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IN-DEPTH END MARKET ANALYSIS AND BOTTOM-UP BUSINESS ENVIRONMENT REFORM

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DISCLAIMER

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INTRODUCTION

As value chain analysis matures as a development approach, it is increasingly important to improve its effectiveness through enhancing and building on its most successful components. Through an AMAP-funded action research task order DAI is collaborating with USAID to develop specialized tools to increase the rigor of two phases of the value chain approach: end market analysis and business environment analysis and reform. These in-depth tools assist practitioners and stakeholders in assessing and prioritizing upgrading needs and can be implemented alongside or independently of standard value chain analysis. This paper describes the tools and presents examples of how they have been implemented.

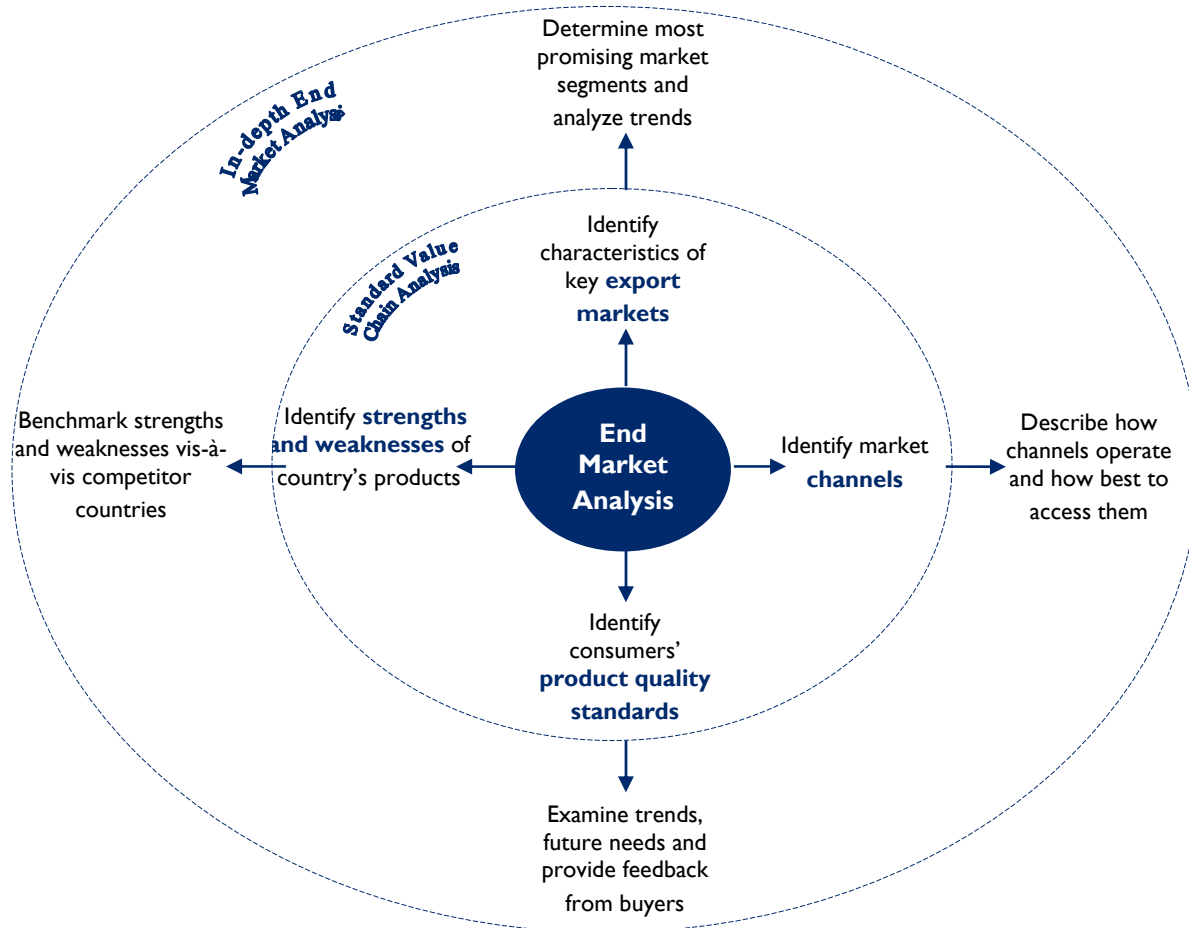
I. IN-DEPTH END MARKET ANALYSIS

Assessing end market requirements to inform producers of upgrading needs is a critical component of value chain analysis. Frequently, however, resources and time are not sufficient to conduct as thorough an analysis as is desired. The in-depth end market analysis (EMA) tool USAID and DAI have developed builds on basic value chain analysis to provide a deeper, broader assessment of the characteristics of key end markets and identifies anticipated trends for 5 to 10 years in the future. The findings of end market analysis have been used to help value chain participants develop competitiveness strategies and improve industry's competitive positioning in end markets.

Few developing country producers have the luxury of traveling to their key markets to better understand buyer requirements and industry trends. Including in-depth EMA as a component of a value chain development project brings a detailed picture of producers' customers and competitors home to value chain participants. EMA investigates the demand for a particular product in key end markets, focusing on demand trends, buyer requirements, and the structure of these markets, including distribution channels, price segments and product categories. Its main objective is to identify the highest potential market and product niches based on buyer sourcing requirements and the industry's competitive position, strengths and weaknesses. As a result, all value chain firms and partners gain a better understanding of their upgrading needs in order to sell higher value products in more lucrative markets. EMA helps value chain participants prioritize upgrading needs in line with market requirements and develop more focused competitiveness strategies with a clear end market positioning component.

