



Making Markets Work for the Poor Case Studies Series

Improving the environment for small businesses in Indonesia and Russia: Experiences from Swisscontact

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November 2006

This case study was prepared on behalf of the Fauno Consortium (Skat, Springfield Centre, Swisscontact, Facet, Inbas), which is a mandate of the Employment and Income Division of the Swiss Agency for Development and Cooperation (SDC).

This case is one of a series exploring the application of the Making Markets Work for the Poor approach to different areas of private sector development. This document represents the views of the author and does not imply the expression of any opinion whatsoever of the SDC, Employment and Income Division.

Summary

Improving the environment for business is a priority for governments and development agencies across the globe. A hostile business environment weighs particularly heavily on small and informal enterprises, which comprise the bulk of the business population in most developing economies.

This case examines Swisscontact's experience in stimulating a more conducive environment for small businesses in Indonesia and Russia. Learning from experience, Swisscontact has sought a departure from conventional approaches to business environment reform; in doing so, it has intervened in a "systemic" way, consistent with the making markets work for the poor (M4P) approach. The experience can be seen as distinctive in terms of Swisscontact's rationale for intervention, its approach to understanding and intervention and the sustainability of its impacts.

Understanding the business environment as a system

Guided by a systemic view of the business environment, a number of constraints to making business environment reform work for small and informal businesses were identified. These can be categorised as: the absence of mechanisms for dialogue; weak public and private sector capacity; and a lack of supporting functions such as research, information and communication. The case demonstrates that in a dynamic business environment, knowledge acquisition is an ongoing, iterative process, making local support and capacity for diagnosis and response vital if reform is to be sustained.

Interventions guided by an ethos of sustainability

Swisscontact conducted an array of interventions shaped by its understanding of the local systems in which it was intervening. Key interventions included: business environment assessments with stakeholders; strengthening of private sector representation organisations; specific capacity building for government; involving other specialised stakeholders such as the media and universities in reform processes; and support for new mechanisms for public-private dialogue. In contrast with many conventional approaches, Swisscontact's approach:

- Was guided by an ethos of sustainability: that capacity and commitment for reform should reside within the local system after Swisscontact had withdrawn.
- Emphasised process, intervening *with* stakeholders to encourage ownership.
- Concentrated on strengthening functions and rules that support the system for environment reform, rather than trying to deliver specific reforms directly.
- Built on a reputation of independence and credibility as a result of an established presence on the ground, through a variety of other areas of private sector development intervention.

Impact

Several encouraging dimensions of change have been observed: perceptions and interaction between local stakeholders have become more constructive; commitment and practices of local stakeholders have been sustainably enhanced; and positive impact on public services and their users has occurred.

Whilst the scale of Swisscontact's interventions has been relatively modest, its experience in applying the M4P approach to business environment reform offers valuable insights into how agencies can encourage sustainable and appropriate reform processes which respond to and are driven by local ownership and, in particular, the needs of small and informal businesses. It is from the "how to" dimensions of this experience that other agencies can learn and adapt.

1. Introduction

1.1. Context

The International Donor Conference "*Reforming the Business Environment*" in Cairo in 2005 emphasised that reform of the business environment is an important area of the international development agenda, as an essential dimension of private sector development and the promotion of pro-poor growth. In reviewing recent international experience of efforts to improve the business environment, a number of challenges have been identified:¹

- Whilst conventional enabling environment interventions have tended to target policy, legal and regulatory reform, usually at the macro level, there is no common understanding of what constitutes an enabling business environment.
- In general, agency efforts have focused on delivering reform rather than strengthening local institutions that can conduct reform processes on an on-going basis. This has been compounded by a narrow focus solely on government rather than on the wider spectrum of supporting actors who influence the business environment and reform processes (media, business representative groups, legislators). Consequently, local ownership has been neglected with the result that reform processes have often proved unsustainable. There is increasing recognition of the need to build local ability to conduct reform and to rethink the role of development agencies in doing this.
- Enabling environment interventions have been criticised for their generic focus on private sector development and their failure to understand why the business environment is not conducive for the poor or particular disadvantaged groups.
- Some agencies have found it difficult to move from analysis to intervention. Information collection has tended to describe the symptoms of an adverse business environment rather its underlying causes.
- Many interventions have (unsuccessfully) attempted to import or replicate models and mechanisms which inappropriate for prevailing local conditions.

The main lesson from this experience is that the success and sustainability of reforms can only be ensured if they are woven into specific cultural, social and economic contexts. Business environment reforms work best when they are designed on the basis of a sound understanding of specific national and sub-national contexts and build on the ownership and involvement of local stakeholders.

1.2. About this case study

This case study was prepared on behalf of the Fauno Consortium, which is a mandate of the Employment and Income Division of the Swiss Agency for Development and Cooperation (SDC). This case is one of a series exploring the application of the M4P approach to different fields of private sector development. A consideration of business environment issues features prominently in M4P approaches, where an understanding of how the "rules of the game" influence whether markets are pro-poor or not is the starting point for intervention.

This case study draws on a range of small-scale or pilot activities to improve the business environment by Swisscontact in Indonesia and Russia. The purpose of the case is to provide insights into how M4P-oriented approaches to business environment interventions can help address some of the challenges cited above (in particular those of ownership and sustainability).

¹ White, S & Chacaltana J (2002) "*Enabling small enterprise development through a better business environment*"; Committee of Donor Agencies for Small Enterprise Development. White, S & Fortune, P (2004) "*Review of DFID activities in the enabling environment*"; DFID.

Many of Swisscontact's interventions reviewed here (see Table 1) pre-date the emergence of formal M4P thinking and practice and were therefore not designed explicitly as M4P programmes. Moreover, interventions have been evolutionary, reflecting learning in the real world. However the result of this evolution is an approach to intervention which is consistent with many elements of what would now be regarded as an M4P approach.

Table 1: Project information

	Indonesia	Russia
Project name	Small and Medium Enterprise Promotion Programme	SME project
Location	Different locations in Java, Indonesia	Nizhny Novgorod, Russia
Implementing agency	Swisscontact	Swisscontact
Funding agency	Swisscontact / SDC	SDC
Timescale	1999 – ongoing	May 2002 – April 2006
Funds	Average CHF 0.25m/year for EE interventions	CHF 3m (across whole project)

2 Rationale

2.1. General picture

Indonesia and Russia have little in common other than their size and diversity (see Table 2), but they are similar in the sense that they are not favourable places to do business, ranking 115th and 79th respectively (out of 155 countries) in the World Bank's "*Doing Business*" assessment in 2005/06. A tradition of autocracy and state paternalism in both countries means that transparency and dialogue between government and citizens has been limited; effective governance has been constrained by pervasive institutional weaknesses; and official attitudes towards private enterprise historically have been negative or neglectful. The recent pasts of both countries are characterised by high degrees of centralisation, pronounced power imbalances and domination by elites, widespread corruption and a heavy burden of state-inspired transactions costs for businesses of all sizes. Such adverse business environments have been inhibitive to private sector development and acted as a brake on economic growth.

