



# Enterprise Growth Initiatives:

## Strategic Directions and Options

### *Handbook*

Prepared for the U.S. Agency for International  
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Ulrich Ernst  
Marina Krivoshelykova  
Donald R. Snodgrass  
James Packard Winkler

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Development *Alternatives*, Inc.

7250 Woodmont Avenue, Suite 200, Bethesda, Maryland 20814  
Tel: (301) 718-8699 Fax: (301) 718-7968 Email: info@dai.com



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## INTRODUCTION

This handbook is for practitioners who would like more information and practical guidance on the concepts, analysis, and recommendations contained in the report, “Enterprise Growth Initiatives: Strategic Directions and Options.” The handbook is organized as a companion guide to the report, developing the report’s concepts and analysis by drawing on case studies, questions, and discussion that arose during five regional workshops sponsored by the U.S. Agency for International Development’s Economic Growth, Agriculture, and Trade Bureau, (USAID/EGAT) for more than 100 USAID officers and practitioners.

USAID/EGAT launched the workshops on enterprise growth initiatives to guide field missions and economic growth officers on key issues addressed in the report:

- What key factors contribute to the sustainable growth of private enterprises?
- When and under what circumstances does enterprise growth translate into economic growth?
- What can donors do to facilitate private enterprise creation and growth in developing and transitional economies?
- Are globalization and other political and economic changes altering the answers to these questions?

The workshops took place in Santo Domingo, February 10-13, 2004; Budapest, Hungary, March 9-12, 2004; Gaborone, Botswana, March 16-19, 2004; Bangkok, Thailand, April 13-16, 2004; and Washington, D.C., June 8-9, 2004. The case studies, questions, and issues discussed in these workshops are included in this handbook as additional reference material.

We expect that readers will have already read the report before using this handbook, which complements the report by focusing on key issues in the following chapters:

- Chapter One provides additional insight into the strategic framework for the growth of sustainable private enterprise (see Figure 1 of the report, as amplified by Table 1 in Chapter One of the handbook). It addresses key questions raised by USAID officers during workshops, and expands on issues of strategy formulation and monitoring and evaluation—two key elements of the framework that guide project design, implementation, and management.
- Chapter Two focuses on designing enterprise growth initiatives in dynamic markets. Various approaches to strategic analysis at the country, industry, and enterprise level provide market-based guidance on growth opportunities, baseline indicators, and ways to work with unanticipated change.
- Chapter Three provides additional insights into monitoring and evaluation, perhaps the most difficult and critical aspect of enterprise growth initiatives. This chapter provides information on approaches, concepts, and tools.

Each handbook chapter also features pertinent questions and answers, as well as examples and case studies from the five workshops.



## CHAPTER ONE

### GROWTH OF SUSTAINABLE PRIVATE ENTERPRISES

#### INTRODUCTION: THE FRAMEWORK IN ACTION

Private enterprises are profit-seeking firms of any size that produce or trade goods and services for sale to consumers and other producers. They are the main productive units and wealth creators in nearly all the world's economies and they respond to market demand in local and foreign markets. Collectively, private enterprises make up the private sector (formal and informal). Since the collapse of communism and shrinkage in the relative size of the public sector in many other countries, the private sector has assumed a dominant position in almost all economies. Smoothly functioning markets result in strong enterprise growth, efficient resource allocation, and the maximization of profits and social well-being. But markets do not always function well. Market failures and under-performing economies create conditions that require governments and donors to intervene to make markets more efficient and encourage enterprise growth.

Enterprises in the private sector are influenced by three broad sets of factors:

- **Demand** for the goods and services they produce is critical for enterprise growth. As the economy develops, national markets become more integrated and transportation and communication infrastructure improves, widening the market in which firms hope to sell their products. Domestic markets in many developing and transition countries are small and/or stagnant, so enterprises must rely heavily on regional and global markets for continued demand growth. Yet developing country exporters may face trade barriers such as tariffs, quantitative restrictions, and health and safety standards that are difficult and expensive to satisfy. Demand therefore remains a major challenge in enterprise development.
- The second important influence on enterprise growth is the quality of the **business environment**, which may either promote or inhibit enterprise creation and growth. The business environment is the product of many factors, including infrastructure, human and physical capital, macroeconomic policies, and microeconomic regulations. A favorable business environment provides economic and political stability, offers low costs for business transactions, and allows for efficient business operations, which lead to greater innovation and creativity. Most regulatory systems impose proportionally higher transaction costs on micro and small enterprises (MSEs). For these small firms to thrive, the bias favoring larger firms must be minimized.
- **Private sector supply response** refers to the ability of private enterprises to meet the demand for goods and services. It is strengthened when firms have access to appropriate financial and business services. Supply response is increasingly regarded as a function not only of enterprise efficiency and an enterprise's understanding of customers' needs—it is also a function of the networks to which enterprises are connected. These networks can include clusters of enterprises producing similar products, as well as value chain

relationships with external suppliers, processing agents, marketing firms, think tanks, government entities, and others. Today, these business relationships increasingly stretch around the world. They expedite the flow of information, reduce transaction costs, and serve as the basis for policy dialogue on key reform issues.

Markets do not work in a vacuum. They are influenced by the legal, social, and cultural setting in each country, as well as by official attitudes toward the market economy. Governments can improve the workings of the market by simplifying their rules and procedures and investing in infrastructure and public services to reduce transaction costs; by providing incentives for the private sector to invest in human capital or organize itself through business associations to provide valuable marketing services; and by providing important information (on product safety or standards, for example) that would otherwise not be available. When reform is needed but not undertaken (because the government is controlled by special interests, for instance, or in chaos), firms tend to operate informally. If needed reform is not forthcoming, the situation can be termed a government failure and is tied to market failure.

Donor interventions are appropriate when markets fail. When government responses are inadequate, donors may advocate needed reforms, target informal economic activity, or try to help firms succeed by temporarily providing services that a well-functioning government would provide if one existed. Donors can strengthen the private sector supply response directly when production and marketing information is not instantly and freely available to everyone. Donors can help the private sector learn to operate more effectively in this era of globalization. In many post-socialist and low-income settings, donors can assist with entry into new markets, such as nontraditional exports. In countries where recent events have interrupted the flow of foreign direct investment, donors can concentrate on firms with high growth potential.

### **Business Environment or Private Sector Supply Response: “Tastes Great or Less Filling”**

There are two basic approaches to facilitating enterprise growth. The more traditional approach, still favored by many economists, emphasizes the role of improvement in the business environment and takes a very cautious attitude toward efforts to strengthen the private sector supply response. Recent work by the World Bank (*Doing Business in 2004*; *Doing Business in 2005*) demonstrates that enterprises in developing and transition economies generally face much higher costs—in time and money, especially relative to their lower income and wealth levels—than do their counterparts in richer countries. If these barriers were lowered, according to this argument, private firms would be able to do a much better job of picking investments, products, markets, and production technologies.

Critics of this orthodox view argue that reforms have often failed to bring about the desired and predicted impact. Something more is needed, they say—specifically, some form of intervention that will bolster the private sector’s supply response to the incentives offered. To this, defenders of the orthodox position may retort that the reforms did not focus sufficiently

on micro-level issues, were not implemented with sufficient vigor, or were not given enough time to show results. Their critics, often inspired by Michael Porter of the Harvard Business School, insist that policy reform is not enough—work to stimulate the supply response is needed. Amid this contention, a middle position argues that supply-side intervention is appropriate, but only if the overall business environment is sufficiently favorable to permit enterprise development measures to work.

This whole controversy reminds us of the old “Lite Beer” commercials in which two groups of men argued over their reasons for preferring a certain beer. “Tastes great,” shouts one side, while their opponents respond with equal vigor, “Less filling.” We see the debate over rival approaches to enterprise growth promotion as essentially a false dilemma. In virtually all the settings in which USAID works, both improvements in the business environment and efforts to improve the private sector supply response are likely to be necessary. All enterprise development projects should pay close attention to the business environment, and nearly all should include some effort to improve the environment in which private firms work. The relationship between the business environment and the private sector supply response is complex. Many questions of relative emphasis and sequencing arise. If there are clear indications of market failure, one should certainly not wait for a perfect business environment to be established before contemplating supply-side intervention. Yet the business environment will impinge on all such interventions, and it would be foolhardy to support businesses that cannot survive in the existing environment.

### **Strategy Formulation: Maximizing Impact in Changing Market Conditions**

Donors should craft integrated and strategic programs for enterprise growth that are responsive to the country context—the overall political and economic environment in which enterprises operate. Depending on the country, packages should include policy and institutional reform as well as interventions for improving the productivity and profits of private enterprises. Specific activities may occur at the national, sector, cluster, and/or firm levels. The design and sequencing of program elements should not only address systemic constraints to enterprise growth but should also take account of other donor efforts and national government attitudes toward private sector development. In the process, attention should be paid to issues such as the nature and impact of existing and possibly new incentives driving enterprise behavior, the usefulness of rigorous experimentation that leverages commercial incentives and mobilizes the private sector to advocate change, and the need for better monitoring of performance and assessment of impact.

Enterprise growth initiatives provide donors with opportunities to help revitalize and reform market institutions, provided their interventions are backed by adequate analysis and strategic thinking regarding market linkages and market dynamics.

Entry points into the process of program development include market analysis, strategy to leverage market dynamics, multiple levels of engagement, and an understanding of country typologies (development phases and key variables).

## *Market Analysis*

Donors operate in countries where for-profit companies often fail to overcome market failures and compete in global markets. Market failures arising from monopolies, lack of information, and other causes raise serious challenges for designing enterprise growth initiatives. Successful designs start from an analysis of the existing enterprise structure that identifies promising growth industries, export-oriented sectors, and opportunities for improving productivity. The importance of coalitions for reform (private sector associations and public-private partnerships) should not be overlooked. Change-minded coalitions can be outmaneuvered by rent-seeking coalitions unless they are organized with a clear agenda that offers greater benefits than the existing economic regime.

Table E-2 in the report presents a conceptual framework for assessing strategic opportunities for enterprise growth initiatives at the national, sector, and enterprise levels. This framework covers project design and implementation with respect to improving access to markets, capital, and services. Any country analysis underpinning program design should investigate and shed light on the prospects for improving the business climate, increasing growth in demand, improving productivity, and leveraging economic growth initiatives.

## *Strategy Leverages Market Dynamics*

Donor-supported enterprise growth initiatives often occur in difficult or unstable environments and economic circumstances that present harsh conditions in which to reduce poverty and promote growth. Strategic management of enterprise growth initiatives involves broad, systemic thinking about how to identify and achieve specific objectives. Many countries undergo changes in political and economic openness during the 5- to 10-year timeframes of most initiatives because of political coups, regime changes, conflict, or economic cycles. Strategic management requires continuous adaptation to market conditions and emergent opportunities for change. Cost-effective enterprise growth initiatives should ride the wave of positive market trends and sidestep or ameliorate, when possible, negative results.

Strategic management entails four steps that focus on global markets:

- Analyzing market dynamics with key public and private sector stakeholders (focusing on trends, demand opportunities, and threats) to build consensus on how to reposition a country, its industries, and its enterprises.
- Setting measurable objectives by developing realistic performance indicators for improving the business environment, strengthening industry performance, or restructuring and repositioning enterprises.
- Organizing resources and building the governance capacity of market-focused institutions such as cluster-based trade associations, trade promotion organizations, research and development organizations, venture capital funds, and standards institutes.

- Monitoring results, assessing the initiatives' impact at multiple levels (national, industry, and enterprise) and adjusting strategies and resource management accordingly.

Figure 5 in the report illustrates the strategic management process, including the dynamic interrelationship among strategy, implementation, and learning. The process is challenging because it requires rigorous analysis of market conditions, proper attention to critical variables (such as open versus closed political and economic systems), and strategic decisions about which counterpart organizations to support and which interventions are likely to have greatest impact. The finite pool of financial resources also requires integrating initiatives, as appropriate, with other activities in USAID's portfolio in a given country, as well as complementing other donor programs for optimal results.

### *Multiple Levels of Engagement*

As discussed in Chapter Two of the handbook, the global market is the benchmark for harmonizing market dynamics at the national, sector, and enterprise levels. The global market sets the bar for enterprise performance. Whether local or foreign, enterprises with the most favorable business environment and greatest aptitude for meeting client demands and international standards within an industry or sector are ultimately the strongest competitors. This dynamic, captured in the business literature, explains how competition and rivalry for market share encourage innovation and enterprise growth.

Figure 6 of the report depicts the global market framework and shows the market dynamics facing enterprises, industries, and countries as they develop strategies and policies in response to global market factors. To succeed, enterprise growth initiatives must operate strategically in all these market environments in order to align the local economy better with the global one. In the process, initiatives will assist governments and private sector leaders to respond to localized and broader market trends, opportunities, and threats.

Table 5 of the report presents a range of programmatic interventions that may occur concurrently or sequentially.

### *Country Typologies: Development Phases and Key Variables*

Economic growth initiatives operate in a variety of countries with different development phases and numerous variables. A stable business environment is critical to successful enterprise growth, yet many enterprise growth initiatives operate under extremely difficult business conditions. A country may regress or progress across different development phases and experience rapid change in political and economic variables in a relatively short time period. Zimbabwe, for example, after decades of peace and prosperity, descended dramatically into conflict and political chaos beginning in 1999. Donor programs suddenly had to deal with a closed political system, weak purchasing power in the domestic market, and political and economic instability after a radical land reform confiscated land from

commercial farmers who were the major producers, processors, and traders in the economy. USAID's enterprise growth project adjusted by concentrating on small farmers' production and marketing systems. Simultaneously, USAID integrated HIV/AIDS activities that improved nutrition and health services for at-risk groups among project beneficiaries. As currently structured, the project helps to stabilize the economic situation of project participants and contributes an important humanitarian response, thereby maintaining important social relationships, which can be triggered for economic growth when the opportunity arises.

Variations in development, with a wide range of variation across countries or even within one country, require flexible strategies, which allow for adjustment and fine-tuning while responding to core economic growth objectives. Table 6 of the report presents an overview of development phases and variables, with suggestions for appropriate intervention. Table E-2 poses questions for testing possible approaches in different types of countries. In responding to each country's unique combination of variables, each strategy will still need to take into account multiple levels of engagement, appropriate targeting of clients, and the correct sequencing of activities. In all cases, enterprise growth initiatives should aim at improving the business environment and accelerating the rate of economic growth.

While it is impossible to specify donor-sponsored enterprise growth initiatives for all countries—because each country has distinct leaders and institutions; different political, economic, and historical factors; and industries differing in composition and structure—the fundamental principles described in this handbook, regarding demand, the business environment, and the private sector supply response, should be upheld. A venture-minded approach to managing these initiatives is crucial.

In cases where analysis supports a well-conceived strategic enterprise growth initiative, such initiatives can be cost-effective, affordable, and manageable for the average USAID mission, which has an annual budget of \$30 million, three expatriate staff, and up to 30 local staff, personal service contractors, and fellows. Approximately 10 percent of the total program budget, or \$3 million per year, can support an effective strategic enterprise growth initiative with multiple components. USAID missions may increase or decrease their program budget commitments based on the results achieved by economic growth initiatives over time.

## **Performance Monitoring and Impact Assessment**

Especially in view of the complexity of enterprise development and current debates about which programmatic approaches are likely to be most effective, it is important that each enterprise program include monitoring and evaluation systems that generate information about how well the program is working and what is being achieved. A system of performance monitoring should be built into all economic development projects from the start. In addition, selective impact assessment studies are needed to determine whether particular enterprise growth programs are achieving their intended objectives.

Performance monitoring (tracking of project activities and intermediate results) should be incorporated in all projects as a management tool for determining whether the program is on course and achieving at least the immediate results desired. Such a process will identify any opportunities to make changes in the program's design that may improve its ultimate results.

Impact assessment (analysis to determine whether the program brought about the changes intended) is a more complex and expensive process and thus should be undertaken selectively. Nevertheless, it is important that impact assessments be carried out on some programs (particularly large and/or innovative ones) to determine the effects of particular programs or programmatic approaches at the level of ultimate objectives, such as increasing exports, raising rural income, or creating employment as a way of reducing poverty.

The thought process that must precede the design of performance monitoring and impact assessment systems resembles the strategic management process discussed in the previous section. First, one must know what a program is trying to achieve: what are its fundamental objectives? Second, one must have a clear picture of the means by which these objectives are to be achieved: what problem are you trying to solve, what specific program activities are envisaged, what intermediate results are they expected to yield, and how will achievement of these intermediate results contribute in turn to realizing the project's fundamental objectives? Finally, one must be acutely aware of the environment in which the program will be implemented, especially of factors outside the framework of the project that may impinge significantly (in positive or negative ways) on the program's success.

Once a firm grasp on these fundamental points is achieved, designing performance monitoring and impact assessment systems becomes feasible. Chapter Three of the handbook discusses what is involved in more detail.

## KEY QUESTIONS AND ANSWERS

Following are relevant questions and answers compiled from discussions during the five enterprise study workshops.

**Q: Is the “Growth of Sustainable Private Enterprises” framework addressing competitiveness within the country context, or is it addressing international demand in the local market?**

A: The framework addresses global demand in local and international markets. Product markets typically offer consumers both local and foreign products. Even in local markets, enterprises must compete with products from other countries. Some factors that affect country competitiveness, such as product quality standards, labor standards, and consumer safety, are increasingly international. In today's world economy, all markets are global. In many instances, “demand pull” comes from international markets, especially if domestic market opportunities are limited because of small market size or low purchasing power of consumers. Enterprises that want to grow often have to compete against foreign countries in their home market, or have to export to other countries.

**Q: What are the roles and responsibilities of different actors with respect to this framework and intervention options?**

A: The options for intervention in the business environment and private sector supply response side are listed in Table 1 of the report. However, these options should not be seen as one-way interventions. Enterprise development is a dynamic process and participation of both the private sector and government are needed. It is therefore necessary to consult with both the private sector and public sector organizations to define the objectives of interventions and responsibilities of different actors. The role of donor-financed projects is to facilitate consultations with the private sector and government, and assist them in developing strategies to improve enterprise growth that leads to economic growth.

**Q: How does regional competitiveness relate to this framework?**

A: The regional aspect is definitely important. Such issues as improving terms of trade and harmonizing regional markets are crucial for improving competitiveness and expanding market access. Bilateral or regional trade agreements also make it easier to enforce compliance with treaty obligations. Finally, evidence suggests that intra-regional trade creates more economic interdependency, thereby reducing the risk of conflict.

**Q: What are the incentives for innovation and the role of intellectual property rights (IPR) with respect to this framework?**

A: Innovation is crucial to dynamic growth of enterprises. Enterprises must continuously innovate in order to effectively compete. The main incentive for enterprises is profit, which depends on continuous innovation and the protection of intellectual property in higher value products and services. Stronger IPR protection reduces the degree of risk, particularly for foreign investors or global brands, which serves as an incentive for innovation. If new products are copied by a competitor because there is not legal protection, then companies will not innovate, and foreign investors will not invest.. Incentive is not just the expected profit, but also the lowered risk. Yet there is also a tradeoff between information flows among competitors and intellectual property protection. The relative success of Silicon Valley compared to the Boston area has been attributed in part to California's form of IPR protection, which allowed for greater exchange of information among competing firms.

