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# The Local Business Environment and Local Economic Development: Comparing Approaches

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**Summary**

Recent years have seen an increasing effort in developing and transformation countries to improve the business environment. The focus has mainly been at reducing red tape and improving the regulatory environment. Initially addressing primarily the national level, the focus has started to shift towards regional and local levels since it is here that government agencies directly interact with businesses. In this way, an overlap has emerged between the business environment approach and the local economic development (LED) approach. However, from the LED perspective, a favourable business environment involves a broad set of locational factors which is only partly shaped by government. Another important difference refers to the intervention approach. While BE interventions have a tendency to be top-down and to depend on external consultants, the LED approach emphasises bottom-up processes and a strong involvement of local actors. A consistent effort to reduce red tape and improve the local regulatory environment is an important element of bottom-up LED processes. It is important, though, to understand that an effort to fight red tape has little impact on the competitive advantage of a location. In fact, an argument can be made that efforts to improve the business environment will have a stronger impact in already strong locations, so that it can ultimately widen the gap between growing and lagging locations and thus reinforce spatial disparities.

# 1 Introduction

Over the last decade or so donors and governments in developing and transition countries have been paying growing attention to improving the environment for business as a means of promoting enterprise development and, through it, of growing their economies, increasing employment, improving welfare and reducing poverty.[1] The focus on the business environment (BE) is a response to disappointing experiences with direct support measures to firms, including finance and business development services (BDS), and the finding that the positive effects of direct support measures, where they occur, are undermined if the wider environment is characterised by burdensome regulations, poor service delivery, corruption and a weak entrepreneurial culture. For instance, a couple of years ago research found that registering a business in Canada took two days, involved two procedures and cost next to nothing, while in South Africa it took 30 days, involved seven procedures and cost the equivalent of a third of the annual per capita GDP, and in Bolivia 82 days, 20 procedures and 2.5 times the value of the annual per capita GDP (Djankov et al. 2001). This was a startling finding, in particular in view of the fact that countries like Bolivia had been subjected to "Structural Adjustment Programs" since the 1980s.

Initially, most of the effort to create improved environments for business was focussed on the national level, particularly on national policies, laws, regulations and their administration. However, in the last two years or so, a number of initiatives have been launched that focus on the environment for business at the local level. This follows from the realisation that even if na-

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1 The focus on improving the business environment may be traced through a number of websites, notably, www.businessenvironment.org and www.enterprise-development.org. The former was launched early in 2005 as an 'Inter-Agency Exchange Information' on donor-supported work to improve the business environment for small enterprises and promote "pro-poor growth". It covers overall approaches of small and medium enterprise policies and institutions and provides useful links with most other websites on the business environment. The latter is the official website of the Donor Committee for Enterprise Development (formerly Committee of Donor Agencies for Small Enterprise Development), established in 1976 as a forum to share experiences and provide common guidelines for enterprise development work in developing countries. Since the formation, in 2001, of the 'Enabling Environment' working group, the improvement of the business environment has become a major focus of the Committee. This culminated with the Conference on "Reforming the Business Environment for Small Enterprise Development", in Cairo, in November 2005.

tional reforms are undertaken, this does not automatically mean that business will experience improvement at the local level, since local actors and institutions may be slow to respond to national reforms. Particularly for small businesses, relations with government are most intense and direct at the local level, and decentralisation policies, which have been pursued in numerous countries since the 1990s, have increased the importance of the relationship between government and business at this level.

Improving the local business environment (LBE) has also, in effect, been a focus of local economic development (LED), an area of development practice whose focus is on sub-national territories rather than whole countries. Within LED the concept that most closely approximates that of the LBE is locational quality, a term that covers the attributes of a location that make it attractive for businesses interested in operating there. Locational development represents one focus of a wider field of practice which also includes enterprise development, community development and governance.[2]

LED as a field of development practice differs from the BE not only in terms of its focus on local factors, but also the degree to which it is grounded in a conceptual framework and has gained experience in the use of methods and tools of implementation. LBE – the application of BE methods at the local level – is a new area of practice in which one finds both similarities and difference with LED. There are some signs that the two practice areas are beginning to converge.

