Private Sector Competitiveness Enhancement Program

PRIVATE SECTOR COMPETITIVENESS ENHANCEMENT PROGRAM

YEAR 1 WORK PLAN

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SECTION I. INTRODUCTION

Chemonics International is pleased to present the first annual work plan for the USAID Private Sector Competitiveness Enhancement Program (PSCEP). Competitiveness is a complex, multi-dimensional concept, but at its core, it is about two broad issues: strategy and execution. PSCEP's strategic focus, its overall guiding vision that defines strategic choices, has been articulated in USAID's Request for Proposal (RFP) for the project, Chemonics' proposal, and the project contract. This strategy is summarized below.

As the adage says, a strategy that cannot be executed is nothing but a dream. Put another way, the best conceived strategy will fail if it cannot be executed effectively with the available resources and necessary time frame. This document focuses on PSCEP's first year of operations and execution plan. It provides a road map that illustrates how, when, and by whom project activities will be executed. Although it covers the entire period from October 2008 to September 2009, it emphasizes the first six months of operation, through April 2009. At that time, the PSCEP management team, together with USAID and the Ministry of Economic Development (MOED) will assess progress to date and make any necessary first-year corrections.

This Work Plan reflects several tenets of our approach that are integral to the described program activities.

It is imperative to demonstrate program impact over the short run. Chemonics shares USAID's sense of unique opportunity at a time when the Government of Azerbaijan (GOAJ) and the private sector are investing major resources in the country's economy. Similarly, we share a common urgency about delivering results quickly.

Developing early, productive institutional relationships with key USAID stakeholders is essential. A key work plan objective is developing close working relationships with institutions such as the Ministry of Economic Development (MOED), the Azerbaijan Investment Company (AIC), international companies such as British Petroleum (BP) and its Enterprise Development Center (EDC), Regional Executive Committees, other USAID and donor programs, and existing associations and stakeholder groupings.

Leveraging investment capital, know-how, and human resources is central to all activities. We will focus on identifying synergies and what we deem "leveraging points," i.e., strategic activities where USAID resources can be the catalyst in bringing to bear much greater resources.

SECTION II. PROMOTING COMPETITIVE VALUE CHAINS AND ECONOMIC SECTORS

A. Conceptual Framework

PSCEP aims to increase private sector competitiveness and growth through strategic interventions aimed at creating jobs and income generation in key sectors of the economy. Although competitiveness must be driven by the private sector, government needs to be a partner in its attainment. Accordingly, PSCEP will also work closely with key GOAJ institutions such as the MOED, AIC, and regional authorities to promote effective public-private sector partnerships.

The program will focus on a combination of targeted, sector-based technical assistance and training designed to provide technology transfer, promote greater access to sustainable capital, enhance value chains, and help identify new markets and strategic partnerships.

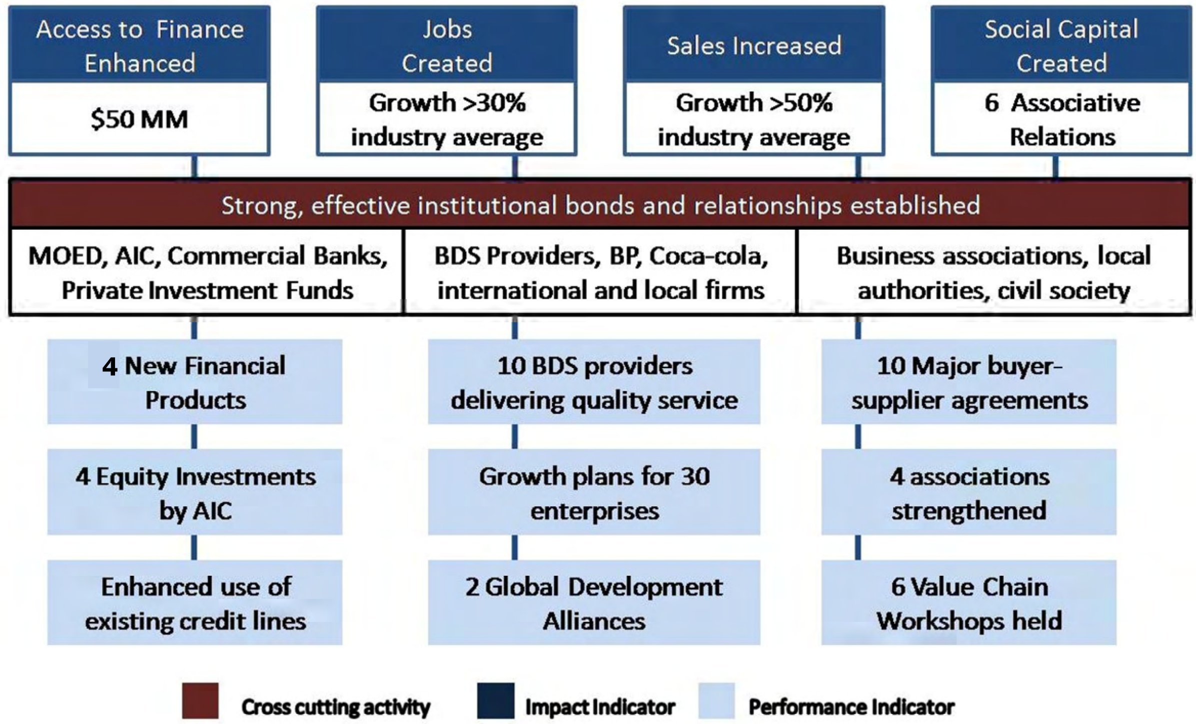
As Michael Porter noted in his seminal work, *The Competitive Advantage of Nations*, it is not sectors or nations per se that attain "competitiveness," but individual companies. A sector or nation's competitiveness is nothing more than that of the aggregate of all its enterprises, which are, of course, influenced by the enabling environment in which they work. For this reason, PSCEP undoubtedly needs to undertake strategic enterprise-level assistance. We fully share the vision of USAID and the GOAJ, however, that the program will not be a continuation of the enterprise-level focus of ABAD, RECP, and other legacy USAID business development program but will build on those efforts, including lessons learned. For example, several business development service (BDS) providers initiated by ABAD and RECP are likely to become part of PSCEP's BDS portfolio.

While necessarily delivering strategic firm-level assistance, PSCEP will focus on sector-level impact and competitiveness. PSCEP will provide firm-level assistance when it enhances sector-level objectives (e.g., promoting business relationships between lead or "anchor" firms and smaller enterprises). Program activities highlighted below will also address cross-cutting sector concerns such as access to capital, food safety and quality management, standards, and training. As discussed in more detail below, a major sector-level focus will be to promote associative relationships in each sector (e.g., through association creation and strengthening, and cluster promotion).

B. Hierarchy of Objectives and Targets

In implementing PSCEP, we have set for ourselves a broad array of targets and benchmarks, including the number of enterprises assisted, profitability, employment, and many others discussed in Annex A, our Performance Monitoring Plan (PMP). These may be divided, however, into two broad categories: primary and secondary targets. Primary targets are *ends* that comprise the essence of program success: promoting investment, creating jobs, increasing sales, and creating social capital through associative relationships. Secondary program targets are *means*, i.e., training, number of enterprises assisted, etc. While striving to meet all program targets, our focus will be on the former: promoting investment, creating jobs, increasing sales, and creating social capital.[1] It could be reasonably argued that social capital is a second-tier objective, i.e., it is an input in creating jobs, sales, and even investments. PSCEP's perspective is that although this view is technically correct, the issue is much more complex: USAID's emphasis on associative relationships is well placed. We would argue that it is quite possible to create jobs and sales without social capital, e.g., it is not a required input. For example, an investor may be looking primarily for cheap labor. Creating *sustainable* jobs, however, requires a strong infusion of social capital and "mindset" changes. Although one could argue that it is an input, its crucial importance to development and sustainability makes it equally appropriate as a primary objective. Figure 1 below highlights this hierarchy of objectives.

Figure 1. PSCEP Hierarchy of Objectives and Key Year 1 Benchmarks



[1] The PMP provides a detailed discussion of these targets. Increasing profitability is perhaps even more important than increasing sales. On the other hand, measuring the former can be difficult in non-transparent societies and even in developed economies, for firms that are not publicly traded. Similarly, there are some inherent contradictions in choosing employment as a competitiveness indicator. Some firms and sectors may become more competitive by shedding, not increasing jobs. But this is an issue that USAID and donors must address worldwide, not just for PSCEP. The focus will be on the creation of sustainable jobs that enhance productivity. In fact, according to Nobel Laureate Economist Paul Krugman, productivity is competitiveness' one essential metric. Neither the PSCEP nor the current PMP plan calls for measuring PSCEP's contribution to sector productivity, but this is an area that we will explore in the near term.

[2] Jim Collins, *Good to Great: Why Some Companies Make the Leap…and Others Don't,* New York: Harper Business, 2001.

But there should be no misunderstanding or question about our commitment and our confidence in delivering quick results: By the end of the *first six months* of operations (April 2009), USAID, the GOAJ, and project stakeholders will begin receiving continuous feedback on project progress that reflects well on the investment by USAID and the GOAJ. This will include:

- Quantitative and qualitative analysis of six sectors and at least eight to ten subsectors that reflects solid strategic thinking, including detailed value chain action plans.

- Institutional relationships developed with key stakeholders, including memoranda of understanding (MOUs) or other strategic alliance relationships with AIC, BP, and at least three associations in the sectors selected. Beyond quantitative measures, we expect that by the end of January, these and other institutions will view USAID/PSCEP as a strong ally and advisor.

- AIC road shows, with PSCEP assistance in all major regions in the country, with significantly improved deal flow for our partner and a comprehensive institutional training plan being implemented by AIC. By the end of Year 1, we expect AIC to make no less than four major investments, with our assistance. Similarly, we expect a close relationship with the Caspian International Investment Fund (CIIF), framed by a MOU with that institution.

- Concrete plans with commercial banks to develop at least four new financial mechanisms developed to increase access to finance.

- Relationships established with 10 BDS providers, providing direct assistance in market information systems and investment and access to capital.

- Considerable progress toward creating social capital, including no less than one associative relationship formed per sector.

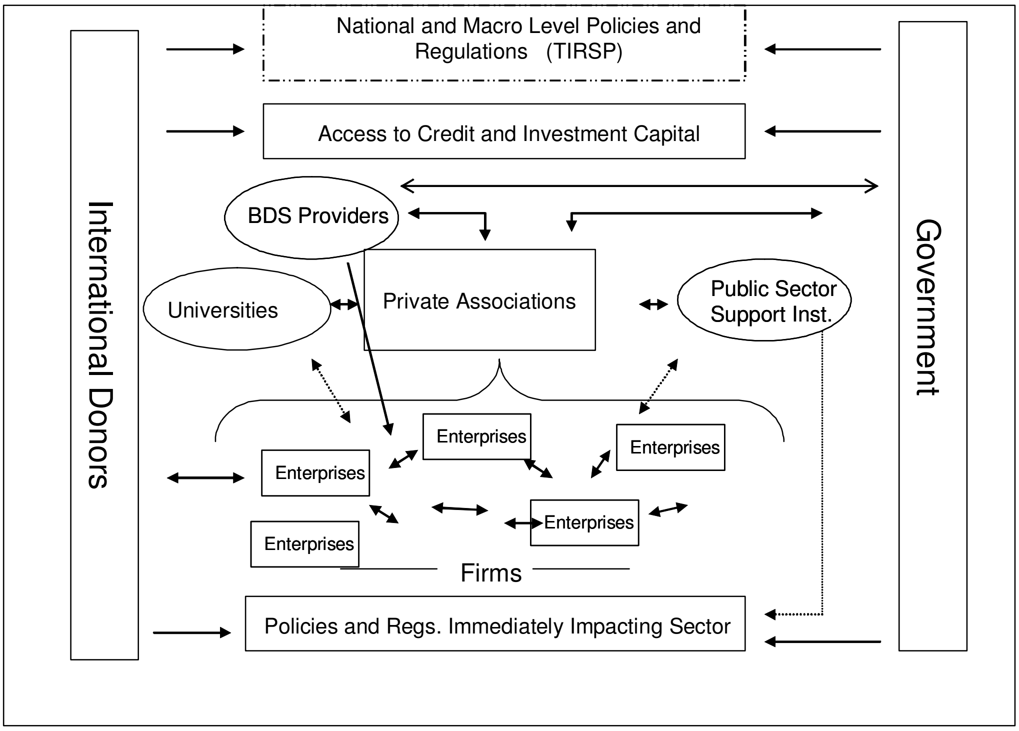
In Year 1, these activities will result in more than $50 million in leverage investment and access to finance, job creation and sales of 50 percent above the industry trend line for the sectors we work in, and associative relationships that will lead to the creation of social capital and generate economic returns well into the future. We expect that our work will impact directly or indirectly on more than 100 companies.