Table 2: Indonesia and Russia: basic facts and figures

	Indonesia	Russia
Population	230m	143m
GDP growth rate	5.5%	6.4%
GDP/ capita	US\$ 800	US\$ 9,800
Provinces	32	7
Districts/ Oblasts	450	88
Surface area	2m km ²	17m km ²
Population density	111 inhabitants/ km ²	8.4 inhabitants/ km ²

Recently this situation has begun to improve. Decentralisation (perhaps in Indonesia more than in Russia) and increasing pressure on national and local governments have fostered greater recognition and willingness to improve the business environment. This has been accompanied by recognition of the need for a shift in government's role. Nevertheless, government and other stakeholders remain challenged to actually deliver on this new level of commitment, for a variety of reasons:

- Macro level reform (or commitment to reform) has often not been complemented by sufficient micro level reform and / or consideration of capacities to respond to reform efforts.
- Frequently coherence between national and local levels of government policy, regulation and intervention has been limited.
- A lack of common understanding and attitudes between key stakeholders has resulted in conflict rather than collaboration or compliance.
- The capacity and practices of key stakeholders to initiate, implement or respond to reforms are inappropriate.
- Mechanisms for stakeholder organisation and dialogue are absent or underdeveloped, undermining constructive engagement and representation.

Development agencies have recognised that they can play a role in overcoming these challenges by introducing new practices or mechanisms that shift reform from an aspiration on paper to reality on the ground. That said, the experience has been that many interventions have tended to focus on “quick fixes” in terms of regulatory change or the introduction of standard measures (e.g. Regulatory Impact Assessment or One Stop Shops) based on Western experience. Often these have not gained the commitment of local stakeholders or been appropriate for local context and frequently proved to be of limited effect or unsustainable beyond the period of aid-funded support. (See Annex II.)

2.2. A pro-poor rationale for enabling environment reform

Swisscontact’s engagement in enabling environment in Indonesia and Russia has been defined by this general context, but the rationale for its interventions rests on a consideration of how the prevailing business environment adversely affects small businesses and poor households specifically.

The failure of high-level reforms to translate into positive change at the local level, particularly affects small businesses and the poor, who typically engage with formal public bodies at the local level. Furthermore, efforts to reform the business environment have tended to be generic (e.g. simplifying business registration procedures), whereas many of the business environment constraints that affect the poor most severely have strong locational or sectoral dimensions. For example, in the case of informal businesses, where the dividing line between the business and the household is often indistinct, business regulations may be of less of a concern than regulations governing the provision of basic local services such as sanitation, electricity or infrastructure facilities.

The costs of an adverse business environment fall disproportionately heavily on SME as a proportion of their turnover or income and barriers to formalisation restrict small businesses’ access to a variety of services upon which they rely and which larger, formal business can avail with ease. Moreover, small and informal businesses lack the organisation and resources to mitigate these predations privately or the representation to seek public redress or engage in reform processes to further their interests.

Recently initiated processes of decentralisation generated an opportunity for Swisscontact, already present on the ground, to address some of these constraints. New and rejuvenated local administrations felt more accountable to local people and appeared willing to depart from conventional ways of doing things. An appetite for reform existed, permitting Swisscontact to stimulate a variety of solutions in numerous locations over time, appropriate for local contexts and driven by local stakeholders.

3 Understanding specific market system constraints

3.1. Business environment as a system

Swisscontact has long history in small enterprise development, originally focusing on skills development and business and financial services. As a result of this involvement on the ground, at the local and enterprise level, Swisscontact recognised that it also needed to focus on the wider business environment, as this was the source of many of the constraints enterprises faced. In both Indonesia and Russia, Swisscontact has – in different ways – come to recognise the importance of looking at and understanding the business environment as a “system”, rather than simply pursuing a specific reform measure.² The two experiences are different. In Indonesia, a systemic view emerged over a period of time, based on Swisscontact’s experience. In Russia, Swisscontact’s picture of the system was arguably more complete from the outset.

Figure 1: The enabling environment as a system

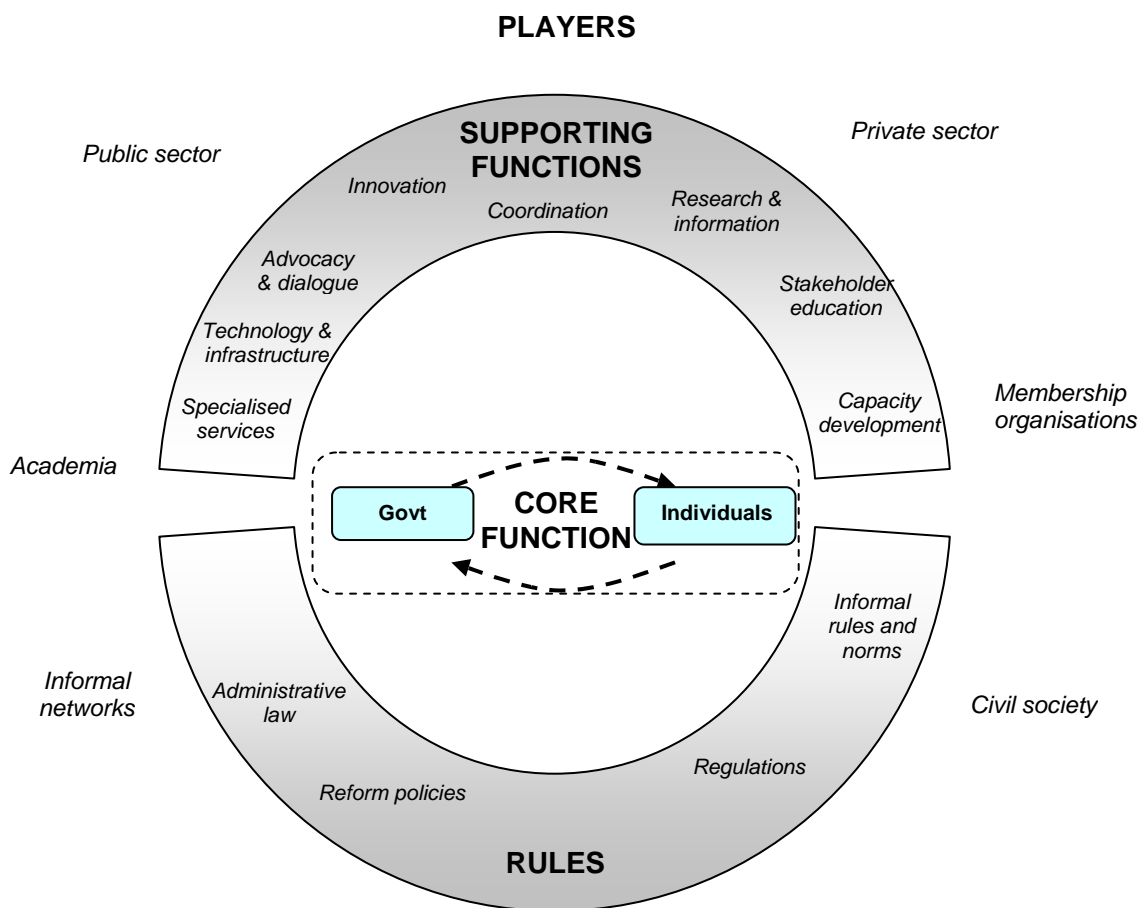


Figure 1 is a conceptual representation of this systemic view. Typically business environment reform focuses on a particular function – a public service or regulation – deemed to be unsatisfactory. This core function in essence involves a transaction or interface between government (the regulator or provider of a public service) and the business or individual (the regulated or recipient/user or a public service).