The purpose of this paper is to explore these similarities and differences in order to extract insights and lessons that could help strengthen local development promotion. The paper looks first at the meaning of the business environment and then compares it with locational development to see where the boundaries of the two fields lie in relation to each other. This is followed by an examination of the way practitioners go about undertaking reform in the two fields. The final section draws out some issues for consideration when designing and implementing LBE and LED initiatives.

There are two main sources of information on which this paper is based. The information on the LBE initiatives is taken primarily from papers presented to the conference on "Reforming the Business Environment", held in Cairo in December 2005, and from an Internet search on the business environment. The information on LED is based the ongoing observation by

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2 LED is itself a rapidly changing field of practice and conceptual development in which its focus, scope and conceptual foundations are by no means settled. In this paper we will be comparing LBE with what we regard as the most conceptually coherent and practically effective approaches in LED.

mesopartner, an international development consultancy focussing on LED, of the literature on experiences in industrialised, developing and transformation countries.[3] The conceptual framework of LED developed by mesopartner is set out in the Hexagon of LED[4], its implementation methodology in a number of concepts and tools, the most widely known being the Participatory Appraisal of Competitive Advantage (PACA)[5], which by December 2006 had been applied in several hundred localities in more than 30 transition and developing countries.

It should be borne in mind that this set of sources provides only partial insights into the initiatives involved. This means that full justice has not been given to the interpretation of any single initiative. This paper focuses on the approach that is either explicitly set out or implicit in the documents that describe the initiatives discussed here. The aim here is not to provide an exhaustive evaluation of each initiative – something that is beyond our resources at this time. Rather the aim is to use these sources to as an entry point for discussion of conceptual frameworks and implementation methodologies underlying BE and LED, and to assess their implications for practice in local development.

## 2 What is the business environment?

Adopting the definition of Simon White, the term BE, as used here, refers to all those factors external to businesses that either inhibit or favour their development. Aside from this all-encompassing definition, there is no unanimity in the BE literature on what should be included in the term. White has shown that development agencies currently use a number of rival terms to cover the same or similar ground. These include "Business Climate", "Investment Climate" and "Enabling Environment".[6] A related approach is the "Regulatory Impact Assessment".[7] Note that in the donor community the term "Business Climate" is used in a way that is quite different from the

3 www.mesopartner.com

4 Meyer-Stamer (2003).

5 Information on the PACA approach may be found in Meyer-Stamer (2003) " Participatory Appraisal of Competitive Advantage (PACA): Launching Local Economic Development Initiatives", Mesopartner, Duisburg. www.mesopartner.com

