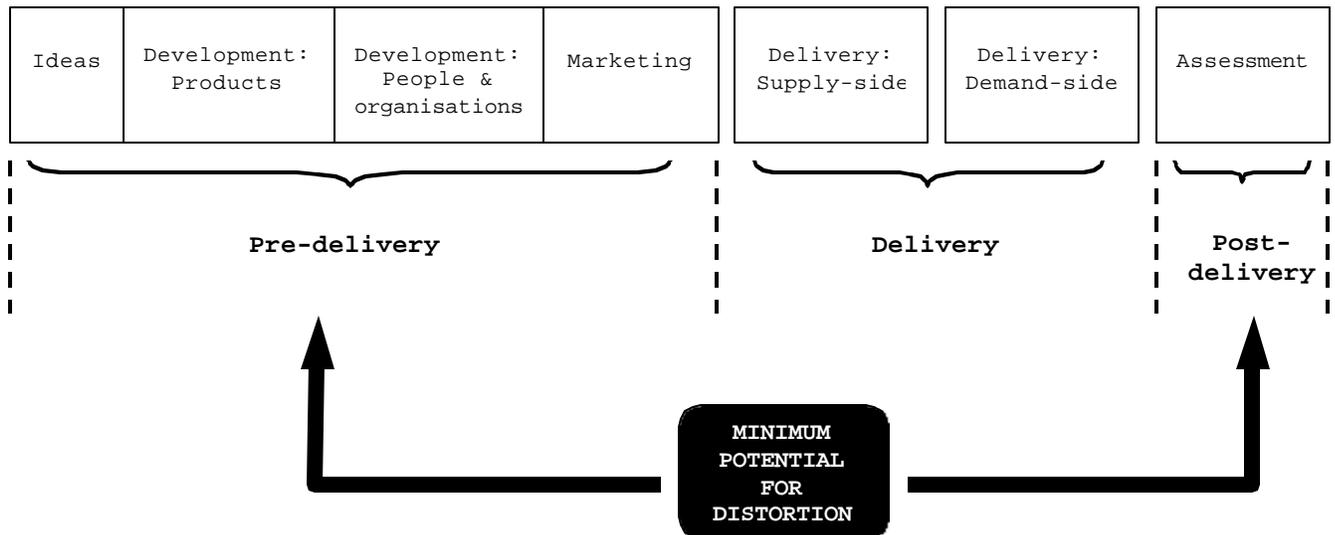
Where to intervene to minimise distortion?

All donor-financed support is a form of subsidy and has some impact on the BDS market place and therefore the potential to be positive or negative (i.e., distorting) in relation to the objective of market development. Distortion in markets is manifested in several ways, for example:

- Crowding out: an absence of private sector providers because of years of government/donor free provision;
- Low prices: SMEs, accustomed to significant subsidies in the delivery of products, place low value on BDS products;
- Distorted products: many "standard" products originating from development agencies (especially in training) were developed essentially as public education packages (costly and rather academic) rather than commercial products;
- Fee expectations: providers, accustomed to donor generosity, expect fees several times more than the levels suggested by "real" economy situations.

One key consideration in seeking to minimise distortion and strengthen market development is where donor subsidies should be located (Figure 9). In general, subsidies placed directly between the provider and the SME consumer have the greatest potential to distort markets than in the pre- and post- delivery stages (although they *may* also be a useful mechanism to support their development).

Figure 9: Minimising distortion - options for intervention in the BDS product cycle



Achieving leverage

Concerns about distortion should not lead development agencies to adopt interventions that are so minimalist that they achieve nothing. The challenge is to design interventions that find ways to *leverage* the private sector into investing, trading, developing products, etc. (using relatively few resources), rather than *replacing* private sector activity (through intensive intervention). Leverage might mean attracting matching investment from private sector providers, developing new products for licensing or franchising, or increasing private sector provision in a new market through some form of information provision.