² Swisscontact Enabling Environment Strategy (2005).

At the heart of Swisscontact's experiences lies the recognition that effective, sustainable reform involves more than changing this core function; it means considering the wider system for reform. This system comprises different **players** with different interests and incentives; it is governed by formal and informal institutions or **rules** such as regulations or culture; and requires **supporting functions** such as information, coordination or advocacy that facilitate interaction between different players, create awareness about specific regulations or aid compliance with a regulation.

The business environment can only be genuinely improved if change is pursued from within the system. Moreover, reform of the enabling environment is not an isolated event: players should be able to repeat change processes in the context of a dynamic business world. For this, players within the system need appropriate capacity to engage in reform (see Box 1). This starting point is different from many enabling environment efforts, which tend to be narrower in their definition.

Box 1: Information and analysis as part of the system

The business environment is dynamic; players within the system change or adapt their behaviour according to this dynamism. Therefore, analysis of the business environment is ongoing, not just a task conducted at the start of an intervention. Swisscontact also recognised that information is an integral part of the system and that it was crucial to think carefully about how information collection, analysis and provision continue in the long term. This means working through appropriate local players to ensure sustainability. Swisscontact has endeavoured to ensure that the local stakeholders have the necessary capacity to continue analysing and improving their environment once Swisscontact's interventions end. This recognition has led Swisscontact to engage with other stakeholders who were important sources or users of information in the business environment, such as media, parliament, consultants and universities.

Consequently, many of Swisscontact's interventions with local partners were explicitly about enhancing their capacity to collect and distribute information or conduct analysis about the business environment. Development of Swisscontact's understanding thus goes hand-in-hand with local partners. For example, interventions to develop ombudsmen or complaint centres have generated information about local environment constraints, which have further informed Swisscontact's interventions as well as the actions of local actors. Surveys conducted together with business membership organisations have not only been a source of information for Swisscontact, but raised awareness within such groups and ensured that better information was at their disposal for more informed dialogue with other stakeholders.

This approach to information contrasts with many enabling environment interventions, which tend to see information and analysis as the role of the project. For example, White suggests that enabling environment interventions need to "*offer sound analysis*". While it is certainly the case that projects need to have information to be credible and effective, Swisscontact's experience suggests that project's key role is to assist appropriate partners develop capacity to conduct such analysis themselves and stimulate other stakeholders to "demand" such information. For example, in the so-called "bulldozer approach"³ a project would conduct analysis and stimulate the reform process itself. If local players (e.g. BMO) are weak, their role would be further marginalised rather than strengthened by such an approach. A more systemic approach would ensure that BMO or similar players become "drivers", capable of conducting or commissioning such analysis themselves.

3.2. General approach: identifying why systems do not work for the poor

Swisscontact's approach to understanding the business environment has been defined by a number of features: (a) a focus on the wider system for business environment reform; (b) the centrality of information (discussed above); and, most importantly, (c) identifying why systems do not work for the poor specifically.

The analytical tools that Swisscontact has applied in assessing the constraints to a more pro-poor business environment have mainly been participatory, building on local knowledge and involvement. As discussed in Box 1, by working through relevant local stakeholders as far as possible, local ownership is ensured. In this respect clear and tangible contributions are vital for all

³ A term coined by some agencies to describe an approach to business environment reform which is more active and direct, with the intention of creating a high profile impetus for reform.

parties: Swisscontact has contributed its staff time and expertise; local stakeholders contribute their time, information, knowledge, networks and infrastructure; financial requirements – typically modest – have been matching wherever possible. Most importantly, even at this analysis stage, it is important that the implementing agency has a clear exit strategy, explicitly signalled and constantly reviewed. This requires an iterative process, with regular feedback loops. Typical tools used include:

- Conventional studies and analysis (both primary and secondary).⁴
- Adapted consumer research techniques such as surveys and focus group discussions.
- Participatory techniques for stakeholder engagement (as used commonly used in LED projects e.g. “Triple A”, see Box 3 on page 14).
- Pilot activities and action research.

In focusing on where the poor are in the business environment and how it affects them, Swisscontact has found that its analysis has to go beyond the conventional business environment focus on formal macro policy, legal and regulatory constraints. Applying participatory tools that put the poor at the centre of analysis can lead to surprising conclusions. For example, complaint centres that were established in Indonesia report that 41% of all complaints received in 2005 related to basic services: water, waste collection, maintenance of public spaces, public market infrastructure and basic legal documents, like land or birth certificates. On a day-to-day basis these issues often matter more to micro and informal entrepreneurs than formal or sophisticated matters like licence- or finance-related issues (32% and 21% of complaints respectively). Focusing on such issues helps ensure that business environment reform is more pro-poor.⁵

3.3. Constraints identified

The range of business constraints identified by Swisscontact, given the timescale and range of contexts in which it has operated, is too extensive to discuss in this case study. In a dynamic business environment constraints to enterprise will always exist and will continually change: this is a fact of life. Therefore, Swisscontact’s response has not been to simply identify particular constraints of the day and deal with these, but to understand, on a more fundamental level, why those constraints have not been dealt with expeditiously by local players.

In this regard, its research has identified a range of private sector, public sector and dialogue-related constraints, which were broadly common between Indonesia and Russia.

(a) Private sector constraints

The ability of a nascent private sector, characterised by high proportions of small or informal firms, to engage in reform processes on a representative basis is limited in both Indonesia and Russia. Much of the private sector lacked the recognition, organisation and information to be taken seriously and make their case in a constructive manner towards local government authorities. Specific constraints included:

- Organisation of businesses into representative groups was limited.⁶
- Weak advocacy capacity of existing groups: engagement and dialogue were typically unsophisticated – that is to say, ill-informed and unconstructive.

⁴ For example in Russia this included sociological studies covering: BMO as parties to dialogue; public authorities as parties to dialogue; self-regulating organisations of entrepreneurs; overcoming administrative barriers through interaction between public authorities and businesses.

⁵ This depends on the characteristics of target populations. In Indonesia the target population was more small-scale, informal and arguably poorer than in Russia where the challenges faced by the target population were more “conventional” business regulation hurdles.

⁶ In Indonesia one of the key constraints identified was a legacy of the centralised, top-down approach of the Suharto era: a lack of independent organisations which could function as the local voice of the private sector in discussions with local governments newly established under the decentralisation process.

- Limited availability of local information and limited research capacity with regard to the business environment, inhibiting informed dialogue with other stakeholders.
- A general lack of awareness and understanding about the structures and regulatory regimes involved in specific areas of reform.
- Significant perception gaps with other stakeholders about the business environment, resulting in contradictory or hostile positions or attitudes.

(b) Public sector constraints

These private sector constraints notwithstanding, government culture, capacity and practices were not geared to engage with and be responsive to the private sector. Where business organisations were mobilised and active, their representations were frequently not received or responded to effectively by government. Specific constraints included:

- Government practices in terms of information gathering, regulatory consultation and review and coordination were rudimentary. For example regulations were frequently found to have been drafted without participation of affected parties, nor were the potential negative impacts of a regulation assessed. This situation had been exacerbated by decentralisation, as legislative power was delegated to local governments without sufficient preparation for their new roles and responsibilities.
- Limited availability of local information and limited research capacity within government with regard to business environment and limited contact with potential sources of such information.
- Multiplicity of players and reporting structures undermining coordination and coherence.⁷ Government rarely discussed its strategies for economic development with other stakeholders. Different parts of government have their own plans, often not communicated to others, whilst the private sector and civil society also had their own initiatives about which government is not informed.
- A general lack of awareness and understanding about the structures and regulatory regimes involved in specific areas of reform.
- Lack of organised routes into government to specifically tackle business environment issues.
- Significant perception gaps with other stakeholders about the business environment, resulting in contradictory or hostile positions or attitudes.