6 White (2004).

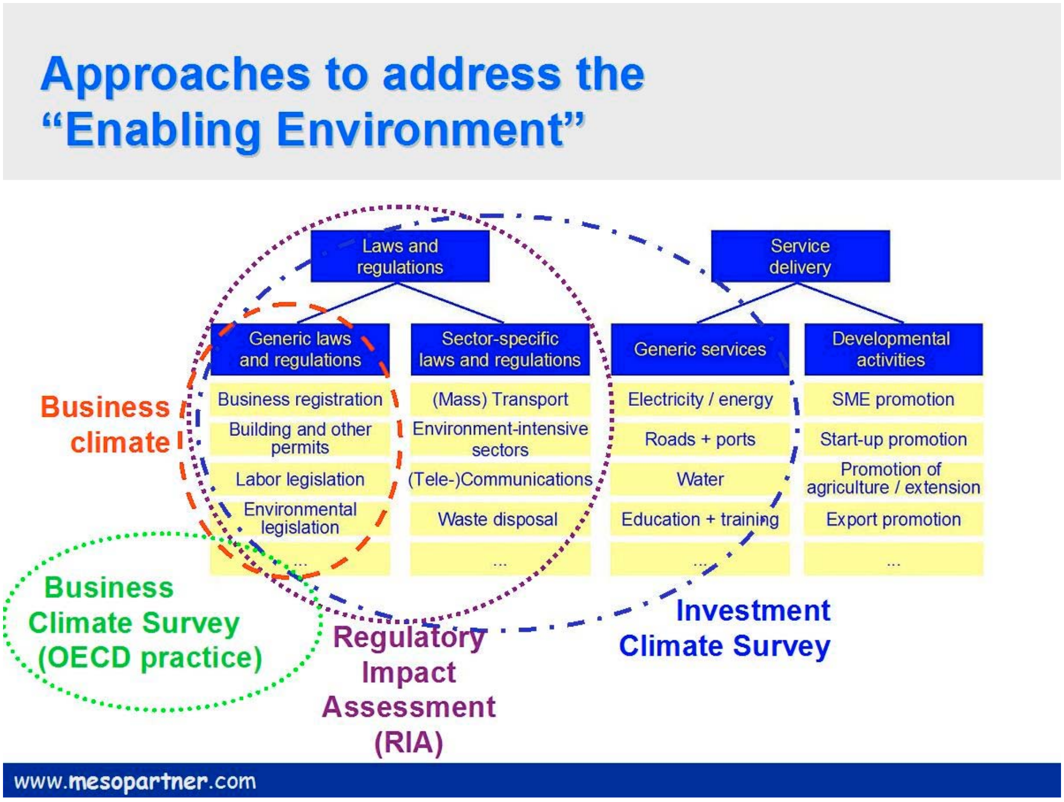
7 Ladegaard (2005)

practice in OECD countries, where the term "business climate" refers primarily to the perception of the business cycle.

In a recent review aimed at creating some order out of this terminological disarray, White identifies a number of key factors that donor agencies include in their definitions. These are governance, policy frameworks, macroeconomic policies and strategies, legal and regulatory frameworks, organisational frameworks, organisational capacity, access to infrastructure, cost of infrastructure, access to finance, cost of finance, social conditions & services, cultural & attitudinal influences and support services.

Taking this further, we suggest distinguishing a number of approaches in terms of the issues they cover, as set out in the following figure.

**Figure 1:**




1. The concept of "business climate", as used by donor agencies, refers to the laws and regulations that directly impact companies. A "Business Climate Survey" (BCS) primarily looks at laws and regulations and the extent to which they do or do not discourage business activities. In a BCS in a developing country, the first question is: "What is the state of government?" In contrast, in a BCS in a European country, the first question is "What is the state of business?"

2. A “Regulatory Impact Assessment” (RIA) comes from a somewhat different background. It was originally introduced in Anglo-Saxon industrialised countries with a long history of regulating private providers in markets that are subject to “natural monopoly”; in contrast, continental European countries until very recently mostly chose to address natural monopoly within state-owned enterprise. In RIA, the term “regulation” was introduced from this background, yet over time acquired a broader meaning. Still, an RIA would take a close look at, for instance, how the electricity market is regulated, something that a BCS would not necessarily do.

3. An Investment Climate Survey (ICS) takes a yet wider perspective and also investigates service provision from government in areas like physical infrastructure.

Note that government service delivery in developmental activities is not addressed by any of the approaches mentioned so far. According to the orthodox view in donor agencies, this is the world of business development services (BDS), i.e. an area where government should not directly deliver services to companies in the first place. Yet, in reality, governments in low income countries put considerable effort into provision of business services, for example in many African countries.

So what then is the “business environment”? BCS, RIA and ICS each give a different answer. The common denominator, though, is their focus on government. They are all based on the assumption that government intervention is the problem, not the solution, and that the most promising approach to creating a favourable business environment is to get government out of the way as far as possible.