**Q: How do you conduct enterprise development interventions without picking winners, or do we need to pick winners?**

A: The nuance behind the answer to this question is the importance of being market-friendly. Economists would say that industrial policies do not work and you should not pick winners. The business school approach is to pick the best entrepreneur, particularly if you are making equity or debt investments in firms. We can't pick winners, and yet we must. We can identify through trade analysis which industries have succeeded in exports or hold a healthy market share. Interviews with buyers can help to identify what they want and how they rate various product areas. It is important to understand the market signals so that enterprises and

industries self-select the winners by responding to buyer and market requirements, and to find a middle way between magically picking winners and letting the markets do it. For example, if businesspeople aren't willing to invest in a particular activity, such as a trade mission or participation in a trade show, we should probably not invest donor money. Market signals should be followed to avoid crowding out the market with donor subsidies that create distortions. Ensuring dynamic change and monitoring performance through rigorous baseline data is especially important.

**Q: How do you measure economic growth?**

A: Economic growth can be measured as the increase in gross domestic product (GDP) per capita, adjusted for purchasing power parity (PPP). Some would argue that to qualify as true economic growth, GDP growth must be accompanied by poverty reduction, in other words a fall in the number of people living below the poverty line.

**Q: What is pro-poor growth?**

A: Pro-poor growth is a development process that creates productive employment and reduces poverty. Increased employment is important, but it is also important to determine what kind of employment is being created. Productive employment creates jobs that raise people's incomes. It leads to a redistribution of assets and an expansion of opportunities to participate in the economy. The alternative to pro-poor growth is growth that does not generate new jobs and higher wages that improve people's lives.

**Q: What is more successful—working with the business environment or on the private sector supply response?**

A: There are situations, such as Zimbabwe or Ukraine, where improving the business environment is difficult or insufficient to achieve improved enterprise growth. When governments are not interested in reform, donors may opt to work with the private sector at the firm or industry level to build momentum for reform. Ideally, projects should work with both the government and the private sector to improve the business environment. There are many different options available, both on the business environment and on the private sector side. One of the key areas is to involve the private sector in work on business environment issues. To achieve sustainable economic growth, we need to get the private sector to communicate with the government. Public-private partnerships can become the critical link between policy and the business world. To decide on the appropriate interventions, we should use the analytical framework to explain what is really going on in the marketplace. It is important to understand both the structure of the economy and political issues, and the ability of interest groups to influence both areas. Transaction costs are a critical issue in countries where we work: for instance, high transaction costs due to excessive, unnecessary or inefficient regulations and restrictions facing businesspeople in many developing countries—combined with relatively poor wages for those who enforce those regulations—can motivate bribery in the system, as reflected in the number of “low salary-high income” positions in such bureaucracies. *Doing Business in 2005* helps measure these and other transaction costs. Analyzing the markets is necessary in order to achieve change because

businesses often do not understand global market demand and the fact that they are competing in a global marketplace. Monitoring and evaluation is a crucial element of this market analysis.

**Q: What is an example of addressing a market failure? Is lack of access to credit a market failure?**

A: Well-known examples of market failure include public goods, for which it is difficult or impossible to charge individual consumers, and private goods that have significant positive or negative externalities—that is, they confer benefits or impose costs on society that the individual consumer or producer may not take into account. Asymmetric information (when buyers and/or sellers are insufficiently informed about a prospective transaction) also causes market failure. When markets fail, government intervention to improve efficiency may be warranted, but it is important to ensure that this does not lead to government failure—the inability of government to perform well because of incompetence, underfunding, or corruption. Lack of access to credit can be an example of market failure if lenders are unaware that they can lend safely to a given class of borrowers. The “microfinance revolution” showed that properly structured credit programs can sustainably make small loans to the poor at commercial interest rates. In other cases, difficulties in obtaining credit can reflect genuinely high risks to lenders.

**Q: What should be an exit and sustainability strategy, leaving the support behind through other resources?**

A: In the private sector world, a sustainable enterprise is one that has an ongoing commercial profit incentive. Commercial relationships between buyers and sellers are one form of sustainability. Sustainability can be enhanced by reducing risk—a critical variable that programs such as the Development Credit Authority (DCA) seek to address—and reducing transaction costs. Most countries, for example, measure how long it takes for a business to register and how many steps registration involves. Sustainability can also be achieved through public and private institutions, such as NGOs that register Internet names or membership-based associations that provide services-for-fee that cover the costs of service delivery.

**Q: How do we know that when we intervene we are not just helping business, but also helping society?**

A: One common criticism is that enterprise projects forget about the greater or public good. We do not have all the answers yet, but we know that we cannot focus on business only—it is important to look at the bigger picture of what we do. In most of the countries in which we work, parts of the population are marginalized and become rebels or criminals, often as a result of portions of society being left out of the development process. As they see the rest of the society moving along, they get bitter. Development practitioners must focus on these kinds of questions and on the business environment to ensure incentives are created for

businesses to reach out to these layers of the population by providing employment, affordable services, and tax revenues that support education, roads, and other social services.

**Table 1: Design Process for Growth and Development of Sustainable Private Enterprises**

<b>Step 1: Country-Level Analysis</b>	
<b>Analysis Process</b>	<b>Tools</b>
<ul style="list-style-type: none"> <li>▪ Understand cultural, political, social, and economic context</li> <li>▪ Analyze market dynamics, demand, and competitive context</li> <li>▪ Define constraints in business environment and investment climate</li> <li>▪ Understand the competitive position of leading industries in their respective markets</li> <li>▪ Analyze trade competitiveness and export performance of various commodity groups</li> <li>▪ Identify industries with high potential for growth</li> </ul>	<ul style="list-style-type: none"> <li>▪ Environmental scanning</li> <li>▪ Benchmarking and competitiveness rankings</li> <li>▪ SWOT analysis</li> <li>▪ GAP analysis</li> </ul>
<b>Step 2: Industry/Sector-Level Analysis</b>	
<b>Analysis Process</b>	<b>Tools</b>
<ul style="list-style-type: none"> <li>▪ Understand industry structure and power relations (competitors and complementors)</li> <li>▪ Analyze market demand, trends, and driving forces</li> <li>▪ Map out existing market channels</li> <li>▪ Understand industry-specific rules, regulations, and quality standards</li> <li>▪ Define market failures, constraints, and opportunities</li> <li>▪ Formulate strategy for industry development in response to market opportunities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Subsector analysis</li> <li>▪ Value-chain analysis</li> <li>▪ Strategic management analysis</li> <li>▪ Porter's Diamond</li> <li>▪ Porter's Five Forces</li> <li>▪ SWOT analysis</li> <li>▪ Benchmarking</li> <li>▪ Market segmentation</li> <li>▪ GAP analysis</li> </ul>
<b>Step 3: Firm-Level Analysis</b>	
<b>Analysis Process</b>	<b>Tools</b>
Analyze firm-level constraints, such as: <ul style="list-style-type: none"> <li>▪ Quality standards</li> <li>▪ Innovative capacity</li> <li>▪ Productivity</li> <li>▪ Need for product and process upgrading</li> </ul>	<ul style="list-style-type: none"> <li>▪ SWOT analysis</li> <li>▪ Benchmarking</li> <li>▪ GAP analysis</li> <li>▪ Management and profitability audits</li> </ul>
<b>Step 4: Formulate Strategy and Identify Enterprise Intervention Options</b>	
<ul style="list-style-type: none"> <li>▪ Direct firm-level technical assistance</li> <li>▪ Industry cluster initiatives</li> <li>▪ Sector initiatives (such as financial sector, export-oriented sectors, ect.)</li> <li>▪ Policy and institutional reforms</li> <li>▪ Global integration facilitation</li> </ul>	
<b>Step 5: Establish Framework for Monitoring and Evaluation</b>	
<ul style="list-style-type: none"> <li>▪ Define objectives</li> <li>▪ Identify measurement indicators and tools</li> <li>▪ Collect baseline data</li> <li>▪ Establish benchmarks</li> </ul>	
<b>Step 6: Monitor Performance and Assess Impact</b>	
<ul style="list-style-type: none"> <li>▪ Monitor project activities and outputs</li> <li>▪ Track the value of indicators over time</li> <li>▪ Collect qualitative and quantitative information</li> <li>▪ Adjust/improve interventions based on performance</li> <li>▪ Conduct baseline and follow-up surveys</li> </ul>	



## CHAPTER TWO

# DESIGNING ENTERPRISE GROWTH INITIATIVES

### INTRODUCTION

This chapter explores the steps involved in designing enterprise growth initiatives, from the underlying strategic analysis, to translating the results of that analysis into a strategy based on selected scenarios, and the monitoring and evaluation critical for strategic management of the process. A separate section illustrates strategy formulation in the case of Georgia.

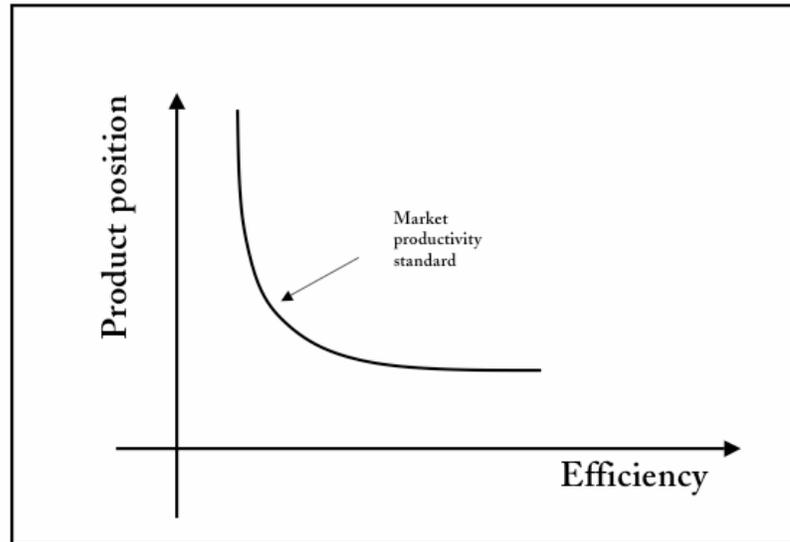
### STRATEGIC ANALYSIS TOOLS AND PROCESSES

The design and implementation of successful enterprise growth initiatives hinges on sound strategic analysis. While good analysis by itself is not synonymous with good strategy, analytical rigor is essential for guiding the process and establishing the framework for effective monitoring and evaluation.

At the center of any effective strategy is the notion that the driving force for both enterprise and economic growth is rising productivity. In fact, the definition of competitiveness as sustained productivity growth to keep up with or surpass the standard set by competitors in a given market is gaining ground. Strategic analysis addresses the three interrelated elements of interventions in support of productivity growth—firm-level assistance, policy reform to improve the business environment, and efforts to strengthen the network of market linkages (that is, support at the cluster or sector level). Each element poses different analytical challenges, but their interdependence means the analysis cannot be compartmentalized. The emphasis on strategy provides a common frame of reference, unified by the central role of productivity growth in the development process.

Productivity is simply the ratio of the value of a good or service in the marketplace—what the consumer or buyer is willing to pay—to the value of all resources and inputs used in its production. Following Michael Porter, Figure 1 in the handbook shows the relations between the two dimensions of the productivity standard in a given market or market segment, the value or the uniqueness of a product and the efficiency of producing it. For a highly commoditized product, competition is defined in terms of efficiency, the lower right-hand side of the graph. Targeting cost advantage has long been the position for enterprise development efforts in developing countries. However, what we have learned is that competition based on lowest cost does not confer a sustainable advantage. To compete effectively, the product or service needs a better market position. Efforts to “brand” the country or a particular region, from the *appellation d’origine* to marketing coffee from Haiti as Haitian Bleu, are the prime example of adding such a dimension. Those above and to the right of the competitiveness or productivity standard have a competitive advantage. Enterprises that cannot reach this market standard, below and to the left of the line, require subsidies from somewhere—from the state, or from consumers as a result of effective protection—to stay in business.

Figure 1: Tradeoffs in Productivity



## Setting Priorities for Productivity-Enhancing Investments

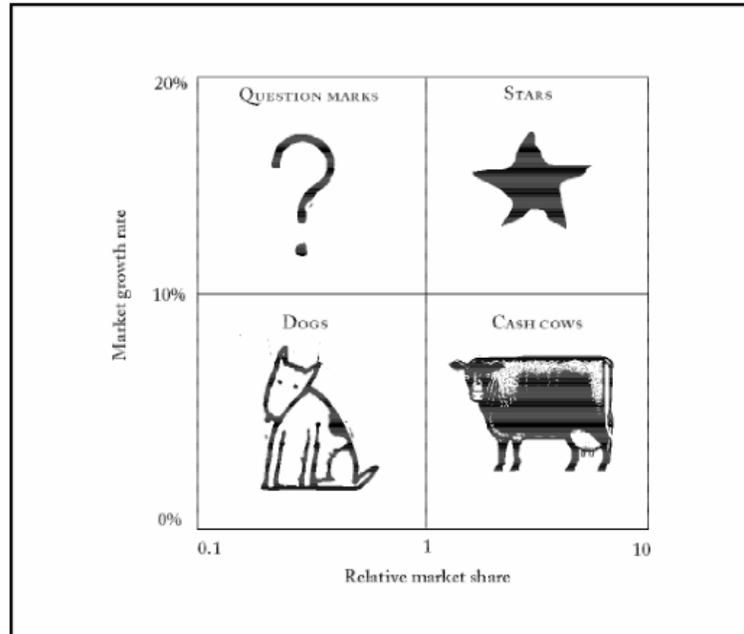
### *Tools from Business Strategy: The Boston Matrix*

Sustained productivity growth depends on constant innovation, not necessarily of the breakthrough kind, but the gradual improvement of the product or process to match or exceed the gains by competitors. In practice, that means understanding market trends to anticipate shifts in consumer preferences, emerging norms and standards, and innovation by competitors. Effective innovation, however, also requires investments. Choosing the product lines for investment to improve the position in the market or to raise efficiency is a strategic decision, or rather a series of strategic decisions. One analytical tool that informs and guides these strategic decisions has been around for some time, yet remains useful—the *Boston matrix*, named after its developer, Bruce Henderson of the Boston Consulting Group. The Boston matrix combines information on market dynamics and the competitive position of the firm in a given market segment to provide criteria for investments aimed at productivity (and therefore enterprise) growth.

Specifically, the Boston matrix measures the growth of the market size for a particular product line on one axis, and the *relative market share*—the market share of the firm divided by that of its largest competitor—on the other. This relative market share in effect represents a signal from the market as to how well the firm is doing with respect to productivity standards, or the value/price relationship. These two axes form a matrix, as shown in Figure 2 of the handbook. The placement of the dividing lines or center axes already reflects strategic considerations. On the x-axis, using 1 as the dividing point reflects the assumption that anything less than having market share at least equal to the largest competitor implies a weak

market position. On the y-axis, the choice of the cut-off point between growing and stagnant markets reflects in part the nature of the business.

**Figure 2: The Boston Matrix**



Any product for which the firm has a strong market position in an expanding market (the upper right-hand quadrant) is a “star.” This status reflects success in innovation to move beyond the productivity standard in the market. The strategic implication is that investments here should be geared toward maintaining this favorable market position and deterring competitors from investing to take away market share. The “dogs” are products in markets that are stagnant or in decline, where the firm has a weak market position. There is little justification for investing to gain market share.

The lower right-hand quadrant comprises product lines in stagnant markets where the firm has a strong market position. These market segments are the competitors’ dogs, and it is therefore unlikely that they will invest to gain market share. These product lines therefore do not require much investment in innovation to defend the market position—they are the “cash cows.” Finally, the upper left-hand quadrant contains products that are some competitor’s stars. Here the firm needs to decide whether the growth of the market warrants investments to improve the competitive position, or whether the competitors are too strong.

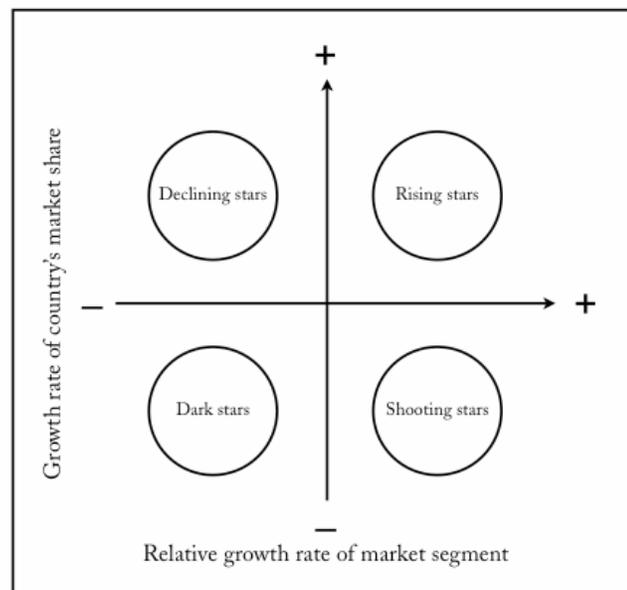
The focus on the relative market position makes the Boston matrix a powerful tool in many situations by looking at strategic choices vis-à-vis those of competitors. The battle for market share assumes strategic aspects that have been explored further in game theory. Moreover, the Boston matrix also emphasizes the importance of dynamic aspects of market performance.

### *From the Boston Matrix to Trade Competitiveness*

Initiatives to promote enterprise (productivity) growth in effect represent investments in innovation for the targeted firms and clusters. The formal process of choosing these targets therefore resembles the firm's choosing among product lines. What is the competitive position of selected clusters in their respective markets? In a global context, a cluster's competitors are producers in other countries (or regions), whether in domestic or export markets. Export markets are of particular interest, since exports are often (though not always, and certainly not exclusively) driving enterprise growth across the economy. Adapting the Boston matrix to the strategic analysis of export performance, therefore, can help clarify options with respect to targeting enterprise growth interventions. This approach was first developed by the U.N. Economic Commission for Latin America and the Caribbean (ECLAC) as the "Trade Competitiveness Analysis of Nations" (TradeCAN), and has since been further developed by the U.N. Conference on Trade and Development's International Trade Center (ITC) and others.

Development Alternatives, Inc. (DAI) has adapted and simplified this approach. The trade competitiveness analysis as adapted by DAI uses two dimensions—the growth of a particular market segment defined in terms of a specific commodity for an importing country or group of countries, and the rate of change of the market share for the exporting country. The market growth rate is adjusted for fluctuations in the total level of imports for the country or group of countries; that is, we are looking at the *relative* growth of the respective market segment. Reversing the axes from the original Boston matrix, we obtain the four quadrants shown in Figure 3 of the handbook, as follows.

**Figure 3: The Trade Competitiveness Matrix**



Classifying a country's exports by commodity market segment provides useful information for choosing priorities in enterprise growth initiatives. However, its value is contingent on both the rigor of the analysis and the appropriate interpretation of its findings. The parallel to business strategy can easily be overstretched: the premises are different, the product categories are broader than for a firm's product lines, the number of competitors (countries) is large, and cross-border linkages in the value chain may provide misleading indications. The prime example for the latter is the role of re-exports, often of goods imported from the target country, as in the case of apparel.

The real contribution of this type of analysis lies in raising questions that have strategic implications. *Why* are a country's exporters in a particular market gaining (or losing) market share? Are there specific factors that could strengthen the competitive position? What explains the performance of competitors; that is, why are they gaining or losing market share? Dealing with these questions requires not only rigorous empirical analysis but also complementary on-the-ground research in the country itself, and sometimes in its target markets.

Two additional caveats. First, while the trade competitiveness analysis stresses the dynamic nature of market performance, it focuses on historical patterns. It plays at best a supporting role in exploring how a country's productive potential in a particular market may be able to penetrate—let alone create—new markets. Second, while the concepts apply both to merchandise exports and services, the analysis of service markets raises both conceptual and data problems.

