BRIEFING PAPER

BUSINESS ENABLING ENVIRONMENT AND THE VALUE CHAIN

INTRODUCTION

Historically, reform interventions tended to target exclusively the *macro*-level, emphasizing privatization, macroeconomic reform or fiscal reform. Despite considerable investments of time and resources, results were disappointing in terms of economic growth and poverty reduction. Recently, there has been a growing excitement about the potential for *micro*-level business enabling environment (BEE) interventions to fuel growth, create jobs and reduce poverty by stimulating and supporting changes in the behavior of private-sector firms, strengthening their incentives to invest. Adding to this excitement is recognition of a new willingness on the part of many developing country governments to make changes in the BEE—in part as a result of the World Bank's "Doing Business"[1] guides, which have helped create transparency and regional competition by rating countries according to the impact of their regulatory frameworks on economic growth.

While micro-level BEE interventions can be used in support of a broad range of economic development programs including sectoral development, micro-, small and medium-sized enterprise development and competitiveness programs, this briefing paper focuses on the intersection of the BEE reform and value chain development processes. The reason for this focus is twofold: first, BEE interventions complement the value chain approach in its targeting of specific industries, use of analytical tools and development of industry constituencies; and second, the value chain framework is a useful construct for selecting and prioritizing reforms.

WHAT IS SUCCESSFUL REFORM?

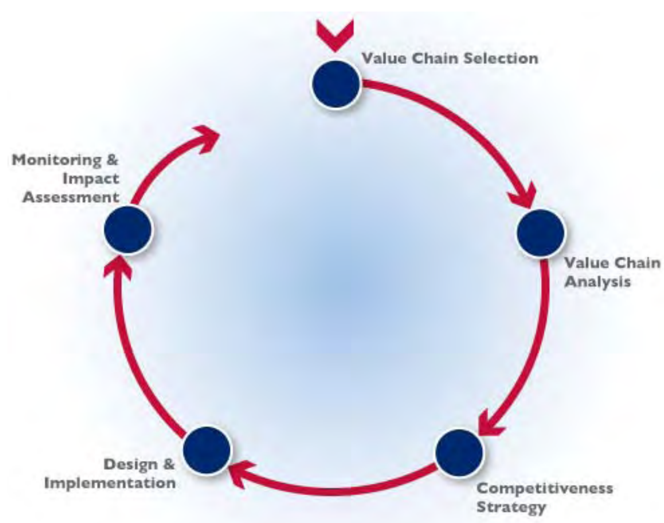
Reform is a political process that encompasses much more than a series of inputs leading to discrete legal outputs. Successful reform incorporates relationships and shapes incentives that drive both business and government behavior. Successful reform builds trust, promotes transparency and ensures that benefits accrue to those taking risk. The most significant policy reform may not be the creation of a new law or policy, but rather changing or improving the implementation of an existing law or policy.

Successful policy reform requires changing three things: 1) how laws are implemented; 2) the burdens that are placed on businesses and the relationships in which businesses can engage; and 3) the incentives that drive business decisions. If a reform cannot be confidently expected to change how businesses make decisions, it may be preferable to focus resources elsewhere. Private-sector entities within a value chain can inform the process: they know whether or not a law is important, and whether reform is likely to change how they behave.

BEE AND THE VALUE CHAIN PROJECT CYCLE

Consideration of the enabling environment should inform each stage of a value chain development project (see figure 1). BEE constraints or opportunities may

Figure 1: Value Chain Project Cycle



[1] www.doingbusiness.org

influence the *selection* of value chains targeted for development; an analysis of policy constraints and opportunities, which is integral to *value chain analysis*, can be used during the development of a *competitiveness strategy* to identify where and how to compete in target markets; activities leading to policy reform are often a key component during *implementation*; and *monitoring* of progress in the area of reform may lead to a reassessment of the choice of value chain should BEE constraints be so binding as to prohibit or severely limit the return on investment.

The value chain provides both a context for assessing policy barriers and a framework for organizing and prioritizing reforms. The value chain framework facilitates the identification of binding BEE constraints (see text box) and the "reform selection process" framework (figure 2) aids in the strategic prioritization of these potential reforms and an assessment of their impact on the chain's performance. Such an assessment helps avoid *ad hoc* decision-making and promotes a more thorough determination of which reforms will change investment behavior. Working within the context of a value chain allows the impact of a reform to be identified and quantified. This type of analysis contrasts with others, such as national policy studies, which do not necessarily reveal the contribution of a reform to the growth of specific industries.