In-depth EMA goes beyond standard value chain analysis in its level of detail, emphasis on primary end market sources, and consistent focus on market dynamics (see Figure 1). A traditional value chain analysis identifies key export markets and market channels and often discusses the pros and cons of each. An in-depth EMA looks at markets as dynamic systems constantly undergoing transformation and seeks to understand the key drivers of demand which are likely to affect the market in 5 to 10 years. It analyzes trends in key markets and discusses the most promising market segments. It describes how channels operate and how best to access them. An in-depth EMA not only identifies consumers' product quality standards, it examines trends and future needs and also provides detailed feedback from buyers. In addition to identifying the country's products' strengths and weaknesses in export markets, an in-depth EMA benchmarks these strengths and weaknesses against competitor countries. The result is that producers can gain bargaining power vis-à-vis buyers. In-depth EMA enables producers to identify unique products and market niches, understand price points and assess their competitive position. They can target products to a particular buyer and/or channel from the start.

Figure 1: Comparison of In-depth EMA versus Standard Value Chain Analysis



DESCRIPTION OF APPROACH

In-depth end market analysis begins with analyzing global demand, market structure and 5- to10-year market trends. Whenever possible, data is gathered at the market segment level and is compared to the most important competitor countries. In-depth EMA is generally conducted early enough in the value chain analysis process to feed into the development of a competitiveness strategy. However, it is important to have a significant amount of value chain analysis completed before EMA begins in order to inform competitive benchmarking and understand the industry supply capacity and constraints as the end market actors are being interviewed.

Following an in-depth desk study and trade data analysis, researchers conduct interviews with importers, retailers, agents and buyers. These interviews deepen researchers' understanding of industry leaders, buyer requirements and purchasing patterns, and sales channels. Interviews with industry experts such as commercial market analysts, product developers and designers assist researchers in identifying trends and those market segments that provide the greatest potential for success relative to competitor countries. When possible, attending trade shows can be beneficial for qualitative benchmarking.

Results of EMA and recommendations on end market positioning strategies are presented to industry stakeholders and help facilitate the development of competitiveness strategy and prioritization of upgrading needs. Using videos

and photos to disseminate the results of the in-depth end market analysis is highly recommended in order to better demonstrate end market characteristics to local producers.