(c) Constraints to public-private dialogue

Given the history of autocratic government in both countries mechanisms for dialogue were either absent or ineffective. Specific constraints include:

- Government agencies (and some parts of the business community) preferred to pursue dialogue with individuals rather than representatives of groups.
- In some instances, competing channels for dialogue existed, diluting the effectiveness of any single channel.
- Where dialogue had taken place, it was rarely followed up, with initiatives fizzling out and few concrete changes resulting.⁸
- Administrative barriers adversely affected the establishment of constructive public-private dialogue and less formal alternatives were not well recognised (e.g. delegation of certain tasks to self-regulating bodies⁹).

⁷ For example in Nizhny Novgorod it was estimated that there were more than thirty organisations employing in excess of 600 people directly on business issues on regional level.

⁸ "We take part in all the meetings with the authorities on all levels. If there is any important activity or event organized in the region on SME support topics or if foreign investors come to the region, then we are also invited. However, there are no practical results out of all that, simply nothing." (Guild of Bakers and Confectioners; Nizhny Novgorod).

In addition to the above constraints, other stakeholders who were potentially important in the business environment, among them media, parliament and other supporting functions and actors (such as consultants, universities and IT consultants) were found not to be particularly well-informed or active and were often neglected in reform efforts.

What emerged from both Swisscontact Indonesia and Russia's efforts to understand the system was that there was: a lack of basic *understanding* of the regulatory challenge (which actor is responsible for what in the system? What are specific causes of adverse impacts on businesses?); a lack of basic capacity within government to define and deliver its role vis-à-vis businesses; a lack of *routes* into government for providing businesses' perspectives; and weak business organisation and representation. Consequently Swisscontact concluded that multi-faceted interventions adapted to specific contexts were required to address these inter-related constraints.

3.4. Benefits of taking a systemic view of the business environment

It has been Swisscontact's experience that there are clear benefits to developing this wider understanding of the business environment:

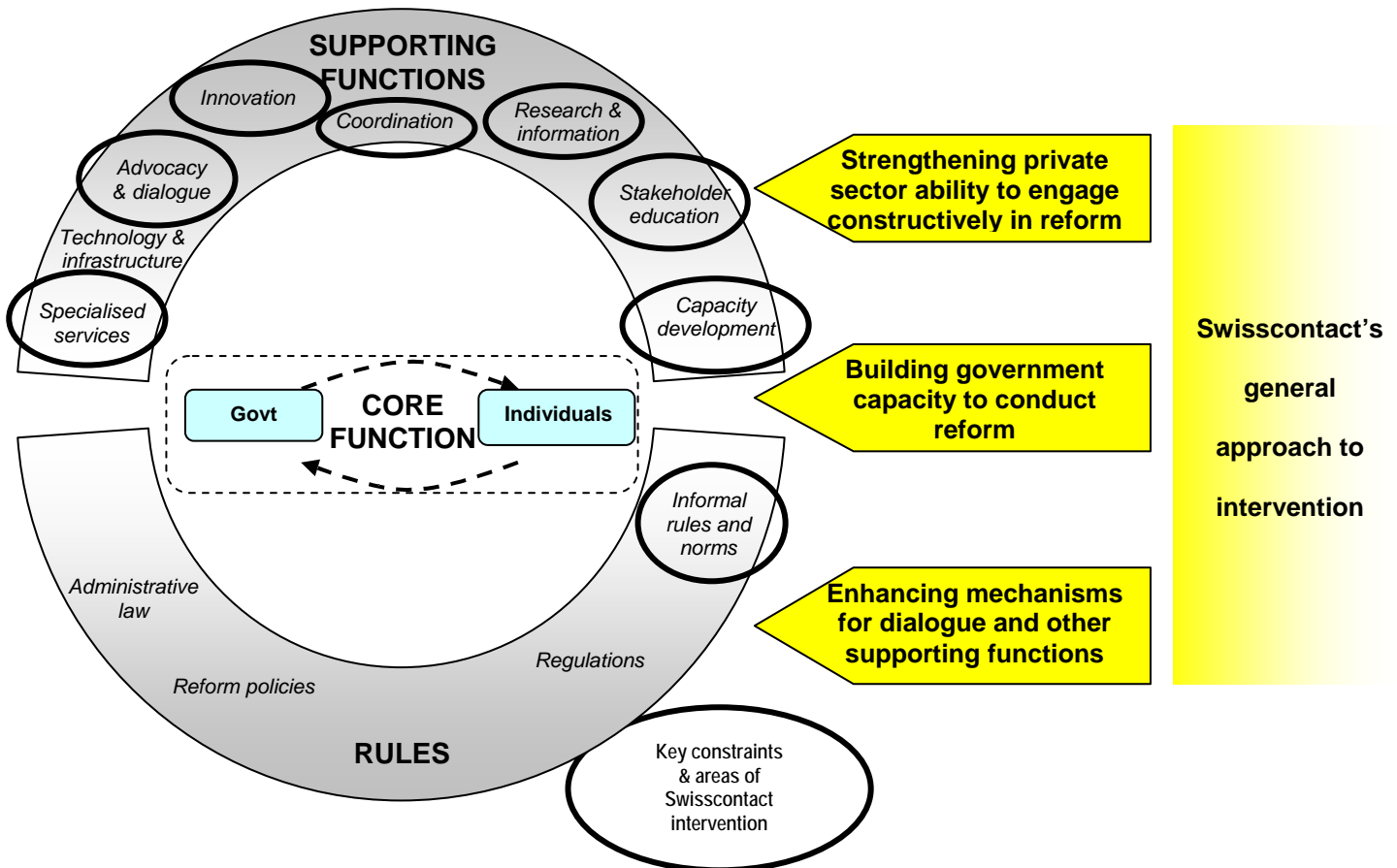
- A systemic understanding helps to give a more realistic view of sources of problems and potential solutions and more options in terms of interventions in a specific context.
- In particular, understanding the balance of incentives (the "political economy" of the business environment) and specific institutional mechanisms is vital, if local ownership and therefore sustainability is to be achieved.
- This approach avoids working with a singular perspective and with a single partner, reducing the risk of imbalance and bias.

⁹ In certain conditions, delegation by government of control, coordination, supervision and licensing functions can circumvent such formal administrative obstacles. Such self-regulating mechanisms eg a non-profit business membership organisation, can develop rules of conduct, establish penalties for the breach of rules and means of conflict resolution and maintain dialogue with other controlling and supervisory organisations, with the approval and oversight, but not direct control, of government.

4 Interventions to strengthen the system

From Swisscontact’s “systems” perspective of the business environment a number of key areas of intervention emerged, in terms of business environment functions and players. In all these areas, Swisscontact adhered to some general principles of intervention (see Figure 2).

Figure 2: Key areas of intervention in the business environment system



4.1. General intervention approach

Swisscontact’s interventions have been guided by two primary and inter-related considerations, which emerge from experience in the business environment field and other fields, such as business services.