Making support transactional

Fostering more effective, business-like BDS provision has implications for the capacity of facilitators (see 7.3) and for the way in which they deal with partners. In particular, they themselves must be more business-like. *Soft* support sends entirely the wrong messages to BDS providers, their clients and the marketplace undermining market signals or incentives. The implications for support are:

- Defining the package of support: recognising that just as there is a transaction between BDS provider and SME consumer, so there is a transaction between facilitator and provider. To be successful any transaction must have a distinct offer to both parties - who is going to get what?
- Linking support to performance: again this requires that the offer on both sides is defined. Performance-based support also means walking away when partners consistently fail to deliver (rather than keeping them on life-support). If the sanction for under-performance is not credible, incentives will not work.
- Reflecting market costs and mechanisms: ultimately any form of support, transactional or not, is artificial and carries the potential to distort service provision away from business and towards the donor. One solution to this would be to transfer support itself to the marketplace, using market mechanisms (and pricing). Some initiatives have begun considering such mechanisms as leasing of equipment, debt or equity financing for investment and 'priced' technical assistance.

Focusing on the basics: costs and profits!

One of the key weaknesses of many BDS interventions is *building organisations in advance of need*. Large 'front-end' investments are made in facilities, equipment and staff, resulting in a bloated cost base that bears no relation to the earning capacity of the BDS provider but rather is a creation of the more generous (but artificial) world of donor support. The language of this kind of intervention - *cost recovery* rather than *profit* - promotes an equally artificial culture of 'clawing back' revenues to finance unrealistic cost bases and unproductive investments, in response to donor demands for sustainability. Small businesses do not have this luxury: they grow in response to increasing demand and invest, when they can afford to, for productive purposes, to make a profit.

BDS for disadvantaged groups

The whole market development approach summarised throughout this paper is aimed ultimately at reducing poverty by embedding people with markets. Understanding the reality of BDS markets around SMEs and intervening to help them work more effectively is relevant for the economy as a whole and for the poor. Yet there may be particular mechanisms that can be adopted to particularly focus interventions that economic development is more explicitly pro-poor.

- Intervene *where the poor are*: some economic sectors are especially important to the poor (as self-employed people or employees). Women - generally poorer rather than men - often work in specific industries. Focusing market analysis around these may also focus benefits on the poor.
- Adopt a *portfolio approach* to partners. Working with a range of providers permits the intervention to pick partners who correspond to the particular market segments or target groups of the intervention, rather than trying to develop a one-size-fits-all single partner.
- Develop *efficient, low cost and appropriate institutions, mechanisms and products* to reach the disadvantaged, rather than simply subsidising services. As in microfinance, this will require that far greater attention is paid to measurement and costs, if the 'frontier' of BDS is to be extended.
- View *disadvantaged groups as potential market niches* for private sector providers, rather than pliant charity cases.

Finally, of course, it does need to be recognised that BDS is not a solution to all problems. In some cases people will not have the ability to pay, their situation will be too adverse. BDS cannot hope to overcome more fundamental problems related to, for example, the failure of governments to deliver basic services.

7.3 What are the implications for the capacities of donors and facilitators?

The change in approach to BDS outlined in this paper is significant. Built on a different view of SME development and BDS, it envisages new types of intervention, often with new partners and based on new relationships. For many agencies seeking to follow this approach, the change inherent within it will have major implications for their internal capacities and systems. Indeed it is likely that for some agencies the kind of change required to pursue BDS market development may be beyond their capability.¹⁶ Among the potential key challenges to be faced are:

¹⁶ In these cases, if structural reasons prevent donors playing a valid role then probably their focus should move to other areas - such as the policy environment.

Institutional structure

Facilitating agencies dealing with providers and other market players need to be able to develop transactional, business-like relations with them. This may need a degree of closeness and entrepreneurial flexibility that is difficult to achieve within the confines of a formal and accountable donor agency. In these circumstances, working with a "buffer" facilitator (probably a business or an NGO) may be necessary (see Appendix 1).

