

Donor Committee for Enterprise Development

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## Supporting Business Environment Reforms: Practical Guidance for Development Agencies

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## Key Messages

A **healthy business environment is essential** for growth and poverty reduction. Business environment reform is needed where inappropriate regulation, excessive taxation, lack of fair competition, lack of voice and an unstable policy environment restrict investment and the development of markets, stifle entrepreneurship and force many businesses to operate in the informal economy.

**Business environment reform is complex**, operating on many levels and involving a very wide range of stakeholders. Development agencies should therefore ensure a **thorough diagnostic analysis** and maintain, as far as possible, a **systemic approach** and an understanding of the broader causal picture.

**Business environment reform is always political** and development agencies should therefore take care to analyse the political context. They should have strategies to build coalitions of support and to manage those who wish to protect the status quo.

**Government should lead and own reform; donors should support them.** The right balance between international and local expertise must also be found.

Development agencies should ensure that the **inputs and participation of all stakeholders**, including politicians, officials, the formal and informal private sector and civil society, are reflected in the reform process. Reform interventions should be designed to **enhance stakeholder capacity** for ongoing and future reforms.

Development agencies should ensure systems are in place for **donor coordination** and take responsibility for **the quality and consistency of the advice and assistance** they provide.

Development agencies should **sequence reforms** according to context. “Quick wins” and taking advantage of ad hoc opportunities such as changes of government, may build reform momentum. However, a long-term perspective is essential to ensure sustainability.

Development agencies should understand and manage **the implementation gap** typically found between the adoption of regulation or principles, and changing practice and enforcing regulations on the ground.

Development agencies should ensure the reform process has a **strong communication programme** so that all stakeholders are engaged and made aware of the benefits of reform.

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## I Introduction

Development agencies support the programmes of partner governments. While there are diverse views regarding the role development agencies can play in reducing poverty through private sector development, much can be gained by coming to agreement on key principles and practices. The Donor Committee for Enterprise Development has been facilitating and documenting these kinds of agreements since its formation in 1979 and, having produced guidance on financial and business development services, now turns its attention to the business environment in which private firms operate.<sup>1</sup>

### Purpose of this guidance and intended readership

This document provides practical guidance to development agencies to improve their support for business environment reforms in developing and transition countries, which aim at economic growth, poverty reduction and gender equality. It provides generally applicable, practical guidance for development staff in the design, implementation and monitoring of their programmes. While there are many contested issues, a selection of the most significant being highlighted in the text, as well as a great deal of trial and error in the field of business environment reform, this guidance attempts to provide good principles and practices based on lessons learned. This guidance has been prepared for the international development community at headquarter and field levels, but it is hoped that programme partners will also find value in it.

Development agencies perform a unique and specialised function when supporting reform processes in developing and transition countries – one that differs from the functions of governments, the private sector and other civil society stakeholders. When performing these functions, development agencies respond to the demand in the country and to international commitments and draw upon a number of resources. These include high-level policy frameworks that provide principles and guidance on how development programmes should operate, such as the *Paris Declaration on Aid Effectiveness; Ownership, Harmonisation, Alignment, Results and Mutual Accountability*. While there are resources available providing practical, step-by-step advice on how to undertake specific reforms, this document provides guidance on how to apply broad, high-level policy frameworks when designing and implementing business environment reform support programmes.

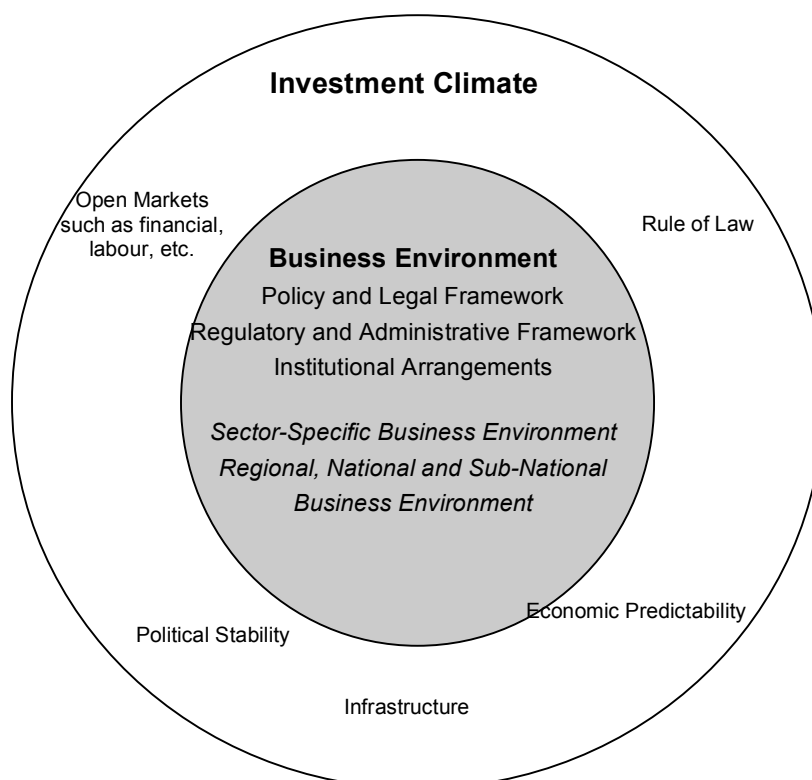
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1 For the guidance on financial and business development services go to: [www.enterprise-development.org/resources/items.asp?cat=Guidelines](http://www.enterprise-development.org/resources/items.asp?cat=Guidelines)

## Defining the business environment and the focus of the guidance

For the purposes of this guidance the Donor Committee for Enterprise Development defines the business environment as a complex of policy, legal, institutional, and regulatory conditions that govern business activities. It is a sub-set of the investment climate and includes the administration and enforcement mechanisms established to implement government policy, as well as the institutional arrangements that influence the way key actors operate (e.g., government agencies, regulatory authorities, and business membership organisations including businesswomen associations, civil society organisations, trade unions, etc.). See Figure 1.

**Figure 1: Defining the business environment**



Along with other private sector development initiatives, the business environment affects the performance of private enterprises in both the formal and informal economies. Business environment reform promotes the development of markets that encourage competition and enhance the effectiveness and sustainability of other development interventions. A conducive business environment is one of the pre-requisites for economic growth and poverty reduction (see Contested Issue 1). While poverty reduction requires more than just economic growth, growth is an essential ingredient. However, in many developing and transition countries, the business environment is hostile to market-led growth; private enterprises suffer excessive regulatory barriers and in most respects regulatory costs are higher than in developed

economies.<sup>2</sup> Poor business environments are also more likely to have a disproportional negative impact on women-owned businesses, which are more likely to remain informal.

**Contested Issue 1: Can we measure the extent to which business environment reform contributes to economic growth and poverty reduction?**

While business environment reform contributes to economic growth and poverty reduction, it is unclear how significant this link is and whether it can be measured. The World Bank claims that if a country reformed sufficiently to move from the bottom quartile to the top quartile of the *Doing Business* ranking, it would add 2.3 percent to the annual growth rate. However, others have contested the extent to which such precision can be applied to this link arguing there is no simple, linear relationship between growth, income and regulation. A low level of regulation is optimal for rich countries, and highly regulated middle-income countries can benefit from deregulation. However, it is argued, regulatory reform may not be the immediate priority in some poor countries, nor for middle-income countries with low levels of regulation. Moreover, consideration should be given to the quality of regulation – not simply the volume – and the affect this has on firm behaviour.