## 3 What is locational quality?

The term locational quality refers to the range of factors that make a location attractive or otherwise for business. Among LED practitioners, it is common to draw a distinction between locational factors that are “tangible” and those that are “intangible”. Tangible factors include geographical location, availability and cost of real estate, availability and efficiency of transport and communication infrastructure, availability and cost of skilled workers, cost of energy and environmental compliance, and taxes, levies and subsidies. Intangibles from a business perspective include the efficiency of government, the business climate, the availability of related industries and supportive institutions. From a household’s perspective, intangibles include the quality of housing and the environment, the availability of schools and higher education institutions, health and social institutions, culture and recreation.[8]

Increasingly, from the perspective of LED, locational development has come to mean efforts to enhance the "competitive advantage" of the location, i.e. to create a unique locational profile that cannot be easily replicated by other localities. This is a term coined by Michael Porter, who argued, based on an enquiry into the competitive advantage of nations, that "it is the combination of national and intensely local conditions that fosters competitive advantage".[9]

Locational quality is something that is the result of market processes, government intervention and collective action. On the one hand, the concept of "locational quality" involves a more holistic perspective than the business environment approach. On the other hand, though, it has a narrower perspective due its focus at a local or regional territory.

## 4 How do "business environment" and "location" differ?

Table 1 re-arranges these elements of the BE into categories that enable comparison between the scope of the business environment and that of the location as set out respectively in White's paper and in the mesopartner publications quoted above.

8 Meyer-Stamer (2003b), p.28.

9 Porter (1990), p 158.

**Table 1: Factors in the business environment and in the location**

| Factors in the Business Environment | Factors in the Location |
|---|---|
| **Physical & natural environments** | **Physical & natural environments** |
| Access to infrastructure | Geographical location |
| Cost of infrastructure | Natural environment |
| | Infrastructure and services |
| **Governance & institutions** | Transport and communications |
| Policy framework | Energy |
| Macro-economic policies & strategies | **Governance & institutions** |
| Legal and regulatory framework | The business climate |
| Organisational framework | Efficiency of government |
| Organisational capacity | Taxes, levies & subsidies |
| Support services | Support institutions |
| | **Social** |
| **Social** | Housing |
| Social conditions & services | Social services |
| Cultural & attitudinal influences | Culture & recreation |
| | **Economic/market** |
| **Economic/markets** | Real estate |
| Access to finance | Skilled workers |
| Cost of finance | Related industries |

The table reveals that there is considerable overlap between the concepts of BE and Location in terms of the factors they cover. Both include infrastructure, governance, institutional, social, and economic factors. In both, all of these are seen from the perspective of improving the environment for business. In this sense, they share the view that promoting business development means more than firm level interventions and that the wider economic, social political and cultural context plays an important part in the success of enterprises within a country or location.

A main difference in scope is, obviously, the inclusion of national policy, including macro-economic policies in the BE, but not in the concept of locational quality. Another difference is the attention given to the physical and natural environments. The BE includes infrastructure, but regarding locational quality, much more has to be addressed, including the geographical location of an area and the state of its natural environment. Transport and energy are highlighted in our definition of location, and, although not shown, would, we presume, form part of White's list of BE factors.

In both BE and LED, governance and governance institutions are key factors, but these appear in different forms. In both approaches, considerable importance is attached to the way government administers regulations and provides services of importance to business, though it should be noted that the term “support institutions” in our definition refers not only to services provided by government, but also those provided by the private sector, including financial services and BDS.

A terminological difference is that we include the “Business Climate” as one important locational factor, referring primarily to market conditions and the ease of establishing business linkages within a location. This is clearly a different meaning of the term “Business Climate” than that given to it by BE practitioners, for whom the term refers to various aspects external to the firm, or the whole BE as used here.[10] In our terminology, following common practice in OECD countries, the business climate addresses primarily factors that are created by businesses. In White’s terminology, the business climate addresses factors that affect business from outside, mainly those created by government.

The different approaches attach different weights to the importance of state and market reform. White’s list makes reference only to access to and the cost of finances (though his paper does show that markets more generally are an important part of the BE), whereas our definition of locational quality includes a wider range of market conditions. An underlying assumption in some of the BE literature is that the main obstacle to business development in developing countries is state failure, whereas we would argue that market failure and network failure require as much attention.