### *Applied Trade Competitiveness Analysis*

A major factor in the strategic usefulness of the trade competitiveness analysis is the quality, timeliness, and reliability of trade data used in the analysis. In adapting and refining the strategic analysis of export performance by commodity groups, DAI obtained a license for the Global Trade Atlas (GTA), compiled and maintained by a private provider, Global Trade Information Services. This trade database is generally acknowledged to be the best in terms of timeliness and reliability. Based on the official merchandise trade statistics of a growing number of reporting countries (more than 50), it includes all the world's major trading blocs. Data for nonreporting countries are mirror data—that is, cif (cost, insurance, and freight) rather than fob (free on board)—which may explain part of the difference between a country's export statistics and the receiving countries' import statistics. Trade data are posted as soon as they are available from the source. In addition, the provider performs consistency checks and updates the information accordingly.<sup>1</sup>

The GTA database provides trade information categorized according to the Harmonized System (HS) for customs statistics. Merchandise trade can be disaggregated to the 6-digit HS level for all reporting countries. Some countries provide information also at the 8- and even

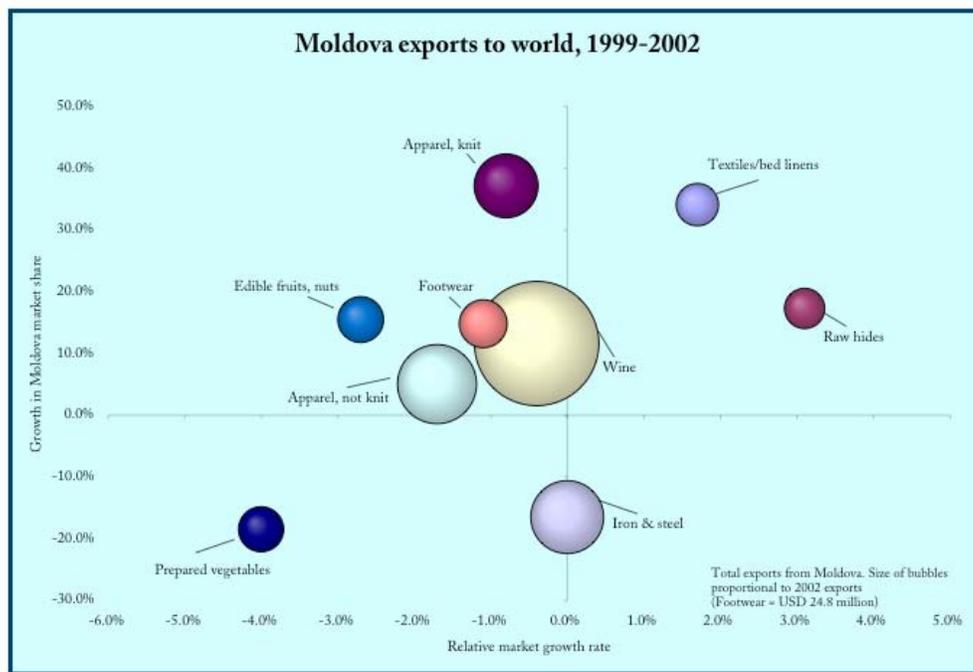
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<sup>1</sup> Much of the analysis can also be done with the ITC's TradeMap, available through USAID for USAID employees and implementers. The differences between the two databases are their timeliness (GTA makes data available earlier and allows for current year analysis) and the ease of manipulating data.

10-digit HS level. While these finer categories are not uniform across countries, they can be useful in exploring selected aspects of market performance in greater detail.

The most important lesson is that the level of aggregation matters in assessing market performance. As a rule, the finest breakdown—that is, the highest degree of market segmentation—provides the most useful information. A trade competitiveness analysis at the 2-digit HS level that aggregates across all export markets may actually yield misleading results. For Moldova, for example, such an analysis would show the patterns in Figure 4 (where the size of the bubbles is proportional to the total value of exports, cif, in 2003). The analysis shows wine, Moldova’s leading export, which accounts for roughly 25 percent of total export proceeds, as a “declining star,” with Moldova gaining share in a declining market. USAID has a license to TRADEMAP and can pass its license rights to Missions and implementers.

**Figure 4: Aggregate Trade Analysis for Moldova, 2-Digit HS Chapters**

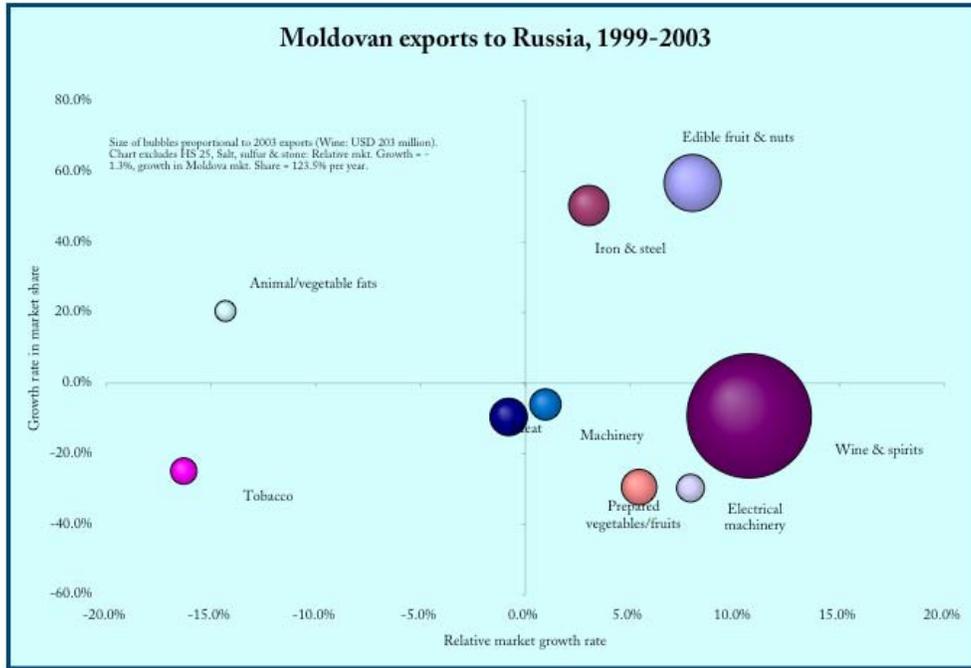


However, Moldova is not exporting wine to the world. It exports most of its wine to its traditional market, Russia. When the analysis is redone for the Russian market alone (still at the 2-digit HS level), the pattern is reversed, as illustrated in Figure 5. Instead of gaining market share in a declining market, as the aggregate analysis would suggest, Moldova’s wine producers and exporters are losing market share in a growing market. That information, together with on-the-ground research in both Moldova and Russia, becomes critical for formulating an appropriate strategy, preferably involving joint action by the country’s wineries.

Similarly, further disaggregation of the HS chapters into 4- or 6-digit-level commodity groups is essential to tracing competitive performance and determining the factors

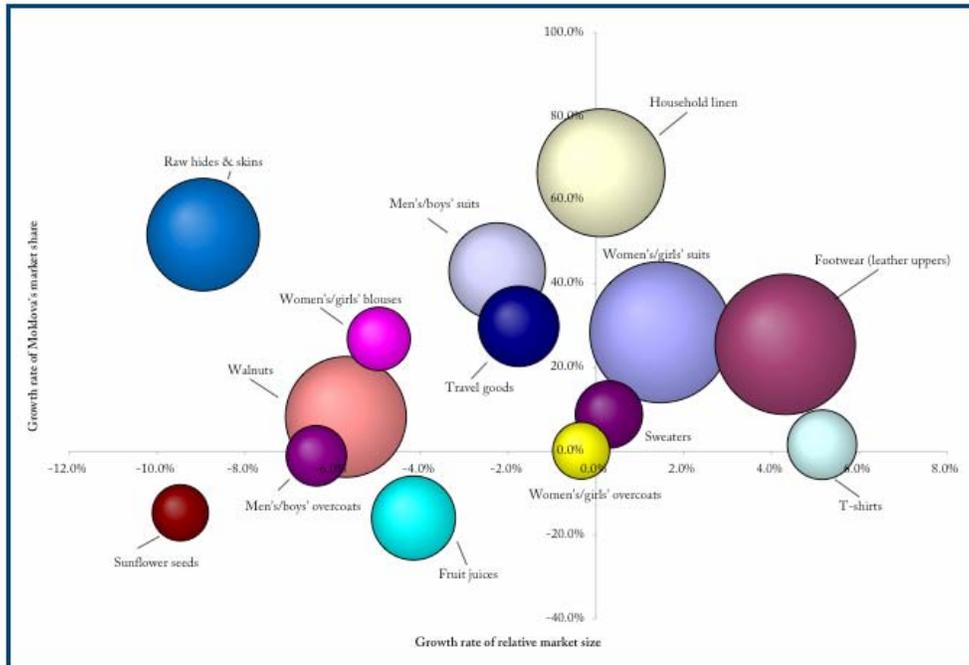
influencing it. Still using the sample case of Moldova, Figure 6 shows competitive performance of Moldovan exports to the European Union 15. The aggregate analysis showed “Raw hides & skins” as a rising star, with Moldova gaining market share in a market that is growing worldwide. However, Moldova’s exports of raw hides go primarily to the EU, where the market has been declining relative to total imports. An initial triage of total exports by the four quadrants of the trade competitiveness matrix may therefore not just conceal important information, it may actually be misleading.

**Figure 5: Moldova Exports to Russia, 2-Digit HS Chapters**



The classification of export performance for markets defined by country or trade bloc and by 4- and 6-digit HS categories can be a fairly tedious process, especially for larger, more complex economies. Restricting the analysis to “significant” exports helps. Official merchandise trade data record even minute amounts. The first step in the analysis is therefore to eliminate all (2-digit) HS chapters with total exports to the target market below a certain threshold. A good rule of thumb is to include only the largest HS chapters which together account for 80 or 90 percent of total exports, but there may be specific issues that warrant a different cut-off.

**Figure 6: Moldova Exports to the EU 15, 4-digit HS Categories**



## Understanding Economic Linkages

### *Subsector Analysis*

Subsector analysis is a tool that helps practitioners better understand the dynamics and competitive context of enterprises in a target subsector, identify dynamic growth opportunities, and design cost-effective interventions that would have the largest impact. It looks at a network of enterprises within a single product group and different forces that influence their competitive position in vertical production and distribution systems, from supply to marketing. Subsector analysis is a systemic approach used to understand the linkages and interaction between both competitors and complementors within a subsector. It does not focus on individual enterprises, but analyzes all subsector firms in their interaction with each other, regardless of their size or function.

Subsector analysis begins by selecting subsectors with high growth potential. To understand the dynamic forces shaping the industry, analysts focus on final markets, map out existing market channels, and assess the competitive position of enterprises in those channels. Channels usually differ by location and income of the final consumer, which in turn determines different requirements for market orientation, quality, and cost in the final product. Examples might include traditional low-quality channels focusing on low-end domestic markets, channels targeting higher-end domestic markets, or channels aimed at higher-quality export markets. Subsector maps can include various overlay maps to graphically present information such as enterprise size, quantity, sales value, employment,

income, and so on. Subsector analysis also covers the subsector environment, including legal and regulatory institutions shaping market access and regulation, as well as support institutions such as business associations, government ministries, nongovernmental organizations (NGOs), and related industries, such as marketing or transportation.

The ultimate goal of a subsector analysis is to identify leverage opportunities for enterprise growth in different market niches and to help inform decisions about potential project interventions. Subsector analysis focuses on understanding the dynamic market trends and constraints to growth, which may include market demand, technological change, input supply, or regulations. In analyzing subsector dynamics, analysts look at those channels that have the best prospects for growth and try to identify ways for competitive repositioning of enterprises to participate in the growing market niches or in higher-quality, more value-added channels often oriented toward exports to global markets.

To achieve results with limited resources, projects must identify a leverage point of intervention that brings higher impact for beneficiaries. By identifying factors that limit participation of enterprises in growing market niches, subsector analysis helps isolate leverage points at which interventions might have a multiplier effect in promoting enterprise growth. Traditional subsector analysis identified three possible indicators of intervention leverage: “system nodes” (points where large volumes of product pass through a few hands), geographic clustering (areas in which business activity is concentrated), and policy areas. Multipliers may result from policy or regulatory changes that affect the entire industry or from targeted interventions with one of the subsector participants that will have an impact on many firms. Interventions might include improving supply channels, marketing, upgrading, improving quality standards, access to market information, removing policy constraints, or export promotion. Leveraged interventions should have a systemic approach and focus on systemic linkages and bottlenecks, not on constraints internal to an individual firm.

Subsector analysis was pioneered in the 1990s and has since been widely used by enterprise development projects to analyze constraints and inform intervention decisions in different industries. Some studies have also linked subsector analysis to business development services, using this tool to identify constraints that can be addressed through increasing access to business services.

#### Resources

- A Subsector Approach to Small Enterprise Promotion and Research (GEMINI Working Paper No. 10, 1991)
- Application of the GEMINI Methodology for Subsector Analysis to MSE Export Activities: A Case Study in Ecuador. (GEMINI Working Paper No. 39, 1993)
- Opportunities for Intervention in Thailand’s Silk Subsector (GEMINI Working Paper No. 27, 1992), [www.dec.org](http://www.dec.org)
- Lesotho Garment Industry Subsector Study, DFID, 2002 (see *Table 2 of the handbook, below*)
- The Kenyan Dairy Subsector Study, DFID, 2001
- The Kenyan Green Bean Subsector, DFID, 2001
- F. Lusby and H. Panlibuton, *Promotion of Commercially Viable Solutions to Subsector and Business Constraints*, 2004

**Table 2: Lesotho Garment Industry Subsector Study (DFID)**

<p><b>1. Driving Forces</b></p> <ul style="list-style-type: none"> <li>▪ Industry has experienced significant growth due to advantages of African Growth and Opportunity Act (AGOA)</li> <li>▪ Growth has caused bottlenecks in the infrastructure capacities, mainly in water supply and telecommunications</li> <li>▪ With expiration of the Multi Fiber Agreement (MFA) in 2005, need to position the industry to compete globally</li> <li>▪ There is a lack of linkages into the garment sector by locally-owned small enterprises</li> </ul>	<p><b>5. Constraints</b></p> <ul style="list-style-type: none"> <li>▪ Inadequate industrial water supply</li> <li>▪ Absence of recycling of industrial waste from the garment sector, threat of environmental degradation</li> <li>▪ Potential threat of HIV/AIDS to the industry</li> <li>▪ Poor telecommunications infrastructure</li> <li>▪ Poor labor relations</li> <li>▪ Poor public image of the garment industry</li> <li>▪ Insufficient factories and industrial estates</li> <li>▪ Low productivity in the industry and lack of relevant training</li> <li>▪ Restrictive customs policy</li> <li>▪ Poor industry-wide cooperation. None of the several industry associations that exist include all players involved in the industry.</li> </ul>
<p><b>2. Markets</b></p> <ul style="list-style-type: none"> <li>▪ 93% of exports go to United States and their share is growing</li> <li>▪ Share of exports to Africa, primarily South Africa, and EU is steady, but small compared to the United States</li> <li>▪ The industry is divided into garments made from woven fabric and garments from knitted fabric. Woven clothing industry has established regional sources of raw materials and is projected to grow. Knitted fabric sector, however, lacks adequate regional sources of knitted fabric and will decline if no steps are taken to establish viable backward linkages either in Lesotho or in the region.</li> </ul>	<p><b>6. Opportunities</b></p> <ul style="list-style-type: none"> <li>▪ Encourage manufacturers in the knitted fabric sector to establish local fabric mills or reliable regional sources of the fabric</li> <li>▪ Provide services to new industrial estates and encourage multinational companies to invest in construction of their own buildings</li> <li>▪ Build modernized, secure, and well-equipped container handling facilities</li> <li>▪ Training to improve productivity within the industry</li> <li>▪ Adopt improved customs regulations</li> <li>▪ Promote a multisector response to HIV/AIDS</li> <li>▪ Establish mechanisms for recycling the water from the garment industry</li> <li>▪ Improve infrastructure to compete with other countries taking advantage of AGOA</li> <li>▪ Improve industrial relations in the factories</li> <li>▪ Improve public image of the garment industry.</li> </ul>
<p><b>3. Subsector Map</b></p> <ul style="list-style-type: none"> <li>▪ Orders are placed by large U.S. brands and retailers, with very little direct purchasing between buyers and Lesotho factories. Lesotho factories act as Cut, Make, and Trim (CMT) plants</li> <li>▪ Standards are specified by major brands and retailers</li> <li>▪ Most raw materials are supplied from the Far East</li> <li>▪ Packaging materials (cartons) are sourced mainly in South Africa, Lesotho, and the Far East</li> <li>▪ South East Asian industrialists operate 85% of the garment factories employing 97% of workers in the industry. Only one factory is locally owned.</li> </ul> <p><b>4. Relevant Institutions</b></p> <ul style="list-style-type: none"> <li>▪ Ministry of Industry, Trade and Marketing</li> <li>▪ The Lesotho National Development Corporation</li> <li>▪ Ministry of Employment and Labor</li> <li>▪ The Directorate of Dispute Prevention and Resolution</li> <li>▪ Lesotho Clothing and Allied Workers Union</li> <li>▪ The Lesotho Exporter Association</li> <li>▪ The Lesotho Industrial Employers Association.</li> </ul>	<p><b>7. Interventions</b></p> <ul style="list-style-type: none"> <li>▪ Create of a factory-level HIV/AIDS program</li> <li>▪ Work with the government to improve services to industrial estates and build additional facilities</li> <li>▪ Government to ensure adequate water supply</li> <li>▪ Conduct cost and benefit analysis of options to reduce environmental threats</li> <li>▪ Upgrade container handling facilities</li> <li>▪ Government to promote the establishment of fabric knitting and processing mills</li> <li>▪ Encourage producers to establish garment industry association</li> <li>▪ Work with the industry to establish a garment industry Productivity and Training Institute</li> <li>▪ Work with all stakeholders to have them commit to an industry five-year action plan, agree on dispute resolution mechanisms, labor code, health, safety, environmental, training and social responsibility standards, and adopt a productivity improvement strategy to maintain industry's cost competitiveness.</li> </ul>

## *Value Chain Analysis*

The reality of global competition, even for non-exporters, makes it important to understand how companies fit into global markets. Since economic development cannot take place in isolation, value chain analysis is a useful tool for understanding how firms and countries participate in the increasingly integrated global economy and how producers are connected to final markets. Value chain analysis focuses on linkages and dynamic business flows within a particular industry. Enterprise development projects use value chain analysis with an increasing focus on upgrading and integrating enterprises into global value chains.

Value chain analysis looks at enterprises as parts of different but linked production and distribution activities operating regionally or globally. As a tool it can increase knowledge of opportunities and constraints throughout the chain and identify points of leverage to improve the position of enterprises. It helps determine the types of intervention and services needed at different levels of the chain and looks at different aspects of the chain to better understand processes and actors.

### *Links in the Value Chain*

By considering all links and activities, value chain analysis helps identify areas that are growing and declining in profitability and understand the possible sources of higher profit in the industry, which could lie in supply, production, design, or marketing, as well as in less tangible factors such as knowledge and skills. Analysis usually starts with one of the following actors in the chain: consumers, retailers, wholesalers, independent buyers, designers, key producers, first-tier suppliers, second- and third-tier suppliers, commodity producers, agricultural producers, informal economy producers, traders, and so on. Focusing on final markets analysis maps out the dynamics of competition, how producers access final markets, and who are the key buyers, using market segmentation analysis as part of the larger framework and identifying distinctive key success factors of each market segment.

### *Governance*

Analyzing chain governance helps understand the value distribution at different levels of the chain, and the various interests and power relations involved. Value chain analysis distinguishes between several types of governance relationships: market-based or “arms length” transactions, where there is little coordination; balanced networks, where enterprises cooperate and have complementary competencies with no control over each other; quasi-hierarchical or “captive” value chains, where one firm exercises control over the others, setting the parameters under which they operate (such value chains can be buyer-driven, in labor intensive industries, or producer-driven, in technology intensive industries); and hierarchical relationships, where enterprises are vertically integrated and a parent company controls the subsidiaries.