People

Intervening to support market development requires a good understanding of business and markets that is often foreign to people from a conventional development background. Staff selection and development therefore need to focus on building this capacity.

Scale of support

Many of the failings of the past in BDS have stemmed from donors' priority to spend budgets "efficiently" rather than on impacting positively on markets. The history of BDS is littered with severe and lasting distortions caused by too much donor money in the wrong place at the wrong time. Unlike say, microfinance, where large-scale disbursements (for on-lending) are possible,¹⁷ interventions that achieve BDS market development will usually be relatively small-scale, with multiple partners and, inevitably, involving *hands-on* management. Using *umbrella* project structures as well as facilitators may help to overcome this problem.

Criteria for assessment

Measuring performance in relation to market indicators has clear implications for approaches to evaluation. Furthermore, in some instances, as part of a transactional relationship, provider rewards may be based on performance against agreed targets. We return to this point in Section 8.

Beyond the mantra of donor collaboration

Finally, BDS markets in developing countries, especially those that are poorest and least developed, are often fragile, having been subject to a variety of more or less positive influences over many years. The BDS market development approach cannot hope to work if donors don't agree to its basic tenets and, if not in harmony, agree not to undermine each other's efforts. This places greater pressure on donors to work meaningfully with each other and with governments to create a consensus over the long-term picture and how we can get there.

¹⁷ Although many would argue that this is also distorting capital markets

8. Monitoring and evaluation in BDS: some distinctive characteristics

This Section highlights key features of monitoring and evaluation in BDS, especially in relation to what is measured (indicators) how these are measured.

Monitoring and evaluation (M & E) is, of course, always a key part of any successful development intervention - and this applies equally to BDS. Furthermore, there have been many other guides/tools that have sought to provide instruction on M & E in development projects (if less so on SME development). Given this, there is no point in trying to repeat here the broad *rules* of M & E. Rather what is more important is to highlight some distinctive challenges and features raised by the new approach to BDS outlined in this document - especially in terms of *what* is measured and *how* we measure.

8.1 Different but still the same

Although there are considerable differences between the BDS market development approach summarised here and "conventional" interventions there is still much that is common between them. BDS interventions - like others - undertake activities leading to delivery of outputs and causing impacts on client groups. Indicators still need to be developed to reflect different types of objectives. There are still a variety of different players in BDS and one needs to be clear who is being served by M & E systems. And there is no escape from the pervasive problems of attribution and displacement that lie at the heart of any attempt at evaluating impact. Most important, the four broad criteria of assessment for any intervention apply here also:

1. **Outreach: how many (breadth) and who are they (depth)?** - the quantitative scale of a project and the identity of people, SMEs and providers *touched* by it.
2. **Efficiency: are we doing things right?** - the rate at which inputs are turned into outputs.
3. **Effectiveness: are we doing the right thing?** - the extent to which higher-order impact objectives - related to changes in the real world of SMEs - have been achieved.
4. **Sustainability: will it last?** - as previously defined, this refers to the supply-side capacity to ensure that relevant, differentiated BDS continue to be offered to and consumed by SMEs beyond the period of an intervention.

M & E in BDS therefore still needs to reflect the above general criteria of performance.

8.2. What is measured: new objectives require different indicators

The key objective ultimately of this approach to BDS is to develop more effective markets and the approach to M & E needs to reflect this difference. In practice, among other indicators that may be used are the following:¹⁸

- Change in market size: number of SMEs purchasing services
- Change in volume of transactions: amount of sales by BDS providers
- Change in number of BDS providers
- Market penetration: change in the proportion of a potential SME market reached by a BDS
- Change in the number of BDS products available to SMEs
- Change in "average" price levels of BDS

Indicators also need to reflect the particular market constraint/failure that an intervention is immediately seeking to address as intermediate steps in promoting wider market development. For example:

<u>Constraint/Problem</u>	→	<u>Possible indicator</u>
Lack of information among SMEs of available BDS	→	Change in proportion of SMEs aware of particular BDS and providers
Low levels of confidence and satisfaction among SMEs in available BDS	→	Change in proportion of SMEs satisfied with particular BDS
Inappropriate and/or low levels of Product quality among BDS providers	→	Change in SME customers' perception of quality of BDS available
Low levels of skills and knowledge Among providers	→	Change in providers' awareness and use of new sources of technical/product information.