IMPLEMENTATION EXAMPLES

Haitian Handicrafts

In the 1970s and 1980s, handicraft production was a promising source of growth and income for Haiti. But by the early 1990s, years of political and social unrest, poor economic policies and embargoes on trade and foreign aid had taken their toll. Sales fell to less than half of what they were a decade before. Despite the widely admired creativity and skills of Haitian artisans, buyers turned elsewhere to find more reliable and less expensive suppliers, often with Haitian designs in hand. China, India and other Asian countries now dominate global handicraft production with low prices, tremendous capacity, and increasing quality. For most large retailers, Haiti simply dropped off the radar screen as a source of handcrafted products.

To assist Haiti in reconstructing its handicraft export sector, USAID sponsored an end-market study. A major finding of the study was favorable for Haitian producers, notably that reduced demand is not one of the many significant exporting challenges facing handicraft producers. The quality and originality of Haiti's designs are still regarded by buyers as world-class and presents a unique market opportunity for Haitian producers given the growing demand for "global style" home accessory products. Rather, the study identified the need for agents as market intermediaries between producers and buyers as the critical missing link required to ensure the flow of market information and buyer contacts. As exports declined in the 1990s, exporters and key intermediaries, such as buyers' agents, closed or reduced operations, leaving importers without the critical services needed to successfully source products. In addition, the study directed the industry towards targeting independent retailers of unique products in the US market as a more sustainable long-term strategy, rather than pursuing opportunities with big-box retail chains.

Based on detailed feedback from buyers, USAID's value chain strengthening projects will help develop intermediary service markets, such as agents and exporters, with the goal of targeting market channels where there is less direct competition with high-volume, low-cost producers of "industrial" handicrafts, like China. Additionally, they now have guidance on how to best build on the strengths of Haitian handicraft producers' creativity and bold designs, while improving their business management, production process, and communication skills.

Tanzanian Horticulture

Attempts to accelerate Tanzania's nascent horticultural export industry have been slow and sporadic. Exports of high value vegetables are declining and are increasingly being exported via Kenya rather than directly to the European Union. The United Kingdom and the Netherlands are the only significant, regular markets for Tanzania's vegetables exports, which mainly comprise peas and beans.

USAID's end market study reported that since Tanzania is still largely unknown in the EU fresh produce sector, it has neither a positive nor a negative reputation. However, compared with the most established growers and exporters in East Africa, Tanzania is almost a full generation behind in terms of developing its horticultural export sector. Of particular concern are the lack of modern handling facilities, limited air connections and the shortage of professional packagers and exporters.

The end market study analyzed major markets for fresh vegetables and assessed Tanzanian performance relative to those markets. It identified an opportunity in the currently small, but growing EU market for baby vegetables. These products retail for a far higher price in the more developed European countries than standard vegetables and offer

significant opportunities for adding value through pre-preparing, bundling (having more than one variety in one packet) and packaging. With technical assistance to improve sophistication, baby vegetables could provide Tanzanian growers and exporters with higher revenues while requiring less volume as the market and infrastructure in Tanzania develop.

Indonesian Garments

USAID's end market study for Indonesia's apparel value chain discovered that the products Indonesia exports represent a significant percentage of total imports for large markets, but that many of these products have slow or declining growth rates. The end market study identified several strategies for accelerating Indonesia's apparel exports, including expanding to fast growing markets and improving production capacity for higher fashion garments.

Accessing high-growth developing markets such as Russia and the new members of the European Union requires developing relationships with key buying agents as many retail companies never contract directly with factories. Although these buying agents add a layer of separation between the factory and the end-market apparel retailer, they serve as trusted emissaries who ensure garment quality, on-time delivery, and satisfactory performance and enable the flow of critical market information to producers. Agents are familiar with the demands of the Western fashion industry and know how to keep customers satisfied while also meeting the needs of producers.