Understanding the governance structure of a target value chain is critical for designing and implementing competitiveness strategies. Most value chains have one or more governors, who may be members of the chain or external parties. They are responsible for organization; for setting product, process, or logistics requirements; and often for ensuring the capacity of participants to upgrade and to comply with international standards. Governors may hold a large share of the chain's buying power or control critical assets such as key technology or brand name. Besides buyers and producers, the governance role can be played by other parties, such as first-tier suppliers, buying agents, business associations, or government programs, which often act as intermediaries and help enterprises meet the standard requirements.

### *Upgrading*

Value chain analysis is also used to understand the key challenges in promoting upgrading. It distinguishes between process upgrading (enhancing the efficiency of internal processes; upgrading a product, either by introducing new products or improving old ones; and functional upgrading, such as changing organizational structure) and chain upgrading—moving to a new value chain. With standards in products and processes an increasingly important qualifying requirement for participation in global markets, the ability to meet changing process and product standards is an important component of upgrading.

### *Integration in Global Value Chains and Market Access*

Value chain analysis seeks to identify opportunities for integration into global value chains. Analysis of the governance structure helps identify possible avenues for participation in global markets in one of the following ways:

- Sell into final markets on an arms-length basis when products pass through a number of intermediary local or international buyers before they reach the final consumer;
- Sell as clusters of producers with similar levels of power who group together to penetrate global markets and to benefit from pool of skills, common infrastructure and suppliers, and joint marketing or branding;
- Sell as part of a quasi-hierarchical chain where one of the parties is dominant and determines who is included in global chains and what standards they need to meet, assists enterprises to meet these standards, and audits their performance; or
- Sell as part of a multinational corporation and its vertically integrated value chain, either as a subsidiary or by feeding into one of the operations.

#### **Resources**

- R. Kaplinsky and M. Morris, A Handbook for Value Chain Research (<http://www.ids.ac.uk/ids/global/man&hand.html>)
- R. Kaplinsky and Jeff Readman, Integrating SMEs in Global Value Chains (UNIDO, 2001)
- Value Chain Assessment: Indonesia Cocoa (Action for Enterprise, 2004)
- L. Loebis and H. Schmitz, Java Furniture Makers: Winners or Losers from Globalization (2004, forthcoming)
- Global Value Chain Initiative <http://www.ids.ac.uk/globalvaluechains/>
- Hubert Schmitz, Clusters and Chains: How Inter-firm Organization Influences Industrial Upgrading

In addition to upgrading, enterprises must understand and connect to final markets. Value chain analysis is a useful tool for identifying ways to help them understand these markets, define their business, upgrade their manufacturing strategy, improve value chain links, and connect with final markets.

### *Benchmarking*

Value chain analysis also involves benchmarking against local and international competitors, focusing on cost competitiveness, quality, lead time to satisfy customer needs, and capacity to make minor and more fundamental changes to products and processes.

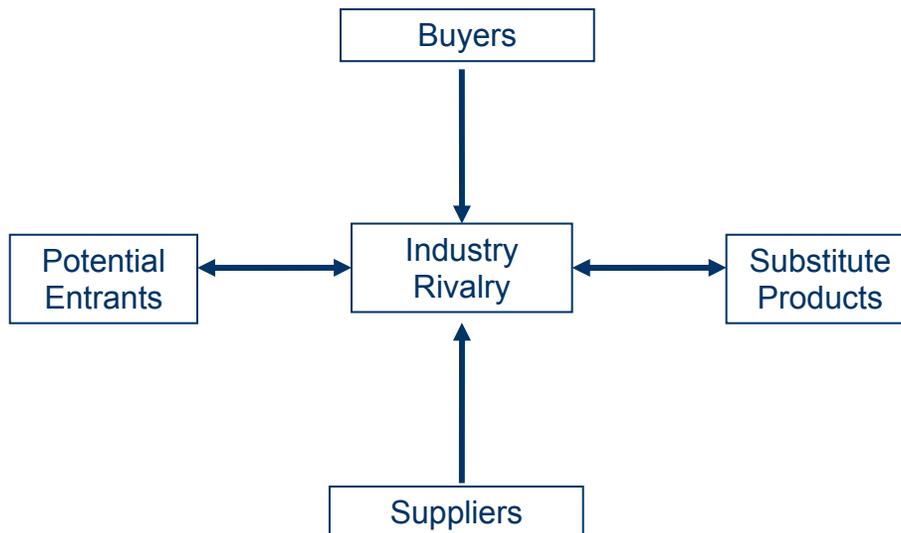
## **Additional Strategic Analysis Tools**

### *Porter's Five Forces Model*

Michael Porter's Five Forces model is a classic business school tool widely used by many competitiveness projects (Figure 7 in the handbook). It identifies four variables that influence competition and profitability within an industry and offers a useful framework for analyzing processes shaping this industry. The five forces of competitive pressure in an industry include horizontal competition from substitutes, new entrants and established rivals, and vertical competition from suppliers and buyers. Analysts ask the following questions:

<b>Resources</b>
<ul style="list-style-type: none"> <li>▪ Michael E. Porter, <i>Competitive Strategy: Techniques for Analyzing Industries and Competitors</i> (New York; Free Press, 1980)</li> <li>▪ Harvard Institute for Strategy and Competitiveness <a href="http://www.isc.hbs.edu/">http://www.isc.hbs.edu/</a></li> </ul>

**Figure 7: Porter's Five Forces Model**



- What rivalry exists among current competitors?
- What is the threat of new entrants into the market?
- What is the threat of substitute products or services?
- How much bargaining power do buyers have?
- How much bargaining power do suppliers have?

The strength of each of these forces and their impact on a particular industry sector is determined by the following structural variables:

<p><b>Industry rivalry</b></p> <ul style="list-style-type: none"> <li>▪ Level of concentration</li> <li>▪ Diversity of competitors</li> <li>▪ Product differentiation</li> <li>▪ Access capacity and exit barriers</li> <li>▪ Cost conditions</li> </ul>	<p><b>Threat of substitutes</b></p> <ul style="list-style-type: none"> <li>▪ Buyer propensity to substitute</li> <li>▪ Relative price performance of substitutes</li> <li>▪ Switching costs</li> </ul>
<p><b>Threat of entry</b></p> <ul style="list-style-type: none"> <li>▪ Economies of scale</li> <li>▪ Cost advantages</li> <li>▪ Capital requirements</li> <li>▪ Product differentiation</li> <li>▪ Access to distribution channels</li> <li>▪ Government and legal barriers</li> </ul>	<p><b>Buyer/supplier power</b></p> <ul style="list-style-type: none"> <li>▪ Cost of product relative to total cost</li> <li>▪ Product differentiation</li> <li>▪ Competition between buyers/suppliers</li> <li>▪ Size and concentration of buyers/suppliers relative to producers</li> <li>▪ Switching costs</li> <li>▪ Access to information</li> </ul>

The five forces model helps understand the power relationships within an industry and the nature of competition, as well as helping to identify possible threats and opportunities for future industry development.

*Porter’s Diamond*

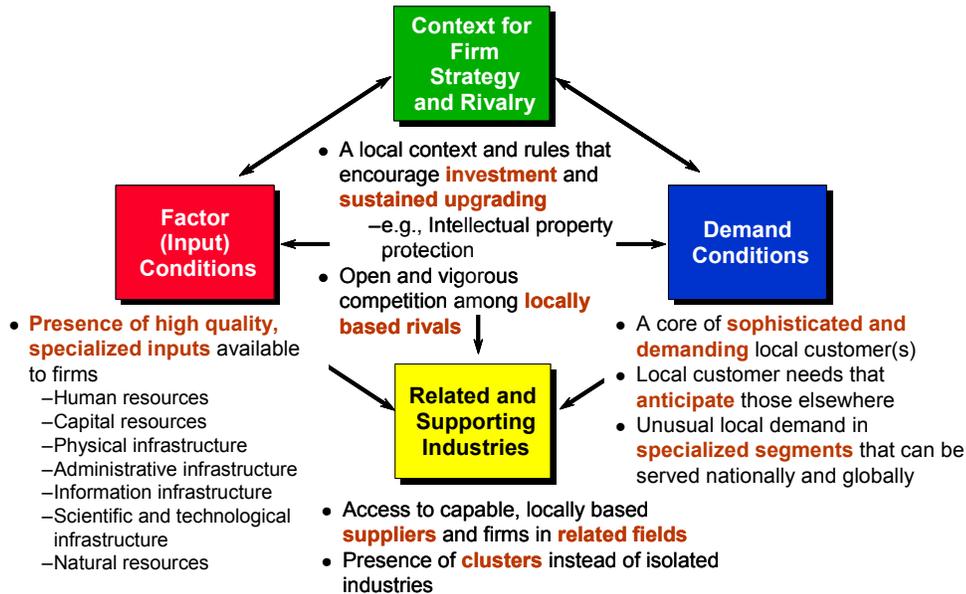
Porter’s Diamond, also called the National Diamond Framework, is a widely used tool for analyzing countries and industries that helps understand the nature of national conditions influencing enterprise development in a particular industry or sector. Illustrated in Figure 8 of the handbook, it focuses on dynamic forces that determine the nature of demand, factor conditions or resources, development of related and supporting industries, and the nature of firm strategy, structure, and rivalry in the marketplace. In analyzing the country context as it affects a particular industry, development practitioners look at specific determinants in the four areas described in the framework above.

Porter’s diamond can be a powerful participatory analysis tool and is often used by cluster-based competitiveness projects to engage all the stakeholders in analyzing the industry and developing strategy. It is also a useful tool for analyzing competitiveness of service industries such as tourism.

**Resource**

Michael E. Porter, *The Competitive Advantage of Nations* (New York; Free Press, 1990)

Figure 8: Porter's Diamond



Source: Michael E. Porter, "Microeconomics of Competitiveness—Learnings about Process," Presentation at the Inter-American Development Bank, Washington, D.C., November 18, 2002

### Environmental Scanning

In the diverse and challenging environments where development projects operate, a crucial aspect of every intervention is to understand the broad political, economic, and cultural context. Analysis of the environment should precede the assessment of firms and industries. Environmental scanning is a useful tool for assessing political, economic, social, and technological factors (hence the term PEST analysis). Understanding cultural background is also important. All of these factors shape the business environment for firms and industries and help forecast the development of countries and industries. Environmental scanning can be an important part of larger-scale strategic assessments, such as the strategic management approach described above.

### Benchmarking

Benchmarking is an important tool for assessing competitiveness of countries, industries, and enterprises, and for measuring their performance over time. In the global economy, international benchmarking is increasingly important even for enterprises not operating in the global markets directly. Benchmarking can be conducted against the following indicators:

#### Benchmarking Resources

- Global Competitiveness Report, World Economic Forum: <http://www.weforum.org>
- Doing Business in 2005, the World Bank <http://rru.worldbank.org/DoingBusiness/>
- American National Standards Institute: <http://www.ansi.org>
- World Intellectual Property Organization: <http://www.wipo.int>
- Benchmarking of SPS Management Capacity in Five Central American Countries: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, USAID/RAISE/SPS program 2003, (MSU and Abt Associates, Inc.)

- Own historic performance of a country, industry, or firm;
- Performance of countries, industries, and firms operating in similar markets;
- Performance of firms in the same sector or similar industries, but producing different products; and
- Performance of firms in different sectors or industries, but having similar processes.

Benchmarking should be a critical element of every enterprise development intervention. A most common problem in developing countries is the lack of available information about global markets and competitor best practices. Various indices are available that can be used as a basis for analysis, including the *Global Competitiveness Report* (see discussion of “Comparative Rankings,” below) and *Doing Business in 2004*. Used as part of a participatory assessment exercise, these indicators can help stakeholders understand their position in relation to main competitors.

### *SWOT Analysis*

The strengths, weaknesses, opportunities, and threats (SWOT) framework is a common business school tool often used as a project design and decision-making tool. Like environmental scanning, it is a basic tool present in one way or another in every analysis.

### *Market Segmentation*

Market segmentation can be used individually to assess product markets and demand, and is also an important element of large-scale assessments, such as the subsector and value chain analysis described above. With market access being a focus of many enterprise development initiatives, it is important to understand the dynamics of local and global markets and the nature of demand in order to design the strategy for repositioning enterprises toward growing and more profitable markets.

Segmentation analysis begins with determining the key segmentation variables. Analysis usually focuses on types of buyers and products with various buyer and product characteristics serving as segmentation variables. After market segments have been identified, analysis focuses on determining the key success factors for targeting and competing in relevant market segments.

### *GAP Analysis*

GAP analysis can be used to analyze both enterprises and industries. GAP analysis is often the outcome of a benchmarking exercise and includes identifying the difference—or gap—between where the firm or industry is positioned at present and what its competitors are doing. GAP analysis can be used as a basis for developing a strategic action plan and creating a vision for repositioning the industry within a defined timeframe. GAP analysis leads to understanding the background and sources of the problem, defining goals, and determining

action steps for achieving these goals. GAP analysis is a participatory process that can involve all stakeholders.

## Assessing the Business Environment

### *Comparative Rankings*

The business environment—shaped by both policy and customs, or the business culture—in effect defines the structure of incentives for innovative activity. Understanding how a country’s business environment stacks up against that of its competitors is of course critical for addressing the policy dimension of enterprise growth initiatives. This premise underlies the burgeoning interest in—and literature on—international “competitiveness” comparisons and rankings that focus on the quality of the business environment, however measured. The Web site of the Foreign Investment Advisory Service (FIAS—World Bank and International Finance Corporation), [www.fias.net/investment\\_climate.html](http://www.fias.net/investment_climate.html), currently lists some 21 periodic publications that compare investment climates, or selected aspects of the investment climate, across countries.

One of the better-known examples of international competitiveness rankings is the World Economic Forum’s *Global Competitiveness Report*, which uses two composite indices, the Growth Competitiveness Index (originally developed by Jeffrey Sachs) and the Business Competitiveness Index (developed by Michael Porter). The latest issue (2003-2004) covers 102 countries, and the coverage is expected to expand, in part with USAID support. A competing ranking exercise is the *World Competitiveness Yearbook*, published by the Institute of Management Development (IMD) in Lausanne, Switzerland. Other relevant efforts include the ratings of the business environment in different countries by the Economist Intelligence Unit (EIU), or the semiannual ratings of creditworthiness by *Institutional Investor* magazine (a rating used as one eligibility indicator by the Millennium Challenge Account [MCA]). Finally, the most recent addition to this literature is the World Bank’s annual “doing business” report, the most recent of which is *Doing Business in 2004*, which Andrei Shleifer helped develop.

### *Using the Rankings Strategically*

These kinds of rankings, in particular the indicators they employ, can be used for a number of purposes:

- **Tracking the position** of the country vis-à-vis competitors: it is important to know where the country is seen in a global context, even if there is disagreement about some of the measures such as “soft” criteria or perceptions;

- **Setting priorities:** understanding the relative strengths and weaknesses of the country's investment climate, as seen by outsiders, enables better targeting of policies to leverage strengths and mitigate weaknesses;
- **Keeping score:** monitoring indicators related to country competitiveness makes it easier to assess the effectiveness of policy initiatives in improving the investment climate; and
- **Making the case:** understanding the perceived strengths and weaknesses of the country can guide the design of more effective outreach and information strategies.

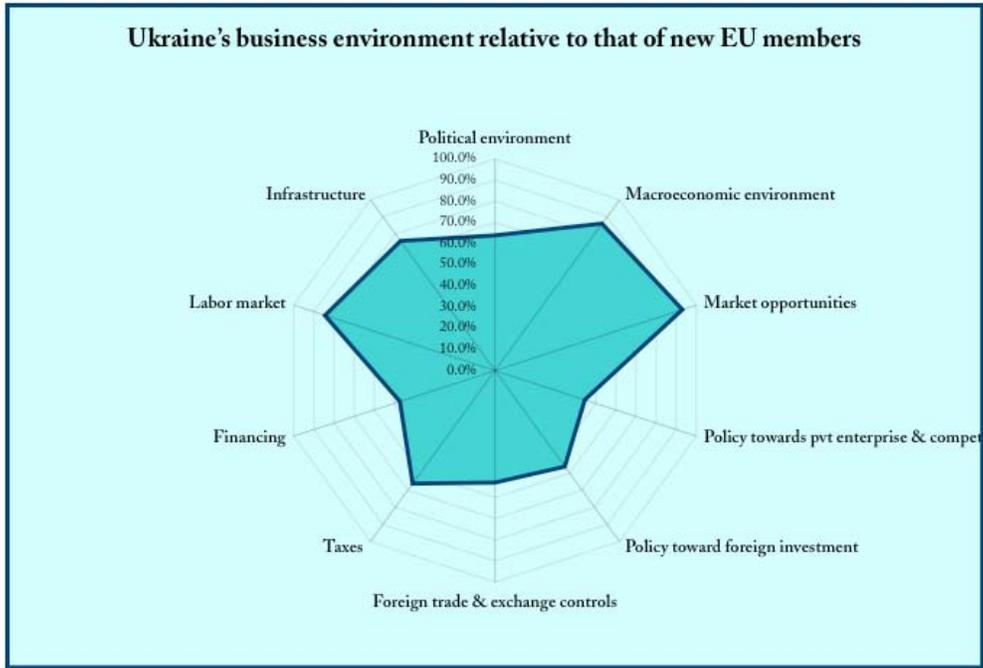
Much of the debate concerning comparative appraisals of the competitiveness of countries or their business environments has focused on the rankings themselves. Ultimately, however, it matters little whether a country ranks #47 or #57. From a strategic point of view, what matters is the relative performance in the areas of competitiveness being measured, because it provides guidance on priorities for structural reform.

In a very basic sense, policy priorities aim at building on strengths and mitigating weaknesses. But policies should also take into account specific opportunities and threats. If a country has a relatively high score in the area of technology, for example, it matters how it rates on individual components in the technology area. It may score high on measures such as the level of new technology development, quality of research institutions, and quality of science education, but low on factors shaping the prospects for building on these strengths, such as the extent of the "brain drain," procedures for licensing new technologies, level of intellectual property protection, or potential for investing in education and research. Focusing on specific weaknesses establishes priorities for the policy reform agenda.

Conversely, individual indicators can also serve as a guide for identifying or clarifying *opportunities*. Real gains in terms of building competitive advantage in a country's economy require a clear sense of priorities, both with respect to macro level measures and with respect to industrial clusters or value chains. Obviously, clusters that take advantage of strengths (and are capable of reinforcing those strengths)—or are less affected by particular weaknesses in the business environment—should become a particular focus of strategic management approaches to improving investment climate and performance.