SOURCES: (1) Djankov, S. et al. (2006) *Regulation and Growth*, World Bank:

[www.doingbusiness.org/documents/growthpaper\\_03\\_17.pdf](http://www.doingbusiness.org/documents/growthpaper_03_17.pdf)

(2) Eifert, B. P. (2007) The Economic Response to Regulatory Reform, 2003-06, working paper:

<http://beifert.googlepages.com/eifertinvestmentresponsetoreform10-2.doc>

## Objectives of business environment reform

Reforming the business environment is a priority for development agencies and governments because of the significant influence the business environment has on the development of the private sector and therefore on economic growth and the generation of livelihoods and jobs. Development agencies design business environment reform support programmes in developing and transition countries so that businesses are able to change their behaviours in ways that lead to increased levels of investment and innovation, and the creation of more and better jobs. This is done by:

1. Reducing business costs: to increase profits (that may lead to increased investment) or increasing market share (and thereby output and employment);
2. Reducing risks: poor or frequently changing government policies, laws and regulations pose a risk for business, thus, reducing the value of capital (and thereby increasing the number of attractive investments in the market); and
3. Increasing competitive pressures through new entry: to stimulate the efficiency and innovating incentives of the market.

Development agencies design programmes to support reforms in developing and transition countries that improve the business environment by reducing legal, institutional and regulatory constraints for doing business. They support governments and other development partners (e.g., other state organs such as the legislature and the judiciary, as well as the private sector and civil society organizations) in their efforts to make the business environment more conducive to the growth and competitiveness of the private sector. For development agencies, the principal objective of a better business environment is the reduction of poverty and the increase in productive employment opportunities for the poor. Figure 2 provides some examples of how business environment reform can contribute to the achievement of specific Millennium Development Goals.

2 Indigenous Private Sector Development and Regulation in Africa and Central Europe: A 10 Country Study, 2002, by Bannock *et al.*  
[www.businessenvironment.org/dyn/be/besearch.details?p\\_phase\\_id=35&p\\_lang=en&p\\_phase\\_type\\_id=1](http://www.businessenvironment.org/dyn/be/besearch.details?p_phase_id=35&p_lang=en&p_phase_type_id=1)

**Figure 2: Some examples of how business environment reform contributes to achieving the Millennium Development Goals**

Millennium Development Goals	Contributing Business Environment Reform
MDG 1: THE ERADICATION OF EXTREME POVERTY AND HUNGER	Removing the constraints and barriers to business establishment and growth so that the private sector can contribute more to economic growth and job creation, as well as by removing the constraints and barriers to participation by the poor in the private sector.
MDG 3: THE PROMOTION OF GENDER EQUALITY AND EMPOWERMENT OF WOMEN	Reforming the business environment addresses many of the problems experienced by informal firms, the majority of which are owned and managed by women. Reforming the business environment can also address gender-specific regulations and institutions which constrain women who own and manage their own businesses.
MDG 7: ENVIRONMENTAL SUSTAINABILITY	Improving compliance rates among private enterprises and ensuring that sound environmental laws and regulations are enforced.
MDG 8: A GLOBAL PARTNERSHIP FOR DEVELOPMENT	Integrating national business environments with global trade and investment opportunities – promoting an open, rule-based, predictable, non-discriminatory trading system, and a commitment to good governance, development, and poverty reduction.

Because business environment reform is a process and not a single event, another objective of development agency support is to make reforms sustainable by building the capacity of key public and private stakeholders to manage reforms over the long term. Emphasis should be given to supporting the implementation of reform and to improving the systems in which private enterprises operate.

Poor business environments provide incentives for firms to operate informally or extra-legally. Thus, improvements to the business environment can contribute to reducing the size of the informal economy.<sup>3</sup> Development agencies should support initiatives that examine the effect the business environment has on the informal economy (e.g., identifying barriers that prevent informal enterprises graduating to the formal economy and identifying the incentives for formality and informality) and how this varies between women and men. However, business environment reform is not the only response required to the problem of informality. Because informal firms often experience substantial deficits in terms of skills, access to information and access to finance, they can be less able to enjoy the benefits of an improved business environment. Thus, private sector development programmes that address the concerns of the informal economy should include activities that help these firms to be better able respond to emerging market-driven opportunities.

While economic growth is an essential prerequisite to poverty reduction, the rate of poverty reduction is also determined by the patterns of growth. Specific, carefully targeted interventions are necessary to enhance the impact business environment reform has on poverty reduction. This includes giving the poor greater opportunities to participate in markets and reducing the risks and vulnerability poor people tend to experience at levels greater than others in the business environment. It is widely acknowledged that women are more severely affected by poverty than men and that gender inequalities, especially in education and labour market participation, result in substantive losses in terms of economic growth. Therefore, in order to effectively reduce poverty and stimulate pro-poor growth, interventions and policies should be designed in a gender sensitive manner and - if required - be complemented by interventions that specifically target women in order to create an equitable situation for both sexes. Addressing the challenges of poverty reduction through business environment reform therefore entails two areas of focus:

Ensuring the benefits of economic growth created by business environment reform are diffused so that they benefit the poor (e.g., by increasing the demand for employment); and

3 See, for example: <http://www.csd.bg/news/bert/nenova.pdf> and <http://rru.worldbank.org/documents/publicpolicyjournal/313Klapper.pdf>

Ensuring the participation of poor women and men in business environment reform processes is increased.<sup>4</sup>

**Contested Issue 2: Should business environment reform focus on enterprises that are owned and managed by poor people?**

While the reduction of poverty is the ultimate purpose behind most development agencies' support for business environment reform, not all agencies agree on how this is best achieved. Some agencies argue that general reforms of the business environment are not sufficient and there is a need to focus reforms on the specific barriers that poor women and men experience directly when operating in the business environment. Others argue that targeted approaches create additional biases and market distortions and are not consistent with a systemic approach to business environment reform that improves the system for everyone. The former approach aims to address equity issues directly, while the latter approach worries that by directly addressing equity new market distortions will be created that dampen the benefits of an improved business environment on economic growth. A related aspect to this issue concerns the emergence of a so-called "bottom of the pyramid" approach to business environment reform where the primary focus for reform is on the markets in which poor women and men purchase goods and services. In this approach, the poor are seen as resilient, creative entrepreneurs and value-demanding consumers. Development agencies are advised to maintain a systemic approach to this issue. Whether or not they support business environment reforms that focus on the poor, they should assess the impact these reforms have on markets and the broader economy. For further information see:

OECD, *Promoting Pro-poor Growth: Policy Guidance for Donors*:

<http://www.oecd.org/dataoecd/33/54/36570936.pdf>

OECD, *Promoting Pro-poor Growth: Private Sector Development*:

<http://www.oecd.org/dataoecd/43/63/36427804.pdf>

OECD, *Accelerating Pro-poor Growth through Support for Private Sector Development*:

<http://www.oecd.org/dataoecd/53/21/34055384.pdf>

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4 Recent developments in the Making Markets Work for the Poor (M4P) are a good example of this emphasis on pro-poor economic development. The M4P approach is a development objective and a broad approach to poverty eradication based on the premise that well-functioning markets can help reduce poverty by delivering affordable products and services to poor people, offering poor people better return on their assets and labour, and presenting poor people with better employment opportunities. Key documents on this approach are available at: [www.bdsknowledge.org](http://www.bdsknowledge.org)

## II Dimensions of business environment reform

This chapter describes three key dimensions to supporting business environment reforms. First, development agencies should recognise the four levels at which business environment reform can be supported (i.e., regional, national, sub-national and sectoral). Second, reforms can also address key functional areas that affect business activity described later in this chapter. Third, there are four programme cycles phases that can be used to guide development agencies in their support for business environment reform.

### Levels of business environment reform

There are different levels of the business environment that affect how reform interventions are designed, managed and assessed. Figure 3 displays a matrix highlighting four levels of business environment reform.<sup>5</sup> The approach taken to supporting business environment may vary according to the type of government system that is in place (e.g., federal or unitary systems of government).