First, a good understanding of the system shapes intervention. The information and knowledge of the system and its political economy has a practical utility: not just to identify areas of intervention, but to influence and alter perceptions, create awareness and strengthen appropriate incentives.

Second, explicit and realistic objectives for sustainability are essential from the outset. This meant being clear about “where” Swisscontact is intervening in relation to the system, “who” it is engaging with and “how” it is conducting intervention, in terms of the kind of relationships it has with partners, how much support it provides and the type of support provided. These factors are derived from Swisscontact’s objectives to stimulate local actors, wherever possible, to shape and take ownership of reform (i.e. “crowd in”), rather than “crowding out” local actors by excessively direct or intensive project interventions.

However, Swisscontact also recognised that different reform mechanisms prevail in different places. The specifics of interventions therefore depend on analysis of the specific system in question, meaning that a “blueprint” intervention approach is not realistic. But the general principles of intervention have been similar in all cases:

- Understand the alignment, incentives and capacities of key players in the system.
- Identify opportunities to strengthen more appropriate capacity and ownership of the reform process once Swisscontact has exited.
- Intervene as sensitively as possible – by “right-sizing” support, working through others where possible and by being a catalyst rather than a direct actor or financier – to stimulate appropriate solutions which are locally owned and driven.

4.2. Interventions

Swisscontact has undertaken myriad interventions over a period of years in several areas, which are impossible to document in a short case study. In the following section, a flavour of the main areas and experiences are described (presented thematically, not chronologically). Interventions have generally focused at the local level (although often requiring a good understanding and networks at the national level): this is where Swisscontact’s assessments indicated important constraints were located, this is where conditions presented the best opportunities for intervention (e.g. as a result of decentralisation) and this is where Swisscontact – as a small agency – had the strongest offer.¹⁰

(a) Strengthening private sector ability to engage constructively in reform

Assessments clearly showed that small businesses lacked the recognition, organisation and information to be taken seriously and make their case in a constructive manner towards local government authorities. One key area of intervention in both countries therefore has been to support the formation of BMO or strengthen existing BMO, with the objective of demonstrating their value as effective advocates for change, a reliable partner for regional and local government and a representative platform for its members.

Swisscontact supported capacity building of BMO leaders and key staff in BMO management, methods of political dialogue as well as providing examples of BMO success stories to illustrate how BMO can deliver on regulatory issues for their members. Support also focused on involving BMO in information gathering and research activities, communication campaigns aimed at creating a positive image and reputation for BMO among members, public officials and the local community. Swisscontact support typically has taken the form of technical assistance, linking BMO to other sources of technical support and some financial assistance. A key principle of support was that significant matching funds or other in-kind contribution was required from BMO to ensure both their commitment and a level of “hard-headed” realism about solutions.

¹⁰ It is important to acknowledge that Swisscontact’s established presence in a country and its track record were essential preconditions in its ability to intervene in systems characterised by conflicting interests to address sensitive issues such as rent-seeking.

Box 2: Building effective business membership organisations in Indonesia

In Indonesia Swisscontact strengthened informal groups of 30-150 enterprises, known as FORDA (local SME forums), a total of 72 in 21 provinces. A key feature of the approach was to work with FORDA on preparing and conducting a 10-city survey that helped to raise awareness within the FORDA and to ensure that better information was at the disposal of FORDA for more informed dialogue with other stakeholders (as well as a source of information for Swisscontact).

As a specific tool for analysing the local business constraints and for strengthening the voice of the FORDA, an *SME Environment Rating System* was jointly developed (with indicators for bureaucracy, access to credit and services, access to input and output markets, and infrastructure) and implemented in 10 different cities (based on samples of 25-30 entrepreneurs per city). The main objective of the rating was not to achieve a scientific analysis of the business environment, but to develop jointly with the SME groups a tool which provided them with more representative picture on the business environment than just individual judgments and opinions. In addition, the ranking allowed comparison between different cities and therefore stimulated the sense of curiosity or competition between local governments.

The result of making this information available to the public has been higher levels of recognition of FORDA, which have become accepted as discussion partners by various stakeholders and has considerably increased the awareness on business enabling environment issues among governments.¹¹ Further self-help groups have emerged and the survey instrument has become widely accepted by BMO and government and is now implemented every two years in more than 200 districts.

(b) Building capacity of government to conduct reform

Assessments show that the roots of constraints in the business environment relate in part to inadequate government capacity, inter alia; insufficient regulatory and planning capacity, limited coherence and coordination across government and an absence of tradition or mechanisms for engaging with and responding to stakeholders. Consequently, Swisscontact interventions with the public sector have included; building governments regulatory capacity (using regulatory impact assessment techniques); introducing participatory strategic planning processes; and building multi-stakeholder teams in government.

Swisscontact has introduced *Regulatory Impact Assessment (RIA)* as a tool for analysis of impact of regulation on businesses and households to raise the awareness of local governments about the potentially negative impact of regulations, to increase the capacity of local governments to produce “good regulations” as well as to stimulate public-private dialogue for improving the environment for businesses. As a result of assessment, specific regulations that need to be reformed are identified and jointly selected by government and other stakeholders and specific changes are proposed to the legislature.

Importantly RIA was not regarded as a static tool, but part of a continuous process of reviewing new and existing regulations and the impact of any changes made. Emphasis was therefore to have RIA-like methodologies embedded and institutionalised within the system of local governments. Swisscontact adapted RIA to be appropriate and affordable for the resources of governments in low-income countries (“right-sized”) – something that has not always been the case when RIA has been used in conventional interventions. Swisscontact developed the capacity of relevant parts of local government for RIA, promoted links between government and local technical specialists and raised awareness of regulatory good practices amongst influential stakeholders (such as media and legislators) to ensure that pressure for the use of RIA continues to be applied after Swisscontact has withdrawn.

¹¹ A simple anecdote may underline this: In the location with the overall worst ranking, the SME groups presented the results to the head of the local government. His first reaction was that he was convinced that the results were manipulated. He contracted a local research organisation to conduct a similar survey, which generated similar results to the 10-city survey. As a result, the FORDA in this city was invited to start a policy dialogue with government, which has resulted in concrete improvements.

Strengthening participatory strategic planning capacity: Whilst an ability to address specific regulatory constraints is undoubtedly important, the risk is that actions are piecemeal unless guided by overarching strategy for the economic development of a geographical or political area or economic sector. Assessments indicated that such strategies were often highly fragmented and lacked inputs from important stakeholders, resulting in conflict and incoherence. In order to support local communities in developing joint development strategies, Swisscontact has introduced Triple A as a strategic planning tool. An emphasis of this process has been: to draw on existing information resources and plans, rather than support expensive new commissions which are beyond the resources of local government; to identify a key local driver of the process; and to secure significant contribution of local resources. Swisscontact support has principally been for initiation and coordination in the early stages of the process.

Box 3: Triple A as a strategic planning tool (Indonesia)

Atlas: A mapping of the local area's assets in terms of infrastructure, education, health, economic indicators etc is conducted by the public and the private sector. The atlas utilises data which is already locally available but typically not brought together in an accessible manner.

Agenda: An overview of existing investment and developments plans, which is jointly put together in a common and accessible format, laying the ground for common development strategies and more coordinated actions.