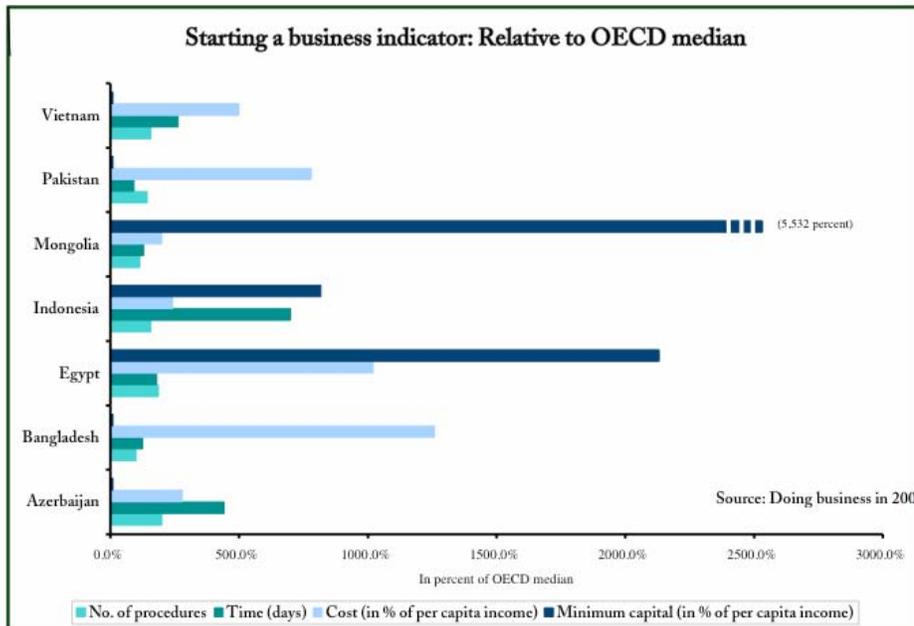
One option for mapping the relative strengths and weaknesses of a country's business environment or national competitiveness is the kind of "radar chart" often used by the FIAS in its investment climate reports. In this kind of chart, the scores are depicted relative to a standard, either the maximum achievable or the scores of relevant competitors. Using the business environment scores for 27 transition economies published by the Economist Intelligence Unit in September 2003 as an example, Figure 9 depicts a comparison of the scores for Ukraine to the average score of the eight new EU members from central and eastern Europe and the Baltics. The average for the new EU members is set at 100, and the scores for Ukraine are expressed as percentages of the reference standard. This kind of chart can be useful in the public-private debate, since it succinctly highlights Ukraine's major strengths (market opportunities, given the size of the Ukrainian economy) and weaknesses (policy toward private enterprise and competition, and financing.)

**Figure 9: Mapping a Country's Business Environment (Ukraine)**



Similar information can be conveyed using the measures from the World Bank's *Doing Business in 2004* analysis, as illustrated in Figure 10. Again, the emphasis is on comparing individual scores for selected countries to a reference set, in this case the average scores for countries in the Organisation for Economic Co-operation and Development (OECD).

**Figure 10: Doing Business in 2004—Starting a Business**



These comparisons that focus on individual areas of the business environment can serve as a basis for strategic management of policy reform in the areas concerned. Singapore, for example, which tends to score high in these international rankings, has made it a policy to focus the government's public comments on areas of relative weakness, thereby helping to set the policy agenda.

At the same time, working directly with firms also identifies key priorities for reforming the investment climate. This type of firm-level feedback loop is precisely why the portfolio approach—providing simultaneous assistance at the firm, cluster/sector, and policy level—raises the overall risk-return threshold on enterprise growth initiatives.

### **Engaging Stakeholders in the Strategic Analysis Process**

While the quantitative and qualitative analysis of trade data and business environment appraisals is necessary, and can contribute to the process of setting strategic priorities, it is all but useless without the active engagement of stakeholders. Strategic management principles demand stakeholder involvement from the analysis through formulation and implementation of appropriate strategy to monitoring and evaluation. Participation is needed both at the policy level, through such mechanisms as a national economic dialogue or joint public-private institutions, and at the level of the local cluster.

Engaging stakeholders is particularly important in tracing linkages along the value chain and identifying obstacles to more competitive performance or institutional chokepoints in the chain, such as participants with excessive market power. One approach used successfully in various settings is the Participatory Appraisal of Competitive Advantage (PACA), developed and refined by Jörg Meyer-Stramer ([www.mesopartner.com](http://www.mesopartner.com)).

## **STRATEGIES FOR DYNAMIC GROWTH**

Table E-1 from the report provides general guidelines for structuring enterprise growth initiatives in response to political and economic variables within various country typologies. While these guidelines can be useful, they are limited by the reality that change must come from within the specific market institutions and environment of a given country. Change usually involves a combination of reform and revitalization of market institutions that improve productivity performance and reposition the enterprises and industries of an economy in response to dynamic growth in the global marketplace.

Dynamic growth and the competitive forces that shape markets affect all levels of the economy: enterprise, industry, and national level. Growth is often shaped by factors beyond the control of policy makers, industry leaders, and entrepreneurs. These uncontrollable social, technological, environmental, economic, and political variables are critical factors that must be analyzed and factored into a strategy to improve productivity performance and economic growth. Strategy formulation should engage key stakeholders of a particular industry or enterprise as a group to analyze the major trends and issues that affect their

market environment. The art and science of strategy formulation requires a process that is participatory and engaging, combined with rigorous analysis to ensure that the right assumptions and information guide the strategy.

This section presents the strategic, participatory approach to strategy formulation within the context of dynamic markets. The process engages key stakeholders to analyze market trends, explore possible scenarios that may affect the marketplace in the next three to five years, and formulate a strategy in response to market developments beyond their control.

The case study of Georgia illustrates application of the strategic management approach for strategy formulation for an enterprise growth initiative. The case was developed by four teams consisting of USAID economic growth officers and practitioners during a workshop in Washington, D.C., on June 8-9, 2004. The results of the case work among the four teams are presented below. The case study materials are included in Annex A.

### **Purpose of Enterprise Growth Initiatives**

USAID's investment in enterprise development is aimed to improve overall economic performance. A five-year investment should focus on supporting positive change that improves economic growth, exports, employment, and other key measures. Improving productivity, or what is often referred to as competitiveness, should sustain higher standards of living for consumers, workers, and society overall.

A strategic enterprise growth intervention in Georgia—a country struggling to adjust from a Soviet command economy to a market economy—would seek to leverage growth and the benefits associated with the emergence of market economy institutions after the dramatic economic decline of 2001-2002 (see Figure 12 of the handbook, following). A strategic intervention must fully analyze the market situation and the opportunities for strengthening market institutions from 2004 to 2008, while taking into consideration the opportunities and threats in the market economy.

### **Strategy Formulation: The Strategic Management Approach**

By strategy, in this context, we mean simply the approach used to achieve a specific goal. In the case of Georgia, the case teams were asked to analyze the market trends and develop scenarios from 2004 to 2008 that might affect Georgian industries and enterprises. Strategic management is the process by which an organization identifies present and future customer needs and empowers its leaders and staff to provide excellent products and services to meet those needs. The case teams in the June workshop acted as a USAID mission to formulate a strategy to improve the market institutions, industries, and enterprises in Georgia.

Other kinds of organizations in Georgia that could employ the strategic management approach might include a wine making company, a wine producers association, a federation of trade associations, or an industry group of public and private sector stakeholders who want

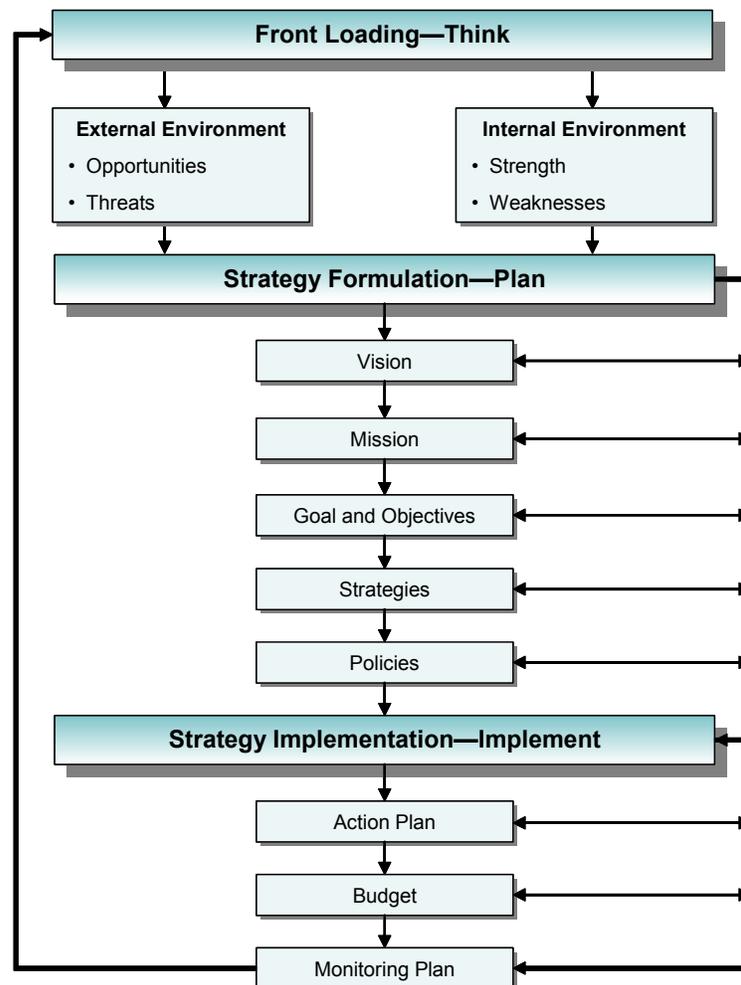
to improve the performance of the wine industry. In each case, a facilitator would work with the stakeholder group to analyze the critical factors affecting their market and define an appropriate strategy in response.

The strategic management process has three important phases:

- **Strategic thinking:** assessing the future effects of outside forces on the organization. The purpose of strategic thinking is to build a consensus or a corporate understanding of the critical factors affecting the organization.
- **Strategic planning:** developing the plan that includes a vision, mission, objectives, and activities.
- **Strategic implementation:** implementing the plan with activities aimed at meeting strategic objectives and measurable performance targets.

Figure 11 of the handbook presents an overview of the strategic management process.

**Figure 11: Strategic Management Process**



Strategy formulation is a dynamic, interactive process that requires continuous reassessment and rigorous management over time by the stakeholders. A successful strategy is:

- Results-focused;
- Information-based;
- Written and realistic;
- Ongoing and flexible;
- The driver of action and operations; and
- Measurable

Many strategic plans fail due to:

- Lack of ownership by leaders and staff;
- Poor information leading to faulty conclusions;
- Performance measures that are not meaningful to the stakeholders; and
- No connection between the plan and the real world of the private sector and global markets.

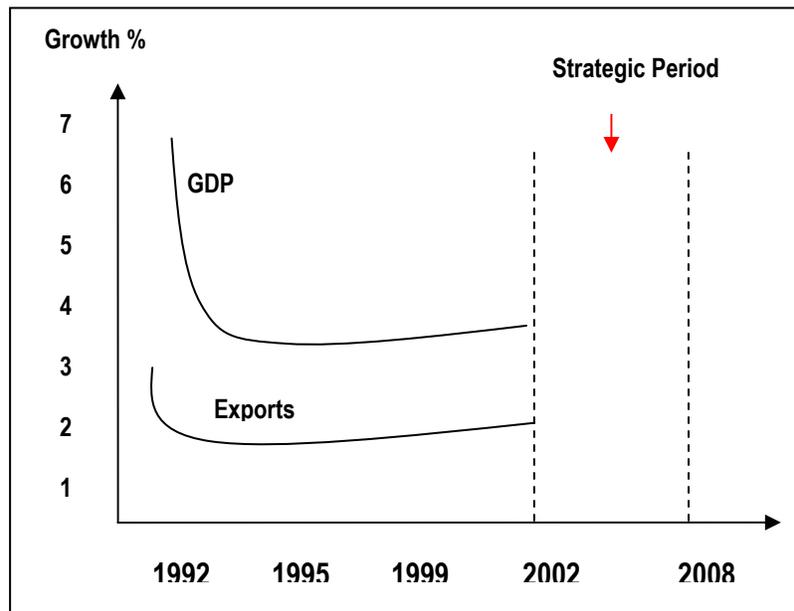
Effective facilitation of a group of stakeholders will lead the group to engage in environmental scanning and scenario planning, which, in turn, shape strategy formulation.

### **Step 1: Environmental Scanning**

This step focuses on the external environment, or the opportunities and threats in the market environment. The process includes:

- Analyzing the business environment and global market dynamics—the group brainstorms the economic, social, legal, technological, political, and environmental trends that affect the country and economy;
- Discussing issues with businesses, leaders, and organizations;
- Talking to experts;
- Analyzing economic and industry trends; and
- Analyzing the business environment, using *Doing Business in 2004*, the *Investor's Roadmap*, and other analysis and surveys, formal or informal.

The case study of Georgia (see Figure 12 of the handbook) was conducted in a four-hour case exercise, and does not benefit from the rigor of formulating hypotheses, then testing and analyzing these hypotheses through consultations and review of data over time. Nevertheless, the Georgia case study illustrates the value of building consensus, even in a short period of time, among a group of stakeholders who rarely think together about the challenges they face.

**Figure 12: Strategic Intervention for Economic Growth in Georgia**

## Step 2: Scenario Planning

A critical mistake made by many managers and policy makers is to devise a strategy for what they hope or prefer the future might be, rather than what it is likely to be. But the course of events and of markets is often determined by factors beyond our control. Strategy formulation should try to anticipate economically significant factors, such as political coups, economic shocks, or other external factors that shape the market environment. History may be a guide to some extent, but equally we need to exercise our imagination and reason to consider eventualities that might affect our business, industry, and economy.

The approach to scenario planning is:

- Prioritize the factors identified in Step 1.
- Select the top two factors as your strategic axes. In the case of Georgia, the group decided the two key factors were:
  - Stable versus unstable political environment, including foreign and domestic factors (vertical axis);
  - Informal, statist kleptocracy versus a market-oriented economy (horizontal axis).
- On the basis of these two factors, establish four scenarios (that is, the four possible combinations of the two factors; see “Scenario Planning for Georgia” section, below).
- Answer the following questions under each scenario, using a five-year timeframe:
  - What is the state of the business environment, private sector institutions, and industry?

- Who will be the stakeholders and customers?
- What are their needs?
- Based on analysis of the four scenarios, the group determines those requirements that will be critical to the private sector regardless of which scenario might play out in the target period. These requirements will form the core focus of the emerging strategy.

During the past five years, Georgia has experienced all four of the scenarios analyzed in the case study, including periods of stability and instability, as well as periods inclining toward a market economy and toward the old Soviet-style economy. The team’s strategy is designed to create the most favorable environment for a market economy, based not on wishful thinking but on realistic analysis of what the future may hold, including possible shifts in market conditions.

### **Step 3: Define the Vision, Mission, and Strategic Goals**

Based on the scenario planning, the group should prioritize strategic goals for the private sector—the customer—over the next five years. The group should agree on:

- **Vision:** what it hopes to accomplish by the end of the five-year period.
- **Mission:** how it will accomplish the vision.
- **Strategic Goals:** derived from market analysis of private sector needs in an emerging or transitional market economy.

### **Step 4: Assess Internal Strengths and Weaknesses**

After analyzing the external environment, the group should evaluate the strengths and weaknesses of its own organization compared to other organizations, such as competitors, and in light of the market analysis. A USAID mission devising a strategy for Georgia, for example, should assess USAID’s relative ability vis-à-vis other donors to implement a strategy complementary to other donors and focusing on priorities consistent with U.S. foreign policy objectives and what USAID does best.

The strategy should be derived from a SWOT analysis: a market analysis in Steps 1-2 that focuses on external opportunities and threats, and an organizational analysis of strengths and weaknesses (in the case study of Georgia, the latter analysis was not undertaken).

### **Step 5: Design Annual Action Plans**

The strategy should be relevant for the three- to five-year period, even though major shifts may occur through political and environment factors. Annual action plans will allow tactical

adjustments to specific activities. If change occurs very rapidly, action plans can be adjusted to a quarterly or monthly basis. The core strategy should still be relevant, but the tactics will be adapted to the changing circumstances.

A successful enterprise growth initiative will be “venture” oriented in that it will accurately assess the market realities and allow for tactical maneuvering to take advantage of changes in the marketplace and build on successes.

The results of the Georgia case study are presented in the following section to demonstrate the outcome of three hours of discussions.

## **GEORGIA CASE STUDY—RESULTS OF CASE ANALYSIS**

### **Who Are the Winners and Losers?**

The group analyzed the current winners and losers in Georgia. This analysis is crucial to identify the stakeholders who are potential forces for progressive change, as well as those who may resist change.

<b>Winners</b>	<b>Losers</b>
<ul style="list-style-type: none"> <li>▪ Customs agents</li> <li>▪ Owners of “infant industries”</li> <li>▪ SOEs or privatized monopolies</li> <li>▪ Enterprises with access to energy</li> <li>▪ Civil servants or military who support existing corrupt business practices</li> </ul>	<ul style="list-style-type: none"> <li>▪ New enterprise entrants</li> <li>▪ Entrepreneurs</li> <li>▪ Young people</li> <li>▪ People who invested in their education</li> <li>▪ People in rural areas</li> <li>▪ Law abiding people</li> <li>▪ Foreign investors</li> </ul>

A successful enterprise growth intervention will segment the market of winners and losers, take into consideration the supporters and opponents of change, and identify public and private sector champions who will lead the change process that increases economic opportunities and support for economic growth.

The strategic management process, outlined in more detail below, should be conducted with a group of stakeholders who want to change their society, economy, industry, or enterprise, and who will “own” the strategy for change.

### **What are the Positive Trends?**

- New government, U.S.-educated president, energized democratic political movement
- Relatively good legal environment
- Oil resources
- International foreign direct investment (FDI) and interest

- World Trade Organization (WTO) accession/membership, although the benefits are not realized
- Strategic location close to key markets in Europe and Russia
- Two fine ports
- A well-educated population
- Russians are drinking more wine, a major product of Georgia
- Decreased conflict in domestic politics
- Numerous climatic zones; 27 micro climates that create opportunities for high value horticultural production and agribusiness
- Slow growth and recovery since the dramatic economic decline after collapse of the Soviet Union
- MCA qualified

### **What Are the Negative Trends?**

- Low technology diffusion
- Adverse demographics
- Low productivity
- MFA quotas on textiles going down
- Spotty electricity
- Poor transport
- Dependence on energy import
- Two-thirds of economy is in informal sector
- Weak domestic demand
- Kleptocracy
- Statist economy is alive and well
- 55 percent of population live below poverty line
- No credit or credit registry
- Decline in school attendance and completion rates
- Problems with work force skills
- Short-term focus, no long-term investment or development

### **What Are the Key Constraints?**

- Tolerance of corruption
- Low standards and quality
- Need to rely on exports for growth—system doesn't support it
- Weak infrastructure

## Scenario Planning for Georgia

Table 3 of the handbook highlights the group's analysis of four possible scenarios for Georgia for the next three to five years. The scenarios are defined by stable versus unstable market conditions and informal statist kleptocracy versus a market-oriented economy.