C. Making the Whole Greater than the Sum of Its Parts

As previously noted, we are committed to ensure that the *sum impact of our enterprise-level activities is greater than the simple aggregate of these efforts.*

In our work, PSCEP will follow a value chain analysis (VCA) approach, akin to what we described in our technical proposal as a "sector innovation system." Figure 2 below illustrates this approach. The system or complete value chain is the network of institutions, and information and idea flow in the public and private sectors whose activities and interactions initiate, import, modify, and diffuse new technologies and approaches.

Figure 2. A Sector Innovation or Enhanced Value Chain Approach



As we noted in our proposal, the key elements of such sector innovation systems are already in place in Azerbaijan. The GOAJ is investing in the regions and the non-oil sector through new infrastructure, communications, and energy, as well as through support organizations like the Azerbaijan Export and Investment Promotion Foundation (AZPROMO). The AIC is actively looking for investment opportunities in many of the sectors in which we will work, with PSCEP assistance.

Despite progress, there is a dearth of effective coordination, and many programs operate independently from one another. What is needed is someone to be the dynamic central amalgamator, to bring disparate programs together to create synergies that ensure that the total impact of these initiatives is greater than sum of individual programs — and PSCEP proposes to fulfill that role by the end of Year 1.

D. Implementing the Value Chain Approach

PSCEP will implement this approach by:

- Addressing value chain obstacles that affect the sector as a whole, e.g., packaging, logistics, human capital requirements, access to credit, and undertaking this analysis in a participatory fashion;

- Widely disseminating the results of value chain analyses, with stakeholder feedback;

- Incorporating a broad group of stakeholders in each value chain (buyers, sellers, suppliers, financial institutions, local authorities and communities, and the public sector);

- Focusing on value chain/sector level impact, even as we work with individual firms (e.g., forging associative groups of suppliers to work with a single lead firm which may be the focus of our assistance);

- Forging partnerships and associative relationships between sector stakeholders, especially public-private partnerships; and,

- Identifying key policy and regulatory issues and building the capacity of the private sector to forge dialogue with the public sector on these issues, without getting caught up in long-term policy reform work.

Specific Activities:

Sector or value chain action plans. These plans, which will be undertaken following sector selection, will be the primary vehicle for developing PSCEP activities. Action Plans will be based on a conventional value chain analysis (VCA) that includes:

- *Market analysis*. An analysis of industry trends, recent exports, price trends, known buyers and, especially, their demands and expectations. This analysis will provide a good understanding of the sector's standing within the national, regional, and world economies.

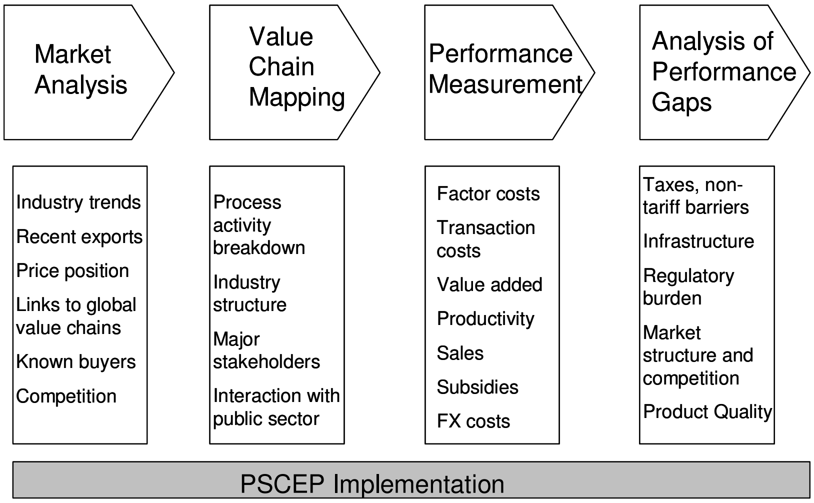
- *Value-chain mapping*. A value chain map depicts all activities, stakeholders, and relationships among segments of the chain and the interactions between producers and intermediaries. It identifies major stakeholders and their relative importance, including the relative strength of particular segments, value chain governance issues, etc.

- *Performance measures and benchmarks.* Disaggregating costs along the value chain in transforming raw and intermediate inputs into a final product helps to identify the key cost drivers that influence the final landed price of a product. Cost drivers can be examined and linked to macroeconomic factors (e.g., interest rates, foreign exchange rates, as well as microeconomic factors). A Domestic Resource Cost analysis (DRC), undertaken for selected sectors, will contribute to this effort.

- *Analysis of performance gaps*. We will use Strength, Weaknesses, Opportunities, and Threats (SWOT) and other types of analysis to identify constraints with product quality and standards, pricing and competitive positioning, administrative/regulatory/policy barriers, human resource constraints, etc.

This VCA focus is illustrated is Figure 3 below.

Figure 3. Key Elements of Value Chain Action Plans



Value Chain Exchanges and Dialogue. PSCEP will lead an ongoing dialogue with value chain stakeholders on constraints and opportunities facing the sector. Much of this dialogue will be informal. As discussed in the previous section, our experience worldwide, especially in creating social capital, shows that bringing people together in large formal meetings without undertaking sufficient relationship-building work is often counterproductive. Consultants putting together the Value Chain Action Plans will meet with various stakeholders as part of this process and provide a written and oral presentation to this group. PSCEP staff, including BDS provider partners, will enhance this work through additional inputs, dialogue, and exchanges. Taking advantage of a consultant's return to implement part of the Value Chain Action Plan Strategy, we will undertake one or more larger, more formal, and highly visible workshops in Baku or the regions. From these exchanges and the inclusion of a growing list of stakeholders, PSCEP will work with the private and public sectors to develop a sector innovation system whose work will be led by Azerbaijanis and therefore will have full ownership within the country. This strategy will be applied for each sector.

Training and Human Resource Development. As appropriate for each sector, PSCEP will develop training and human resource development initiatives. Most of these efforts will involve leveraging existing resources. For example, we expect to lead at least one university-private sector curriculum enhancement initiative in Year 1.

Table 1. Key Value Chain Activities in First Semester

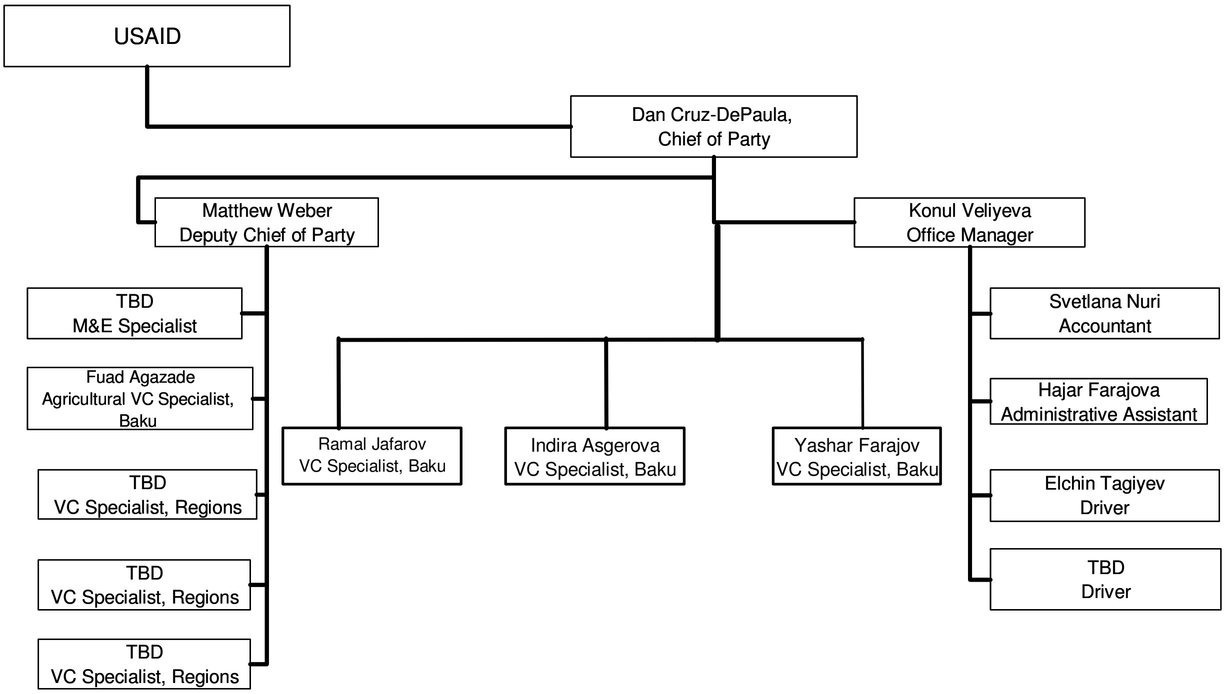
Selected Key Benchmarks	Timing
Sector Action Plans. For first three sectors/Two additional sectors/Final sector (subsectors will be identified on a rolling basis).	December 2008- January 2009 (first three)/ March 2009 (2)/April 2009 (1). Expect to have 3 agricultural subsectors by January 2009.
Workshops with leading stakeholders on Value Chain Action Plans	February 2009 (1); March 2009 (1); remaining April-June 2009
Publications on value chain issues for local press, stakeholder groups	March 2009 (2) remaining will be ongoing
AIC training needs plan developed / Begin implementation	January 2009 / February 2009
Azerbaijani led Value Chain Analysis, undertaken by stakeholder association	June 2009
University-Stakeholder associative relationship, focused on human resource needs	April 2009

SECTION III. MANAGING FOR RESULTS

A. Staffing for Results

PSCEP's organizational chart is presented in Figure 4.

Figure 4. PSCEP Organizational Chart



As a client-focused organization, our team will work under, and respond to, USAID guidance. Although the relationship with the MOED will be managed primarily by USAID, we are aware that as a stockholder in PSCEP, the MOED is also part of the client structure.

Chief of Party Danilo Cruz-DePaula will provide overall program leadership. Specifically, he will manage and be responsible for the key institutional relationships. This includes USAID first of all, but also the MOED (under USAID direction), AIC, international companies such as BP, other donor coordination, major private companies, and liaison with other USAID programs. He will also directly supervise nonagricultural value chain specialists and administrative staff.

In selecting value chain specialists, we have looked for a combination of attributes and skills. Building on the knowledge and lessons learned from the business development efforts of USAID and other donors is important. All four Baku-based value chain specialists have had at least some exposure to previous USAID small and medium enterprise (SME) programs and some of them have extensive experience. We have also looked for business savvy and an understanding that PSCEP is indeed different from previous programs, in short, for people who want to go beyond just doing what was done in the past. We have not simply tried to identify people who fit into a preconceived box on an organizational chart; we look at the person's particular skills and experience and then find a place for them to fit organizationally. In delivering effective consulting services, people are everything.

Deputy Chief of Party Matthew Weber will be responsible for the agribusiness sectors and subsectors. He will supervise at least one Baku-based value chain specialist dedicated to agriculture and at least three field-based employees, hired under performance-based contracts. We have identified a list of potential value chain specialists. The critical path for their hiring, however, includes BDS selection as well as extensive due diligence in ensuring that the proposed incentive compensation scheme complies with USAID regulations, as described in the following section.