**Figure 3: Levels of business environment reform**

Functional Areas of Business Environment Reform				
	Levels of Business Environment Reform			
	Regional	National	Sub-National	Sectoral
<b>Key Programme Partners</b>	Regional development bodies (e.g., AU, ASEAN), regional economic communities (e.g., SADC), World Trade Organisation	Parliament, political parties, national government ministries, regulators, private sector representatives, business membership organizations, business media, worker organisations, and consumer groups	Sub-national legislatures, provincial, regional and local government authorities, local business associations, community-based organisations	Sector-specific business associations, regulators, government authorities, policies
<b>Policy and Legal Framework</b>	Improving policies and harmonising laws and regulations that improve regional trade and investment	Improving national policies and laws that promote competition, open markets and the general conditions for private sector development	Improving local policies for private sector development	Sectoral policies and laws often deal with promotional interventions and ways to enhance the value chain
	Trade policies, laws and regulations	Competition, tax, trade, labour policies and laws	Sub-national policies for regional development, local economic development and private sector development	Sector development policies
<b>Regulatory and Administrative Framework</b>	Improving the regulations that hamper regional trade and investment	Improving national regulations that affect the establishment, operation and closure of private enterprises	Improving the regulations created by sub-national authorities	Improving business regulations that apply to specific industry sectors or sub-sectors

<sup>5</sup> The categories presented in this matrix are not mutually exclusive. It is likely that development agencies will work at different levels and, for example, that sectoral reforms can have a regional, national and sub-national character.

	Trade regulations, customs administration	Business regulations; tax laws and administration; labour laws and regulation; trade regulations; customs administration	Business start-up and licensing procedures	Sector licenses and permits
<b>Institutional Arrangements</b>	Supporting member states of regional bodies to design and implement reforms; improving public-private dialogue at the regional level	Improving dialogue between national government and private sector representative agencies (e.g., public-private dialogue)	Supporting local structures and processes for sub-national public private dialogue	Building and supporting sectoral business membership organizations to participate in discussions with government agencies to improve the business environment
	Trade facilitation Capacity building	Regulatory Governance Capacity building	Capacity building	Capacity building

### Supporting regional business environment reforms<sup>6</sup>

Development agencies should work closely with regional institutions (e.g., Regional Economic Communities in Africa, the African Union, Association of South East Asian Nations, Asia-Pacific Economic Cooperation) in order to support harmonised reform efforts among their member states and better integration of regional markets. Regional bodies play an important role in stimulating the demand for reform among their member states and promoting good practice and quality policies, laws and regulations. Moreover, support for reforms through global institutions, such as the World Trade Organisation, should also be considered.

### Supporting national business environment reform

Development agencies should work with the national legislature, reform agencies, parliamentarians, senior public officials, and national business membership organisations to help them better reform current policies, laws and regulations and to consider policy alternatives and reform options. National reform programmes can have a significant impact on the business environment by improving competition in national markets as well as access to foreign markets, improving the effectiveness of national organisations (public and private), strengthening the rule of law, and creating a business-friendly regulatory framework.

Supporting national-level reforms also involves facilitating and institutionalising dialogue between the public and private sectors – including special efforts to consult with women and informal firms. This is done to improve the quality of governance by providing the private sector with the opportunity to comment on, review and oversee regulatory reforms, while promoting greater levels of transparency and accountability.

6 Support for regional business environment reforms is not considered in detail in this guidance, partly because the DCED's conferences to date have only briefly surveyed donor activities at this level. See papers presented at Accra Conference 2007 Session 1.2: Priorities for Regional Economic Communities: [http://www.businessenvironment.org/dyn/be/besearch.details?p\\_phase\\_id=148&p\\_lang=en&p\\_phase\\_type\\_id=3](http://www.businessenvironment.org/dyn/be/besearch.details?p_phase_id=148&p_lang=en&p_phase_type_id=3)

**Box 1: The process of business environment reform in Vietnam 2005**

In 2003, the government of Vietnam announced that the existing legal framework for business would be revised, combining four laws regulating all types of businesses into two comprehensive laws aimed at harmonizing the overall framework for investment and business, eliminating many distinctions between domestic and foreign investment, and ensuring Vietnam complies with relevant international agreements as it seeks to join World Trade Organisation. The two laws - the Enterprise Law and Investment Law - were adopted in December 2005, and came into effect following the issuance of implementing decrees. Over the course of three years, the International Finance Corporation, through the Mekong Private Sector Development Facility, partnered with government, the business community and other development partners to provide a comprehensive technical assistance. This support had an explicit focus on policy reform processes and changing the mindsets of the range of stakeholders: the business community, policy experts, the media, and especially lawmakers (members of National Assembly in particular). The multi-faceted project spanned the entire legislative process, from helping to develop the guiding principles for the legal framework, providing ongoing advocacy until the laws were passed, providing technical assistance to develop implementing decrees of the laws, and now that the laws have passed, assisting in the monitoring process.

In a related move in 2005, the Vietnamese Government announced it wanted to double the number of registered private sector enterprises from 250,000 to 500,000 by 2010, with the expectation that these new enterprises would create 2.7 million new jobs and help increase the quantity and quality of exports by the SME sector. With assistance from UNIDO, the Agency for SME Development (ASMED) in the Ministry of Planning and Investment, in a highly participatory and consultative process, prepared the SME Development Action Plan 2006-2010, which consisted of 45 specific actions, 39 of which aim at improving the regulatory and administrative environment. ASMED designed a nationwide business registration reform programme that would create a computerized single-point business, tax and statistics registration system to lower the cost of market entry and doing business in the country. ASMED and 19 collaborating ministries, agencies and departments were further assisted in the establishment of the Government Business Portal ([www.business.gov.vn](http://www.business.gov.vn)).

**Supporting sub-national business environment reform**

With increasing regulatory power of sub-national authorities it is important to consider the variations that exist across sub-national business environments (i.e., across provincial, regional and local jurisdictions). While administrative relationships and powers between national and sub-national governments vary from country to country, the reform of local business environments is a necessary systematic response to decentralized governance. The decentralization of regulatory responsibilities to local governments may result in costly barriers to the operation of internal markets. Strong competition safeguards have to be put in place so that there is not an explosion of superfluous regulatory requirements at the sub-national level. Local governments have to have the same good regulation capacities and procedures as national governments if they are to regulate to the same standards.

Sub-national business environment reforms should not be seen as simply a local reflection of the national situation. In many countries, local governments can exert significant pressure for reform on the national political process. Furthermore, sub-national reforms can be replicated from one locality to another. See Box 2. Sub-national business environment reforms should recognise and respond to local diversity in the business environment as well as to the mandates and political powers assigned to sub-national government authorities. Sub-national reforms can complement other sub-national development processes, such as local economic development programmes and can be used to promote competition among sub-national jurisdictions (e.g., cities), which can be a useful driver of reform. Development agencies should support sub-national reform efforts by building and strengthening local systems, procedures, skills and institutions in order to identify and remove new bottlenecks to business growth, reduce risk and improve competition in local markets.

**Box 2: Streamlining business permits and licensing procedures in Ormoc City, Philippines**

In order to improve the business environment in Local Government Units (LGUs), the German Technical Cooperation and the Philippine Department of Trade and Industry through the Small and Medium Enterprises Development for Sustainable Employment Programme (SMEDSEP), provided technical assistance to the LGU in Ormoc City to simplify the city's business permits and licensing processes. The main objectives of the project were to: monitor and evaluate the improved business licensing procedures; recommend ways of further improving the current licensing procedures to achieve client satisfaction; and present the lessons learned to selected LGUs to encourage similar efforts. Assessment, planning, implementation and evaluation took about 18 months (December 2004 to April 2006). The reform reduced the process of business registration from 17 steps to five, and the time from 17 days to two days. This led to a 25 percent increase in the number of registered businesses in Ormoc from 2005 to 2006. The Philippine Chamber of Commerce and Industry awarded Ormoc City as the Most Business Friendly City for Visayas in 2006. Other municipal and provincial LGUs in the region are reviewing their business licensing and permit systems guided by the practical Ormoc model. By the end of December 2007, it is expected that about 50 percent or 21 more LGUs will have successfully streamlined their procedures.

SOURCE: [www.smedsep.ph](http://www.smedsep.ph)

In some cases, development agencies have supported business environment reforms at the local level because reform at the national level was deemed to be too difficult or unsustainable. Political instability, weak or ineffective national structures, high levels of corruption or a lack of good governance at the national level have led many development agencies to work with sub-national structures and jurisdictions that have been more open to reform.