Aturan Main (Rules of the Game): This is a description of responsibilities as well as how decisions are taken, disputes resolved and collaboration between government and other stakeholders conducted.

Building multi-stakeholder teams: In the response to mistrust, misunderstanding and limited experience of working, for example, across departmental or geographical boundaries, Swisscontact sought to build teams of like-minded people involving public officials from regional and municipal authorities, chief executives of public agencies and (where relevant) non-government stakeholders, with remits in local economic or private sector development. The objective was to build greater familiarity and collaboration on planning, programming and dialogue with the private sector. Swisscontact support involved contests to select team members, training and study tours, team building exercises and the joint design and implementation of pilot initiatives.

(c) Enhancing mechanisms for dialogue and other supporting functions

Evidence showed that decisions by local bureaucracies were taken with little consideration of or input from affected stakeholders. Even when public-private dialogue took place, bureaucracies rarely utilised any inputs: dialogue did not influence decision-making. Unless policy dialogue and feedback was institutionalised within the government administration, it remained coincidental and limited in impact. Swisscontact support therefore focused on the institutionalisation of mechanisms for stakeholder communication and feedback: overcoming the obstacles to initiation of dialogue; improving the practices of interaction between the parties; increasing the efficiency of dialogue; and design and piloting new forms of cooperation between the authorities and the business community.

This involved working in multi-stakeholder teams, involving a wide circle of experts; communication activities (e.g. round table discussions, conferences, forums) and efforts to stimulate local initiatives to improve dialogue. In Indonesia, for example, a tender process was conducted, to identify potential pilot projects for such institutional mechanisms. The guidelines for this tender were:

- Swisscontact would only work through a local agent to assure local ownership.
- Swisscontact would leave the initiative to the local stakeholders in the private sector and government – the only restriction being that ideas must related to mechanisms to improve dialogue on business environment issues.
- Government and the private sector had to be involved from the beginning.
- Government and the private sector needed to commit the majority of resources required.

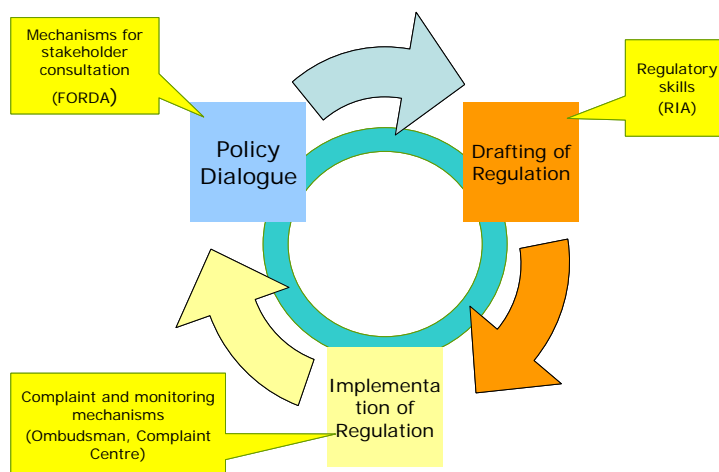
As a result of the tender process, Swisscontact selected two proposals, one from the city of Yogyakarta for introduction of an information and complaint unit within the government, and one from the city of Salatiga for the introduction of an ombudsman for small businesses.

The Information and Complaint Center in Yogyakarta was initiated by the Mayor of Yogyakarta as a management instrument for himself and as feedback mechanism for bringing the city administration closer to private sector and civil society. Through the centre, all citizens can ask for information or file complaints by letter, phone or SMS. The centre is part of the information department of the city of Yogyakarta and managed by its staff. The centre collects and registers the information and complaints and forwards the requests for follow-up to the government department (or other related institutions) as well as to the Mayor for information and monitoring. The departments in charge are obliged to react and to report follow-up. The centre’s operational costs are paid by the government, Swisscontact has provided technical assistance and some financial assistance for the development of the centre’s software.

The idea of the *Ombudsman* was initiated by the FORDA of Salatiga. FORDA Salatiga frequently complained about unresponsiveness of the city administration towards SME concerns. The role of the Ombudsman was defined as mediator between private sector and public agencies. The Department for Cooperatives and SMEs of Salatiga supported the initiative and provided an office and a small budget for the operational cost of the Ombudsman. For the position of the Ombudsman, a highly recognised and experienced teacher from the University of Salatiga was assigned by private sector representatives.

Involving other stakeholders: Across all areas of intervention Swisscontact recognised the need to developing or involve important supporting functions for business environment reform. This has included technical experts, local legislators, the media, researchers and academia. Where possible, any support provided by Swisscontact has been conducted in conjunction with or linked to such players. For example, in Russia Swisscontact supported the establishment of a regular small business column on business environment issues in leading business newspapers, with the objective of improving newspapers ability to cover these issues accurately and constructively. In Indonesia, the Information and Complaint Centre and Ombudsman were complemented by a strong media component. Newspapers and local radios were linked to the Centre and the Ombudsman to encourage routine interaction, for example to air incoming complaints. The Centre’s statistics were published regularly and specific issues were discussed in the media. In Salatiga, the Ombudsman has a regular column in a local newspaper and is a frequent guest in the local radio.

Figure 3: Regulatory cycle for ongoing review of regulations: interventions initiated in Indonesia



4.3. Intervening to promote local ownership and sustainability

A number of important points emerge from Swisscontact's interventions:

- Typical activities performed directly by conventional interventions were recognised by Swisscontact as supporting functions. Therefore, Swisscontact tried to stimulate local provision, ownership and sustainability. For example, capacity building efforts sought to link local sources of know-how, such as universities, consultants or IT providers with targeted parts of government or BMO.
- Interventions were designed that tried to stimulate and build on local initiative (e.g. refining existing government plans or ensuring matching investment). Swisscontact's role was to facilitate processes initiated rather than "getting in there and getting it done".
- Swisscontact's role in any public-private dialogue was temporary. From the beginning of an intervention, this required clear strategies for getting out of the system and encouraging others to get in, to ensure sustainability. The facilitator's task is a delicate one: to push and pull within a system in such a way that distortion is avoided. Sensitivity, patience and experience is needed to assess each situation and to gauge how much "pushing", "pulling" or even "waiting" is warranted.
- Beyond this temporary stimulation, everything else, especially knowledge and information, should come from the local stakeholders. Available information should be shared and verified by the stakeholders and build the basis for a common strategy to improve the environment for the small businesses. Crucial elements for building ownership of such a process are transparency and accountability.

5 Results

The experiences described in this case have been relatively small-scale pilot activities: accordingly impacts have been commensurately small-scale. Moreover, they have not been subject to formal evaluation. However, impact assessment is a wider area of concern in the business environment field, even for larger scale interventions, and is a challenge for all agencies engaging in the enabling environment. As White et al observe: "*The measurement of impact of donor-support reforms on the business environment is a complicated issue. So complicated, in fact, that most donors have not undertaken such impact assessments.*"

It was Swisscontact's intention to demonstrate good examples of more effective advocacy, regulatory practices and public-private dialogue with pilot activities that then can be copied and replicated rather than developing comprehensive enabling environment programmes. As the experiences in Indonesia and Russia show, this goal has been achieved to some extent, with public and private actors "crowding in" and assuming new roles on an independent basis.