Given the importance of the agribusiness sectors and subsectors and the anticipated level of travel to the regions, we believe that this division of responsibilities between the chief and deputy chief of party with respect to supervising value chain specialists makes sense. The deputy chief of party will also supervise the monitoring and evaluation function, which, as discussed below, is important both for reporting results to USAID and the MOED, as well as to ensure fair and effective performance-based incentives.

This organizational structure will be reviewed periodically and amended as required. Moreover, technical and other responsibilities are not rigid. The deputy chief of party will be fully involved in administrative issues and decisions. Mr. Weber will also assist in ongoing non-agricultural issues. Similarly, the chief of party will spend considerable time — certainly initially — in establishing the relationships with the agricultural BDS providers and regional staff.

We are very pleased with the team we have assembled over the last month. Nonetheless, we have made it clear to all hires that six months from now, our team will have demonstrable passion for their work, evident willingness to persevere despite initial obstacles, and will be fully committed to results and strong team players. That we can guarantee. *Who* will be seated in the chairs depends on their performance. We will not hesitate to make quick staffing changes, if required, to ensure that we have the right team.

B. Incentives for Performance

Development economist William Easterly argues that a major reason that when development programs fail, it is often because of their inability to align the incentives of those who execute the programs with donor objectives and/or with the motivations of the clients they serve. We plan to attack that potential problem head on by providing USAID-compliant financial performance incentives for PSCEP's value chain specialists to deliver results. Local staff will be rewarded for exceptional performance in exceeding targets.

USAID shares the GOAJ's goal to revitalize and transform selected sectors of Azerbaijan's economy. Businesspeople in those sectors want to make money, chiefly by increasing sales. To ensure that the same aspirations drive our value chain specialists, we shall reward them financially for exceeding their negotiated annual targets. We will establish a bonus pool for both Baku-based and field-based staff for this purpose. The more they exceed established targets, the more they will earn, up to the pool amount. Targets will be based on "incremental" sales, i.e., sales above both predetermined baselines and overall sector growth rates.

Operationally, the chief of party will negotiate sales targets with the value chain specialists and the BDS providers at the beginning of each year.

Incentives for BDS providers and value chain specialists in the regions. As described below, PSCEP will subcontract through a transparent, competitive mechanism with BDS companies initially in Ganja, Guba, and Lankaran to provide "facilitation" services in the north and northwest, east, and southern regions of the country, respectively. Each company will provide one or two value chain specialists. Their mandate will be to expand economic activity in the sectors of interest to PSCEP in their regions.[3] Specifically, we plan to pay the BDS provider to hire, with PSCEP approval, a value chain specialist at a salary of approximately 500 AZN (to be negotiated), which is relatively low by local standards. PSCEP will compensate these BDS providers (and indirectly their chosen value chain specialist), however, with "commissions" or "success fees" for the extent to which they exceed their sales targets. We are still refining our scale, but believe that the scale described in Table 2 provides the appropriate incentives — although we are still analyzing the best possible structure.

Each regional BDS provider will have its own targets. For BDS providers that have more than one value chain specialist, the specialists will receive two-thirds of their bonuses based on their combined effort and one-third from their individual performance, to encourage cooperation and teamwork. In other words, we will provide a big incentive to cooperate and work together, while still rewarding individual performance.

In negotiating sales targets, the chief of party will rely on experience from ABAD and other projects around the world that have set sales targets for business service providers. From that experience, it is possible to make reasonable inferences as to how much sales we can expect an investment in business facilitation services to deliver. Because PSCEP proposes to focus its support on activities with the promise of sector-level impact, it will be possible to set higher targets for PSCEP than, all other things being equal, for projects focusing on individual firms.

Performance targets will be much smaller than the targets for the entire project. That is so for two reasons. First, they are targets for specific business service providers in specific regions, not for the entire project. Second, the targets will limit themselves to what lies within those providers' immediate manageable interest, exclusive of the broader effects we expect to see emerge in the economy at large.

[3] It should be noted that it is common in Azerbaijan for BDS providers to operate on commission, that is, to charge, not by time expended, but as a percentage of results achieved. PSCEP will build on that practice.

Table 2. Illustrative Performance Incentive Scale

Rewarding Results	
% over the target	**AZN per person per year**
>200	10,000
175-199	8,750
150-174	7,250
125-149	6,125
100-124	5,000
75-99	4,000
50-74	3,000
25-49	2,000
0-24	1,000
<0	0

BDS providers will be given incentives to provide results. In addition to performance bonuses, we will pay a nominal fee to each BDS to cover direct office expenses (printing, paper, etc.). Most importantly, these value chain specialists will serve as "rain makers" for the firm. As described below, we do not intend to crowd out private companies from providing for-fee BDS services. The clients that the value chain specialists bring in will also generate income for the companies, setting them on a path to sustainability.

We will incorporate finance and investment into the bonus mix. In the medium term, the ongoing competitiveness of the priority sectors for PSCEP will depend heavily on investment in physical plant and equipment. It is therefore essential that the regional value chain specialists go beyond spot sales and think and act strategically for the longer run. For performance incentive purposes, therefore, each dollar of investment in physical plant and equipment (not working capital) that the value chain specialists generate in their regions will be weighted five times greater than a dollar of sales per se.

Incentives for value chain specialists in Baku. We foresee regional value chain specialists as working primarily to generate transactions. In contrast, the work of PSCEP value chain specialists in Baku will be more diversified, involving considerable interaction with a broad range of stakeholders. While the regional value chain specialists will be completely focused on generating sales, jobs, and investments, Baku-based staff will often be involved in doing research and other functions. Undoubtedly, their work will contribute to sales, but not always in the same relatively immediate way as in the regions. For that reason, the incentive system we put in place in Baku will necessarily be more ad hoc and will involve considerably smaller bonuses. PSCEP will provide up to 8.33 percent in annual bonuses to its Baku-based value chain specialists. This amounts to a thirteenth month of salary, which is paid by some employers in the country but not automatically by PSCEP. The chief of party will establish performance targets with each specialist, including a broad set of indicators, and will provide a clear "contract" of expectations through annual work plans. PSCEP value chain specialists understand that this bonus will be paid only for outstanding work that surpasses expectations. To the extent that individual value chain specialists work with sector-specific groups and their lead firms in

Baku, the performance incentive system will mirror that in the regions. But it will also include criteria that, although objectively verifiable, will be qualitative in nature. PSCEP's chief of party will negotiate a performance incentive package with each value chain specialist in Baku tailored to each individual's particular responsibilities. The annual work plans and periodic reviews will serve to ensure that each value chain specialist knows where he or she stands regarding work performance and potential bonuses. At the same time, the final bonus decision will be at the sole discretion of the chief of party.

Incentives for other local staff. PSCEP's success will depend not only on the talent, dedication, and drive of its value chain specialists, but also on the degree to which they operate as a team, sharing leads, potential opportunities, etc. The last thing we want is for the promise of performance incentives to lead the value chain specialists to become overly proprietary and set up independent fiefdoms.[4] Program success will also depend heavily on the contributions of local support staff. We therefore plan to build into the performance incentive system a program-wide bonus, which we propose to distribute to all local staff, regardless of the position they hold. Like the Baku-based value chain specialists, this bonus will be up to 8.33 percent, or the equivalent of full or partial payment of a thirteenth-month payment.

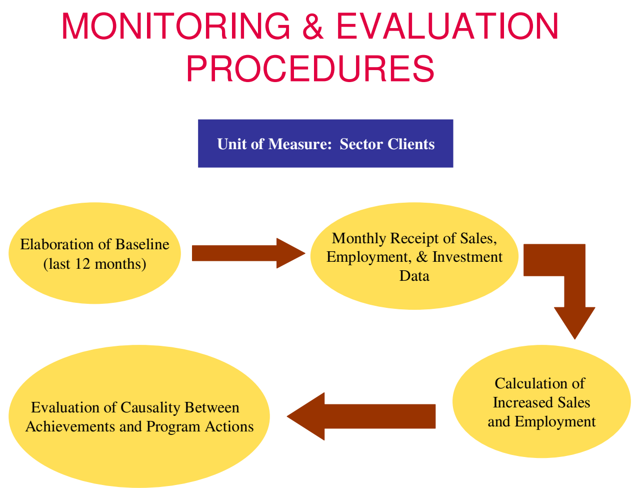
Implications for monitoring and evaluation. Setting up a performance incentive system places additional burden on PSCEP to do serious monitoring and evaluation. Because the earnings of the value chain specialists will be based on incremental sector sales, we must not commit the judge-and-jury error of giving value chain specialists the final say on the veracity and attribution of the results they generate. Although we shall look to the value chain specialists to report the sales, jobs, and investment results of the sectors they service, PSCEP's monitoring and evaluation specialist will enjoy semi-autonomy within the program both to audit those results for correctness and to assess whether we can legitimately attribute them to the program's support. Procedurally, the monitoring and evaluation specialist will work as illustrated in Figure 5 below.

The unit of measure for monitoring and evaluation purposes will be client businesses in the sectors of priority to PSCEP. Under the overall umbrella of the sector action plans discussed below, we plan to channel our support to sectors through "growth plans," i.e., an informal and brief "contract" between PSCEP and the firm/client assisted defining objectives and responsibilities. Depending on the programmatic requirements in each instance, we shall sign the growth plans either with groups of clients — the preferred case — or with individual lead firms. In addition, the growth plans will provide sales and jobs baselines against which we can measure progress. The monitoring and evaluation specialist will meet independently with clients to verify that information. Each month, the value chain specialists will report the gross sales and jobs achieved and the investment in physical plant and equipment made under the growth plans. The monitoring and evaluation specialist will verify that information, too, and assess whether there is a prima

[4] Something which our experience has shown can happen, in business development programs, investment banking, sales and other incentive-based industries.

facie cause-effect relationship between what PSCEP has done and the achievements in question. Once a year, the monitoring and evaluation specialist will deflate all sales and jobs results by the overall growth rates of the sectors in question.

Figure 5. Monitoring and Evaluation Schematic



In verifying sales, jobs, and investment information, the monitoring and evaluation specialist will ask for written evidence, such as sales receipts and payroll records, that what clients claim has actually taken place. At least initially, a client may be reluctant to share information in writing, which may make it necessary to check what the client professes verbally with independent information — trade data, agricultural technology in use in the area, purchasers of the client's products, employee interviews, etc. Despite initial reluctance, experience elsewhere suggests that most clients open up considerably when they realize that support from the project is in fact making a difference — and, in fact, often wind up asking projects to broadcast their successes.

PSCEP's performance monitoring and monitoring and evaluation systems will keep the eyes of all team members squarely on the prize: transformational increases in sales, jobs, and investment in priority sectors of the Azerbaijani economy. Hierarchically, we view everything else — all the activities we carry out day-by-day — as means to bring about those ends. Accordingly, we fully expect USAID to hold us accountable for delivering sales, jobs, and investment on the order specified in our contract — we welcome that challenge — but, at the same time, we request that USAID regard the targets for all activities in support of the contract's key objectives as indicative, not definitive, at this point. Managerially, we need the flexibility to assign resources to their most cost-effective uses. For example, if we find along the way that additional formal grades and standards certification is unlikely to lead to expansion of sales, jobs, and investment in our priority sectors, we would propose to shift resources to those activities that will. In short, we plan to take managing for results seriously, and we have prepared our companion PMP in that spirit, distinguishing clearly between "accountable" targets and "indicative" targets, and proposing to focus much more on the former than on the latter.

SECTION IV. DELIVERING RESULTS

Delivering results in sales, jobs, and investment will require the provision of key sector cross-cutting inputs that will form the thrust of our business assistance efforts. These include the provision of effective and sustainable business delivery services, access to finance, food safety and quality management assistance, and timely market information. In the following sections, we describe what we intend to do and how we will do it.