When working on business environment reform at the sub-national level, development agencies should engage local stakeholders to know their perception of the business environment and to share their assessment results with government and the private sector before publication. Gender specific barriers should be identified and adequately addressed at an early stage. It can be useful to compare national assessment benchmarks (such as those in the World Bank *Doing Business* reports) with local assessment results and collect and share stories on local business environment reform processes that sub-national government authorities are already engaged in.<sup>7</sup>

#### Supporting sector-specific business environment reform<sup>8</sup>

Reforms are often needed to address policy, legal and regulatory requirements that unnecessarily raise the cost of doing business, increase risks or reduce competition within specific sector or industry categories. These approaches to business environment reform allow for a deeper analysis within those sectors that are most strategic for national development or pro-poor economic growth.

Policies and institutions that are sector-specific are important drivers of economic performance; by assessing specific sectors it is possible to identify causal links between the business environment and firm performance.<sup>9</sup> Furthermore, support for sectoral business environment reforms can complement and enhance the impact of other sector and sub-sector development initiatives such as the promotion of industry clusters. The pro-poor impacts of a focus on the business environment in agriculture, in particular, are likely to be substantial.<sup>10</sup>

7 Useful examples of sub-national business environment assessments include the Philippine Cities Competitiveness Ranking Project (<http://www.aim.edu/home/announcementc.asp?id=721>), the Vietnam Provincial Competitiveness Index ([http://www.vnci.org/Xportal/Upload/docs/PCI\\_2006\\_Summary\\_Report.pdf](http://www.vnci.org/Xportal/Upload/docs/PCI_2006_Summary_Report.pdf)) and the Municipal Scorecard for Latin America (<http://www.municipalscorecard.com/>)

8 Sectoral reform issues are not considered in detail in this guidance, partly because of their diversity, and partly because the DCED's conferences to date have not included extensive materials on the topic.

9 See for example: [www.fias.net/ifcext/fias.nsf/AttachmentsByTitle/IndustryLevelAnalysis/\\$FILE/Industry+level+analysis+-+the+way+to+identify+binding+constraints+to+growth.pdf](http://www.fias.net/ifcext/fias.nsf/AttachmentsByTitle/IndustryLevelAnalysis/$FILE/Industry+level+analysis+-+the+way+to+identify+binding+constraints+to+growth.pdf) [mckinsey.com/mgi/rp/CSProductivity](http://mckinsey.com/mgi/rp/CSProductivity)

10 See for example: [www.dfid.gov.uk/pubs/files/growth-poverty-report.pdf](http://www.dfid.gov.uk/pubs/files/growth-poverty-report.pdf) and [www.oecd.org/dac/poverty](http://www.povertyfrontiers.org/www.oecd.org/dac/poverty).

## Functional areas and their various levels

Within the levels of business environment reform identified above there are a number of functional areas that have a direct impact on setting the environment for private enterprise operation. Manuals have now been published on many of these functional areas, for example, describing how to streamline registration processes at the national and sub-national levels.<sup>11</sup> Functional areas of business environment reforms include:

- Simplifying business registration and licensing procedures;
- Improving tax policies and administration;
- Improving labour laws and administration;
- Improving the overall quality of regulatory governance;
- Improving land titles, registers and administration;
- Simplifying and speeding up access to commercial courts and to alternative dispute resolution mechanisms;
- Broadening public-private dialogue processes with a particular focus on including informal operators, especially women;
- Improving access to market information; and
- Enabling better access to finance.

Attention should be given to removing bottlenecks (i.e., reforming the current stock of policies, laws and regulations), as well as the way government addresses the delivery of public functions (i.e., the flow of regulations). See Box 3. In most countries, businesses face hundreds of regulations. Indeed, the true count is often not known and substantially underestimated. Development agencies can help their partner governments to simplify and streamline those business regulations that are a major barrier to business growth and formalisation. They should increase the awareness of the need for gender responsive business environment reforms and support partner governments with the design of appropriate policies. However, the challenge of sustainable reform is not to pick a handful of licenses out of thousands or to streamline existing regulations. While these can be useful first steps, it is necessary to reform the system of business registration and to change the incentives that often drive governments to regulate as a way of raising new fees and revenues.

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11 For example of national level resources see: [http://www.businessenvironment.org/dyn/be/besearch.details?p\\_phase\\_id=139&p\\_lang=en&p\\_phase\\_type\\_id=2](http://www.businessenvironment.org/dyn/be/besearch.details?p_phase_id=139&p_lang=en&p_phase_type_id=2) and sub national level: [http://www.businessenvironment.org/dyn/be/besearch.details?p\\_phase\\_id=96&p\\_lang=en&p\\_phase\\_type\\_id=2](http://www.businessenvironment.org/dyn/be/besearch.details?p_phase_id=96&p_lang=en&p_phase_type_id=2) For example of sub-national level resources see: [www.businessenvironment.org/dyn/be/besearch.details?p\\_phase\\_id=96&p\\_lang=en&p\\_phase\\_type\\_id=2](http://www.businessenvironment.org/dyn/be/besearch.details?p_phase_id=96&p_lang=en&p_phase_type_id=2) and [www.businessenvironment.org/dyn/be/docs/65/GTZRedTapeFacilitatorsManualV1-1.pdf](http://www.businessenvironment.org/dyn/be/docs/65/GTZRedTapeFacilitatorsManualV1-1.pdf)

**Box 3: Better Regulation for Growth - improving the governance framework for investment**

The Better Regulation for Growth programme supports high quality, low-cost and low-risk business regulation in developing countries by adapting and communicating best practices on regulatory simplification and systemic regulatory reform. Programme products cover: creating an effective regulatory management system; building the institutions to carry out good regulation; upgrading quality of existing regulations; and improving the quality of new regulations. The programme deals with three aspects of regulatory reform:

- (i) The immediate bottlenecks - **the stock** of existing regulations;
- (ii) The way that government works when considering new policies, laws, regulations and delivery of public functions (i.e., **the flow** of regulations); and
- (iii) **The institutions** responsible for preparing and vetting draft regulation, and for driving the regulatory reform agenda.

Development agencies need to find the right institutional “host” for managing regulatory reform – one that dedicates staff to these activities and displays a sustained commitment to reform. Reform programmes should work with key support agencies, such as local management training institutions, to deliver basic regulatory best practice training to members of parliament and technical staff who have a critical role to play in the drafting and scrutinising of new laws and regulations.

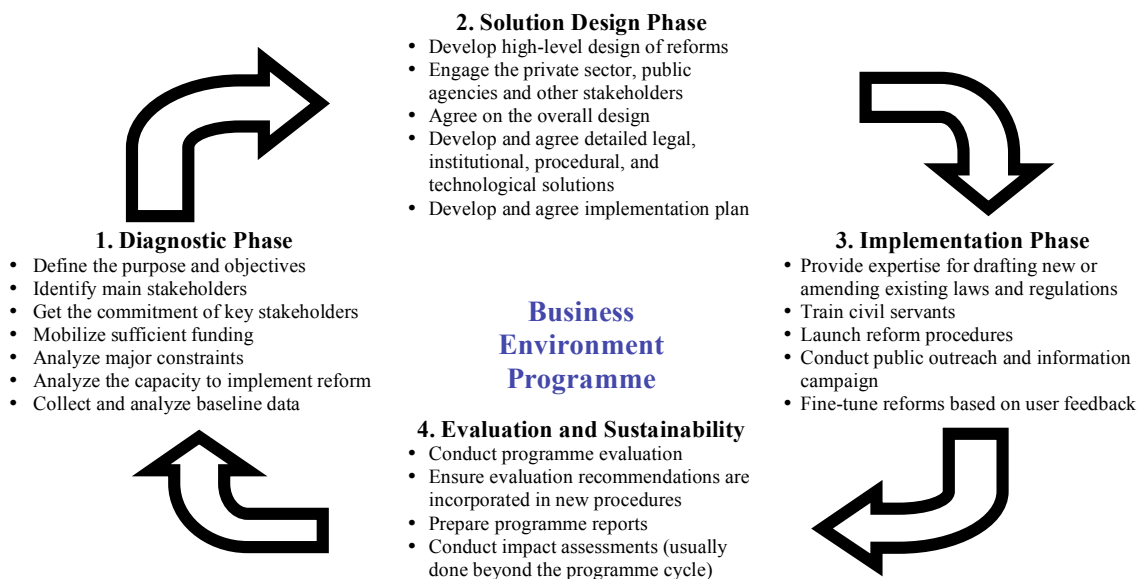
When proposing reforms in specific functional areas the linkages between environmental, social and economic aspects, including the impact of gender, must be factored in and the trade-offs examined. Concerns about social and environmental costs and benefits are just as important as the impact on business. Furthermore, business environment reforms affecting labour and labour-related laws must balance the need to reduce compliance costs with the need to safeguard and, where appropriate, improve protection for workers, including their right to social protection.