## 5 What is local economic development?

Locational development represents only one element of LED. To compare BE and LED as approaches, it is therefore necessary to take a more comprehensive look at LED.

What then is LED? A widely accepted definition is that it is a process in which partnerships between local government, the private sector and the community are established to manage local, and access external, resources that can be used to stimulate the economy of a well defined territory. In its earlier incarnations, the goal of LED was generally restricted to growing the economic and tax base of a location. More recently, in the context of the Millennium Development Goals, a distinction has been made between eco-

10 See, for example, the definition of Business Climate used by DANIDA, quoted in White, op. cit. p. 20.

nomic growth as the "immediate goal", and poverty eradication as the "overall goal" of LED.[11]

Taking this further, Jorg Meyer-Stamer has developed the Hexagon of LED, a framework grounded in the concept of systemic competitiveness.[12] This organises the various elements and processes of LED in the form of a hexagon, as presented in Figure 1.

In the Hexagon, the target group for LED is enterprises, which includes large, medium, small and micro enterprises. They may be locally established enterprises (and the approach to address them is often called Business Retention & Expansion), business start-ups, and external investors. Enterprise development involves improvements in the efficiency and competitiveness of existing firms, the promotion of business start-ups, and the attraction of external investors. Increasingly, LED practitioners approach enterprise development from the perspective of economic clusters and value chains which often cross-cut territorial boundaries, creating challenges for locational development.

Locational development, the elements of which have already appeared in table 1 above, refers to improvements in the environment for business within a location, including its infrastructure, natural environment, support and service industries and the efficiency of government, all seen from the perspective of businesses operating in the area or considering investing in it.

"Synergies" refers to relationships between enterprise, location and community (social) development in a location. Within the synergies triangle, these are analysed first in terms of the conflicts that typically characterize these relationships and then the potential for synergies between them that exploit opportunities that are of mutual benefit.

The sustainability triangle examines enterprise, location and community from the perspective of economic, ecological and social sustainability, showing how lack of attention to the conditions for sustainability of any one sphere will ultimately undermine the sustainability of the other two. It also

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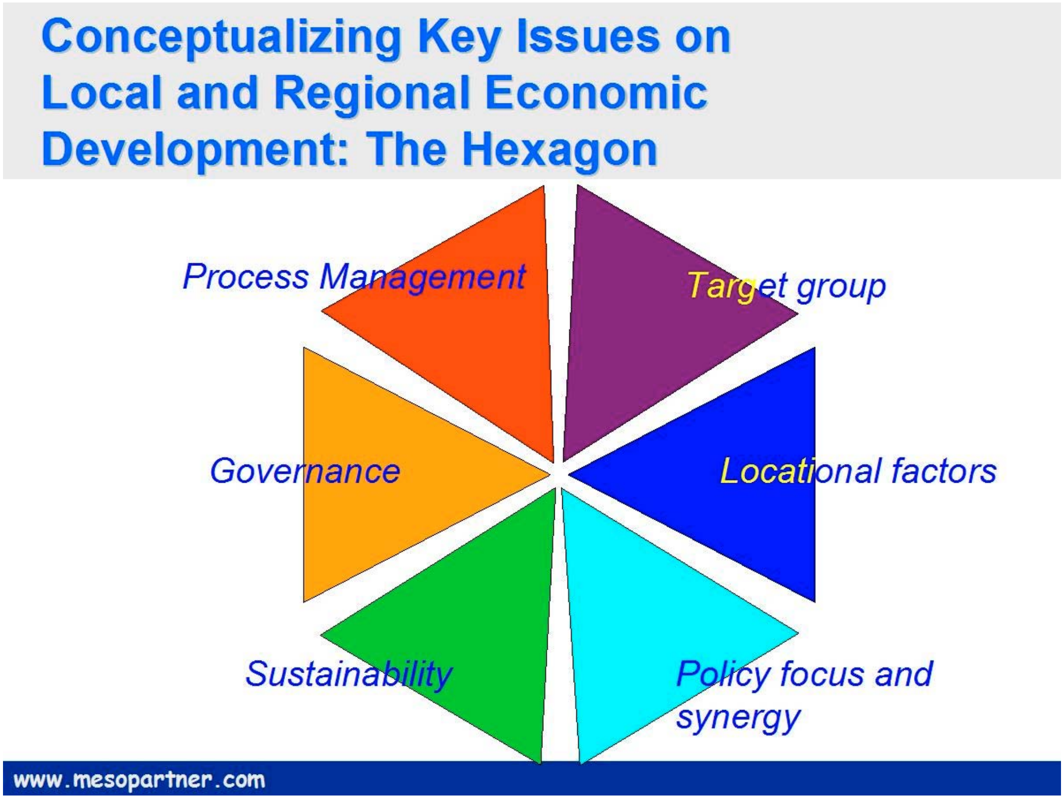
11 Conventional definitions of LED generally take the growth of the local economy, employment and the tax base as their objectives. Growing concern to connect LED with poverty reduction strategies, including the United Nations Millennium goals, suggests that it is useful to distinguish between its immediate objective and overall goal, particularly because not all LED support measures that promote growth also lead to poverty reduction.