A. Assistance to Enterprises through BDS Providers

Principles/strategic approach. Business development services (BDS) is a derived-demand sector; that is, it grows only to the extent that the sectors it serves grow themselves. Supporting BDS in isolation from those sectors makes little sense. Operationally, therefore, we plan to put the horse before the cart, to focus on growing selected sectors and develop BDS as part of that strategy.

The traditional approach to BDS sustainability is for the most part supply-push; it focuses primarily on building capacity to deliver services effectively. But unless there is effective *demand* to pay for those services, such capacity building can come to naught. Our strategy approaches the problem from the demand side: as we help increase economic activity in our priority sectors, demand for BDS will rise — embryonically, at first— and set in motion a growing appreciation among sector participants for the value of BDS and, over time, a willingness to pay more of its full cost. In the short term, local BDS providers may not have the expertise to provide the increasingly sophisticated services that our growing sectors will require. That is where PSCEP will step in, building service provision capacity among local BDS firms, not in isolation from real market transactions, but in a mentored, learning-by-doing, action-oriented way.

Experience worldwide suggests the wisdom of distinguishing clearly between “facilitation” and conventional business development services. As a practical matter, facilitation — which some prefer to call “honest brokering” — typically boils down to building trust among value chain participants who come to the scene with a strong predisposition to have nothing to do with each other. Overcoming such distrust is often a precondition for growth. Yet neither party is willing to pay for this service. Facilitation addresses a market failure that requires subsidy financing to overcome.

Conventional business development services are the commercial services that buyers and sellers in a mature market recognize the value of and typically are willing to pay for. Such services include assistance in developing business plans, market analysis, and technical advice.

Most donor programs work through existing or create new business service providers. Since donor money is a subsidy, it is important that the business service providers in question limit themselves to facilitation — or, to put it negatively, that they not crowd out competitors in the conventional BDS market. PSCEP’s strategy responds to that guiding principle by ensuring that relationships with selected BDS providers do not crowd out private, fee-based initiatives. In essence, the main job of PSCEP's value chain specialists, whether in Baku or in the regions, will be to identify opportunities to expand value chains within our priority sectors and nurture relationships of trust among the parties involved to propel those opportunities along. To the extent that conventional business development services are necessary for that purpose, they will not provide those services themselves but look to BDS providers for these services, thereby expanding business opportunities for — rather than crowding out — the competition.

Operationally, building of trust normally requires physical presence. In the regions, especially, it will not develop by flying program personnel from and to Baku. For that reason, we plan to operate initially through BDS centers in Ganja, Guba, Sheki, and Lankaran to give PSCEP effectual national coverage. We will also engage BDS providers in Baku, for non-agricultural sectors.

Selecting BDS providers. PSCEP will engage two levels of BDS providers. The first set will be selected through a transparent, competitive bidding process where stakeholders such as the GOAJ will participate. We will select the first four by January-February 2009 in each of the aforementioned regions. We will select another three in March, after the remaining sectors are selected. We will also pre-qualify between 5 and 10 BDS providers, also through a competitive bidding process, to establish an Indefinite Quantity Contract type mechanism to provide specific services to client firms and stakeholder organizations. This mechanism will permit PSCEP to respond to client and stakeholder needs and engage these BDS providers on a regular basis with the program. We expect to complete this procurement in January. PSCEP will pre-qualify conventional BDS providers by the types of services they provide and by the sectors and regions they serve. The existence of a database of qualified providers with which we can work will allow us to meet our commitments expeditiously after we have signed growth plans. Under the leadership of the deputy chief of party, the development of that database has already begun, relying heavily on the providers identified in the agricultural sector assessment and those that work closely with members of the Azerbaijan Microfinance Association and those previously engaged with the ABAD and RECP programs.

BDS operations. More specifically, the key elements of the operational strategy include the following:

- PSCEP will subcontract competitively with at least one BDS provider in Ganja, Guba, Sheki, and Lankaran, and other regions to be determined. Each of these companies will assign one or two value chain specialists to PSCEP. We shall remunerate the BDS center for the salary of a value chain specialist in accordance with the performance incentive system. This specialist will provide facilitation services to priority sector value chains in their regions. The facilitation in question will involve the following:

  — Identifying lead firms in each selected sector in their regions;

  — Nurturing relationships of trust with those firms;

— Diagnosing the sector-wide and firm-specific binding constraints to their growth;

— Developing cost-effective solutions to these constraints;

— Formalizing action commitments in "growth plans;" and

— Monitoring the execution of the growth plans so that they bring about expected results.

In addition to developing collaborative relationships with local government officials, industry associations, and other donors, the value chain specialist in Baku will provide facilitation services along the same lines as their regional counterparts.

- As discussed in the performance incentives section, the value chain specialist will have annual sales targets, to which PSCEP management will hold them accountable. The agriculture value chain specialists in Baku and the regional BDS providers will report directly to the deputy chief of party. To respond to promising opportunities as they emerge, communication between supervisors and supervisees will necessarily be fluid. Formal reporting will consist of the following:

— Bi-weekly executive reports summarizing activities over the previous two weeks, opportunities and problems encountered, and specific actions planned for the subsequent two weeks;

— Monthly reports of sales, jobs, and investment results under the growth plans; and

— Quarterly reports reflecting on experience over the previous three months and reassessing broader strategic options for bringing about sector-wide increases in sales, jobs, and investment.

- The growth plans will be contractual in nature, spelling out what each party will be accountable for under the proposed collaboration between clients and program. The BDS providers will develop the competitiveness plans with prospective clients. Before the chief or deputy chief of party signs them, the value chain specialist in charge of the particular "account" will dialogue with the monitoring and evaluation specialist to check the development logic of the proposed support — that is, whether it is reasonable to expect the anticipated results to derive from the actions taken. Before signing, the chief of party will also compare the proposed PSCEP contribution with the current budget. Content-wise, the plans will include the following:

— A baseline of clients' sales and jobs over the last year;

— The (no more than) three major problems constraining the clients' growth;

— The actions that each party will undertake to solve those problems, including resource commitments, whether in cash or in kind; and

— The sales, jobs, and investment results expected from execution of the growth plan.

To ensure that PSCEP comes up with cost-effective solutions to sector problems, it will execute competitiveness plans only when expected sales are at least five times the (variable cost) contribution that PSCEP will make to the plan. Sticking to this 5:1 rule will not only enhance the cost-effectiveness of USAID resources but furnish practical incentives to leverage contributions from other sources, an additional objective of the overall program.

All other things being equal, the ratio of expected sales and investment to PSCEP's resources will be greater the more value chain and sector actors are involved. Accordingly, PSCEP will give highest priority to growth plans that involve a broad spectrum of firms within a sector. That said, working with individual firms can also have broad sector-wide impact. For example, support to an entrepreneur with interest in investing in cold chain facilities can redound to the benefit of many more economic agents. In a similar vein, helping supermarkets develop effective sourcing relationships with fruit and vegetable suppliers can have dramatic backward linkage effects. At the current time, we are engaged in preliminary discussions with the Almali supermarket chain to develop a national program along those very lines. Working with that one firm as a client promises to have a dramatic multiplier effect, allowing us not only to reach substantial numbers of small firms but, through upgrading, to enable them to take advantage of value-added opportunities.

The collaborative relationship we plan to develop with Almali is a good example of how we plan to build creatively on the embedded BDS model already in practice in Azerbaijan. Under that model, lead firms provide inputs and technical guidance directly to their suppliers without recourse to third-party business development service providers. Our contract recognizes explicitly the potential of that model as a promising way to develop the broader BDS market, and we plan to apply it not only with Almali but with other sector clients as well.

PSCEP's role. PSCEP will provide the critical role of overall oversight, mentoring, and direct assistance to BDS providers and clients. This contribution begins with the formulation of the sector action plans that will provide a strategic road map of key sector activities, including the needs of leading firms in the region. To build synergy among program activities and avoid duplication of effort, the regional value chain specialists' first task will be to conduct interviews for the DRC analysis. That strategy will allow PSCEP both to get a handle on binding sector constraints and to start building trust with potential lead sector clients at a very early stage.

PSCEP will also provide direct assistance to address sector-wide issues, including enterprise-level assistance that may impact the entire sector. For example, in many cases, the growth plans that value chain specialists develop with clients will call for conventional business development services from third-party providers. When these cannot be provided by the BDS provider, the value chain specialist will develop scopes of work, and the program will subcontract competitively with other BDS providers for a specific service. If local providers do not have the requisite expertise, PSCEP will bring in expatriate short-term technical assistance not only to deliver the business solutions required but also to train local providers in a learning-by-doing mode. The clients — typically, lead sector firms — will bear a portion of the costs of the services, whether local or a combination of expatriate and local.

Another important PSCEP contribution to the BDS network is catalyzing synergies among stakeholders. For example, we have discussed with the Caspian International Investment Fund (CIIF) a formal agreement to use PSCEP BDS providers to provide direct assistance to CIIF companies. Similar relationships will likely be possible with other leading companies and investors.

Table 3. BDS Delivery: First Semester Targets

Key Benchmarks	Timing
Three sectors/sub-sectors selected with Value Chain Action Plans	December 2008/January 2009
Seven additional sectors/sub-sectors selected with Value Chain Action Plans	January-March 2009
Four Core BDS providers selected in Guba, Ganja, Sheki, and Lankaran	February 2008
Up to 5 BDS providers pre-qualified to provide direct TA to sector firms through IQC-type mechanism	March 2009
Three additional BDS providers selected for agricultural and non-agricultural sectors	March 2009
At least 3 MOUs or other instruments signed for BDS alliances with financial sector and/or international companies such as BP and/or Coca-Cola.	February - March 2009
At least six leading anchor firms have developed associative relationships with producers/suppliers with PSCEP assistance	March 2009

As the program evolves, we propose to bring value chain specialists financed by other parties into the program. For example, the Azerbaijan International Mining Company (AIMC) is about to commence operations in Gadabay. It has set up a fledgling business development services office there to generate private sector jobs for communities nearby and is looking for programmatic ways to accomplish that. In our preliminary discussions with AIMC, they have expressed interest in incorporating a business promoter — the equivalent of one of our value chain specialists — in PSCEP. Under this arrangement, the individual in question will participate in the training we shall provide for our value chain specialists in January. The idea is win-win: The plan allows us to expand our geographic coverage at no cost and allows the communities in AIMC's orbit to benefit from concrete demands that we identify as part of our work in other parts of the country. If this form of collaboration works well, we propose to expand it, first, with AIMC as they extend their mining operations to five other regions of the country, and, second, with other companies and donors with similar interests.

B. Enhanced Access to Finance and Investment

Principles and strategic approach. As in most emerging economies, smaller firms are often the most dynamic and innovative. If Azerbaijan inhibits this potential by imposing or not removing financial constraints, the country will not only lose the growth opportunity of these enterprises but also risks missing the chance to diversify into new areas with potential comparative advantages. Accordingly, enhancing access to financing and investment will be a major PSCEP objective. Our approach is four-pronged, we will: (1) build associative relationships with key institutions and leveraging existing resources, especially building on USAID support through the Financial Stability Support Program (FSSP); (2) introduce new financial loan products that service firms in our selected sectors; (3) work with the AIC, CIIC, and private investment funds to facilitate their investments; and (4) promote investment in selected sectors by international and domestic investors.

The access to financing depends not only on the individual enterprise but also on the wider policy and institutional environment. PSCEP is not a policy reform program, and some of these issues may impede how quickly we progress. It also depends on the existence and effectiveness of a variety of intermediaries and ancillary financial firms that help bring providers and users of funds together in the market. We will work especially closely with the FSSP's commercial banking component and the five banks with whom it works to significantly upgrade the quality of the financial intermediation services they provide to SMEs. In particular, PSCEP will coordinate efforts with these banks to penetrate new market segments, develop new product strategies, and introduce effective pricing strategies.