Development agencies are advised to consider the ways they can support the introduction or upgrading of information and communications technology (ICT) to improve regulatory processes and provide a more effective communications channel to constituent businesses. The potential benefits arising from the effective use of ICT, as part of a larger regulatory simplification initiative, can include some or all of the following: (1) increased efficiency of the reformed regulatory processes; (2) reduced scope for official corruption; (3) improved information availability and transparency; (4) reduced obstacles to formality; (5) increased tax compliance and government revenue generation; and (6) improved facilitation of new investment projects.

### Programme-cycle phases in supporting business environment reform

Many business environment reform support programmes can be categorised into four programme-cycle phases (see Figure 4). These phases systematise development considerations in the design of short, medium and long-term interventions in line with the different challenges and priorities found in developing and transition countries. The links between each of these lifecycle phases are critical: for instance, the outcomes of business environment assessments inform the design of reform programmes. However, it should be recognised that the conceptual model presented here does not necessarily reflect the process of reform in all cases: the sequence of steps may slightly change or two phases may be undertaken simultaneously.

Figure 4: Phases of business environment reform support programmes



#### Phase 1: Diagnostics: assessing the business environment

Development agencies have invested heavily in developing tools to assess the business environment; there are now over thirty survey instruments for assessing aspects of the business environment.<sup>12</sup> Such tools in themselves may generate demand for reform if evidence about the likely costs and benefits can be presented clearly. Rankings have also proven to be effective in generating demand for reform. This can be effective at both national and sub-national levels.<sup>13</sup>

Business environment diagnostics are used to identify priorities for reform; define the purpose and objectives of future reform support programmes; gain commitment from their programme partners for business environment reforms; identify the main stakeholders and change agents in the business environment; create a demand for reform; and collect baseline data against which the outcomes of reform programmes can be measured. Development agencies should use available recent diagnostic information for identifying constraints and prioritizing business environment reforms before considering a separate diagnostic exercise. In a complex and fragmented regulatory environment, stakeholders may not be able to easily see the big picture. It is likely that changes to more than one law, regulation or procedure will be required in order to achieve meaningful results. Mapping out the current process from beginning to end allows stakeholders to see additional real impediments and to better understand the broad scope of the reforms required.

Development agencies should support and build the capacities in partner country governments, the private sector and civil society organisations to carry out their own assessments of the business environment. Local expertise from research centres, consulting firms and universities should be used as much as possible. The findings of business environment assessments should be publicised. However, it is important to work closely with the government in this process and to ensure government officials have time to consider the results of the assessment and their response to these results. If managed properly, this process can ensure that government officials

12 For a list of diagnostic tools go to:

[www.businessenvironment.org/dyn/be/besearch.details?p\\_phase\\_id=69&p\\_lang=en&p\\_phase\\_type\\_id=1](http://www.businessenvironment.org/dyn/be/besearch.details?p_phase_id=69&p_lang=en&p_phase_type_id=1)

13 For example as of national rankings go to: [www.besnapshots.org](http://www.besnapshots.org), [www.DoingBusiness.org](http://www.DoingBusiness.org) and

[www.ebrd.com/country/sector/econo/surveys/beeps.htm](http://www.ebrd.com/country/sector/econo/surveys/beeps.htm) For example as of sub-national rankings in Cambodia go to: [www.businessenvironment.org/dyn/be/docs/118/Session1.2Paper1.2.1HorNguyen.pdf](http://www.businessenvironment.org/dyn/be/docs/118/Session1.2Paper1.2.1HorNguyen.pdf)

(who may initially resent or disagree with unfavourable assessment results) become partners in a process through which identified problems with the business environment are discussed and addressed through reform programmes.

#### Phase 2: Designing reform support programmes

Development agencies should make good use of local knowledge when designing reform support programmes to gain stakeholder confidence and respect. Not only sharing best international practice, but also identifying specific problems based on local experience is critical in building a case for reform and a solution strategy. Identifying specific local regulatory problems and their consequences provides key stakeholders with ammunition to support their reform efforts.

When designing reform support programmes it is important to anticipate the potential outcomes of reform, whether desired or not. These should be included in the design of a proper monitoring and evaluation system that identifies key measurable outputs, outcomes and impact indicators. This includes social outcomes as they affect female-owned enterprises and workers, as well as environmental outcomes as they affect the use of natural resources.

#### Phase 3: Implementing reform support programmes

Reform support programmes should be implemented in a flexible manner and with the capacity to respond to new requests and changing circumstances. Because business environment reform is a continuous process it is important to ensure that reforms are sustained over the long term. Sustainability refers to the ability of programme partners (e.g., government and the private sector) to continue on-going reforms; initiate the next generation of reforms and be able to monitor the progress and manage reforms once development agency support has been withdrawn. Sustainability of reform programmes results from the following:

- Building the capacity and capability of relevant organizations (e.g., government ministries, business membership organizations, regulatory agencies);
- Ensuring local programme partners have ownership of the reform agenda and processes;
- Increase public dialogue and debate on the demand for reform – this includes, but is not limited to, public-private dialogue;
- Changing attitudes and mind-sets so that key stakeholders have a greater appetite for reform of the business environment;
- Improving transparency in public administration;
- Enhancing accountability by the government towards key stakeholders; and
- Creating a financial plan to ensure adequacy of resources in the future.

The best way to ensure sustainability in business environment reform is to institutionalise some form of business environment monitoring or watchdog functions that involve representatives from the public and private sectors. Organisations of this kind can regularly assess the businesses environment; monitor reform outcomes and impacts; identify the demand for future reforms; and provide training, advice and information to government agencies and other stakeholders in the design and implementation of reform programmes.

#### Phase 4: Monitoring and evaluating reform support programmes

A sound monitoring and evaluation system is essential for the success of business environment reform support programmes. Such a system should exhibit well-defined indicators that measure programme outputs and outcomes and clearly connect anticipated programme outputs with outcomes and their impact on poverty reduction.

By definition, business environment reform support programmes are not reform programmes in their own right – they support the reform efforts of programme partners. Thus, it is necessary to consider the performance of a programme in terms of its influence on programme partners to assess the business environment, and design and implement reforms. Monitoring business environment reforms speeds up the learning process in governments by clarifying the reasons for success and failure. Development agencies can help partner governments to become more results-oriented and improve the accountability and transparency of their reform efforts through the use of monitoring systems.

Special attention should be given to assessing the impact of business environment reform. This includes assessing the impact business environment reform has on enterprise development and pro-poor growth – as well as on special groups such as informal firms and women-owned enterprises. This should be done in partnership with government and the private sector in order to increase transparency and accountability among all parties. In many cases it is impossible to measure the impact of a single business environment reform support programme on poverty reduction because there are so many other factors that affect this ultimate goal. However, development agencies can be precise about the impacts they anticipate their programmes will achieve and how these contribute to broader development goals. See Contested Issue 1.