**Table 3: Scenario Planning for Georgia**

<p style="text-align: center;"><b>SCENARIO 1: STABLE, STATIST KLEPTOCRACY</b></p> <p><b>Business Environment</b></p> <ul style="list-style-type: none"> <li>▪ Inward oriented</li> <li>▪ Prices are stable</li> <li>▪ Economic activity increased</li> <li>▪ Zero sum gain environment</li> <li>▪ Corruption</li> <li>▪ No incentive to change or innovate</li> </ul> <p><b>Enterprises/FDI/Institutions</b></p> <ul style="list-style-type: none"> <li>▪ Some large foreign investors</li> <li>▪ Some domestic business, agriculture, and services</li> <li>▪ Not conducive to small business</li> <li>▪ Lack access to capital; informal, over regulated</li> <li>▪ Ineffective institutions</li> <li>▪ State-owned enterprises (SOEs) play a role</li> <li>▪ Small firm size, evolving toward larger</li> <li>▪ More diversification</li> <li>▪ More long-term integrated production, less efficient</li> </ul> <p><b>Major Needs of the Private Sector</b></p> <ul style="list-style-type: none"> <li>▪ Strengthen institutions</li> <li>▪ Information and services</li> <li>▪ Investment</li> <li>▪ Better regulatory environment</li> </ul>	<p style="text-align: center;"><b>SCENARIO 2: STABLE, MARKET-ORIENTED ECONOMY</b></p> <p><b>Business Environment</b></p> <ul style="list-style-type: none"> <li>▪ Improved regulatory environment, low enforcement</li> <li>▪ Government providing more effective services</li> <li>▪ Less corruption, more transparency</li> </ul> <p><b>Enterprises/FDI/Institutions</b></p> <ul style="list-style-type: none"> <li>▪ Increased FDI</li> <li>▪ More complex production</li> <li>▪ Diverse size and scope of business</li> <li>▪ Long-term investment, domestic investment, outsourcing contracts</li> <li>▪ Larger domestic market; more exports</li> <li>▪ Public-private partnerships and trade associations; commerce, etc.</li> <li>▪ Access to diversified financials (more development finance services)</li> <li>▪ Good legal and regulatory enforcement</li> <li>▪ Price stability</li> <li>▪ Better infrastructure</li> <li>▪ Less corruption</li> <li>▪ FDI: better services and infrastructure</li> <li>▪ Trade associations emerging</li> <li>▪ Business services</li> </ul> <p><b>Major Needs of the Private Sector</b></p> <ul style="list-style-type: none"> <li>▪ Information (markets, export regulations and rules); global benchmarking</li> <li>▪ Financial services</li> <li>▪ Improved infrastructure</li> <li>▪ National branding</li> <li>▪ Education for innovation</li> <li>▪ Linkages (domestic and international partners)</li> </ul>
<p style="text-align: center;"><b>SCENARIO 3: UNSTABLE, STATIST KLEPTOCRACY</b></p> <p><b>Business Environment</b></p> <ul style="list-style-type: none"> <li>▪ Poor, no investment</li> <li>▪ Breakdown in infrastructure</li> <li>▪ Increased shadow economy; possible price instability</li> <li>▪ Slowdown in economic activity</li> <li>▪ FDI falls</li> <li>▪ Barter economy, shadow economy</li> <li>▪ More primary, not value-added production in agriculture sector</li> </ul>	<p style="text-align: center;"><b>SCENARIO 4: UNSTABLE, MARKET ECONOMY</b></p> <p><b>Business Environment</b></p> <ul style="list-style-type: none"> <li>▪ Lack of regulatory environment and informality prevails; legal and regulatory system is weak</li> <li>▪ Less corruption</li> <li>▪ Less FDI</li> <li>▪ Better infrastructure, but under strain</li> <li>▪ Lack of public goods: information, infrastructure, and supporting services</li> </ul> <p><b>Enterprises/FDI/Institutions</b></p>

<ul style="list-style-type: none"> <li>▪ Corrupt, zero sum economy</li> <li>▪ Decreased tourism sector</li> <li>▪ Courts cannot enforce laws</li> <li>▪ Government does not provide essential services, but taxes remain high</li> <li>▪ Failed state</li> </ul> <p><b>Enterprises/FDI/Institutions</b></p> <ul style="list-style-type: none"> <li>▪ Little investment</li> <li>▪ No local institutional development; lack of viable private sector institutions</li> <li>▪ Weak institutions</li> <li>▪ SOEs dominant</li> <li>▪ Low value-added production</li> <li>▪ Low investment</li> <li>▪ Small scale enterprises</li> </ul> <p><b>Major Needs of the Private Sector</b></p> <ul style="list-style-type: none"> <li>▪ Services: information and technical</li> <li>▪ Improved legal framework for company remittances</li> <li>▪ Access to financing</li> <li>▪ Change legal and regulatory regime; transparency</li> <li>▪ Civil service reform</li> </ul>	<ul style="list-style-type: none"> <li>▪ Small businesses/informal and large formal</li> <li>▪ Minimal FDI</li> <li>▪ Little public-private partnership; underdeveloped public institutions</li> <li>▪ Reduced exposure of firms; short-term time frame for investment</li> </ul> <p><b>Major Needs of the Private Sector</b></p> <ul style="list-style-type: none"> <li>▪ Services: information and technical</li> <li>▪ Access to financing</li> <li>▪ Improved transport</li> <li>▪ Support of government institutions to provide services</li> </ul>
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## Strategy Formulation

The group used the scenario analysis to define the vision, strategic mission, and goals:

**Vision:** by 2008, USAID's program will support a dynamic private sector, responsive to markets within a more secure and stable business environment.

**Strategic mission and goals:** USAID's program will support a dynamic, private sector-led, market economy by:

- Improving the level of effective dialogue and advocacy between the private sector and government (public-private partnerships);
- Improving government response and institutional capacity to respond to private sector needs (business environment); and
- Improving business services to increase the productivity and performance of the private sector, and improving trade linkages with the U.S., EU and other export markets (private sector supply response).

## Strategic Program

The scenario analysis resulted in the following strategic goals and objectives:

**Strategic Goal 1:** Improving the level of effective dialogue and advocacy between the private sector and government to improve the business environment (public-private partnerships)

- Develop institutional capacity among private and public sector organizations in policy analysis and focus dialogue on outcomes.
- Improve business registration regulations.
- Support partnerships for education for innovation and work force development.

**Strategic Goal 2:** Improving government response and institutional capacity to respond to private sector needs (business environment)

- Support sound regulations and enforcement economy-wide.
- Support development of a regulatory environment for private infrastructure investment.
- Support customs reform to improve trade efficiency.
- Support tax reform (rates and effective tax) to encourage growth of the formal sector.
- Improve bank supervision and oversight of financial services industry.

**Strategic Goal 3:** Improving business services to increase the productivity and performance of the private sector, and improving trade linkages with the U.S., EU, and other export markets (private sector supply response).

- Improve market information and technical assistance focused on market trends, buyers, trade requirements, buyer networks, “how to” trade information, regulations, branding, and standards.
- Improve small and medium-sized enterprise (SME) financing in response to market opportunities.
  - Identify why existing finance institutions do not lend (why are clients not “good borrowers”)
  - Find innovative ways to provide incentives for financial institutions to invest in value chain players (for example, DCA)
  - Complement the World Bank creditors’ rights project (new laws, collateral registry, training judges, and so on).
- Train bank employees and upgrade banks to provide credit to SMEs.
- Support private sector responsiveness to market opportunities.
  - Assess and support sectors with potential for value-added growth
  - Identify world market demand for products

- Identify constraints to meeting demand
- Improve standards, transport, packaging, branding, grades, production capability, inputs, technology, and so on
- Develop rolling/flexible response to growth industries, including, among others, agriculture, tourism (Russians, Turks, Georgians), healthcare, and transport.

### **Performance Indicators**

- Number of providers of infrastructure services; cost of telephone calls; collection rates; access.
- Value of exports; market share; farmer productivity and incomes; new products; new markets.
- Number of exports increased in selected industries.
- Reduction in number of steps and cost of registering a business.
- Number of days to import/export goods.
- Tax compliance increased.
- Increase in portfolio of financial services (number of new borrowers; size of portfolios).
- Increase in FDI
  - Number of new markets entered in a sustainable way
  - Number of new products created in a sustainable way
  - Number of export-related jobs created.

### **KEY QUESTIONS AND ANSWERS**

**Q: With limited resources, how do you tackle a whole set of constraints an industry might face, such as fiscal issues, lack of information, land ownership, poor business environment, need for trade capacity building?**

A: Some combination of these constraints exists in every country. It is almost impossible to address all constraints at the same time because political resistance often prevents major change. Successful reform has usually focused on windows of opportunity where policy makers and business leaders see greater benefits than costs associated with a particular change. Export processing zones were successful in Southeast Asia, Latin America, and other regions because reforms could be confined to a small geographic area rather than the entire country, with tangible results generated by increased investment. Without focusing on the market it is very difficult to break through a myriad of issues that can seem daunting and overwhelming. A lot of these issues are wrapped up in an industry and actually give you a

leverage point if there is growth potential—the profit opportunity that provides incentive for change. According to principles of market demand, an industry will have the incentives to push through new regulations if these regulations improve profitability performance. In each of these areas, you can identify an agenda in each industry that has the potential to cut across the whole reform area.

**Q: Is reliance on traditional sales into CIS markets a good thing for the transition economies of the former Soviet Union? On the other hand, shouldn't these countries address the low-quality markets because their companies are already making money exporting there and because higher-quality markets are extremely price and quality competitive?**

A: Companies that already export to CIS markets have a revenue stream that may be important for their survival. There are also growth opportunities in CIS markets within market segments of consumers that will pay higher prices for higher quality wine from Georgia, for example. Because of the standards issue, moving away from CIS markets is important. Companies need to improve standards in order to get into the EU markets. However, it takes time for enterprises to restructure. It is important to leverage existing opportunities for the future. But focusing on where it is easiest to do business is not always the best way to become competitive. We often see a long-standing reliance on low-quality markets. The downside of these markets is that the value contribution is low. They aren't necessarily preparing companies to live up to international standards or EU requirements where markets are moving very quickly. Productivity should be the ultimate goal. In the short term, CIS markets will generate revenue and will continue to grow. But if companies are to improve in the long run they need to focus on higher-quality markets. In the long term, a competitive repositioning strategy is required.

**Q: Is it up to the business to learn how to take advantage of the WTO or for the government to respond to opportunities?**

A: Many enterprises do not have the time or ability to understand the complex trade agreements and requirements of WTO. This information gap may be adequately filled by government or donor projects because larger markets offer demand pull incentives. There is a five-year period for implementation of WTO requirements, but if the private sector is not at the table from the very beginning, government is often going to get it wrong. Government and the private sector have different roles, but they must interact and work together to take advantage of the opportunities offered by the WTO.

**Q: How do you balance interventions with the tendency on the part of the government to go back to supporting traditional industries?**

A: Analysis should focus on the ways to absorb the employment in the traditional industries. One of the options is to use nontraditional ways to change the markets in traditional industries. We need to look at market trends for specific industries and decide which are the best to work with to create change.

**Q: What is the reason for working with agriculture if there are no indicators that this is the winning sector?**

A: Roughly half of all enterprises in developing countries are in agriculture. It is important to think about making the markets work. The need to leverage the market is a strategy question, even more important than picking winners. Agriculture and agribusiness often have large employment potential in rural areas where growth is an important development priority. We know that structural changes will shift employment from rural to urban areas and that more sophisticated technology may reduce employment in agriculture over time. Agriculture is very important to health and nutrition and generating higher value goods for consumers.

**Q: How can we facilitate demand?**

A: One of the fundamentals to remember in addressing this issue is that profit is a critical incentive. In seeking to maximize profits by meeting demand of buyers and consumers, markets can fail when there is inadequate access to information about quantity, price, or quality characteristics. Some of the cluster approaches facilitate demand by improving access to market information. We need to determine where there is demand, what are the constraints to meeting it, and how constraints can be removed.

**Q: How do you address the issue of skills? How can you build skills through an industry approach?**

A: We do not treat skills as a standalone issue. The issue of skills is an important part of accessing markets. Skills are part of how enterprises produce in order to respond to market/buyer requirements, and should be addressed as part of the overall strategy to increase productivity. Some projects did a lot of business skills training, which was useless without focusing on improving productivity in response to demand. Training on its own does not help improve business performance. It has to be driven by growth in the economy and should improve enterprise productivity. Skills training should focus on specific things that companies in a particular industry need and are willing to pay for.

**Q: How do you make sure not to crowd out local business service providers? How do you avoid a situation where business service providers are oriented towards donors as their main client?**

A: Projects should work with local consulting companies, put out bids on a commercial basis, and pre-qualify a number of firms in different areas. The goal is to broker commercial relationships between service providers and firms that need assistance and to develop an exit strategy. Keep subsidies low and short-term so that commercial incentives determine effective demand and value of suppliers.

**Q: How can you take advantage of the embedded services that are provided by companies operating in the market, by increasing trade rather than focusing on business service providers?**

A: A large exporter which buys from local producers can also provide small firms with technical assistance (on how to produce) or with logistical support or with supplier credit. It is important to conduct a value chain analysis and determine what financial and non-financial services are absent and what services can be introduced to improve productivity.

**Q: How do you work with information and communication technology (ICT)? What partners would you look for in existing environments?**

A: ICT is critical in all developing countries because access and use of the Internet is important to businesses, schools, government agencies, and households. All participants in the industry, including software designers, value-added hardware service providers, Internet service providers, and telecommunications companies, benefit from developing the infrastructure required for ICT growth, such as increasing access and use of the Internet or promoting non-metered pricing of telecommunications. Any international company, such as HP or Microsoft, would be willing to invest in the country in which it operates if it improves the growth of the market. If they are working in a particular country, they have an interest in this marketplace and can bring global standards to local companies. Microsoft is interested in providing CMM training for software engineers, for example, because it improves Microsoft's reputation and the quality of services of their suppliers. Creating educational institutions, opening Internet cafes, building policy reform coalitions to support IPR or telecommunications deregulation, and creating better public and private institutions for ICT—these are the ways to intervene in the ICT sector.

**Q: If the banking sector will only lend based on a collateral, not on a cash-flow basis, how do you get around this issue?**

A: It is difficult to reform the whole financial sector. A number of projects have been successful in creating individual financial institutions that were able to demonstrate results and become sustainable. The DCA also provides risk sharing schemes that encourage banks to lend.

**Q: Can subsidized credit work in the short term?**

A: In the short term, subsidized credit might appear to work, but it is not a long-term solution and it creates market distortions. The same is true for business services. In order to add value, it is necessary to withdraw subsidies. Subsidized business services only work if enterprises start paying for these services.

## CHAPTER THREE

### MONITORING RESULTS AND ASSESSING IMPACT

*“Not everything that counts is measurable.  
Not everything that is measurable counts.”*

*Attributed to Albert Einstein*

#### BACKGROUND

Program evaluation is essential for understanding what types of enterprise development programs achieve their objectives, and in what settings. The more USAID learns about the successes and failures of its own programs, as well as those of other donors, the less likely it is to fall into the trap of moving from one paradigm to another with no clear understanding of what was good and bad in previous approaches. Program evaluation can also provide indications of what changes in approach might offer better results.

In 1995, USAID changed its policy on program evaluation as part of the government-wide process of “reengineering government.” Previously, there had been a requirement that all projects undertaken by USAID undergo mid-term and final evaluations. Under the new guidelines, evaluations were to be carried out “only if needed for managerial purposes.” Whether to evaluate projects was left to the discretion of Mission Directors and other USAID decision makers, who frequently chose not to have their projects evaluated. As a result, the number of evaluations carried out by USAID declined drastically.

Other problems have been the low quality of many of evaluations and lack of access to available studies. The questionable methodology and doubtful usefulness of much of the work undertaken is as great a concern as the dwindling number of evaluations. Program monitoring is often substituted for impact assessment (see definitions below) and efforts to measure program impacts often take the form of subjective, even casual, inquiries.

*“The methods used for USAID evaluations are dominated by the ‘fly-in’ approach having a serious effect on the quality of the evaluations. As things stand now: Scopes ask a team to come for 4-6 weeks and interview the mission, the activity staff, and ‘representatives’ of the local people. There isn’t enough time to get any kind of representative sample. The team frequently tells the USAID manager pretty much what he already knows. This isn’t worth the money we are spending on it.” (Clapp-Wincek and Blue 2001, p. iv)<sup>2</sup>*

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<sup>2</sup> Cynthia Clapp-Wincek and Richard Blue. 2001. "Evaluation of Recent USAID Evaluation Experience." Working Paper No. 320. Washington, Center for Development Information and Evaluation, USAID (June).

Moreover, only a small percentage of studies carried out find their way into USAID's central depository for such information, the Center for Development Information and Evaluation (CIDE).

In recent years, USAID has been using a performance monitoring program (PMP) to ensure that the projects undertaken by a particular mission bear some logical relationship to each other and contribute to realization of a small number of higher-level strategic objectives (SOs), below which lie a series of intermediate results (IRs). Project implementers are often asked to help define a small number of suitable indicators for the objectives defined in the IRs and SOs, then track those indicators as a measure of performance. This is a useful logical exercise, but it is important to recognize that it is not an adequate substitute for impact assessment. What the PMP lacks, from the point of view of impact assessment, is clear attribution of the changes observed to USAID projects.

In the example given below, for example, fruit subsector development projects in Kenya are intended to help realize the mission's SO7, which is to raise average rural income. Measures of rural income in Kenya are tracked to determine whether this average value rises or falls, but the findings have little to say about the effectiveness of USAID projects. For example, the tree fruit projects could be quite successful in raising the incomes of participating farmers, yet this could escape detection if average rural income nevertheless fell as a result of other adverse factors, such as drought or unfavorable trends in export prices or market access. Alternatively, the projects could fail, but average rural incomes might still rise for other reasons. To see what effects the tree fruits projects have had on rural incomes and other target variables, program monitoring and impact assessment are required.

USAID continues to strive to carry out high-quality programs and has recently been testing new paradigms in the area of enterprise development. There is widespread recognition that more and better program evaluation is needed so that the Agency can learn more systematically about the effects of its activities and use the information acquired to bring about continuous improvement. In a survey conducted in 2000, 60 percent of USAID respondents reported that evaluation was critical to their understanding of activity performance (Clapp-Wincek and Blue 2001, p. iii). Talking with USAID staff members in Washington and the field over the past few months, we learned that there is widespread support within the Agency for doing more and better program evaluation. How can this strong demand for evaluative information about the development projects of USAID—and also of other donors, which may be testing alternative approaches—be satisfied?

## KEY CONCEPTS AND APPROACH

Terminology differs among users, but we define **program evaluation** as an overarching concept that includes any analysis that tries to relate a program's activities to achievement of its goals. Evaluations can be carried out before, during, or after program implementation. Pre-implementation evaluations try to determine whether a project is worth undertaking. In-course or post-implementation evaluations try to determine the extent to which the project followed its intended course and achieved its intended goals. Evaluations are sometimes

classified as either *formative* or *summative*. That is, they are intended to provide information that can be used either to *improve* the program being evaluated or to *prove* that it resulted in at least some of its intended benefits. In fact, evaluations can serve both objectives. Even summative evaluations have an improving function, however, since their conclusions can tell us about which types of development projects are likely to make significant contributions to achieving which development goals, and in what kinds of settings.

To us, the most important distinction is that between **program monitoring** and **impact assessment**. Both of these types of evaluation derive from a **causal chain** that links project activities to project goals. Figure 13 of the handbook (below) provides an example for two tree fruit subsector development projects in Kenya. In this causal chain, *project activities* intended to promote the integration of small-scale growers of mangos, avocados, and passion fruit into more productive value chains lead, in the first instance, to *project outputs*, such as improved market access, more training and extension, and better input supply. These outputs, in turn, lead to desired *outcomes*, such as increased participation by smallholders in the value chains and improved competitiveness for the subsector. The outcomes, finally, lead to *project impacts*, such as better performance (sales, productivity, and trade) both for the targeted firms and for the subsector as a whole, increased remunerative employment, and higher incomes in fruit-growing households. The higher-level goal to which the projects contribute is increased rural household incomes, the Kenya Mission's SO7.