Building associative relationships. Building associative relationships and leveraging financial and technical resources from current stakeholders is a key element in PSCEP's approach to finance. In the first six months of operation, we will place special emphasis on developing strategic and working relationships with commercial banks, NGOs (e.g., Azerbaijan Microfinance Association, Access Bank [formerly the Microfinance Bank of Azerbaijan], FINCA, Viator Microcredit in Ganja Association), the KfW-supported Azerbaijan fund, and the BP Enterprise Centre in Baku. PSCEP will adopt a "comprehensive access to finance program" by collaborating in SME lending programs with current stakeholders like the EBRD, ADB, IFC, KfW, BP, AIC, CIIC and USAID's FSSP.

We see two opportunities to do this. One is to create synergies between our BDS providers, external technical assistance, and existing credit programs, especially the FSSP commercial banks, for example, to develop alliances between lenders and BDS providers that essentially reduce lending risk. The other is to cooperate in the innovation of new products, as discussed below.

Enhancing access to capital through existing and new products. Driven by these principles, PSCEP will follow a pragmatic and results-oriented “financial product-based strategic approach.” The program will innovate, develop, and introduce new products to the financial market; improve and continue promoting products like leasing and commercial credit; and strengthen the capacity of lenders, borrowers, and investors in the marketplace through targeted technical assistance and training.

Financial institutions are likely to know well the enterprise landscape of the sectors to which they lend. For example, Access Bank knows the construction finishes sector well. In 2007, it significantly increased its loan portfolio to firms in this sector. PSCEP will partner with local lenders to deliver technical assistance that complements selective sector program components while reducing risks to lending. PSCEP will also provide lenders, including FSSP-supported commercial banks, with technical assistance in introducing new financial instruments and help businesses improve their borrowing capacity to secure appropriate financing and investment opportunities. As part of the BDS program, PSCEP will provide guidance, training, and tools for financial management and matching financing for SME’s specific needs.

Existing Products

Of the multitude of financial relationships that currently exist and that can be formed between value chain actors in the agriculture sector, the following appear promising for PSCEP intervention.

Credit facilities. Numerous credit lines and facilities can be tapped by firms in PSCEP’s selected sectors. We will coordinate with FSSP and the five commercial banks with which the project is working to maximize use of these lines, as well as existing EBRD, BP, and other credit lines.

Trader credits. These are short-term, seasonal loans, generally from agricultural producers to either input suppliers or produce buyers (processors, traders, etc.). Financial institutions are occasionally involved. When provided as a loan, it tends to be limited to working capital (for inputs) and is usually provided in kind. Relationships between buyers and sellers are often temporary and price-driven. These programs are common in Azerbaijan. PSCEP will work with anchor firms in expanding current programs and in making them more efficient.

Contract farming or out-grower schemes. These are relationships in which buyers of agricultural products lend funds (either in-kind or in cash) to producers. The loan is generally tied to a purchasing agreement. It is often direct financing, but may be complemented by the involvement of a financial institution that recognizes the value of the close-knit relationship between the buyer (often a well-respected entity with a strong reputation for dependability) and producers (often farmers who have demonstrated a willingness and capacity to provide consistent high-quality products to the buyer). The buyer often provides additional services, such as technical assistance. This increased level of involvement is more often seen among buyers and sellers of high-value, specialty products, such as horticultural products and export crops. Again, these relationships can be found in the Azerbaijan agricultural sector. Buyers tell us that the organizational mechanisms necessary to unite producers in associations or other groups are often lacking, which makes these schemes less expensive and more reliable. PSCEP will work with producers and processors in creating these associative relationships

Supplier Finance Facility (SFF). BP and its co-ventures are currently funding an SFF aimed at supporting the provision of transparent sources of funding for SMEs and designed to give Azerbaijan's local oil and gas industry supplier and service enterprises greater access to transparent sources of finance. Under a pilot SFF through the BP/IFC Supplier Linage Program, Access Bank recently issued its first loan to the local Azerbaijani company Azmetco, specializing in metering services. Resources for the SFF are provided by BP, IFC, and Access Bank. Loans to local suppliers are backed in large part by the local companies' contracts with BP and its partners. The project is in line with BP and its partners' target to double their total spending with locally-owned companies by 2010, raising it to more than $500 million a year. Local companies eligible to receive SFF loans are selected through competitive pre-qualification exercises by the BP Enterprise Centre, pass through Access Bank's credit appraisal, and receive final approval from the SFF Credit Committee, which comprises representatives of the three parties involved. This pilot project is being implemented through an IFC grant agreement to Access Bank and has a total loan capital of $316,000. BP provides $140,000 on behalf of its partners, IFC provides $140,000 (of which $20,000 is for technical development and appraisal of the pilot phase), and the remaining $56,000 is invested by Access Bank. PSCEP will take full advantage of this innovative program, assisting companies in our selected sectors to understand the concept and meet its terms.

Leasing. Another important financial instrument, especially for the agricultural sector, is leasing. This mechanism has reportedly expanded rapidly in Azerbaijan in recent years, among others, by the ABAD and RECP projects. Much of the work in this area has been introducing producers and agribusinesses to leasing basics, which is a necessary step. PSCEP will move from this approach to help lenders and target firms increase leasing transactions. Reportedly, the National Leasing Association meets periodically, but has been ineffective in voicing concerns on the impediments to expanding leasing. One possible activity in Year 1 is to work with the association on capacity building, without getting caught up in time-consuming and long-term policy reforms.

New Products

Warehouse receipt financing. Warehouse receipts (WRs) are an example of indirect value chain financing that requires a financial institution to complete the transaction. Warehousing is a beneficial service on its own, allowing producers to sell when market prices are more advantageous. WRs are issued to depositors of non-perishable commodities by bonded and certified warehouses (privately or state owned). This is also called inventory credit, a system of providing loans against the security of goods held in store, and it is not widely available to small farmers. It is more commonly provided to retail and trading businesses. Warehousing finance is a useful tool for farmers that are frequently forced to sell their crops quickly at harvest time because they do not have sufficient reserves or other sources of income with which to purchase essentials. As a result, they normally receive low prices for their crops and do not have sufficient funds to purchase fertilizer and good quality seeds for the next production cycle. Warehousing finance is currently not available in Azerbaijan, due to the absence of bonded warehouses and supporting regulations. We believe, however, that it has considerable promise and should be actively explored. We have had some preliminary discussions with some institutions such as the CIIF who will invest in regional warehouses and see the business potential of such a program. CIIF has expressed an initial interest in becoming a champion for this effort.

Factoring. The instrument is a type of supplier financing in which firms sell their creditworthy accounts receivable at a discount (generally equal to interest plus service fees) to a financial intermediary and receive immediate cash. Factoring is currently not developed in Azerbaijan but is being explored by the IFC and BP. The advantage of factoring is that it provides immediate working capital financing, but is not a loan and does not show up as a liability on the firm's balance sheet. In addition, factoring is often done "without recourse;" the financial intermediary that purchases the receivables assumes the credit risk for the buyer's ability to pay. Factoring can be a powerful tool in providing financing to high-risk suppliers with a lack of market information. Its key virtue is that its underwriting is based on the risk of the receivables (i.e., the buyer) rather than the risk of the supplier. Therefore, factoring is particularly well suited for financing receivables from large foreign firms (i.e., BP) whose receivables are the obligations of the buyers, who are more creditworthy than the sellers themselves.

Purchase Order Financing. Purchase order financing (POF) allows a company to accept a purchase order, regardless of its current capital availability. It is an ideal tool for companies that have exhausted their available funds or bank options. POF enables a company to finance up to 100 percent of its supplier costs, allowing it to deliver more and bigger orders. Furthermore, unlike bank financing, this instrument has no arbitrary limits and is directly tied to sales. This means that all a company needs to do to obtain additional financing is to obtain orders from solid commercial or government customers (i.e., BP). POF is an ideal tool for companies such as wholesalers, distributors, and resellers that sell third-party products. POF can also be a co-financing mechanism to leverage a bank loan. Therefore, it can be developed and offered by financial institutions.

Enhancing the Efficiency and Impact of Equity Capital

Partnership with the AIC. PSCEP will build a close working partnership with AIC, becoming one of the institution's key advisors. With over $90 million at its disposal for equity capital, helping the AIC invest its capital effectively could be a major achievement for USAID through the PSCEP program. In large part through the relationships forged by USAID to date, which we have built on during our first month of operation, we believe that PSCEP is well on its way to accomplishing this objective.

Assistance from PSCEP will involve capacity building, new product development, and go-to-market strategies. Key Year 1 activities include the following:

- Providing technical support in go-to-market strategies. The first activity will consist of supporting AIC in “launching” road shows in Guba in December 2008, followed by similar events in Lankaran, Ganja, and Sheki in February and March 2009.

- Enhancing deal flow. The second phase of the road shows will consist of PSCEP-supported BDS providers working with AIC investment targets in investor presentations and supporting AIC in due diligence. We expect no less than four investment transactions to be completed by AIC as a result of PSCEP assistance.

- Enriching the financial package. PSCEP will work with the commercial banks supported by USAID’s FSSP banks and sector firms to identify opportunities in which a strategic equity investment in an enterprise can be part of an integrated package of technical and financing assistance. We expect that all four transactions completed in Year 1 will be part of such a package.

- Strengthening AIC. In the area of capacity building and in line with international best practices, PSCEP will offer a comprehensive review of AIC’s charter, including governance (building on work done to date through other USAID consultants), investment policies, and core staff technical skill’s strengthening needs. PSCEP will develop a comprehensive training program for the institution in February 2009. Chemonics Senior Investment and Finance Consultant Roberto Toso provided an overview of possible lines of action that was enthusiastically received by Farida Akhundova, AIC’s head of investor relations. As part of his deliverable for his current consultancy, Mr. Toso will provide a written action plan for training.

- In product development, PSCEP can make a substantial contribution in assisting with the development of new product offerings, especially investment-lending hybrid products developed in partnership with commercial banks. One example is mezzanine or subordinated debt financing, a hybrid debt and equity financing that is typically used to finance the expansion of fast-growing companies who have a need for at favorable terms without necessarily giving up large amounts of ownership or equity. While we do not expect to have such an instrument fully developed in Year 1, we will begin the educational process of this and other instruments and move forward as quickly as possible.

To summarize, we believe that we are well positioned to develop a synergistic relationship with AIC that provides a win-win-win scenario for AIC, USAID, and sector enterprises.

Partnership with the Caspian International Investment Company. PSCEP staff has met several times with the CIIF’s managing company, the CIIC. The CIIC’s senior management has expressed strong interest in developing a formal relationship with PSCEP in the form of a MOU or other instrument to obtain PSCEP assistance in providing technical assistance to the companies in which it invests. Following a discussion on financial strategies and instruments such as mezzanine financing (see above) the CIIC expressed interest in utilizing PSCEP's advisory services to formulate its investment strategy. We believe that it will be possible to sign a formal agreement with them in February 2009.

Summary of Proposed PSCEP Year 1 Interventions

The commercial banking instruments described above provide an inventory or portfolio of attractive opportunities to enhance access to credit in the sectors in which we will work. At this time, we cannot commit to any one particular instrument, but rather to a process in which to select them. How far we move on each during the first year will depend on the regulatory and institutional resistance we encounter. The immediate opportunities in Year 1 are likely to lay with increasing the access to, and use of, existing instruments by target firms. As for improving the efficiency of equity capital, the road map is somewhat clearer, as described above. PSCEP will do the following:

- Maximize awareness and access of existing SME lending programs. PSCEP will partner with a group of financial institutions that participate in the BP, EBRD, and IFC commercial finance programs to prepare borrower-friendly guides and learning material aimed at improving borrowers' capacity to take full advantage of the existing commercial finance programs in the sectors selected by PSCEP.

- Provide short-term technical assistance (STTA) in commercial finance and financial training to prepare learning tools and conduct training sessions for partner banks' loan officers and PSCEP BDS and value chain specialists. PSCEP experts will also contribute international lending best practices in commercial finance by proposing improvements in the existing programs to its bank partners.

- Partner with a select group of financial institutions that specialize in the agriculture sector and who are willing to take ownership and pilot the introduction to their clients of the improved instruments and warehousing finance. As banks know the market and their clients, this intervention also constitutes a feasibility test for the proposed instruments.