### III Principles of business environment reform support

#### Principle 1: Adopt a systemic approach to reform

As far as possible, development agencies should adopt a systemic approach to business environment reform. They should consider the whole system, including all the relevant formal and informal institutions, the “rules of the game”, cultural and social norms and other key elements, such as the existing stock of regulations and the processes of reform in each case.<sup>14</sup> In an interactive system of reform change in one area influences the possibilities of reform in other areas. Reform is not a one-off act, but a process of adapting to new challenges and changes. Such reform includes relatively specific or narrowly focused reforms, those that involve a degree of trial and error (e.g., pilot reforms), as well as more comprehensive reforms of a grander scale. There is often pressure on development agencies to reform one part of this system in order to achieve rapid and measurable outcomes, yet in reality, other parts of the system may be just as important. The implementation and enforcement of reforms is an important element that is often not emphasised enough in support programmes. While development agency support for reforms that achieve quick wins can be useful to build support for larger reforms, these piecemeal efforts are wasted if they do not take into account a systemic and integrated approach. Success and sustainability in reform is often the product of an integrated approach to dealing with the problems faced by the private sector.

#### Principle 2: Understand and respond to the political economy of reform

Business environment reform processes are intimately connected with the political economy of change. This includes the system of accountability and governance exercised within and on the state, the extent to which the state is open or captured, and the extent to which its policy-making processes are open to influence. Because business environment reform is fundamentally a process of political contestation, there are no formulas that may be imported from elsewhere. Each society needs to determine the political settlement that best accommodates its competing interests and then find the appropriate technical solution that suits that political settlement. Development agencies can support these processes with lessons from other countries that can be adapted, as well as by encouraging the process to be transparent (i.e., no secret policy making), evidence-based and equitable so that those who represent the interests of the poor are able to influence it as much as those who represent the interests of the rich and powerful.

There will be times when key local stakeholders resist proposals for reform because they do not understand the benefits of the proposed reform, are used to things as they are and fear change, or because they benefit from the status quo. Thus, the challenge of the reform is building effective reform coalitions to get the best possible reform past that opposition. Development agencies can respond to resistance to reform by understanding where the resistance comes from and why; raising awareness and promoting the benefits of reform; recognising that those who are doing well in a poor business environment (e.g., where competition is reduced) may have something to lose; promoting coalitions of those who support reform – that is building constituencies for change; using regional organisations to support change; and promoting broader and deeper levels of public-private dialogue. Activities to discuss and design reforms should be seen in the wider context of the political economy – they release reform energies and reinforce a growing demand for reform. These kinds of changes help developing and transition country governments overcome governance bottlenecks. While development agencies cannot

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14 See [www.businessenvironment.org/dyn/be/docs/71/Session1.3ReinprechtDoc.pdf](http://www.businessenvironment.org/dyn/be/docs/71/Session1.3ReinprechtDoc.pdf) for a discussion of the influence of culture in reform processes.

change the political economy of a country, a better understanding of these issues will improve the design and execution of reform programmes.

**Principle 3: Respond to and stimulate the demand for reform and drivers of change**

Development agencies respond to domestic demand for reform by adding value to reform processes through technical assistance, financing, training and other forms of skills transfer, as well as information and experience sharing. They can also influence the direction and pace of change by mobilizing and exploiting drivers of change. These are forces that expand the opportunity for reform within the political economy of the country. Drivers of change include strong political leadership, the emergence of political or economic crisis, the processes of globalization, and the demand for increasing competitiveness. In most cases, there is a mix of drivers that contribute to change and not a single event. The strategic exploitation of successive drivers of change is key to the success of sustainable reform.

Reform support programmes should maximise the opportunities that stem from broader calls for reform, such as when a new government has been elected. Indeed, political change and some forms of political crisis can provide opportunities to push through bold business environment reforms. However, there are times when this demand is not apparent or weak. In such a situation, development agencies can stimulate a demand. However, they must be careful not to be too prescriptive or imposing. Some of the most effective ways of stimulating a greater demand for reform include:

- Commissioning research and assessments of the business environment and facilitating broad public discussion of the results;
- Benchmarking and comparing business environments across countries as well as across sub-national areas (e.g., cities) - creating a competitive environment that highlights the need for reform;
- Building the capacity of domestic stakeholders such as private sector representative organizations, consulting firms and research agencies to identify priorities for reform in the business environment and advocate for change;
- Identifying the economic impact of business environment defects can add tremendous leverage to informing the policy dialogue process, while supporting the prioritization of the policy reform agenda;
- Helping policy makers to learn from the experiences of other countries through study tours, training programmes, regional networking and the exchange of information;
- Creating opportunities for public-private dialogue that allow the business community to get across their experiences of the business environment; and
- Creating opportunities for foreign investors to present their experience of the business environment to government policy makers.

It is often necessary for development agencies to recognise the importance of individuals as change agents, whether they are representatives of the government or the private sector. Working with individuals who can motivate and mobilise reform efforts is important, but it is advisable to broaden and institutionalise this engagement as quickly as possible.

**Contested Issue 3: Should development agencies simply respond to demand for reform or should they also contribute to creating a demand for reform?**

In a perfect world, development agencies would only respond to the demands of their programme partners. Instead, development agencies are engaged in a dynamic tension between responding to demand and supporting initiatives that create a demand for business environment reform. Not all development agencies are comfortable with this tension and not all agree on where the limits to stimulating a demand for reform lie. Development agencies are advised to work closely with their programme partners to help them see the broader economic impact business environment reforms can create. They should identify the pros and cons to reform and help their partners identify reforms that are within their reach in technical, political and institutional terms. Development agencies can help their partners ask the right questions about the kinds of reforms that are needed, rather than prescribing the answers to those questions.

**Contested Issue 4: Should development agencies support individuals or institutions?**

Not all development agencies are clear about whether investment in reform leadership should include individuals as well as organisations. There are dangers in supporting one or two reform-minded government officials instead of the broader institution in which these officials work. However, there may be instances where these individuals can champion reform efforts within their organisations and this can be an important strategy when the organisation does not display a willingness to undertake reforms. There can also be danger in investing in the training and awareness of government officials who eventually move to a different, unrelated agency and are no longer able to participate in reform activities.

**Principle 4: Ensure domestic ownership and oversight of reform efforts**

Development agencies should be unbiased brokers that bring together different stakeholders in the reform of the business environment. Domestic stakeholders should take full responsibility for the design and management of business environment reform programmes. While development agencies will support and work with these stakeholders, they should refrain from leading reform efforts themselves or usurping the responsibility of their programme partners. To ensure sustainable results in the long run, it is important that the national government and private sector have full ownership of the business environment reform process.

Organisational oversight is key to ensuring domestic ownership of reform efforts. While the presence of a high-level official at the centre of government or a high-level committee accountable to the centre has proved to be a success factor for business environment reform, it is also important that the designated oversight and management authority cuts across the whole of government. Involving representatives of the private sector (including representatives of businesswomen) and other key stakeholders in oversight structures and processes is also important.

**Principle 5: Strengthen the role and capacity of key stakeholders**

Recognising local stakeholders and developing their capacity to participate in business environment reform is critical for successful and sustainable reforms. This can include strengthening the role and capacity of state agencies, the private sector and other civil society structures, as well as supporting better dialogue and advocacy, and building the capacity or ability of state agencies to manage reform programmes. While capacity development among state agencies can be a legitimate and useful response to the situations created by failed or weak states, working with other programme partners such as the private sector is equally important. Similarly, overly strong and interventionist states often require a counter-balance that is created by the private sector and other civil society groups. It is often necessary to support the embedding of regulatory reform processes into the systems of government or parliament. However, while capacity development is important, agencies should not support the reform of state agencies that artificially substitute self-regulatory market based mechanisms (e.g., accreditation, certification, membership of professional bodies). Development agencies should support a change in the culture in which business reforms occur, such as through the

introduction of a client-oriented culture that encourages public agencies to treat their private sector clients in a more professional, accountable and transparent manner.