TYPICAL BEE BINDING CONSTRAINTS

Policy Issues:

- Trade barriers
- Customs, standards
- Foreign direct investment constraints
- Licensing restrictions
- Government subsidies

Enforcement Issues:

- Unequal enforcement (industry policies, taxes, licensing, permits)
- Unequal access (land, public infrastructure, energy)

By contextualizing policy reform within value chains, more closely aligned constituencies and coherent advocacy groups can be readily identified. This not only increases the speed of reform, but reduces risk by enabling advocacy groups to engage productively with government to achieve common goals: greater competitiveness, increased exports or economic growth. Established constituencies can monitor the reform process to ensure policies are not subverted. In addition, by aligning BEE interventions with value chain development programs, implementation resources can be leveraged. While industry-specific reforms are clearly not the only entry point for BEE interventions, they can increase the probability of success, and inform and lay the foundation for broader reforms.

Value Chain Constraints Assessment and Selection

When targeting reforms, four criteria—impact, cost, time and difficulty—should be assessed together with the trade-offs between them (see figure 2). The resolution of a particular policy constraint may be necessary to reach project objectives or maximize results in a value chain activity. However, before selecting the policy for reform, the feasibility of completing the implementation of the reform within the project cycle should be considered.

Figure 2: Reform Selection Process: Example of a Shrimp Feedstock Import Constraint

Impact	Removing constraint reduces feedstock cost by 50%	
Cost	Will require parliamentary action – significant education, analysis of impact and advocacy involved	
Time	Parliament could pass it in one year	
Difficulty	There is little current support outside of industry No lead firms appears willing to champion this Current licensee holds significant sway in parliament	
Summary	The negatives and positives are roughly equal There may be better opportunities in other reforms	

Some BEE constraints, such as property rights, may require a much longer timeframe to address—often 10-20 years. Furthermore, governments tend to avoid reform if benefits are not expected to materialize until they are already out of office. Therefore, reforms that can be quickly completed and produce benefits within a short period of time are more likely to receive government support. The World Bank has found that the benefits of reforms listed in the "Doing Business" framework often accrue 12-18 months after the reforms are completed. Conversely, beginning a reform agenda with difficult reforms such as land tenure or attacking corruption in the customs administration constitutes a high-risk strategy. By addressing simpler issues first—such as reducing the number of inspections—success and momentum can be created and credibility established, allowing for a transition to increasingly complex policy issues.

The cost of a reform should be assessed carefully. Value chain analysis permits identification of complementary activities being carried out by other donors or projects that might be leveraged to reduce the cost and increase the effectiveness of a BEE intervention.

Implications for Project Design and Implementation

Reforms should be part of an overall BEE strategy. Discrete reforms should build into a larger strategy for a sustainable process of reform. A coherent strategy designed to strengthen the competitiveness of a sector or of the economy as a whole is essential to avoid falling into the trap of providing one-off *ad hoc* solutions that do nothing to ease the process of addressing additional or subsequent constraints. BEE initiatives should build the dialogue, advocacy, trust and momentum necessary to accelerate the removal of policy constraints and engage in the broader reform process.

Information is critical to effective dialogue. Without quantifiable information about the impact of a BEE constraint, a business or group of businesses is just one of countless others complaining about the actions of the government. By addressing reform through a value chain lens, the specific impact of policies can be identified in terms such as the volume of exports forfeited or market share lost to imported products. Such data allows for a more compelling dialogue with the relevant authorities.

Government and private-sector ownership is key. Champions are needed within the government and among businesses within the value chain for reforms to succeed and policies to be enforced and monitored over time. The role of donors is not to advocate, but rather to support the advocacy process in an even-handed way, ensuring transparency and the flow of information. A critical part of government ownership is ensuring that the government receives public recognition and credit for its role in successful reforms.

Local or regional implementation of the existing legal framework may be more important than the reform of national policies. In Vietnam the myriad steps, requirements, days and visits needed to register a business vary enormously among different provinces, despite the existence of a national legal framework. This illustrates two important issues: 1) implementation of the law matters and 2) what happens at the municipal level is more relevant to how businesses operate than decisions and actions taken at the national level. An exclusive focus on the national government misses an enormous opportunity to directly address BEE constraints. Local governments determine transaction costs and the incentives for businesses to formalize. Their support of or hostility to business affects business relationships and upgrading decisions—key factors in the competitiveness of a value chain.