Examining key trends in target markets revealed that Indonesian factories require upgrades in order to handle new designs that are increasingly complex with more embellishments. With the ability to handle more sophisticated design and stitching requirements as well as smaller orders for high-quality, high-fashion products, Indonesia will be able to build on its strength in manmade and blended fabrics to produce higher value-added garments.

CHALLENGES AND POINTS FOR FURTHER DISCUSSION

In-depth end market analysis is a promising complement to existing value chain analysis tools. Through the pilot applications of the approach, it became clear that the most critical success factor is the commitment by an industry expert to lead the research team. It was also determined to be important to give significant attention to translating market information appropriately for the development context usually through the participation of a development practitioner in the analysis and to involve stakeholders in the strategy development process.

End market analysis has successfully helped value chain stakeholders in such countries as Indonesia to galvanize competitiveness strategies for their industries and build momentum for industry cooperation and product upgrading in order to access new lucrative markets and build linkages to buyer agents as facilitators who will help transmit critical market information. Further research should focus on the best ways to use end market information for engaging value chain participants in competitive strategy development, build relationships with agents and other means of institutionalizing industry upgrading processes in response to changing end market requirements.

Additional research is expected to focus on developing an approach for a streamlined in-depth EMA for situations when budgets are small and/or timelines short in order to ensure integration of EMA into effective design of project interventions at project's start.

II. BOTTOM-UP BUSINESS ENVIRONMENT REFORM

Every day an entrepreneur spends filling out paperwork or in line at a government office is a day not making sales or finding new customers. Burdensome and unpredictable regulation is costly both in terms of the time and money required for compliance as well as in opportunity cost. In many countries, these costs are substantial. In Brazil, for example, not only is the tax rate nearly 70 percent, but the procedures are so complicated that the average amount of time required to prepare, file and pay taxes is estimated to be 325 days.¹

A growth-oriented small businessperson faces a choice: comply with regulations and incur costs so high that they jeopardize the business's viability or try to survive in the informal sector without bank credit or enforceable contracts and at constant risk of harassment from authorities. Approximately 60 percent of urban businesses in Africa, 40-60 percent in Asia and 58 percent in Latin America remain outside the formal sector.² They are limited in their ability to grow, attract investment and hire more workers. The workers they do employ have no legal protections. Without informal enterprises' tax contributions, government is limited in its ability to provide services and the tax burden on registered businesses is greater than it should be.

The need for business environment reform is well understood thanks in large part to the publicity given to absurdly burdensome regulations in Peru by Hernando de Soto in his 1989 book, *The Other Path*, and more recently by the World Bank's *Doing Business* series of reports. International rankings and benchmarking reports such as *Doing Business*, the World Economic Forum's *Global Competitiveness Report*, and the Heritage Foundation's *Index of Economic Freedom* stir up positive peer pressure that encourages reform activities. Meeting requirements for WTO and EU membership also provide incentives for reform. The World Bank reports that between April 2006 and June 2007, 98 economies made 200 reforms.

However, these high-level reforms do not always address what is most important to MSMEs. Even when there is significant reform at the national level, implementation at the local level can be inconsistent. Using the value chain as a framework for prioritizing and advocating for reform is an effective way to complement traditional reform activities, such as regulatory guillotines. "Bottom-up" business environment reform activities use a value chain lens to emphasize provincial and local, as well as national, level reforms to improve those aspects of the regulatory environment that most adversely affect enterprises in particular value chain.