When building local capacity, development agencies need to disseminate relevant information on the developmental experiences from economically advanced countries so that developing countries can draw upon historical evidence to make more informed choices about policies and organisations. Development agencies can also learn from the experiences of other agencies and other programme partners located abroad. However, it is always important to remember that solutions that work in one context need to be adapted to suit another.

#### Principle 6: Focus on what the private sector needs through public-private dialogue

Reform programmes should focus on the private sector, since they can create demand for reform and can contribute to the design of reform programmes and provide feedback on proposed reforms (e.g., through regulatory impact assessments); it can also provide technical expertise, and organisational and management support. Many private firms express their views through their representative organizations. However, these representative organizations rarely represent the entire private sector and are predominately made up of larger, formal enterprises. Small and/or informal firms, including women-owned enterprises, are often less involved in these kinds of structures; consequently, their views are often systematically neglected. Development agencies can support private sector representative organisations in their efforts to reform the business environment, but care should be taken not to interfere directly in domestic politics (see Contested Issue 5). They can also make use of formal facilities established to make possible the involvement of different development agencies and the private sector in the support of business environment reforms.<sup>15</sup>

Public-private dialogue is an essential ingredient to effective and sustained business environment reform.<sup>16</sup> The quality and depth of effective business environment reform is related to the intensity and institutionalization of public-private dialogue. While many developing and transition countries have little tradition of constructive dialogue and cooperation between the government and the private sector, such dialogue changes the political economy by empowering allies of reform and enlarging the “reform space” by increasing awareness of the scope and depth of the problem. While dialogue can take both formal and informal forms, it is important for dialogue to be linked to specific reform agendas.<sup>17</sup> In its early stages, public-private dialogue takes time to develop. It is important to build trust and confidence in the process and all parties need to see the benefits of regular, structured dialogue. Development agencies should support public-private dialogue, but should not drive the process.

It is particularly important for development agencies to help small and informal enterprises find a “voice” in the processes that support public-private dialogue. Public-private dialogue processes that are facilitated or supported by development agencies should include a wide range of the private sector representatives and, where possible, endeavour to obtain the views of the less organized business sector.

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15 Examples of these facilities include the Public Private Infrastructure Advisory Facility ([www.ppiaf.org](http://www.ppiaf.org)) and the Investment Climate Facility for Africa: [www.icfafrika.org](http://www.icfafrika.org)

16 For more information on Public Private Dialogue and detailed guidance go to: [www.publicprivatedialogue.org](http://www.publicprivatedialogue.org)

17 Indeed, care should be taken to ensure dialogue occurs around specific policy issues; otherwise it can lead to consultation fatigue (see Pinaud, N. 2006, *Public-Private Policy Dialogue in Developing Countries*, OECD Development Centre, Paris).

**Contested Issue 5: Does support for the private sector interfere with political processes?**

Development agencies can support the private sector organizations to participate more effectively in business environment reform by enhancing their capacity to assess the business environment (e.g., through research) and to advocate for change. However, because business environment reform is a political process, this kind of support can be seen as interference with domestic politics. Because many private sector organisations are weak, especially those dealing with small, informal, rural or women-owned enterprises, they require support to become more capable of engaging effectively in reform processes, but care should be taken to ensure this support is not directed toward any single issue, political agenda or political party.

**Principle 7: Focus on the binding constraints to business growth and scope reforms accordingly**

The success of business environment reforms is not determined by how the government does in delivering just outputs of reforms such as adopting a law, but by the effect reforms have on the behaviour of existing and potential businesses. Steady focus is needed if firms are actually to see material changes in their environment that induce more risk-taking, more investment, more innovation, and other desirable behaviours. Because there may be many areas of the business environment that require reform, the impact of reform is enhanced by assigning a high priority to those that have a strong bearing on the cost of doing business and the effective functioning of markets. These priorities vary from country to country, as well as across local business environments within the same country and between men and women. The greatest impact of reform will come from focusing on the most binding constraints to business activity. Development agencies often focus on the symptoms – the instruments themselves – of bad regulatory systems only to find that the system is resilient, adjusts and reverses the reform in a myriad of ways. If the same problems are created over and over again, development agencies should take a broad approach that changes wrong incentives facing governments and businesses. Governments that exhibit a pattern of poor regulation require changes to the system of producing regulation, whereas governments that are doing generally well, but have isolated and significant problems could benefit from narrow or one-off reforms in those areas.

**Principle 8: Sequence business environment reforms and allow time**

While a focus on the binding constraints to business growth is essential, the design of reform support programmes may not necessarily begin with these. It is often important to consider first-stage reform support programmes that build experience and confidence among reform stakeholders by focussing on those reforms that are the easiest or have the most immediate impact on the business environment and the performance of the private sector. If properly selected and designed, these reforms will demonstrate how reform can create improvements for business, while building competencies and confidence among programme partners. Development agencies should accept that systemic reform takes a long time. They need to be realistic when setting targets and timeframes for business environment reforms, particularly in a country context where the understanding and capacity for good governance are limited.

**Principle 9: Address the implementation gap**

Often, business environment reforms focus on policies, laws and regulations, but overlook the specific challenges associated with ensuring reforms are enforced and implemented. Development agencies should emphasise the importance of implementation. This includes a commitment to developing the competencies and capacities of development agencies and their partners to make reforms work – emphasising the need to address the often more complex issues associated with poor governance, organisational weaknesses and corruption.

**Principle 10: Formulate a communication strategy and use media strategically**

Business environment reform processes should include an assessment of the role communication plays when a new way of doing things is being adopted. Planning a communication strategy requires answers to three key questions: Why is the work important? Which people should be made aware of it? What are the issues that need to be tackled? A sound communication strategy is crucial to developing and maintaining public awareness of business environment reforms and relevant issues. Communication should focus on the benefits of change, rather than on the costs of the status quo; a clear vision of the future system should be presented. Special attention should be given to working with the media. Print and electronic media can become powerful allies for development agencies in their efforts to raise awareness of the need for business environment reform and communicate the broader purpose of reform programmes (See Box 4).

**Box 4: Ukraine SME policy reform**

IFC's Ukraine SME Policy Project worked with the Ukrainian government to improve private sector regulation as a means of promoting investment. The project lobbied a reform of the system of business permits in order to bring Ukrainian practice into line with contemporary European standards. By the end of 2004, IFC had assisted the government to draft a law to improve the permits system by abolishing about 1000 unnecessary permits, and leave in place only key permit procedures for potentially hazardous firms and activities. The challenge was to promote adoption of the law and assure implementation of the law by Ukraine's regulatory agencies. The media proved to be an important stakeholder to engage in this process. IFC initiated a national media campaign on the need for business permit reform. In 2005, this campaign resulted in 220 media appearances for the topic of permits reform (94 press articles, 33 instances of coverage by national television, 23 radio news stories and 46 Internet spots). As a result, the awareness of the need for reform of the permits system among both officials and media sources increased.

SOURCE: IFC, *Lessons of experience in technical assistance*, July 2006

**Principle 11: Work with government as the lead agent**

Unlike other private sector development interventions, government is a primary actor in the process of business environment reform. Government and the other organs of the state enact laws and regulations that govern the behaviour of the private sector. It protects the interests of consumers, workers, owners of property, providers of finance, other businesses, and the environment; and it is responsible for discharging the rule of law and raising taxes to invest in public goods. The relationship that is formed between government and the private sector is of critical interest in business environment reform, as is the way government goes about regulating business activities. It can do this in ways that are transparent, predictable and equitable while reducing the burden on business.

Successful reform support requires a close working partnership with government in which development support adds value to government reform efforts. Development agencies should provide flexible support, information and guidance, and encourage government to take full ownership of reform efforts. This is consistent with the *Paris Declaration on Aid Effectiveness; Ownership, Harmonisation, Alignment, Results and Mutual Accountability*. In situations where government leadership is weak or unresponsive, it may be necessary to support processes that encourage leaders to pay more attention to reform, such as through the support of government think tanks or public-private dialogue.