- Beginning in February 2009, provide international experts in specific products who will work with the local bank partners in developing the instruments, training, and go-to-market strategies for the most appropriate financial instruments to introduce. The experts will also build institutional capacity by conducting technical workshops to train partners' loan officers and PSCEP's BDS and value chain specialists.

- Assist AIC in all road shows, beginning in December 2008, following up with a second round of more intensive deal structuring meetings with investors by February 2009.

- Beginning in February 2009, provide a comprehensive training program for AIC, treating training as an integral part of AIC's institutional needs. This effort will be lead by Chemonics' Roberto Toso and supported by experts from Crimson Capital.

- By December 2008, develop a formal relationship with the CIIC and the CIIF, leveraging equity investments and PSCEP-supported technical assistance through BDS providers.

Operationally, PSCEP will dedicate a full-time local finance and investment advisor, Ramal Jafarov, to drive the process on a daily basis and complement the work of expatriate short-term technical experts drawn from the pool of experts from Chemonics and Crimson Capital. Mr. Jafarov will report to the chief of party, who will also be actively engaged on access to capital issues. Based on international best practices, PSCEP will review current models and enabling regulatory environment in Azerbaijan and propose improvements in existing trader credit and contract farming. PSCEP will also review the existing enabling regulatory environment and develop warehousing finance as a new financing instrument for the agriculture sector. Mr. Jafarov will also be responsible to implement training and guidance to BDS providers and value chain leaders (including PSCEP's own value chain specialists) on financing tools, so they can assist firms improve their borrowing and investment capacity.

Table 4. Access to Finance and Investment: First Semester Targets

Selected Key Benchmarks	Timing
AIC road show in Guba, Sheki, Lankaran, Ganja, and two other locations	December 2008, February-March 2009
Select and sign MOU with partner financial institution(s)	February 2009 (2); March 2009 (1); April 2009 (2)
TA to enhance existing /new financial products / two products at implementation stage / additional two products	February 2009 / June 2009 / September 2009
AIC training needs plan developed	February 2009
Workshops on new and existing financial instrument(s)	March 2009
Workshop on mezzanine financing for AIC and CIIF	April 2009
Initial Investment by AIC in selected sectors completed with two others in pipeline / two additional investments	April 2009 / July 2009

C. Associative Relationships Developed

Principles and Strategic Approach

A growing body of economists asserts that culture and mindsets are the critical determinants of economic development.[5] How else to explain nations such as

[5] See for example, *Development is a State of Mind* by former USAID Mission Director Larry Harrison. Harrison is one of the leading advocates of this thinking, but by no means the only one.

Switzerland, which have few natural endowments, becoming highly developed, while resource-rich nations such as Venezuela suffer from high degrees of poverty? Without becoming absolute in this debate, it is clear that culture, mindsets, and social capital (i.e., the willingness and facility in which people interact with and trust one another to achieve common and better results) are a key factor in competitiveness. When stakeholders distrust one another, it is difficult to solve common problems or generate solutions requiring cooperation to increase productivity. In its value chain work, PSCEP will dedicate time and energy to creating this needed social capital among stakeholders.

An important lesson learned from cluster and other approaches to develop associative relationships is that it cannot be a top-down approach. Despite this relatively obvious tenet, donors and governments consistently try to "jump start" clustering or associative processes with top-down directives such as major events for sector stakeholders to begin "cooperating" or to be directed to form clusters, without laying the foundation of social capital needed to make these efforts. Time and time again, these efforts fail. Creating the necessary base takes considerable effort and on-the-ground preparation. But our chief of party's own experience and lessons learned from other projects indicate that this patience (and perseverance) is essential and leads to concrete results.

Key Activities

PSCEP will develop social capital and associative relationships through a wide variety of mechanisms and forums. Initially, many will be low key, in line with the principles discussed above. In some cases and for some sectors, however, it may be possible to have much more visible activities, such as cooperation and clustering around the suppliers of major international firms (where considerable trust has already been generated), such as BP and Coca-Cola. Key activities will include the following:

Transactions-led associative development. An important principle of economic transactional theory is that the costs of economic transactions will be reduced as they are successfully repeated and trust in subsequent transactions increases. Generating "ground-up" stakeholder relationships and delivering visible concrete results that build trust and lead to higher-level associative relationships will be an important instrument. In building trust, the fundamental commandment is that nothing succeeds like success. Show stakeholders the benefits of associative undertakings and they will follow. Spend time and energy on meetings and workshops that do not generate benefits, and they will not. We will work at the enterprise level, especially with sector anchor firms, to establish successful seller-buyer relations that build this trust. In agriculture and agribusiness, we will also help organize producers to generate economies of scale in procuring inputs (including credit, especially buyer credit from anchor firms), receive training, and help producers meet international grades and standards. During project life, these "ground-up" informal transactions will pave the way for a progression to more informal and formal associative relationships, including the formation of sector "clubs." These types of initiatives, led by Chemonics and repeated regularly by PSCEP's BDS providers will play a key role in helping build trust in each target sector.

Partnering with sector organizations, other donors, and GOAJ institutions. This will happen immediately. PSCEP will execute agreements with key sector institutions to make explicit the objectives in promoting value chain competitiveness. For example, we intend to establish MOUs in February and March 2009 with BP's Enterprise Centre, AIC, CIIF, Coca-Cola, and numerous commercial banks. In terms of building associative relationships, the importance of these agreements extends beyond their immediate utility. By creating formal or informal "clusters" of clients, PSCEP will generate trust in cooperative relationships.

Engaging public-private sector dialogue and partnerships. Building on enterprise-level transactions, and the agreements described above, we will develop no less than two public-private and donor round tables or workshops per sector during the life of the project, the first by January or February of 2009, with broader, more formal workshops by April 2009 (see description in the following section). With the proper preparation in place, the aim of these workshops will be to establish "value chain innovation agendas" that will address sector needs and constraints.

Cluster and Association Strengthening and Development

The ground-up work discussed above is essentially a clustering "process" that will pave the way for formal clusters and associations in Years 1 and 2. On the other hand, some of this work has already been done, at least in part, by BP and other companies in their own programs. Where we see the opportunity, PSCEP will establish formal clusters and related mechanisms in Year 1. We expect at least two such efforts to take place. In addition, we will enter into discussions and better learn the status of existing associations in the selected sectors to see how we can assist them as early as possible. We expect to work with at least two associations during the first six months of operation.

Table 5. Building Associative Relationships: First Semester Targets

Selected Key Benchmarks	Timing
Workshop/training sessions with BDS providers on clustering and social capital	March 2009
Agreement between lead firms and suppliers	March 2009, two more by April 2009, and an additional two by April 2009
MOU with BP, Coca-Cola or another international company in part to develop cluster relationships among its suppliers	March 2009
Agreement with AIC, CIIF to, inter alia, develop associative relationships in sectors they invest, including involving BDS providers	February 2009
Strengthening assistance to initial existing association / two additional associations / three additional associations	January 2009 / February 2009 / April 2009
Formal cluster launched	September 2009

D. Sanitary and Phytosanitary and Other Standards Enhanced

Global quality systems such as ISO in manufacturing and IT, HACCP, Global GAP, BRC, ISTA, ACC in agriculture and food products, ANSI or AATCC in textiles and carpet, ASTM for construction products are increasingly the operating norm. Further standards have moved beyond physical specifications and quality to now include a broader range of attributes that relate to the environment (ISO-14000), organic (NOP and IFOAM), social accountability (ISO-8000), fairness in the supply chain (FairTrade), and religious slaughter and processing standards (Halal and Kosher).

The focus of this component is to build local capacity, developing the sustainable ability for a group of Azerbaijani firms to provide consulting and certification to individual enterprises for key private sector standards, in the sectors in which we will work, primarily in — although not necessarily limited — to agribusiness. Our approach entails: (1) establishing the standards required based on each sector we work in; (2) selecting the certification firms; and (3) training and operations development, including marketing, and sales training/development. Several such firms already exist in the country, including Zygon Caspian Consulting and MEP Consulting, both of which Chemonics has already established relationships through TIRSP. ISO and HACCP consulting/certification is available today in many sectors, and where this is the case, we will not duplicate these efforts.

In December 2008, we will develop preliminary grades and standards for the sectors selected or likely to be selected in the first six months of operation, including a detailed timeline with specific benchmarks. These plans will be continuously amended, with the strategy incorporated into the sector action plans.

International companies such as BP, Coca-Cola, McDonald's, and others have considerable interest in this area. We will aim to develop strategy partnerships with these companies, including at least one global development alliance (GDA) before June 2009.

E. Getting the Message Out — Communications Strategy

PSCEP's communication strategy will be geared to (1) informing USAID and its partners, the donor community, the GOAJ, and private and civil society stakeholders of project progress and innovation and (2) leveraging existing information outlets to communicate sector-specific information, technical development, and market data. Where possible, we will strengthen the capabilities of local institutions to continue this work on a sustainable basis.

To disseminate information on PSCEP, each month, we will deliver an e-mail newsletter to a list of stakeholders approved by USAID. The newsletter will provide project updates and progress, a "Meet the Team" section to introduce PSCEP team members to the GOAJ and our stakeholders — and with time, to introduce these stakeholders to each other (for example, a brief article about the person leading our BDS efforts in Guba). This brief, two-page newsletter will be in both Azerbaijani and English. The first newsletter will be submitted in the first week of March (the February newsletter) and will include an article regarding progress on the DRC analysis. We will undertake a more-in-depth quarterly publication (maybe six pages) on project issues (e.g., progress, importance of food safety and standards). At strategic points, we will also work with USAID and the U.S. Embassy to introduce program issues and accomplishments through the local press.

To promote information flow to improve competitiveness in our selected sectors, we will work hand in hand with stakeholders to leverage and improve their current efforts. For example, as of November 2008, we have already begun working with the AIC in developing an information/educational strategy regarding private equity. The memorandum of understanding or other cooperation instrument to be signed between PSCEP and AIC will include a key communications strategy. We expect this strategy to be in place by January 2009.

Similarly, the World Bank is developing a new project involving market information through wireless telephony and other means. Given the need for PSCEP to leverage resources and the World Bank's lead in this area, our focus will be, first, to leverage this investment to the extent possible, incorporating this program into our BDS system. Second, we will work closely with World Bank staff and technicians to validate their approach, create dialogue between USAID and the World Bank in this area, and provide timely technical expertise in this area.

In partnership with the BDS providers, Chemonics will help develop a state-of-the-art website with market and other information about the selected services. The site will be both informational and practical, with instruction on accessing program assistance and up-to-date market information. At this time, we are examining a potential BDS provider in Ganja that has made considerable progress in establishing such a site. Potentially, this could be one of our first Competitiveness Innovation Fund awards.

F. The Competitiveness Innovation Fund

By March 2009, PSCEP will have a $300,000 Competitiveness Innovation Fund (CIF) in place and make its first awards. As the name implies, the fund will serve to support innovation in the sectors in which we work. We intend to leverage the CIF in several ways. First, we will work with banks and other financial institutions to identify situations in which a strategic grant to an enterprise becomes an integrated package of technical/support/training assistance, as well as debt lending. In some situations, we will use the CIF in securing FDI. A grant may be made to an institution, for example, at the close of an FDI transaction or as part of TA package. We propose a ratio of no less than 2:1 of private sector/fund contribution for any grant transaction. Depending on the transaction, we may require additional leveraging. We expect the CIF to begin awards in March 2009.

SECTION V. SECTOR SELECTION

PSCEP will work in six sectors and at least ten subsectors. "Sectors" will be broad categories, with most project resources focused at the subsector level. The sector selection process was described in Chemonics' proposal and has not changed significantly and is briefly summarized below.