Indonesia: strong focus on local ownership

Indications of impact, particularly with regard to local ownership and sustainability, are:

- Continuing interest and commitment of local actors: governments in several other provinces and districts have requested assistance to initiate similar processes. Some of the local governments, which have received support, now provide technical assistance to other governments.
- Institutionalisation: The Complaint and Information Centre, Ombudsman and RIA are fully institutionalised within specific government structures and are integrated in the regular budget.
- Perceptions among stakeholders have changed due to frequent interaction: there is evidence of a more constructive attitude, based on solving problems commonly, rather pointing the finger of blame, as had been the norm in the past.

- Government practices have improved: RIA-style assessment is fully institutionalised and regularly undertaken. Tender procedures for specialised RIA services have been established and implemented in some authorities.
- Sustainability of BMO has been demonstrated: practices and mechanisms continue without project support, e.g. of 72 FORDA established, 50% are operating with no further support.
- Business organisations and their importance in public-private dialogue are recognised by other stakeholders, especially local government authorities and the media.

Russia: clear focus on sustainable business representation and public-private dialogue

The results achieved, especially with regard to business representation and on-going public-private dialogue, include:

- The development of professional BMOs in the Nizhny Novgorod region has occurred; the number of BMOs has increased by approximately 20%; BMO leaders have become skilled in identifying the interests of entrepreneurs and advocating them towards local authorities. For example, the Guild of Bakers and Confectioners demonstrated that it could successfully advocate and within 18 months, more than 60 paying members joined and financial sustainability was achieved.
- Regulatory documents were produced and disseminated, which ensured further development of the collaborative dialogue between authorities and business in the region. For example, the Balakhna¹² Association of Entrepreneurs designed a framework for self-regulating BMO to define the regulations on these BMO and a methodology for their operation. The good practice of Balakhna is being replicated in other districts of the region.
- A BMO network is being formed: BMO in different districts of the region have established coalitions or associations to increase their membership and strengthen their positions with authorities.
- Eight multi-stakeholder teams have been established in eight districts, consisting of active and competent representatives of the regional and municipal authorities and the business community.
- The regional authorities are being reorganised: now, there is an independent Ministry for SME Support, Consumer Market and Services dealing with strategic and tactical issues of SME development in the region. Only two such ministries exist in Russia – in Moscow and in Nizhny Novgorod.
- The dialogue between business and authorities has become open and positive; the importance of BMO in settling disputes with local authorities is becoming recognised; high-level officials (governors, deputy governors, ministers, etc) take part in dialogue with business representatives. The number of stakeholders involved has risen: executive and legislative authorities at regional and municipal levels, SME support infrastructure bodies, BMO, the business elite and media. The quality of interaction between the parties has increased due to their improved capacity and achievement of concrete results. For example, the procedures for selling and leasing land for production or construction purposes has been simplified: the legalisation period was reduced from two years to three months and land now allocated on tender a basis.
- A number of serious publications now regularly cover administrative barriers. The articles are recognised for their independence from any political parties. Entrepreneurs have become more open in expressing their opinion on regulatory obstacles and are not afraid to provide names and facts regarding corruption, as was the case in the past.
- Anti-corruption efforts have been toughened: a number of corruption cases have now begun to be brought to court.

¹² Balakhna is a district in the Nizhny Novgorod region.

Box 4: Voices from Russia

“The situation could be resolved by the clear and understandable rules of the game in taxation, land allocation and other spheres. BMO enable SME to assert their rights at all tiers of the authority.” (Vladimir Seleznyov, the Deputy Minister for SME Support)

“International experience shows that self-regulation in a number of cases is an effective alternative to the government's intervention in economy because it is more flexible towards the interests of the market players. The Guild today is a model of such a BMO. The organisation has the business standards, a code of professional activity aimed at improving the quality and solving the problems of illegal competition between bakers. The Guild has a customer feedback system and the customers benefit from the bakers' voluntary decision to introduce rigid 'self control'”. (Valery Gradoboyev, the chairman of the Nizhny Novgorod Guild of Bakers and Confectioners)

“The results of our joint work... aimed at building a dialogue between authorities and business are ensuring successful development of entrepreneurship in the region. Today we have come to understand the need for a more professional and efficient management of the processes going on in the business environment and market relationships in general. Therefore, a dedicated Ministry for SME Support, Consumer Market and Services has been established within the regional government, whose functions include not only the making of the policy and strategies, but also direct involvement in the coordination of the activities of major market entities.” (Denis Labuza, the Minister for SME Support, Consumer Market and Services, in an interview with a leading business magazine)

Impact on the poor?

Swisscontact's approach, in seeking to improve the business environment for small and informal businesses, has focused on the excluded and disadvantaged. However it has not comprehensively assessed the impact of its interventions and in particular its impact on these groups. Therefore, evidence of impact is anecdotal, but tangible improvements in dimensions of the business environment that are important to the poor have been reported. Inter alia:

- Public service response times have been improved, e.g. for street light repair and garbage removal from front of shop premises.
- The disruptive street demonstrations of the past have reduced as people have now alternative and more constructive means of seeking redress.

The anecdotes of small business owners and local officials in Box 5 illustrate the perceived benefits at business and even household level.

Box 5: Voices from Indonesia

“[The initiative] has made significant contributions in changing the public and local government. Primarily it has changed the performance of government offices. It has opened the government's eyes to empathy for problems faced by SMEs.” (Idham Ibtu, PKPEK)

“There was no water piping and our staff had to carry water to the shop. We received a letter asking us to pay for piping, but when we paid, there was still no water.” With support from the Ombudsman Sukri compose a letter to local government. Two weeks after sending the letter water supply was provided. [Sukri, shop owner, Salatiga]

“I approached the local phone company several times and still was not connected.” Via Ombudsman, she finally got the line connected within two weeks. [Yuniata Farida, house wife, from Salatiga]

6 Lessons and challenges

By applying M4P in support of more systemic thinking and practice in its work, Swisscontact has been able to contribute to business environment reform in a manner that is more practical, sustainable and oriented to the poor than conventional approaches, particularly given the small-scale nature of its interventions. It has been an ongoing learning process for Swisscontact, where staff experience and credibility has grown to the extent needed to successfully interact with local stakeholders. This takes time, but in the long run, Swisscontact believes it is the most effective way to bring about systemic change and a sustainable improvement in the environment for small businesses.

6.1. Lessons

Summarising some of the key findings for Swisscontact in applying the systemic approach to private sector development:

- ***The benefits of thinking systemically.*** Looking at the business environment as a system has a number of benefits: (a) it encourages agencies to consider where the poor are in the business environment and why, specifically, it is not conducive for them; (b) it requires enabling environment interventions to be more integrated with other areas of private sector development such as business services, value chains or LED, mutually reinforcing each other; and (c) it involves multiple focal points (e.g. levels, players, functions) which allows multiple lines of work, so that when one line stalls or proves to be a dead-end agencies can pursue other options.
- ***A sound understanding of the system is crucial.*** Information is central to business environment work. The challenges in enabling environment interventions are identifying appropriate entry points and agents of change and being well-positioned and sufficiently credible to respond – agencies need to understand the system to do this. Information is also part of the business environment, therefore it is important that interventions focus on building awareness and capacity among actors within the system to generate and utilise information themselves.
- ***Focus on sustainability from the beginning of entering a system is essential.*** Local ownership is the route to sustainability. It is important to create win-win situations for all local stakeholders involved: it helps to overcome initial resistance and creates incentives to continue engaging in local processes and mechanisms for reform. Agencies therefore must have a clear understanding of their temporary role and how they will exit, leaving the system working more effectively. Keeping institutionalisation in mind from the beginning is an important precondition to achieve sustainability. Interventions should focus on improving the existing mechanism and structures rather than adding new ones, which tend to remain isolated and wither away after intervention comes to an end. Critical factors are the openness of government, political endorsement and a local “motor” or driver of reform. Furthermore, donors have to acknowledge that reform processes take time: changing perceptions and building commitment does not occur overnight.
- ***How you do things is as important as what you do.*** Improving the business environment (beyond one-off measures) is a process that requires local ownership. The implication of this is that agencies need to be extremely sensitive in terms of the directness of their actions and the type of support they provide within their interventions if distortion and displacement is to be avoided. This means utilising intelligence and influence, rather than large direct injections of funds. For example, by collecting and disseminating information, local actors are brought together and perceptions, mistrust and differences can be overcome: common understanding can be built by including different perspectives of government, businesses and other stakeholders.