**Contested Issue 6: What role should government play in enterprise development?**

Governments are required to create a "level playing field" in the business environment in which all firms - regardless of whether they are large or small, rural or urban, domestic or foreign, or owned by women or men - operate on an equal footing. Levelling the playing field is a constant process for national and sub-national governments. Not all development agencies agree on the role of government in enterprise development. Some argue for a so-called "minimalist" role in which government limits its role to reducing the regulatory burden on business and reducing the cost of doing business. Others suggest that governments need to intervene more broadly

in the economy with supply-side programmes to produce the social, economic and equity outcomes they desire.

Whatever position they take on this issue, development agencies should work with governments to help them design reforms to the business environment that reduce costs, reduce regulatory risks and boost market competition. They should support the use of systemic approaches to enterprise development and business environment reform wherever possible and caution governments against interventions that further distort the role of markets.

#### Principle 12: Align business environment reforms with national development plans

Development agencies should align private sector development with broader economic, social and environmental policies and include business environment reforms in their efforts to promote private sector development, economic growth, gender equity, and poverty reduction. Similarly, support for reform of the business environment should be integrated into national planning instruments, development policies and global agendas (e.g., Poverty Reduction Strategy Papers, Private Sector Development Strategies, and the Millennium Development Goals). However, care should be taken when applying generic programme planning frameworks as many of these are based on broad poverty reduction perspectives that can be limited in terms of the role of the private sector and the importance of the business environment. Moreover, reform packages that are supported by development agencies should support the integration of policy, legal, regulatory, institutional, procedural, and technological and social solutions. Addressing one element alone (e.g., a new policy) is rarely good enough. While it is not possible to change all elements of the system at once, careful attention must be given to the ways changes in one area (e.g., the review of labour laws and regulations) will affect other areas (e.g., the role of regulatory authorities).

#### Principle 13: Ensure good donor coordination

Development agencies should avoid duplication of reform efforts and coordinate their programmes with other development agencies. Collaboration among development agencies engaged in business environment reform shares risks and provides access to a larger pool of expertise. Even small steps, such as information sharing, can contribute to the more effective delivery of development resources. Where possible, multi-agency mechanisms should be used to support business environment reform and to promote agency coordination.<sup>18</sup> Key elements to successful coordination are:

- A commitment by all parties to coordination and collaboration;
- Recognition at headquarter-level of the importance of coordination in the field - to allow country offices to participate meaningfully in local coordination processes;
- Regular processes and mechanisms for information sharing;
- Leadership and facilitation - this can be provided by the host government or by a nominated development agency;
- Identifying agency competencies and capabilities, and using this as a basis for a clear division of agency responsibilities; and
- Reporting on experiences in the field - successes, challenges, emerging lessons.

Developing and transition country governments can work with the development community to support, enhance and, where necessary, lead coordination and collaboration efforts. In some countries, a high-level government ministry convenes and chairs a development coordination

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18 For further information on country-level coordination in private sector development go to:  
<http://www.enterprise-development.org/groups/group.asp?groupid=9>

committee; in other countries this role is rotated amongst members. In addition, development agencies should recognise the importance of supporting regional organisations. These organisations demonstrate the value of regional coordination and information sharing that can be used to enhance national reform efforts.

**Box 5: Donor coordination in Africa**

A number of countries in Africa display increasing efforts to improve donor coordination and harmonisation with government in the fields of private sector development and business environment reform. This includes improving transparency and accountability, while strengthening the links between development agencies, governments and the private sector.

In Ghana in January 2004, the government approved the National Medium-Term Private Sector Development Strategy and Action Plan 2005-2009. The goal of the PSD Strategy is: ‘sustainable, equitable and widespread private sector-led growth throughout Ghana’, while its purpose is to ‘enhance the competitiveness of the private sector’. Based on the agreed strategy a number of development partners formed a Memorandum of Understanding with the government to establish a framework within which their support for private sector development would be provided. Development partners work through the Development Partners (DP) Group and the PSD Strategy Working Group to assist government in the implementation of the strategy. The PSD Working Group contains representatives of the private sector and oversees the work of all actors, including 17 government ministries, departments and agencies. Progress within the PSD Strategy is reviewed by the PSD Working Group twice a year and a joint monitoring and evaluation framework has been established. In addition, a number of development partners contribute support to the PSD Strategy through a Pooled Fund.

In Tanzania, donor coordination and collaboration with the government is outlined in the Joint Assistance Strategy for Tanzania (JAST) of November 2006. The JAST represents a national medium-term framework for managing development co-operation between the government and development partners so as to achieve national development and poverty reduction goals. It also outlines the role of non-state actors to the extent that they contribute to the successful implementation of the strategy. Few development agencies have also combined their financial and knowledge resources to support the “Business Environment Strengthening for Tanzania” programme.

In Zambia in 2006, the government signed a Memorandum of Understanding with the private sector and eight development agencies (known as “cooperating partners” or CPs) on the coordination of the PSD reform programme. With some ten ministries involved, the Zambia PSD reform programme identified contact CPs within designated reform area in the fields of labour, licensing, energy, financial sector, citizens’ economic empowerment, and trade. This structure promoted a collaborative approach to reform amongst the CPs and the relevant ministries. Falling within the country’s Joint Assistance Strategy, CPs that supported PSD reform met twice a month: once informally and once formally. By the end of 2007, the PSD CPs decided to withdraw from the PSD Steering Committee because the assistance for the start up phase of the reform programme was no longer required. CPs believed participation in the steering committee was not further appropriate, as this is an internal decision-making body, and now focus on assessing results and accountability within their programme focus areas.

**Principle 14: Balance international and national expertise**

In order to build national capacity, development agencies should encourage and assist their programme partners to work with expert international bodies and consultants that are knowledgeable about good practices used in countries facing similar problems. While development agencies can facilitate access to best practices and cross-country experiences, care should be taken to balance the involvement of international consultants with national consultants. Development agencies and their programme partners should be prepared to spend the time and effort to guide consultants in the local context. They should ensure skilled nationals are engaged in reform programmes and provide incentives to keep them in the country and engaged in reform efforts. However, development agencies should avoid hiring staff directly from the very ministries or agencies that are trying to lead reforms.

**Principle 15: Promote quality assurance in development agency support of business environment reform**

Development agencies should ensure they provide the best possible advice and assistance to their partners when supporting reforms that lead to a better business environment. This requires agencies at headquarter and field-office levels to be familiar with current international best practice and responsive to the needs, capacities and expectations of their public, private and

civic partners. Development agencies should encourage the transparent review and assessment of their programmes in collaboration with government, the private sector and other development agencies; they should support and participate in peer review processes and contribute to the improvement of business environment reform programmes through knowledge management, training and seminars, study tours and any other activities that promote the exchange of information and experience toward more effective support programmes.<sup>19</sup>

## IV Conclusion

This donor guidance represents a synthesis of views and experiences of the Donor Committee for Enterprise Development in the field of business environment reforms that lead to economic growth and poverty reduction. Much more work remains to be done by the committee and its members to document best practice in the individual thematic areas of business environment reform. Thus, it is important to explore mechanisms through which all agencies, regardless of their levels of experience in supporting business environment reforms, can learn from the rapidly growing experiences occurring in the field. This should include ways in which country-level and regional experiences can be shared with agency headquarters and through international knowledge management processes.

The Donor Committee for Enterprise Development will continue to support the generation and management of knowledge in donor-supported business environment reform to support the work of development practitioners and programme managers at all levels. In the future, the guidance will be updated in the light of fresh case studies and new approaches. Learning from experience in this way, development agencies can increasingly be effective catalysts for reform of the business environment, supporting partner governments in developing and transition countries to generate economic growth and to further reduce poverty on a large scale.

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19 The Donor Committee for Enterprise Development has a database to share documents and information on donor-supported business environment reform that achieves pro-poor growth:  
[www.businessenvironment.org](http://www.businessenvironment.org)