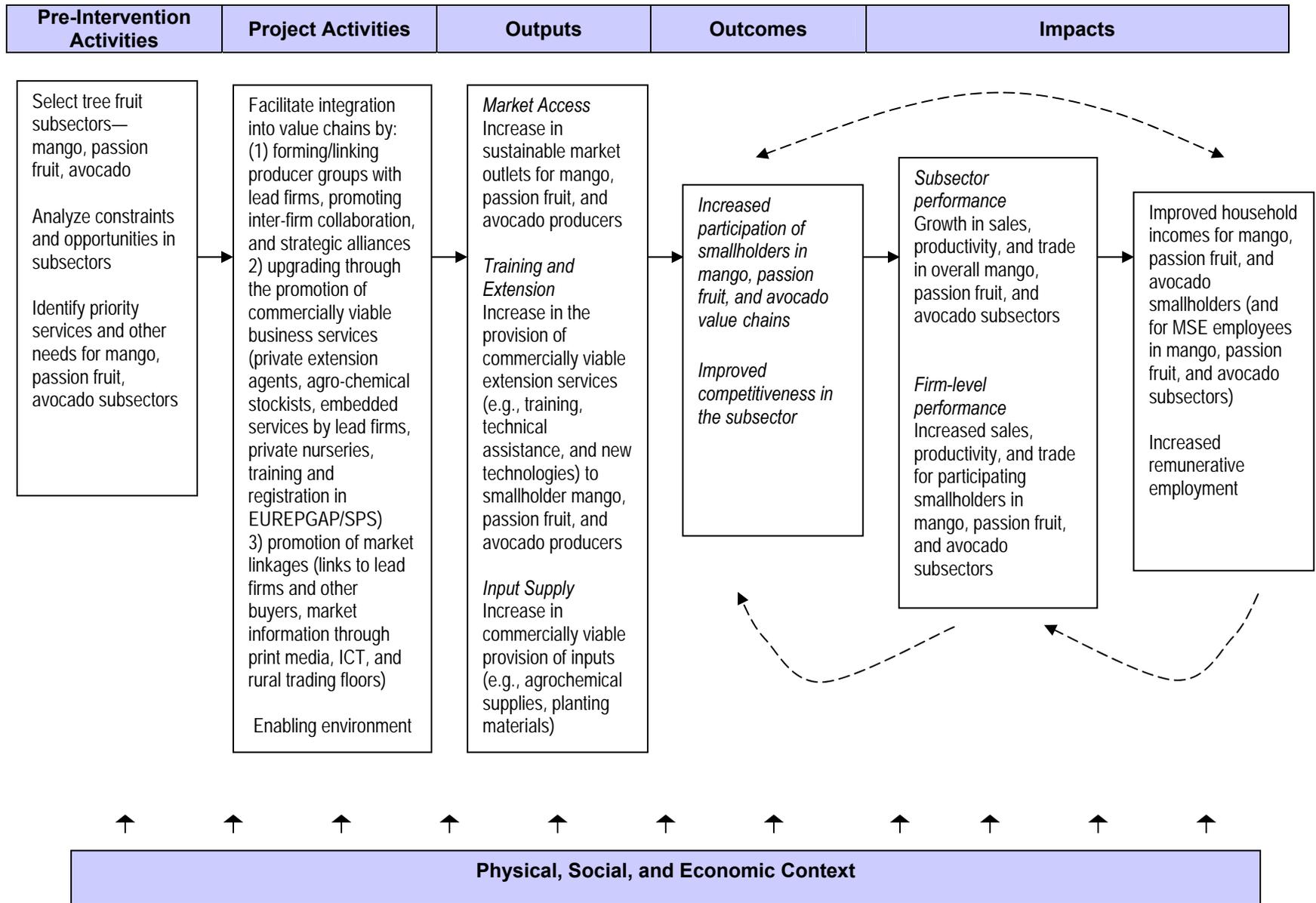
In this depiction of the causal chain through which the two projects are expected to achieve their objectives, program monitoring would track project activities and project outputs. Impact assessment would focus on project impacts but would also take account of project outcomes.

## PROGRAM MONITORING

As just suggested, program monitoring measures the delivery or facilitation of program services and their immediate effects. It should be built into the design of all projects as a mechanism to allow program managers to track and report on their projects' activities. This means laying out the causal chain for the project, defining appropriate indicators, and tracking the value of those indicators at frequent intervals, probably monthly or quarterly. Qualitative information should be collected to supplement the quantitative information. The results of project monitoring should be fed back to project managers with a short turnaround time, so managers can make appropriate corrections in their plans for project implementation.

There are two important points to keep in mind about performance monitoring. First, it is an essential device for project management, since it provides feedback that all managers need and good managers want. Second, it is important to recall that project monitoring primarily measures project activities; although implementers often report the results of performance monitoring as if they measured results achieved, in fact the process measures project activities, not goal achievement. In economic terms, performance monitoring measures input, not outputs.

Figure 13: Causal Model for Kenya BDS and Fintrac HDC Projects



## IMPACT ASSESSMENT

Impact assessment tries to measure the extent to which a project has realized its higher-level goals. It asks, for example, whether average rural household income in Kenya was raised by USAID's tree fruit development projects.

USAID enterprise development projects seek to have impacts at several levels:

- **Enterprises:** most obviously, enterprise development projects should have impacts on the enterprises that use the services and business solutions provided by the projects. The types of impacts sought at this level might include increased sales, productivity, employment, and profitability.
- **Households:** households are often closely integrated with enterprises, particularly microenterprises. Improvement in household income or consumption levels might be sought, along with ancillary improvements such as better nutrition or increased school enrollment by children in the household.
- **Subsectors:** many USAID enterprise development projects focus on a particular sector, such as agribusiness, tourism, or ICT. Getting the subsector as a whole to perform better is often an important objective. Appropriate measures might be the growth of production, productivity, and trade in the subsector.
- **Markets and linkages:** important emerging paradigms in enterprise development involve linking local firms, especially micros and small enterprises, to more productive value chains or to clusters of related firms at the local level.
- **Selected individuals and groups:** some programs aim to promote participation and achievement in business among particular groups of people, such as women or ethnic minorities. In these cases, impact assessment would focus either on enterprises owned and managed by members of the target group or on impacts that affect the roles of individual women and minorities within enterprises and households.

Impact assessments compare changes through time, between a **baseline survey** and one or more follow-up surveys taken, say, at two-year intervals. A comparison of the results of these surveys will reveal the changes that have taken place in the variables in which we are interested. To carry out an impact assessment, however, it is vital that these observed changes be compared to a *counterfactual*—a picture of what would have occurred if the project had not been implemented. Only then can we determine how much of the observed change can be regarded as an impact of the project.

There are several methods of establishing a counterfactual for an enterprise development project:

- **Experimental method:** to conduct a true experiment, program participants must be chosen at random from a larger population of otherwise similar enterprises. The impact of

the program can then be measured by comparing results for the participant group with results for a group of non-participants, called the control group, through a sample survey. This is similar to a drug test, in which one group of subjects receives a medication and another receives a placebo. While scientifically superior, the experimental approach raises practical and perhaps ethical difficulties and as a result has seldom been applied.

- **Quasi-experimental method:** in the more typical case where program participants are chosen by non-random methods (people often have to apply to take part and be selected by program managers or gatekeepers who control access to particular services and linkages), results for the participants can be compared to results for a control group chosen to be as similar to the participant group as possible through a sample survey. If the participants did significantly better than the controls in the performance measures that count, then it can be concluded that the project had a positive impact.
- **Expert and/or participant opinion:** a more subjective way of judging a project's impact is to ask experts and/or program participants what difference they think the project made. Clearly, this is a less reliable way to gauge impact, since many types of bias can enter in. Interviews and focus group discussions to elicit the views of experts and participants about what happened and why can be excellent supplements to sample surveys—for example, by helping to explain changes observed in surveys or drawing out some of their implications—but they are poor substitutes for a quantitative survey.
- **In-depth case studies:** extended and repeated interviews that elicit true stories about how particular project clients are faring and how the project has helped them to overcome their problems are also useful ways of deepening one's understanding of a project's milieu and impact. Again, they are useful supplements to a well-designed sample survey using an experimental or quasi-experimental approach—they are not an adequate substitute. In addition, case histories can be excellent ways of communicating in human terms the operations and impacts of an enterprise development project.

The better methods of assessing program impact have been used relatively infrequently, in part because they are costly relative to the more usual approach of soliciting and evaluating expert (and sometimes also participant) opinion. However, they are probably more cost-effective because they offer a genuine opportunity to learn more about whether, and in what ways, enterprise development projects work to achieve their varied objectives. We believe they should be used more frequently by USAID, albeit selectively. One important opportunity is to examine new paradigms of enterprise development, such as value chain linkage and cluster projects, to see how they work in varied settings in developing and transition economies.

Finally, a word about sustainability: in the market-oriented approaches currently emphasized in enterprise development projects, the most important test of whether enterprises, subsectors, and business service industries have been successfully developed is their sustainability over the long run. Impact assessments that cover a period of two or even four years may be too short to determine the sustainability of the changes measured. Indeed, a project that has greater impact over a two- or four-year period may in time prove to be less

sustainable than another project that has less impact over the shorter run. Since impact assessments cannot go on forever, the best advice we can give future impact assessors is to be conscious of the issue of sustainability and offer their best judgments on the question of how sustainable the benefits measured in the impact assessment might prove to be.

Unlike performance monitoring, which is best carried out by the agency responsible for implementing the project, impact assessment should be done by an independent and objective body.

## MOROCCAN STRAWBERRIES CASE

The Moroccan strawberries case discussed below is an example of a market-based intervention which repositioned one industry sector by increasing the capacity of enterprises to produce, market, and export their products, working both on the private sector supply response side (by delivering market-linking services to agribusinesses and producer associations to increase exports) and on the business environment side (by generating momentum for reform to reduce regulatory constraints and through subsector interventions to lower transaction costs, develop investment and trade opportunities, and facilitate technology transfer). In addition, the project ensured rigorous monitoring and evaluation of intervention results, employing baseline analysis and collecting time series data.

Strawberries was one of the eight subsectors that the USAID-funded Morocco Agribusiness Promotion Project (MAPP) worked in from 1992-1998. Strawberry subsector analysis conducted by the project identified the subsector as one of the most dynamic and important, due to growing demand in major European markets. During 1992-1993, strawberry exports had the strongest growth rate in volume of any crop in Morocco. Despite high growth rates and advantages such as the availability of land, labor, water, and favorable climate conditions, analysis identified a number of constraints and technology needs that prevented the subsector from exploiting its full potential. To address these constraints, the project developed targeted interventions built on the following approaches:

### Approach

#### *Rigorous Monitoring and Evaluation*

From its inception, the project set up a rigorous system for measuring results. Measurement indicators, identified by initial subsector studies, were market-based and linked to targeted results. A market-based analysis was done focusing on a survey of European buyers and their ratings of Moroccan producers. Buyer surveys were conducted initially in 1994-1995 and then again in 1997-1998 to evaluate the change in performance, as measured by the following indicators: price, quality, packaging, and business practice. Based on survey results, MAPP established a baseline linked to time series data that allowed tracking progress over time.

A baseline survey of subsector structure was conducted in 1992, focusing on added value and employment, with a repeat survey taking place in 1995-1996. A project monitoring and evaluation system measured exports, jobs created, spoilage rates, market share, export volume and value, and yields. It also measured export revenue based on deals that resulted directly from the project-initiated market contacts or technology transfer efforts and not from demonstration effects or deals made without project involvement. Policy changes in transportation regulation and plant variety protection also served as result indicators. All the data was market-based and illustrative of changes happening in the marketplace.

### *Analysis of Real Demand Focusing on Potential Buyers*

MAPP focused on products and markets with real opportunities. It surveyed more than 400 European buyers to determine demand for Moroccan products and to identify buyer requirements with respect to product, quantity, and price points. Based on survey results, the project conducted demand forecasts that were published and circulated to Moroccan businesses to help them orient their production. Buyer surveys permitted participants to go beyond the analysis of published trade data and identify trends in consumer demand in ways that Moroccan producers and exporters had not need able to do before.

### *In-depth Subsector Analysis to Identify Export Opportunities and Constraints*

In addition to identifying potential markets and global demand, the project also analyzed subsector constraints to responding to this demand. Through subsector analysis, MAPP identified a number of constraints to Moroccan exports, described in detail in Table 4 of the handbook, below. These studies identified key bottlenecks in various parts of the value chain that prevented increased exports, distinguished market opportunities, and recommended intervention options to modify production and export channels to take advantage of these opportunities.

### *Engaging Subsector Participants and Associations to build Commercially Viable International Business Partnerships and Improve Access to Technology*

MAPP worked with Moroccan growers, processors, and traders and with U.S. agribusinesses to facilitate transfer of technology and to develop commercial links between U.S. technology suppliers and Moroccan distributors. The objective was to ensure that the project was not distorting the market, the technology choices, or the buying decisions of producers and packers. MAPP focused on brokering relationships for real commercial opportunities and linkages, and moving to commercially sustainable operations as quickly as possible by letting Moroccan and U.S. business partners solve commercial, financial, and logistical problems on their own. These partnerships have taken the form of sales contracts or joint equity partnerships.

**Table 4: Constraints and Interventions in Moroccan Strawberries Subsector**

Constraints	Interventions	Results
<p>Strawberry plant variety availability was a key limitation to increased yields and profitability. Traditionally, 80-90% of plants were supplied by Spain, Morocco's competitor, and were of poor quality. Subsector analysis determined that to increase strawberry exports, new sources of plant material had to be identified and dependence of Moroccan growers on Spanish plant suppliers reduced.</p>	<ul style="list-style-type: none"> <li>▪ In 1995, MAPP organized industry tours to the United States for Moroccan strawberry growers, APEFEL leaders, and Ministry of Agriculture representatives to visit Californian nurseries, growers, packers, and institutions that could supply new plant varieties.</li> <li>▪ A Moroccan seed and plant distributor was identified as a commercial importer to group orders for plants, manage imports, and distribute plants, and linked to a U.S. partner firm for strawberry plant purchase and shipment.</li> <li>▪ Moroccan plant distributor and its Moroccan banker met with the Arab-American bank in New York and with MAPP assistance set up a letter of credit guarantee for plant purchases.</li> <li>▪ MAPP also worked with the Moroccan national airline, RAM, to set up a rapid airlift for strawberry plants arriving from California.</li> <li>▪ MAPP provided technical assistance to help build the proper pre-ship inspection, transit to New York, RAM handling, and phytosanitary clearance in Morocco for a near 100% survival of plants.</li> </ul>	<ul style="list-style-type: none"> <li>▪ A partnership between a Californian firm and a Moroccan seed company was established to import and distribute U.S. strawberry plants in Morocco. In the first year, 1 million plants were imported, with 4 million in the second year.</li> <li>▪ In 1995-1996 season, Californian plants outperformed Spanish plants and ended up being less costly.</li> <li>▪ Clear productivity and cost advantage led the Californian and Moroccan firm to set up a joint venture commercial strawberry nursery in Morocco—a high-altitude plant nursery for certified plant production. In 1996, Moroccan distributor and its U.S. partner started trial nurseries and in 1997 delivered to growers the first high-quality certified plant produced in Morocco.</li> <li>▪ Factor productivity of entire industry increased, since plant cost constituted 11% of total cost of production and exports.</li> </ul>
<p>In order to take advantage of export opportunities in the European market it was determined that Moroccan growers needed to replace standard plant varieties with newer, early varieties. It was found, however, that with poor protection of breeder rights, Morocco was 4 to 7 years behind its competitors in obtaining the latest and best plant varieties. While on an industry tour in the United</p>	<ul style="list-style-type: none"> <li>▪ By demonstrating that lack of Plant Variety Protection (PVP) law was putting Morocco 4-7 years behind its major competitors, MAPP started a major policy reform effort.</li> <li>▪ MAPP began a campaign to inform the Ministry of Agriculture and industry associations, such as APEFEL, about the millions of dollars of lost investment and sales caused by lax Moroccan regulations governing intellectual property rights for plant tissue cultures and by lack of a strong plant variety law.</li> </ul>	<ul style="list-style-type: none"> <li>▪ APEFEL members started their own publicity campaign targeting members of parliament and highlighting the deals that fell through because of the inadequate legal framework.</li> <li>▪ Growers and the government were convinced that it was in Morocco's interest to protect breeder rights and create an adequate framework for protecting patented plant varieties.</li> <li>▪ Plant Variety Protection act was passed by the Moroccan parliament in 1996, unlocking access to the best available plant technology and creating an opportunity for direct partnerships between foreign and Moroccan plant breeders.</li> <li>▪ Prior to implementing this law, Morocco's failure to</li> </ul>

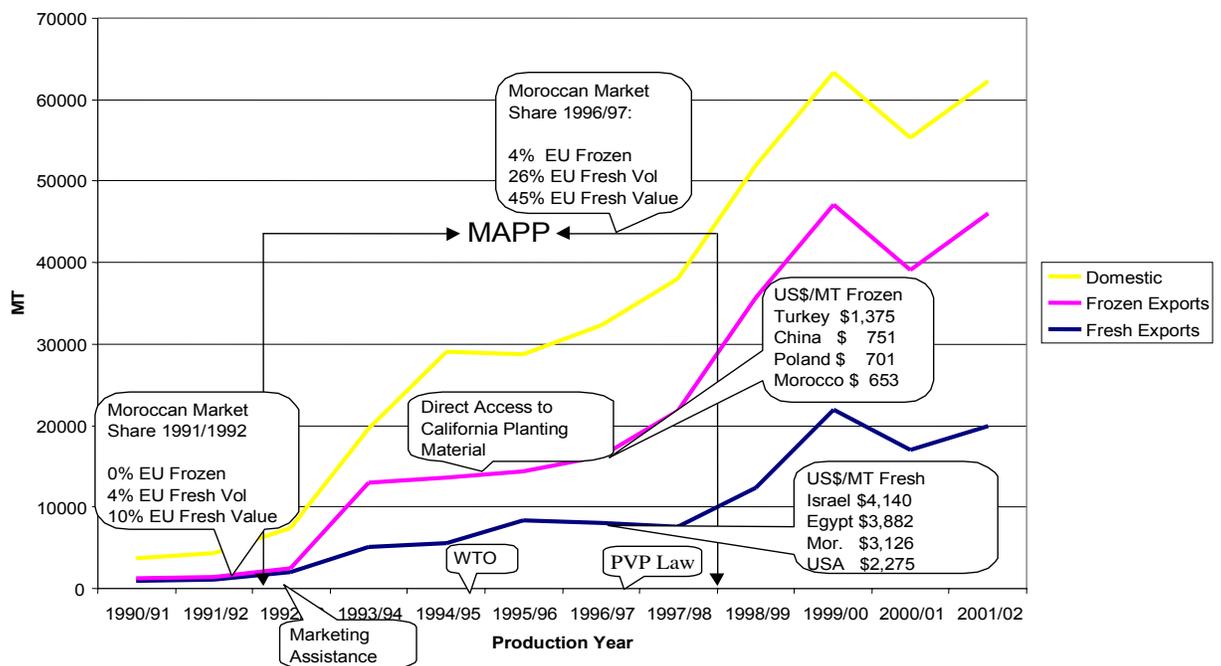
Constraints	Interventions	Results
States, Moroccan businessmen found out they would not be able to buy and import protected breeding lines and patented varieties until Morocco offered transparent and vigorously enforced protection of breeder rights.		protect plant variety and breeder rights was costing the country \$4 million to \$6 million a year in lost investment.
In order to be competitive, Moroccan businesses needed to find ways to reduce excessive government-imposed costs on refrigerated and freezer trucking to Europe.	<ul style="list-style-type: none"> <li>▪ MAPP led analysis of the impact of transport regulation and worked with associations to educate policy makers about the results. It was found that reform of transport policy related to taxation, equipment rules, and cabotage of trucks would lead to 14% reduction in truck freight costs across the board.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Morocco changed trucking and transportation regulations, reforming the complicated trucking rules, which enhanced the efficiency of moving strawberries and decreased transaction costs.</li> <li>▪ This resulted in an increase in productivity efficiency along the whole value chain. Changes cut across all export products, beyond strawberries and agriculture, and benefited other industries such as garments and chilled and frozen seafood.</li> </ul>
Frozen strawberry exports encountered a major problem because of separation of quality inspection, which took place at the plant, and customs inspection, conducted at the port. Since ports had no freezer inspection capacity, products were often defrosted and quality spoiled.	<ul style="list-style-type: none"> <li>▪ Working with the Export Control and Coordination Agency of Morocco (EACCE), MAPP made a case for conducting both inspections at freezer plants, where strawberries would be packed and sealed for export, to avoid damage caused by opening containers, defrosting, and then refreezing the product.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Agreement was reached to centralize quality and customs inspection at freezing plants, which cleared the way to eliminating quality loss at shipment.</li> <li>▪ This agreement enabled the same inspection process to spread to other products and inland processing facilities.</li> </ul>
Improving access to market information and buyer requirements was needed for increasing exports.	<ul style="list-style-type: none"> <li>▪ MAPP surveyed 400 European buyers to get information on product requirements, which was disseminated to Moroccan producers.</li> <li>▪ MAPP provided marketing assistance to growers to find consistent large-lot buyers of fresh and frozen strawberries.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Integrated interventions in marketing, technical assistance to improve productivity, and improving access to technology and supply of plant varieties helped reposition Morocco from a next-to-zero exporter to a major player in the EU strawberry market.</li> </ul>

## Building Institutional Capacity for Supporting High-Value Exports

In addition to building market linkages, MAPP worked with key business associations to create momentum for policy reform on issues crucial for industry competitiveness. The project goal was to create a favorable institutional and policy environment so that once market linkages have been established with project assistance, they will be maintained and become sustainable. MAPP also helped build the capacity of business associations such as APEFEL, the fruit and vegetable producers and exporters association. Management audits of other associations helped them attract new members and identify new service areas and financing mechanisms.