8.3 Implications for how to measure

At the core of the approach described in this paper are core principles of good practice in BDS emphasising the importance of being business-like and designing with the aim of developing more effective markets. These are principles not just on how interventions should be designed and managed but also on how they should be assessed. A number of points are of particular importance:

Using market research tools

In order to facilitate market development, agencies needs to have good market information. This not only provides the rationale for the direction of an intervention but

¹⁸ Many of these need to be defined more tightly for particular circumstances

also the base line for later analysis of impact and change. The market research tools summarised earlier therefore are important for evaluation as well as for intervention design. For many agencies this kind of assessment may be new but it is important if their role in BDS is justified in relation to market development.

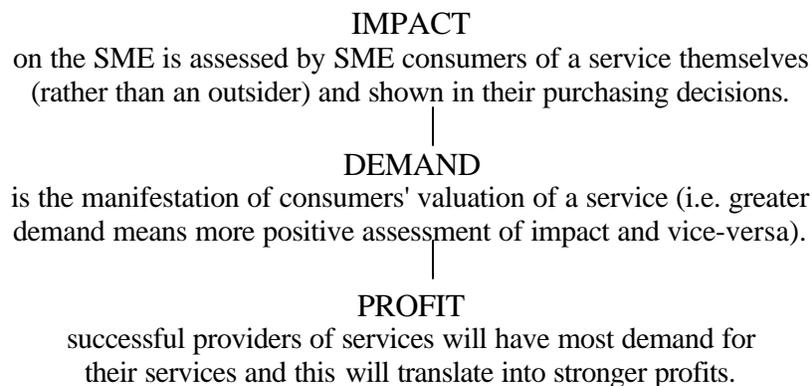
Recognising the business-like imperative in measurement

It clearly makes no sense for facilitators, on the one hand, to encourage providers to behave in a more market-oriented and business-like manner and, on the other, to impose on them restrictions that hinder this development. Yet, this is a common situation when providers are asked to invest their scarce resources in measuring indicators that don't help them to perform better - for example, indicators such as change in financial performance in SME clients or jobs created in the community. On the contrary, the opportunity cost of measurement and the change in behaviour required to measure non-business indicators tends to increase costs and undermines business orientation and leads providers towards donor needs rather than those of the market in which they operate. Two implications flow from this situation:

- As much as possible, facilitators should ensure that their own information requirements correspond with those of providers; and
- Where donors or facilitators have objectives that are clearly different from those of providers, assessment of performance against these should be managed separately rather than burdening providers with this responsibility.

Greater use of (and trust in) market-based proxy indicators

The difficulty and expense of measuring indicators of final impact on SMEs (let alone social impacts) and the belief in the discerning judgement of SME consumers (that underpins the market development approach) mean greater significance is now attached to *proxy* measures of impact. The so-called *profit-demand-impact proxy* is the most important of these. This works as follows:



A renewed focus on costs

One immediate priority in M & E is to focus on information that *can* be defined relatively easily: costs. There is no great methodological issue here; this is a matter of management discipline yet strangely these are often not well defined. Costs are a key part of efficiency and sustainability indicators as well as feeding directly into pricing decisions for market-oriented providers. While there a variety of definitions of costs that can be used, the important point is for transparency in how cost data is presented. Which specific costs are included in indicators will depend on the objectives of an intervention: if the objective is to encourage more profitable providers, all provider costs need to be included; if the commercialisation of a product is the main concern, then only costs directly and indirectly associated with it might be included.

Finally, following the experience of business (and that of microfinance) some agencies active in supporting BDS are pursuing the development of standardised benchmark indicators for performance measurement. However, as yet, it is far from clear that this is feasible in such a diverse field as BDS.