- ***There is a distinctive role for small agencies in enabling environment interventions.*** Much enabling environment work is seen as the preserve of larger bi-lateral and multi-lateral agencies and comprehensive, macro-level initiatives. However there is a real need to “make reform work for the poor” on the ground; heightened awareness and understanding of local actors, better capacity and practices and improved and more innovative mechanisms for dialogue and redress. These are areas that small, flexible agencies are often better placed to address than their larger counterparts.
- ***Theory and practice go hand in hand.*** Dynamic and effective enabling environment interventions require mix of academic and pragmatic steps. A mix of skills and orientation, both in terms of staff and external resources, is essential at all stages of intervention.

6.2. Challenges and implications

Swisscontact’s experience demonstrates that enabling environment interventions are complex and present agencies with a series of challenges and implications:

- Interventions are time consuming and require iterative processes if local ownership is to be stimulated: these characteristics are not easily accommodated within standard project constructs. Project design needs to build in greater flexibility and factor in a realistic pace of change at the local level.
- The approach is demanding. Intervening agencies need a mix of capacities: strategic and systemic thinking, analytical ability, technical competence, political astuteness and mediation. Furthermore, there are clear benefits from having established presence in terms of networks and credibility, which is a barrier to entry for many small-scale agencies trying to initiate enabling environment interventions. This requires closer integration of enabling environment activities with other fields of intervention and collaboration between organisations with different sources of expertise.
- In order to implement interventions effectively, constructive and trust-based relationship need to be established with a variety of local players. Constructive cooperation is only possible when it is based on mutually acceptable and agreed principles. This means that projects have to have a clear and distinctive offer, communicate this effectively and remain consistent and credible throughout the course of intervention. Dramatic changes of course undermine trust.
- Measuring impact, particularly in terms of pro-poor change, is a challenge that the development agency community has yet to resolve satisfactorily. This is a challenge that is beyond the resources of small agencies and individual interventions.
- Swisscontact’s experience has essentially been a series of pilot activities which it has lacked the resources or mandate to pursue. The challenge now is how to ensure that these are built upon. This is not about rolling out standard models but somehow replicating the framework and practices for change at the local level, supported by national governments and donors. This requires not just lesson learning, but a strategy of active engagement with governments and development agencies.

ANNEXES

ANNEX I: ABBREVIATIONS

BMO	Business Membership Organisation
FORDA	Area Forum (representative group of SME)
M4P	Making markets work for the poor
RIA	Regulatory Impact Assessment
SDC	Swiss Agency for Development and Cooperation
SME	Small and Medium Enterprise

ANNEX II: COUNTRY BACKGROUNDS

Indonesia

Decades of the Suharto hegemony, coupled with a longer history of state paternalism, stifled all forms of public dialogue, left governance mechanisms weak and resulted in huge power imbalances: between the centre and the regions, government and business and large and small enterprises.

The financial and political crisis of the late 1990s exposed the weakness of this governance structure and caused instability, conflict and recession. However, the crisis also demonstrated the importance of small businesses to Indonesian economy and the poor in particular: during the crisis these businesses proved to be the economy's backbone, due to their relatively simple but robust balance sheets and their orientation towards comparatively stable domestic consumption (in contrast to their peers' high levels of – particularly foreign-currency denominated – indebtedness and non-performing investments and exposure to more volatile markets). This experience positively changed policy-makers' perceptions and their willingness to support small businesses has grown enormously as a result.

In spite of this positive change, the historical legacy of the Suharto era, combined with a rapid process of decentralisation and regional autonomy (as part of the new democratic era), has created a business environment which is hostile, especially for small businesses. Although this problem is widely recognised, government and other stakeholders appear unable to respond effectively. There has been a tendency to roll out standardised models such as "one-stop-services" (OSS) facilities which are inappropriate for local contexts and which do not address the root causes of the business environment problem.

However, decentralisation has also generated an opportunity for agencies like Swisscontact. New and rejuvenated local administrations feel more accountable to local people and appear willing to depart from conventional ways of doing things: an appetite for reform exists which has permitted Swisscontact to stimulate multiple solutions in numerous locations over time.

Russia

Like Indonesia, Russian society is changing. It has undergone a transformation towards a market economy, necessitating a shift in the respective roles of businesses and government. The business sector is trying to respond to challenges of doing business in a new era with new types of customers, markets, technologies, attitudes and expectations. In responding to these challenges, businesses are increasingly affected and frustrated by an institutional environment, which has yet to catch up with their evolving needs. The regulatory system is generally unsupportive of small business and administrative functions are distorted by a culture of suspicion of business, arising from a perception of business's growing ascendancy over government.

In Nizhny Novgorod, a disjointed, anti-competitive and anti-business stance is apparent at different levels of regional government. This stance is caused by government's lack of understanding about its role and its lack of capacity to fulfil an appropriate role. From the business side, there is increasing awareness of the impact of regulatory costs on business, as the effects of government's general hostility towards business on investment decisions, business performance and growth. In spite of this awareness, the business community's capacity to engage with government is weak, as result of a minimal degree of organisation and limited capacity to advocate effectively for change within those business

I would like... to repeat once again – in my opinion, both public authorities and business are equally reluctant in solving many of the problems and travel reluctantly enough their paths toward each other... the Government was given the commission to develop measures improving essentially the conditions, under which enterprises have to operate "at start". It is also obvious that the existing underhand practice of issuing licenses as well as unjustified delays in exhibiting privatized enterprises for sale limit the scope of energy and capital application by the Russian entrepreneurship... The State has to provide business with predictable working conditions, protect against administrative arbitrariness and monopolists pressure.

V. V. Putin., March 24, 2005
Meeting of the Government of the RF with representatives of Russian business community

organisations that do exist. However, government recognises the fact that small businesses are starting to organise themselves and express interest in coming together with regional government to tackle business environment constraints.

At the federal level, there are government directives about the challenges for government and business to work together in partnership to meet outstanding issues (see insert). There is also a positive impact of the Federal Ministry of Small and Medium Enterprises investing in operations in the Nizhny Novgorod Oblast, formally tasking local authorities with an agenda to promote business, particularly small enterprises.

These dynamics – government recognising the importance of small businesses and small businesses beginning to engage with the government – created an opportunity for Swisscontact (already present in the region) to engage with government on business environment reform issues.