COMPETITIVENESS IMPACT FOR BUSINESS ENVIRONMENT REFORM

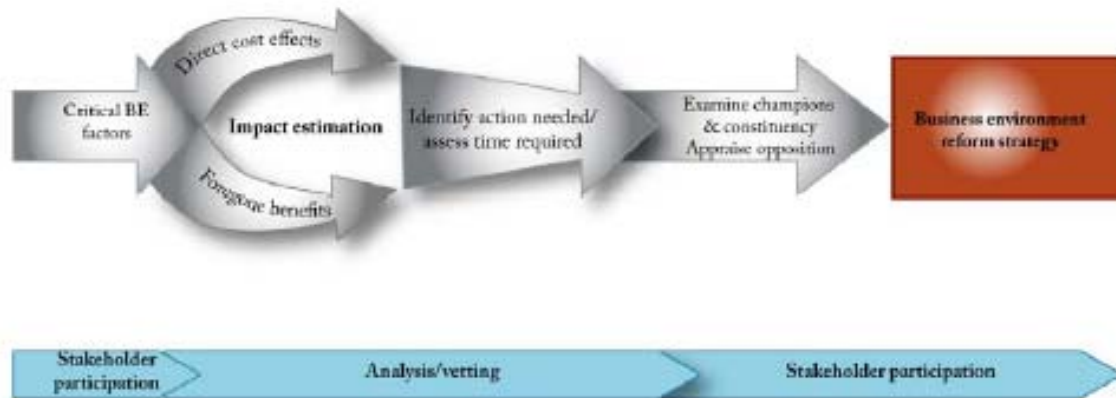
In collaboration with USAID, DAI has developed the Competitiveness Impact of Business Environment Reform (CIBER) tool in order to 1) engage value chain participants in identifying those aspects of the regulatory environment that most negatively affect value chain competitiveness; 2) quantify the costs and benefits of implementing required reforms; and 3) develop practical and effective advocacy plans for achieving reform.

The CIBER process takes a targeted approach toward assessing regulatory reform requirements (see Figure 2). Rather than examine all regulations, administrative procedures and judicial enforcement issues affecting a value chain, it uses input from enterprises and industry experts to determine the scope of analysis.

¹ World Bank. *Doing Business 2008*. www.doingbusiness.com

² K. Floodman Becker, "The Informal Economy: Fact Finding Study." SIDA, 2004.

Figure 2: Competitiveness Impact of Business Environment Reform (CIBER)



The CIBER approach follows the market and chain analysis phase of the value chain project cycle. The first step is to work closely with value chain stakeholders to identify key regulatory and administrative constraints to competitiveness. These constraints may be imposed by overly burdensome, outdated, inappropriate or insufficient regulation. This analysis may draw from a variety of regulatory categories including:

- Regulations governing business activity/factors of production (labor regulations, land use regulations, and financial sector regulations, etc.)
- Required interaction with authorities (business registration, tax collection, licensing, and property registration, etc.)
- Transactions in downstream markets (access to markets, compliance with health, quality, safety standards, and foreign exchange restrictions, etc.)
- Transactions in upstream markets (access to inputs, imports, etc.)

The CIBER approach is highly participatory, relying on a range of value chain participants and other stakeholders at each stage of the process. The approach begins by carrying out—or reviewing in cases where this already exists—a comprehensive strategic analysis of markets and competitors. In on-going projects this is likely to be a thorough value chain analysis, which will provide background information and ideally a preliminary list of business environment issues of importance to competitiveness.

Next, stakeholders are consulted to identify and ground-truth priority issues related to the business environment. This information may be gained through surveys, one-on-one interviews, or focus groups. Consultation with industry experts and international buyers is also helpful for identifying issues that may not be visible to local participants, such as gaps in intellectual property protection that impede opportunities for upgrading.

Once a short list of issues has been identified the method guides researchers, project staff, and industry stakeholders through the process of identifying the costs imposed by specific laws, regulations, implementation issues, or lack of necessary regulations. In some cases it is possible to track the added cost per unit of the product under consideration, as well as added value at each stage of production, using a cost modeling approach. In other instances, such as for issues of quality certification, a qualitative approach or general estimate of the magnitude of impact will be sufficient.

At the next stage of the CIBER exercise, facilitators engage stakeholders in a process of weighing costs and benefits of business environment reforms that target the constraints (or reinforce positive impacts) identified.