Changing incentives can have a powerful effect on behavior. Reforming laws is often insufficient to improve the BEE since it does not change the incentives for poor government behavior. In one Egypt business registration project, corruption was an issue and embedded resistance to reform seemed prohibitive. The project made the registration process transparent and stipulated that if the business registry completed the process within the target number of days the registry employees would receive 50 percent of the registration fee. The employees now had an incentive to keep the process moving and the new transparent systems allowed bottlenecks to be identified. In instances such as this, changing the incentives within an institution can be more effective than changing the law.

A successful reform strategy involves building private sector and local government capacity to engage with each other. Effective engagement between the government and the private sector (including small and informal enterprises) requires training and support for both sides. Private-sector advocacy capacity can be built through studies on specific BEE issues, funding for advocacy initiatives, and the establishment of links between value chain businesses and institutions that can support reform. Similarly, local government skills can be strengthened through training and the facilitation of dialogue between local government agencies and private-sector associations or representatives. Consultation on a particular issue can provide the forum for the organic development of public-private dialogue.

BEE support structures are key to success. For the reform process to be sustainable, support structures must be developed. Value chain stakeholders may need to be linked to specialist service providers such as think-tanks and universities. The media should be encouraged to report on BEE issues and assisted in understanding policy constraints and the positive impact of reform.

Quick successes generate opportunities for more success. The key lesson in implementing a BEE strategy is to start with reforms that can be rapidly implemented and will quickly demonstrate impact. Successful reform in one area generally opens up opportunities for interventions in other parts of the enabling environment. Conversely, stagnation and lack of success will restrict possibilities. Quick successes demonstrate the feasibility and potential benefits of reform, and generate support for broader reforms.

BEST PRACTICES FOR BEE

- Adopt a systemic approach to reform
- Understand and respond to the political economy of reform
- Respond to and stimulate the demand for reform and drivers of change
- Ensure domestic ownership and oversight of reform efforts
- Strengthen the role and capacity of key stakeholders Focus on what the private sector needs through public-private dialogue
- Focus on the binding constraints to business growth and scope reforms accordingly
- Sequence business environment reforms and allow time
- Address the implementation gap
- Formulate a communication strategy and use media strategically
- Work with government as the lead agent
- Align business environment reforms with national development plans
- Ensure good donor coordination
- Balance international and national expertise
- Promote quality assurance in development agency support of business environment reform

Source: Supporting Business Environment Reforms: Practical Guidance for Development Agencies. Donor Committee for Enterprise Development. 2008

THE POST-CONFLICT CONTEXT

Maintaining a focus on the BEE in post-conflict countries can be a challenge due to competing—and more obviously urgent—priorities (humanitarian assistance, the peace building process, de-mining, etc.). However, in many post-conflict environments, policy constraints create bottlenecks in key industries and drive up prices, thereby decreasing the impact of development funds. Failure to relieve such constraints can contribute to destabilization as frustration with the government grows. Conversely, removing these constraints not only facilitates the development of domestic industries and stretches donor funds, but also allows the government to demonstrate its commitment to reform, its legitimacy and effectiveness. Early reforms provide critical signals to investors in post-conflict environments.

Even before reforms have been achieved, government can provide the public with an indication of its commitment to reform by engaging in dialogue with the private sector. Dialogue with the private sector can be used to identify the key laws, regulations and government entities that are constraining business, which become the priorities for reform. In the medium-term, typical reforms include capacity building, licensing reform, trade logistics and customs reform; and in the longer term, business registry and investment promotion

A conflict lens should be applied to understand how the reform process will—at a minimum—adhere to the principle of "Do no harm." Donors and implementers should avoid focusing on regulations that may exacerbate regional disparities and should find multiple champions for reform. Since increased participation in the reform process generally leads to broader public support, which in turn increases the likelihood of success, donors and implementers should ensure that information is available to all stakeholders to enable them to engage in meaningful dialogue.

Please send comments and suggestions on this brief to Jeanne Downing (jdowning@usaid.gov) and/or Ruth Campbell (rcampbell@acdivoca.org).

This paper was written by Scott Kleinberg of USAID and Ruth Campbell of ACDI/VOCA and funded through the **Accelerated Microenterprise Advancement Project (AMAP)**. For more information on AMAP and related publications, please visit www.microLINKS.org or contact Ruth Campbell, ACDI/VOCA AMAP Program Manager (RCampbell@acdivoca.org).