A. Process

Step 1: Initial sector and sub-sector identification. This includes the analysis undertaken at the proposal level and immediately upon contract award, based on existing reports and data from USAID projects, other donors, and government statistics, as well as market intelligence gathered during two visits to Azerbaijan. Key sectors identified included the following:

- Agribusiness
- Oil industry manufacturing support services
- ICT/IT
- Finance
- Light manufacturing
- Packaging materials

Step 2: Filtering for dynamic sectors. This has been an ongoing effort since the PSCEP team arrived in October. We contracted with a local firm to analyze the most dynamic agricultural and agrobusiness subsectors, including analysis of trade data, exports, and constraints for key subsectors. We have also been meeting with donors, investment funds, and private companies to better understand the best sector opportunities.

Given the array of opportunities, the demands of a substantive qualitative analysis, and the fact that competitiveness is a process of strategic choices, we will implement a "rollout" plan for sector selection as follows:

- Four sectors (and several subsectors discussed below) selected in November and December whose action plans will be completed during December and January. These include (1) fruits and vegetables, (2) animal products, and (3) oil-sector manufacturing support services; and (4) finance. Subsectors are discussed below. The first three are sectors where consensus exists regarding their potential. They are also sectors in which previous studies, export statistics, and other data and preliminary analysis from the Domestic Resource Costs (DRC) analysis indicate that there are opportunities not affected by significant market distortions. Finance is a cross-cutting area for all activities. We have chosen to include it as a separate sector to highlight its importance and because it will include its own action plan. In essence, our finance activities will be more than just a "means" to assist our sectors (although they will certainly do that). They will also create access to capital in other sectors and thus, will be much more than just a support activity.

- Two additional sectors sub-sectors will be analyzed in February, with action plans completed in mid-March through April. These are likely to include (5) warehousing / cold storage, and (6) light manufacturing, including specific subsectors for logistics and light manufacturing, as described below. Accordingly, we expect all six sectors, and eight subsectors required by the PSCEP contract to be chosen by the end of February. In fact, PSCEP expects to develop over ten Action Plans by the end of March and thirteen by the end of April.

- Opportunity Assessment and Sector Review. Beginning in April and through the rest of the year, we will begin an ongoing review of progress in each sector relative to the action plan and the development of emerging opportunities. While this is going on, we recommend a formal review with USAID and MOED approximately June 2009.

Experience indicates that not everything we do will work. Like a competitive private sector firm, PSCEP must have the discipline to know when work in a sector is either no longer a worthwhile investment or should be limited to some specific areas. More likely, we will be faced with growing opportunities in a large number of subsectors through our work with banks, investment funds, and contacts, all which seem worth pursuing. To repeat an important tenet, competitiveness is about strategic choices — which means saying “no” to paths that may appear attractive but, given limited resources, will distract us from areas of greatest return.[6]

Step 3: Domestic Resource Cost (DRC) analysis. Chemonics consultant Dr. Dirck Stryker is currently undertaking DRC analysis of approximately 10 agricultural subsectors and 5 non-agricultural areas. He will conclude the analysis for this first group by December 20, 2008. We will analyze another 15 subsectors in January-February 2009 focusing more on nonagricultural products, including many of the sub-sectors highlighted in Table 7. By mid-February, we expect to have completed full analysis of 30 sectors. The following table describes central deliverables within the quantitative sector selection filter and timelines for completion.

DRC methodology suggests that exports that have experienced robust export growth (unless there are clear subsidies to promote this growth) are likely to pass a DRC filter. Cross-checking earlier DRC analysis by the World Bank also confirms that this is likely to be the case, especially in agriculture. Accordingly, we feel relatively confident in moving forward with the selection of some agribusiness subsectors. As is the case with

[6] An interesting case study in the discipline to focus is Apple Computers. For years, Apple has been aware that it has a tremendous opportunity in business computers and systems. Despite the tempting market analysis, CEO Steven Jobs made it clear when he returned to the company that aggressively pursuing the business market would distract the company from its core areas, including some new products that were well into development. At the time that he returned to the company, Apple had plans to delay research on one such new product under development, to focus resources on entering the business market. The product that would have been put on hold was the iPod, which now accounts for a significant portion of Apple revenues. Only now is Apple beginning to focus on the business market. Could it have done both? “No,” said Jobs in a recent interview in Business Week, “that would have been wanting to do everything. And that wasn’t working. Sometimes you have to decide between a good and a great opportunity.”

all sectors and subsectors, however, selection will depend on the results of the DRC analysis.

Table 6. DRC Timeline

DRC Activities	Completion Date
Review qualitative data and additional supplemental material in order to select subsectors and appropriate geographic regions to conduct firm-level surveys.	15-Nov
Preparation of SOWs for tendering to local consulting companies for surveys.	1-Decv
Preparation of survey questionnaires for interviews to be conducted with farmers, traders/exporters, and processors/manufacturers.	10-Decv
Selection and contracting of consulting companies to conduct surveys.	20-Nov
Pre-testing of the questionnaires and training of interviewers.	24-Nov
Conducting interviews, electronic data entry, and transmission of data from field.	6-Dec
Collection of additional information on price comparisons, rates of indirect taxation, subsidy rates, input-output coefficients, wage rates, costs of capital, and factors determining the shadow exchange rate.	6-Dec
Field data analysis and the additional information to estimate domestic resource costs, effective rates of protection, shadow exchange rates, etc	12-Dec
Preparation and submission of survey reports by consulting firms.	14-Dec
Debriefing of survey interviewers, reading of survey reports, and discussion with other informants to verify the conclusions.	14-Dec
Preparation of draft initial report for first 15 sub-sectors.	14-Dec
Similar process as above for second 15 sectors	8-Feb
Receipt of draft final report.	15-Feb
Receipt of comments on draft final report, revision of report, and submission of final version for all 30.	27-Feb

Step 4: Final return on investment determination. This last step will consist of a detailed analysis of the sector or subsector through the action plans. In conjunction with the DRC, this analysis will identify major constraints, opportunities, and specific segments in which to focus activities. For example, in the case of poultry, where it appears increasingly likely that we will not work in the broiler segment—where there appear to be significant non-tariff import restrictions—but in other segments of the market. Another example is young potatoes, a subsector that appears to be a promising, but which has a narrow window to export to Russia and other countries. Capturing this window, however, will require significant investment in storage and other facilities. The key issue then, is not simply whether a sector has an acceptable DRC and appears dynamic, but

whether PSCEP can catalyze the required investment to justify involvement. This analysis will also identify the required investments required to achieve sector competitiveness and a final determination of whether PSCEP can make a significant contribution with program resources and those that we can reasonably expect to leverage.

B. Selection

Even as we emphasize discipline, it is likely that we will be working in more than ten subsectors. Table 7 below describes the sectors and subsectors in which we have decided to work. Highlighted in italics are subsectors that are likely to be among the next set chosen. The focus of PSCEP's work will be at the subsector level. It is at that level where we will make key and disciplined selection decisions.

Table 7. Sector and Subsectors Selected and Promising Candidates

Sector	Possible Subsectors	Comments
Fruits and Vegetables	**(1) fruit juice processing; (2) fresh fruits and vegetables** (early potatoes); (3) hazelnuts; (4) *greenhouse vegetable production*;	Leading anchor firms in fruit juices with strong comparative advantages. Green house vegetable production also very promising.
Animal Products	(5) *poultry*, most likely egg production; (6) some dairy products; (7) processed meats	Broiler production, the most cited promising sub-sector may involve significant market distortions. Dairy products also cited as promising but face issues such as stock and disease that we must analyze further.
Oil-sector Manufacturing Support Services	(*) catering and other food areas; **(8) Maintenance, Repair, and Operations (MRO)**	Catering and food services a distinct activity but primarily part of two sectors above. Very significant opportunities in MRO and related areas. BP has goal of outsourcing over $100 million in next few years. Interested in partnering with PSCEP.
Finance	Cross-cutting area for all activities. Chosen as separate "sector" because is importance is beyond a "means" to support exist other sectors.	Greater access to existing credit programs and development of new financial products. Build on work with nine commercial banks already initiated by USAID's FSSP.
Logistics and Business Support	Includes numerous cross-cutting areas and sub-sectors such as; (9) *food retailing* (10) warehousing/ logistics/cold chain; (11) free zone/industrial zone development	Many of these could easily be individual sectors. Our focus, however, may be much more focused that working on the entire sector, hence a more specific area. Cross cutting areas to support not only PSCEP sectors but broad economy.
Light Manufacturing	Among potential sub-sectors: (12) *packaging materials*; (13) furniture; (14) construction finishes; (15) textiles and carpets	Packaging materials could be an important input into other sectors, especially in agriculture. More research needed in this area. Detailed analysis to be undertaken January-February.
ICT	(16) software development; (17) IPS and other internet services	Potential for GDA. Sector will be focus of January 2009 DRC analysis.

Tourism was identified in the proposal as a possible sector but is not included in this list. Azerbaijan's weak tourism infrastructure and high prices do not seem to make it an area of comparative advantage. We note that the CIIC is actively exploring major investments in this area. Accordingly, we may review the sector at a later time, but it is not an area where we envision work during the first year.

Table 8 highlights relevant activities within each step and timelines sector selection and the accomplishment of programmatic results.

Table 8. Sector Selection Timeline

Activities	Responsible	Resources	Timing
Review initial sectors and subsectors, cross-checking data, existing studies, etc.	COP, DCOP, VC Specialists	Existing studies	Nov 2008
Identification of initial (first four sectors, including initial subsectors)	COP, DCOP, VC Specialists	Local BDS Consulting firm	Dec 2008
DRC analysis of high potential sectors (ten agriculture, five non-agriculture)	Dirck Stryker	STTA, 6 weeks	-Dec 2008
Sector/subsector action plans for poultry, dairy, and oil industry MSS	STTA	Expat, 3 weeks per sector	Dec 2008
DRC analysis of high potential sectors (second set)	Dirck Stryker	Expat, 4 weeks	Jan-Feb 2009
Sector/subsector action plans for fruit juice processing, greenhouse vegetables, processed meats, finance, packaging materials, warehousing and cold storage, others	STTA	Expat, 4 weeks per sector	Jan-March 2009
Selection of additional three to four sectors/subsectors and development of action plans	COP, DCOP, VC Specialists,	BDS Consulting firms	March-Apr

SECTION VI. TIMELINE

The Gantt chart in the next page provides an overview of the sequence of Year 1 PSCEP activities, especially for the first six months.

PSCEP Time Line of Key Activities - Year 1	October	November	December	January	February	March	April	May	June	July	August	September
	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4	1 2 3 4
Project Start Up and Management												
Mobilize team, establish and equipt office												
PSCEP policy and procedures manual developed and approved by USAID												
Present timeline and project summary to MOED												
Undertake DRC analysis for sector selection												
Prepare and present preliminary Year 1 Work Plan (including preliminary sector selection)												
Sector selection for three/four sectors and subsectors												
Develop policy/procedures Competitiveness Innovation Fund (STTA to help local manager with procedures)												
Competitiveness Innovation Grant Fund awards												
Develop monitoring & evaluation system												
COP initial introductions and ongoing meetings with all GOAJ, private sector and civil society partners												
Selection of remaining selectors												
Action Plans for first tranche of subsectors completed -- dairy, poultry, meat, extraction services, early potatoes (STTA)												
Action Plans for second tranche of sectors completed (STTA) -- to be determined												
Preparation of Progress Reports for MOED												
Preparation and presentation of Quarterly Reports												
Workplan review and mid-year corrections												
Objective 1: Competitive Value Chains Enhanced												
Select three/four core BDS providers (competitive, transparent bids incorporating incentive program)												
Develop IQC-type mechanism for BDS providers (to provide "real time" support to sectors, once all selected)												
Workshop on Value Chain and Competitive Sectors and Access to Capital (for BDS providers, other stakeholders)												
Select second tranche of Core BDS providers												
Second Workshop on Value Chain and Competitive Sectors (for BDS providers, other stakeholders)												
Road show preparation and implementation with AIC												
Investment preparation and presentations by sector companies for AIC												
Detailed financial sector action plan (Follow-up to Work Plan -- STTA)												
MOU or Other type of agreement with commericial banks to develop new financial products												
Workshop with other donors on access to capital and financial products (for banks, investment funds, VCs)												
Financial products introduced in market												
Development of MOU or other cooperation agreement with AIC												
Development of MOU or oher cooperation agreement with Caspian Investment Fund												
Development of MOU or other cooperation agreement with major investors/buyers (BP, Coca Cola)												
Workshop on Grades and Standards for agricultural subsectors												
Objective 2: Public Private Partnerships Established												
Ongoing COP meetings with and assessment of associations in selected sectors, building social capital												
Lead firm, supplier relationship established												
Value Chain round tables to discuss constraints, opportunities, common issues												
MOU or other relationship established with existing associations to strengthen capacity (microenter., ag input, etc.)												
GDA with private sector firm developed and signed												
Establishment of new cluster or other formal associative multistakeholder relationship in sector supporter												

ANNEX A. PERFORMANCE MONITORING PLAN

A. Monitoring, Evaluation, Analysis, and Communication

This section presents the PSCEP monitoring and evaluation (M&E) system that will provide the foundation for tracking the project's delivery of expected outputs, determining qualitative and quantitative impacts to measure progress, and supporting USAID/Azerbaijan's M&E needs. The overall goal of this system is to establish a means of providing critical information for decision-makers to help them guide the implementation of project activities toward attainment of project objectives. This goal recognizes that certain elements of the implementation program may require adjustment to respond to evolving conditions. Hence, the M&E system is a management tool for systematically reviewing project progress, troubleshooting problems and issues during project implementation, and assessing areas where project activities may need to be refocused to ensure that plans, schedules, and assignments remain current. Also, where there are real successes or new opportunities beyond what was contemplated, management decisions can be made to channel more resources into those growth areas.