Next, the research team assesses the political and administrative feasibility of each specific reform. This assessment is based on a variety of factors, listed below, which reflect the degree to which reforms will be possible and over what time frame.

Table 1: CIBER Political Feasibility Assessment Checklist

<ul style="list-style-type: none"> • The degree of geographic centralization of the value chain under review • The degree of specificity of the regulation to the value chain • Level of government at which the regulation is promulgated/implemented • Historical factors that have led to or support the current regulatory framework. • Existing incentive structure that has led to or supports the current regulatory framework. • Possibilities for refining the existing incentive structure • Support/opposition in and outside of government. 	<ul style="list-style-type: none"> • Leverage supporters/opponents have to support their own interests. • Expected size of impact in terms of financial, time, political, etc., costs • Past reform initiatives and reason for outcome. • Current or near-term government reform initiatives are planned and who is championing them • Degree of political centralization • Public-private organizational role and structures • “Winners” and “losers” in policy implementation • Degree to which other value chains or private sector actors may be hurt by the reforms
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Table 2: CIBER Administrative Feasibility Assessment Checklist

<ul style="list-style-type: none"> • Administrative efficiency • ICT structures • Presidential Regulation/decreed/instruction • Ministerial Regulation/decreed/instruction • Joint ministerial decree 	<ul style="list-style-type: none"> • Directorate general regulation/decreed/instruction • Provincial regulation • District/city regulation • Governor regulation • Mayoral regulation
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The feasibility assessment supports the final prioritization of reform activities and supports programs to determine short-, medium- and long-term priorities, informing the development of an advocacy approach. These may be designed around public-private dialogue initiatives and/or use locally appropriate media outlets to build a broader base for reform support. Advocacy approaches for policy, regulatory and/or administrative reform will ideally be led and owned by local stakeholders in order to ensure sustainability of these efforts over time.

IMPLEMENTATION

The CIBER approach was piloted in the cashew value chain in Brazil. World cashew nut supply nearly tripled between 1994 and 2005. As competition intensified for the 195,000 producers located mainly in Brazil’s poorest region, the government sought to support cashew exporters with a tax credit. However, poor design and worse implementation in the tax credit refund process imposes costs that reduce the competitiveness of Brazil’s cashew exports. CIBER analysis determined that the cost of production per box of raw cashew nuts for an average processor increased more than 10 percent because of delays in tax credit refunds and lost credits. These increased costs have halved processors’ profit margins.

The reform of national and state-level tax refunds appears to have political currency in the context of a national

movement towards tax reform. Due to the highly concentrated nature of cashew industry processing—located in the Northeast state of Ceará—industry support is also strong and the constituency for reform advocacy efforts is clear. National and state budgets are the primary losers, as they are currently retaining income that is due to be returned to the private sector, but all analyses suggested that this is a constraint that can be overcome.

Armed with the CIBER results, processors affected by the poor regulation now have a powerful argument, supported by an estimate of the financial loss to the value chain, to take to the government when advocating for reform of this tax scheme.

CHALLENGES AND POINTS FOR FURTHER DISCUSSION

Successful pilot applications of the CIBER tool indicate that it is an effective approach for implementing bottom-up business environment reform activities. The use of the value chain as the analytic lens offers a number of innovations for policy reform efforts, most importantly through the identification of committed communities—value chain stakeholders—that can advocate for reform over the long term as needed to overcome entrenched interests. This has the potential to dramatically increase the sustainability of reform efforts after projects have ended as well as to provide demonstration effects through the successful achievement of targeted reforms. More work is expected on institutionalizing CIBER into appropriate host-country organizations as CIBER is designed to be an iterative process relying on improved capacity for evidence-based advocacy efforts and regulatory analysis.

Among the challenges that remain are scaling the CIBER tool to match the needs of smaller or larger projects than those assisted in the initial applications and ensuring that a sufficient level of information is available through in-depth value chain analysis prior to or concurrent with CIBER implementation.