## Impact

**Figure 14: Moroccan Strawberry Production and Exports**



- As a result of decreased transaction costs and new dynamic market linkages, Morocco's share of the fresh strawberry market in Europe increased significantly between 1992 and 1998. Fresh strawberry exports from Morocco to Europe rose from 994 tons in 1991 to more than 7,000 tons in 1994. Frozen strawberry exports, which were virtually nonexistent at MAPP's beginning, grew to 8,000 tons by 1994, gaining a 4 percent EU market share in 1996.

- Due to project interventions, roughly 5,100 jobs were created by the end of the 1998 season in production, freezing, and related services.
- Morocco became the largest supplier of frozen strawberries to Spain, itself the number three worldwide exporter of frozen strawberries.
- The number of producers grew from 60 to 140.
- Buyer ratings for Moroccan producers increased in price, quality, packaging, and overall categories between 1994 and 1997. The least increase was in the business practice rating. (See Table 5 of the handbook.)

**Table 5: Buyers' Ratings of Moroccan Suppliers, 1994-1997**

### Lessons Learned

- Facilitating access to markets that offer incentives critical to improving performance across the whole commodity sector. Real opportunities are needed to create real incentives that drive real change.
- Creating lateral linkages among competitors leads to lateral information exchanges that boost innovation and should result in an emerging organizational structure to maintain these linkages. Enhancing the private sector's ability to adapt to a changing environment and respond to market dynamics is a significant element in increasing sustainability.
- Cutting transaction costs, creating market linkages, and improving compliance with global standards, such as IPR, increases impact and sustainability.
- Interventions are most effective when they are not a one-time deal, but result in a pipeline of technology, skills, and best practice transfer that benefits the whole subsector.
- A good subsector study should map out a strategic pathway for the target industry and should determine milestones to measure progress on key drivers. The strategic pathway, however, is seldom a straight line, and much depends on management's ability to negotiate with key stakeholders, identify creative solutions and opportunities, and adjust rapidly to change.

Buyers' Ratings of Moroccan Suppliers - Scale 1 to 10 1994/5						
Question	Overall	Prices	Quality	Business Practice	Package	
All Products	5.5	5.7	5.2	4.2	5.4	
Buyers' Ratings of Moroccan Suppliers - Scale 1 to 10 1997						
Question	Overall	Prices	Quality	Business Practice	Package	
All Products	6.4	6.1	6.6	4.5	6.5	
Fresh	6.9	6	7.5	4.4	7	
Frozen	5.6	6.1	5.9	4.4	6.6	
Canned	6.7	7.5	6.8	5.8	6.6	
Countries						
UK	6.9	5.8	7.1	5	6.9	
Benelux	6.2	6.4	5.9	4.3	5.6	
Germany	5	6.3	6.4	4	6.3	
France	6.3	6.6	6.8	4	6.4	

- Regulatory reform that reduces transaction costs in one subsector can have positive spillover effects in other related industries.
- Repeat surveys in Morocco showed that business practices are among the most difficult competitive factors to change. Despite improved productivity and quality, it is hard to overcome poor business practice inherent in organizational systems and relationships.
- Successful interventions that result in export sales can produce “demonstration effects” leading to more business deals taking place without direct project intervention.

## **KEY QUESTIONS AND ANSWERS**

### **Q: What is the role of benchmarking?**

A: Benchmarking is the process of judging the performance of a firm or industry according to a standard derived from the performance of more advanced firms or industries. Benchmarking is useful in enterprise development projects because it helps assess the competitive position of enterprises, industries, and countries relative to an objective standard. By emulating some of the practices of more advanced businesses, firms in developing and transition economies may be able to grow fast and upgrade by “catching up.” This process could be captured as part of a project evaluation.

### **Q: Because of the high goals that USAID sets and the often limited resources available to pursue those goals, the task of monitoring is daunting. What should be the standard in a situation where resources are limited?**

A: Any good project should have a monitoring and evaluation plan as part of its design. Remember the old saying, “you can’t manage it if you can’t measure it.” USAID should not insist on ambitious results if adequate resources are not provided to monitor and evaluate project performance. The contractor should propose a realistic plan for monitoring and evaluation that is affordable and relevant to measuring relevant objectives. Initial analysis and design of interventions should define a baseline and indicators for measuring results, which should then be tracked as the project is implemented. Good impact assessments are relatively expensive and may not be feasible for smaller projects, but they are likely to pay for themselves in valuable lessons learned for larger projects, particularly those that incorporate innovative features.

### **Q: USAID writes scopes of work and issues RFPs. Project implementation is the contractor’s role. How should USAID design RFPs in order to ensure results?**

A: It is important not to prescribe how a contractor should implement, but to set objectives instead. Since we have emphasized the importance of understanding and operating within the marketplace, an RFP should not prescribe which industries or firms a project should work in. It is important to give maximum flexibility to the contractor to maneuver in the marketplace,

to leverage opportunities for growth, and to understand the market incentives at work. To ensure results, USAID should insist that contractors develop good monitoring and evaluation plans related to project objectives, then follow through.

**Q: How do you balance USAID's emphasis on results and indicators with competitiveness being a long-term process involving a change in mindset? How can we address the problem of demonstrating results?**

A: Implementers must focus on opportunities that demonstrate results to businesspeople who have much higher expectations than USAID. There should be a focus on demonstration effects and creating linkages and organizational structures that will have a spillover effect. Leveraging opportunities that would result in commercially viable business linkages is critical for demonstrating immediate results and generating success stories. All parties should have realistic expectations about what can be achieved over particular time periods. For example, increases in the number and value of commercial transactions in product, input, and business service markets may not prove that long-term sustainability has been achieved, but they are compelling indicators of progress over the first few years of an enterprise development project.

**Q: What are reasonable levels of expectations and reasonable timeframes for results?**

A: In the causal chain for the project, we would of course expect to see evidence of project activities first, then of project outputs and outcomes, and only later on would we expect there to be measurable project impacts. Exactly how soon one should expect to see significant impacts is hard to say and would probably vary by project type. Within two to four years, however, some level of impact should be visible for any type of enterprise development project. As mentioned earlier, however, sustainability is ultimately what we are aiming for, and impacts over two to four years do not necessarily correlate well with long-term sustainability.

**ANNEX A**

**WORKSHOP REFERENCE MATERIALS**



## **CASE STUDY SCENARIO ECONOMIC GROWTH AND COMPETITIVENESS IN GEORGIA**

### **DAY ONE OF WORKSHOP**

#### **Part I**

You have just received your next assignment for Georgia in the CIS region. You will move there in April 2004 from Thailand, and take up your new position as the new Director of the Economic Growth Office. USAID has sent you a brief profile of the country.

A contact you knew from your IDI days in Washington who now works at the Mission in Georgia tells you that the Ambassador, John White, is a Bush political appointee who knew the President at Harvard Business School. He is a big advocate of the private sector and Michael Porter. He does not have the best relationship with the Mission Director, Napoleon McCauliffe, an Economist who has little experience with enterprise projects and the private sector. The Mission has had a large democracy and governance and health portfolio. You are told by your old colleague that you will be in a difficult position to balance the interests of these two strong personalities, but you also have the opportunity to make both of them look good if you know how to play the game!

You arrive at post and during the first few weeks you review the economic data and visit with private sector leaders and the Ministers of Economy, Trade, Finance, and Industry. There are several important findings from your interviews:

- The Minister of Finance is unhappy with IMF and World Bank structural adjustment programs because they do not address immediate poverty issues and restrict the government from spending programs that would enhance consumption.
- The Minister of Trade believes that Georgia has not benefited in full from the membership in the WTO. Enterprises do not understand the implications of reductions in tariffs and technical requirements for exports into key markets such as the European Union, and none of the donor programs are providing effective support to the private sector. The Minister comments that USAID's agricultural exports project has been quite successful, but he does not know how the supporting services for exports will continue after the project ends in 6 months.
- Corruption, smuggling and falsification inflict considerable losses. The lack of law enforcement creates little incentive for companies to operate legally. The shadow economy remains a critical issue and according to the Minister of Economy represents 40% of the overall economy. Integration into the global economy remains challenging for Georgia, which is still strongly linked to Russia and has few ties to the rest of the world.

Export sectors are heavily dependent on natural resources making the country vulnerable to volatile fluctuations in commodity prices.

- The Minister of Industry claims that liberalized trade is putting high employment industries such as garments and textile goods out of business. He wants USAID to advise the President's trade team on negotiation strategies to protect these industries.
- The private sector is fragmented and there is little cooperation. There is limited formal consultation between the public and private sectors on trade facilitation. The Chairman of the Federation of Exporters believes that the government is not fully responding to WTO trade opportunities, and would like USAID to provide assistance to improve trade capacity. Private enterprises lack market information, technological capabilities, and market oriented business skills. State ownership of large strategic enterprises and control over substantial productive assets, like land, telecommunications, and energy, discourages private initiative and limits competition. He also noted that a current USAID project for SMEs is taking business away from local consulting firms, and he suggests that USAID should be supporting local firms, not putting them out of business. The Executive Director of the Association of Industrial Manufacturers represents import substitution interests, and has lobbied to maintain tariff barriers on key commodities, and spent considerable time on the infant industry arguments.
- Private sector leaders agree that early macro-stabilization efforts by the government have not been followed by the full range of structural and institutional reforms. Reforms are hindered by powerful elites, widespread public corruption and weak institutions. The private sector would like USAID to provide assistance to improve the trade and investment environment, strengthen the capacity of businesses to meet international standards and attract investment. They also mention that enterprises are confused by the multiplicity of trade regimes, such as CIS agreements, WTO and EU regulations, and would like USAID to provide assistance on firm-level trade facilitation.

You know that the Ministers of Finance and Trade are friendly with the U.S. Ambassador, and private sector leaders meet regularly with the Ambassador and commercial attaché who often advises USAID on its programs. You also become aware of the special interests of Georgia because the wife of the U.S. Ambassador and Laura Bush are particularly close. You present a report to the country team, including the Ambassador and Mission Director, about your assessment of growth dynamics and opportunities in the country.

The Mission Director asks you to present your assessment of the current program, and an assessment of the economy and growth dynamics that USAID should take into consideration in formulating a program strategy going forward. The current program was designed by your predecessor who spent a career in the microenterprise office and designed a microfinance lending project with 3 NGO financial institutions and 2 commercial banks to lend to microenterprises. The projects come to an end in 6 months, and you have to decide what to do with the \$12 million annual program budget for each of the next three years.

You gather your team to plot your analysis and outline a program strategy. You are asked to address the following questions after your initial round of interviews and analysis of the economic information. Working groups should discuss the following questions and be prepared to present your conclusions in the plenary session:

1. What growth opportunities exist in Georgia, in the region, and in international markets?
2. How would you assess the business environment? What factors limit the ability of Georgian enterprises to effectively compete?
3. How would you assess the private sector's ability to respond to market opportunities?

## **CASE STUDY SCENARIO ECONOMIC GROWTH AND COMPETITIVENESS IN GEORGIA**

### **Part II**

It is October 8, 2006, eighteen months after you arrive at post. The U.S. embassy is bombed by terrorists, killing two American consular staff. There are indications that there may be links to Al Qaeda, although news and intelligence reports are murky. If the U.S. Ambassador had been in the building, he likely would have been killed as well. This is the first incident of direct targeting of U.S. officials in the country, and raises serious concerns within the Bush Administration which has won a second term in the White House. You watch on CNN President Bush's statements to the world that the United States will not be bullied; he has asked Congress for emergency funds for Georgia and the Eurasia region to strengthen U.S. relationships with friendly countries in the region and to fight terrorism.

The next morning, the Mission Director informs you that he received a cable from Washington that the Assistant Secretary of State for Europe and Eurasia, Marleene Kent, will be arriving next week. She would like a briefing on how the Mission will use an additional \$15 million of emergency funds to support progressive groups in the country, and provide visible, high profile action. You are concerned that the political pressure will undermine a serious effort to improve trade links with the U.S. You have one week to prepare a draft private sector strategy that will be presented to AID/W for review in preparation for the visit of Assistant Secretary Kent.

### **Assignment**

The Working Group should do the following:

1. Use the strategic management method to develop the four scenarios that affect growth dynamics in the economy. For each scenario, define:
  - a. the business environment
  - b. the kinds of businesses that will exist
  - c. the needs of enterprises and the private sector to compete under each scenario
  - d. define the core needs of the private sector that are most relevant for all four scenarios—these become the strategic areas of focus for developing an enterprise growth program strategy.

2. Each group should prepare a brief presentation of about 10 minutes on:
  - a. The scenario analysis in 1. above
  - b. A program strategy to support enterprise and economic growth during the five-year period from 2004 to 2008. Please refer to Table E-1 and E-2 in the Executive Summary in the report, “Enterprise Growth Initiatives: Strategic Directions and Options” to address key strategy considerations.
  - c. For each program activity, identify the performance indicators you will use to measure results for the short, medium and long term and the budget you allocate for each program component.

## INDUSTRY PROFILES FOR GEORGIA

### AGRICULTURAL INDUSTRY: KEY MARKET TRENDS AND CHALLENGES

- Due to its volume and the number of people employed, the agricultural sector plays a significant role in the Georgian economy. In 2000, the sector accounted for over 25% of GDP and over 50% of total employment.
- Agricultural production is currently down by 40% from the levels of the late 1980s. In recent years, the value of food imports has been exceeding agricultural exports.
- Marketing and finance are identified by most sector stakeholders as the key constraints to sector growth. Lack of financing is a major constraint to both farmers and value-added producers. Very little of the limited credit supply is directed to agriculture, and the local banking system does not have the capacity to finance the level of investment required for the growth of the agribusiness sector.
- Availability of information about new markets remains very limited. Only a few Georgians actively seek new markets, and the information about new marketing opportunities is not reaching the producers. The Russian market is still the first target and often the only market being considered. Georgian producers and processors have not been very successful in developing new markets to replace those lost after the Soviet Union broke apart. Sanitation and food safety, packaging and quality standards in Western Europe make it difficult for Georgia to enter those higher-value markets.
- In recent years, small farmers have gained in importance as the primary agricultural production sector in Georgia. Most agricultural SMEs have been privatized, but a substantial number of enterprises are still state-owned. Many of them are old and inefficient. A number of successful local and foreign agro-processing companies exist on the Georgian market, but many of them frequently have to import raw materials and packaging.
- Small producers fear that with the growth of supermarkets and increase in food purchases made at large multinational chains, the market share of traditional food wholesalers will decline, and small producers will lose their main link to the consumer market, not being able to produce large volumes necessary to supply the retail chains.
- Only one third of the agricultural land is privatized. Ownership of the remaining two-thirds is held by the state, only half of which is leased.
- An organized system of input supplies and suppliers that reaches down to the village level has not fully developed to replace the former command system. Many agricultural production inputs are difficult for the small farmers to find. Domestic production of agricultural machinery is limited. Equipment that remains in use is generally in extremely poor condition and not suitable for small farms.

## **TOURISM INDUSTRY: KEY MARKET TRENDS AND CHALLENGES**

- Georgia has a rich cultural heritage, ancient historical sites, mineral and thermal springs, seaside resorts, mountains and winter sports.
- The role of tourism-related business associations in the development of the tourism industry has grown in the last several years. National Tourism and National Hotel Associations are representing and protecting the interests of tourism-related businesses.
- Georgia is a vacation spot undiscovered by the West that is in need of development both in terms of infrastructure, such as road, railroad, electricity, water supply and wastewater treatment, and in terms of tourism-related activities, such as hotels, restaurants and sports facilities.
- Georgia has been striving to establish its image as a tourist destination and to develop infrastructure and a favorable business and investment environment for the development of the tourism industry.
- Besides local health resorts, tourist facilities have never been developed. Political and economic instability after the independence adversely affected the tourism industry. The number of tourists dropped and infrastructure deteriorated from neglect and shortage of funds.
- In the early 1990s, many tourism facilities were converted into joint stock companies and are either fully or partially privatized. The majority of hotels in Georgia are small guesthouses. Many managers of privatized hotels are currently seeking joint-venture partnerships with tourism-related foreign businesses and investors to expand their operations and improve services. There are several international hotels, including the Sheraton Georgia, the Intercontinental, and the Marriott, that operate in the past three years, operating at about 60% capacity.
- Most of the tourism infrastructure, as well as roads, railroads, and communication facilities is in poor condition and needs significant capital investments. Until recently, investment in the tourism sector has been moderate.

## **INFORMATION TECHNOLOGY INDUSTRY: KEY MARKET TRENDS AND CHALLENGES**

- Georgia has a good supply of highly skilled IT specialists and high literacy rates. The first internet provider in Georgia was established in 1991.
- Georgia is considered a moderately computer literate country with a good supply of professional, cheap labor and a reasonable variety of companies involved in the information technology sector in software design, hardware value added service providers, and 3 internet service providers. There is a proliferation of internet cafes. The telecommunications company is state-owned, and metered telephone rates make internet access expensive for most households and businesses.
- The IT industry in Georgia has the following segments: software market (annual turnover of US\$1 million), personal computers assembly (US\$6 million), network installation (US\$2 million) and hardware distribution (over US\$16 million).
- The majority of IT companies are in the retail trade, including the software producing companies. The distribution channels for imported computers are not well developed.

- The main customers of the IT market in Georgia are international donor organizations, big private businesses, banks, and SMEs. The first three categories account for 80% of the purchases.
- Currently, only a handful of international manufacturing companies have opened representative offices in Georgia related to mining and minerals. Registration requirements are relatively simple, but payoffs are expected to government officials to set up foreign operations.
- Several success stories exist of local IT companies successfully operating on the Georgian market. They offer new software design, hardware products, and implementation of advance information and communication technologies. These companies are actively seeking avenues for international cooperation in the region and around the world. Based on their experience, these companies believe that the following sectors are in great demand in Georgia: electronic data exchange and internet security, electronic payment systems, internet enterprise development, ICT consulting, training and certification.

IT industry is affecting the development of the local business consulting services. Several companies are using the internet to provide business information to entrepreneurs, such as information on domestic and international trade and markets, and to help them conduct electronic business transactions.