Monitoring progress and evaluating results are key management functions in PSCEP; an ongoing process that allows managers to determine whether or not a program or activity is making progress toward intended results. Evaluation also helps to identify effects that are attributable to the program. The strength of M&E lies in its ability to provide timely performance information, which is used to manage for results and to improve project performance.

PSCEP will not only collect performance and impact data, it will also add value to the raw data by performing appropriate analysis, and providing context for data interpretation, thereby transforming data into information. For this information to have an impact, it must then be communicated.

The implementation of the M&E system will involve both the PSCEP technical and management team. This is necessary for several reasons:

- *Efficiency*. PSCEP technical team members have firsthand knowledge of activities and immediate results in their areas of work and are best suited to collect, supervise the collection of, and verify basic M&E data in their respective technical areas.
- *Ownership*. By being involved in the M&E system, the system belongs to the entire team. This will ensure that the set of information generated is relevant and consistent with the interests of the entire team and PSCEP partners.
- *Feedback*. Having collected and analyzed M&E information, PSCEP technical team members will have firsthand information on project progress and will be able to use M&E information to guide program implementation.
- *Management*. Because regional BDS partners are provided with a financial incentive to produce results, accurate, reliable, and timely M&E is essential to

effective management. Integrity of data and cross checking of information by both technical and management teams are essential to program design.

The overall M&E system is based on an impact design linking program implementation to desired outcomes and impacts. This design is reflected in the PSCEP Objectives Hierarchy (Figure 1, main text).

B. PSCEP Objectives Hierarchy

The objectives hierarchy is a planning, communications, and management tool that conveys the development hypothesis implicit in project goals and objectives and the cause-effect relationships between project objectives and primary (impact) and secondary (performance) indicators. Hence the objectives hierarchy provides a foundation for work planning and performance monitoring.

The PSCEP proposal included an illustrative results framework (RF) that was conceived at the project proposal stage. At the initial work-planning workshop, it became necessary to revise this framework to reflect the implementation approach that is based on updated, on-the-ground information, and team consensus. Hence, PSCEP work planning began with a critical review of the RF by PSCEP technical staff. During the review, technical issues were considered, potential activities and solutions discussed and key results debated. This resulted in a revised PSCEP Objectives Hierarchy depicted in Figure 1.

To advance the goal of increased competitiveness of the private sector shared by USAID and the GOAJ, PSCEP will work through four project objectives:

- Enhanced Access to Finance
- Increased Employment in Azerbaijan's Private Sector
- Increased Sales for Azerbaijan's Private Sector
- Increased Social Capital

Under the first objective, Enhanced Access to Finance, PSCEP will work with commercial banks, the AIC, and other financial institutions to develop new financial products and reach a larger number of businesses with new or strengthened financial products.

Under the second two objectives, Increased Employment and Sales in Azerbaijan's Private Sector, PSCEP will work to expand market access, increase capacity of enterprises and smallholders to respond to market demand, and increase delivery of effective, demand-driven services.

The final objective, Increased Social Capital, is our cross-cutting objective. PSCEP will work to create and strengthen associative relationships with public and private institutions such as BP, AIC, MOED, and business associations to generate results across the entire project.

Using the objectives hierarchy as a planning tool, PSCEP work planning focused at the secondary indicator level by examining the main activities for achieving each indicator, tasks to be carried out under each activity, timeline for the tasks, and resources required.

Based on the primary impact indicators, PSCEP has identified a list of secondary performance indicators designed to:

- Capture major project impacts;
- Supply information concerning activities undertaken through PSCEP technical assistance and CIF;
- Provide a picture of implementation progress; and
- Contribute to USAID/Azerbaijan's own M&E data needs.

PSCEP has designed the M&E system so that it will not become a data collection burden for project staff and partners. We took care to eliminate correlated indicators and focus on three primary measures that best indicate project performance: sales, jobs, and investment. A complete list of indicators and targets is presented in section H below.

The PSCEP M&E system will target data collection primarily on activities directly implemented by PSCEP and its partners and the impacts of those activities. This principle of manageable interest ensures that the PSCEP M&E system reports only those results that are within the project's ability to influence. PSCEP will also capture secondary impacts through field visits, special studies, and rapid appraisals where appropriate.

Once USAID approves the PSCEP Work Plan and Performance Monitoring Plan (PMP), PSCEP's deputy chief of party and M&E specialist will work with technical staff to implement the various databases and spreadsheets for M&E data collection, establish indicator profile sheets, begin baseline collection, and provide training to staff and partners on the operations of the M&E system.

C. Types of Indicators

To provide the comprehensive coverage needed for project progress review, troubleshooting, and other management tasks, the M&E system will track two main types of indicators: impact (primary) indicators and performance (secondary) indicators. Where appropriate, indicators will be disaggregated by sector, geographic location, and gender.

C1. Impact Indicators

Impact indicators, such as increased sales and enhanced access to finance, measure the effects, or results, of project output. Impact indicators contribute directly to economic development goals of USAID and MOED.

C2. Performance Indicators

Performance indicators track the immediate outputs of the project, as well as deliverables. These are products that are directly attributed to PSCEP activities, such as the number of equity investments in target sectors, GDAs developed, or buyer-supplier agreements signed. Performance indicators provide the means for monitoring project progress, provide feedback to managers on project performance, and help identify areas where implementation strategies may need to be adjusted. Performance indicators for the M&E system are selected based on the overall strategic approach to the project and closely reflect the work plan, capturing the main activities of the project.

D. Target Assumptions

We expect that during the first year of PSCEP, much effort will be focused on building relations with partners, providing trainings and other technical and business advisory services, and building the capacity of partners to provide financial and non-financial services. Therefore, we expect the greatest impact of the project will come starting in Year 2 rather than Year 1.

Indicator targets reflect this trend. We will analyze project achievements against targets in our M&E reports and make recommendations to update the targets if it becomes necessary.

E. Data Collection and Reporting

The M&E system provides critical information for quarterly reports to USAID and the MOED. The PSCEP team will collect and analyze performance information regularly; results from the analyses will help determine whether adjustments to the implementation plan are required. Each technical specialist will be responsible for managing primary data collection and entry in his or her technical area. The M&E specialists will be responsible for verifying field data and incorporating into an M&E database. The chief of party will supervise the overall M&E system.

F. General Indicator Assumptions

In designing PSCEP's M&E system, we focused on indicators within the manageable interest of the activity. This approach allows PSCEP to measure impacts that can be directly attributed to the project. Additionally, the indicators are selected based on the following basic assumptions:

- No extreme movements in commodity prices as a result of shifts in the world.
- No major climatic shocks such as drought, floods, and other weather hazards.
- No phytosanitary shocks such as major pest outbreaks, plant diseases, or other epidemics in the commodity groups.
- Absence of sociopolitical instabilities, including national and regional political and civil instabilities.
- Generally stable macroeconomic situation, barring major impacts from changing oil prices and the world financial crisis.
- Generally stable fiscal and monetary policy.

G. Impact Indicators and Targets

The following four impact indicators correspond to the four primary objectives of the program: Enhanced Access to Finance, Increased Employment in Azerbaijan's Private Sector, Increased Sales for Azerbaijan's Private Sector, and Increased Social Capital.

G1. Value of Financing Leveraged

Definition: investment resources leveraged from lending institutions, equity investors, and/or from PSCEP resources for purposes of investment inside client companies and/or joint investments by value chain/cluster participants.

Unit of measure: Million USD from baseline

Year 1 target: $50 million USD

Life-of-Project (LOP) target: $225 million USD

G2. Percentage of Employment Growth

Definition: Average annual expansion of employment levels of client firms above the relevant industry trend line.

Unit of measure: Percentage difference compared to all firms in sector/subsector

Year 1 target: 30 percent for at least 100 client firms

LOP target: 30 percent for 500 client firms

G3. Percentage of Sales Growth

Definition: Average annual expansion of sales of client firms above the relevant industry trend line.

Unit of measure: Percentage difference compared to all firms in sector/subsector

Year 1 target: 50 percent for at least 100 client firms

LOP target: 50 percent for 500 client firms

G4. Number of Associative Relationships

Definition: Number of formal or informal relationships with public or private sector entities such as business associations, international firms, and banking and non-banking financial institutions. For M&E purposes, formal relationships can be formed by signing and maintaining a MOU, securing a GDA, or developing and implementing a sectoral action plan with an industry association.

Unit of measure: Yes/no. Institutional agreement in place and active commitments and progress against agreement.

Year 1 target: 6

LOP target: 20

H. Performance Indicators and Targets

The following performance indicators are secondary and contribute to achieving the four primary impact indicators listed above.

H1. Number of New Financial Products Introduced

Definition: The number of financial products increased through introduction, innovation, customization, tailoring, and/or expansion of product lines into local financial institutions.

Year 1 target: 4

LOP target: 6

H2. Number of Equity Investments Leveraged

Definition: The number of equity investment transactions facilitated by PSCEP technical assistance, capacity building, new product development, and go-to-market strategies to identify strategic equity investment opportunities.

Year 1 target: 4

LOP target: 20

H3. Percentage of Non-USAID Income of BDS Providers

Definition: Percentage of operational costs on fee-basis or through alternative, non-USAID sources of financial support.

Year 1 target: 50 percent, at least 5 BDS client firms

LOP target: 80, at least 5 BDS client firms

H4. Number of Growth Plans Signed for Client Businesses

Definition: Number of strategic growth plans signed between client businesses and BDS providers.

Year 1 target: 30 strategic growth plans, impacting 100 businesses

LOP target: 100 strategic growth plans, impacting 500 businesses

H5. Number of Global Development Alliances Signed

Definition: Number of GDAs signed between USAID/PSCEP and leading private sector firms.

Year 1 target: 2

LOP target: 8

H6. Number of Buyer-Supplier Agreements Established

Definition: The number of buyer-seller agreements established with PSCEP assistance.

Year 1 target: 5

LOP target: 30

H7. Number of Associations Strengthened

Definition: The number of formal or informal clusters, associations, sector "clubs," or related mechanisms created or strengthened with PSCEP assistance.

Year 1 target: 8

LOP target: 20

H8. Number of Workshops Held

Definition: The number of workshops, seminars, roundtables, and/or public-private sector meetings organized with PSCEP assistance.

Year 1 target: 6

LOP target: 15