12 This concept is set out in Meyer-Stamer (2005).

demonstrates how creative thinking can turn social and environmental sustainability problems into opportunities for business.

**Figure 2:**




Source: Meyer-Stamer J (2004) A Summary of the Hexagon of Local Economic Development, Mesopartner, Duisburg

Governance does not refer only to the application of regulations and administration of services by government and its relations in these processes with business and civil society. The term "governance", as against "government", refers to a shift from government being the main driver of developmental initiatives, including direct government intervention within markets and direct support to individual businesses, towards a network pattern where public, private and community actors interact in the effort to create a locational competitive advantage. Better economic governance entails improvements in the economic performance of local government based on changes in institutional arrangements, accountability and transparency.

The process triangle examines LED from the perspective of its management roles over time. The triangle describes a process beginning with participatory diagnosis of the local economy which stimulates participant motivation. This is followed by participatory prioritization of actions which leads to their implementation. Implementation is monitored and assessed to enable learning and improvement to take place. The circle is completed with a further round of participatory diagnosis which takes the process to a higher level.

How then does LED differ from the BE? It can be seen that all the factors present in the BE approach in one form or another form a part of LED. There are two main ways in which the approaches differ. The first is the scope of the concept. The BE approach looks primarily at government, and addresses government-created obstacles as the main developmental issue, while LED pursues a much wider approach that attaches importance to improving the functioning of markets as well. The second difference refers to the intervention approaches, which is the subject of the next section.

## 6 Business environment and LED processes: How do they compare?

The table below compares the approaches to improving the BE and to LED across the following variables: scope, conceptual framework, approach to diagnosis and approach to implementation. We have drawn up the table to help analyse the differences between the approaches conscious that this oversimplifies the field of play both in LED and BE, and that a more exhaustive examination of both could conceivably reveal greater similarities than suggested here. Our purpose is to draw sharp distinctions to bring out some key issues in these approaches.

From the table, a number of differences emerge. We noted earlier that whereas LED focuses on defined sub-national territories, BE approaches have mainly focussed on national economies, at least until very recently.[13] The substantive scope is not so different in theory since both LED and BE consider all factors external to the firm, the one at the local level and the other from a national perspective. In practice, though, LED has developed a consciously holistic approach, covering environmental, economic, social and governance factors influencing the environment for business, whereas the main focus of BE initiatives in practice has been on the policy, legal, regulatory and institutional environment, while market- and business-related factors have been relatively neglected.

13 For instance, the International Finance Corporation in 2006 published “Simplification of Business Regulations at the Sub-National Level. A Reform Implementation Toolkit for Project Teams”.

This takes us to the conceptual framework underpinning the two approaches, where important differences begin to emerge. As shown above, recent work on LED, notably the Hexagon, has strengthened the conceptual underpinnings of LED, giving order to the range of factors that influence the prospects for local economic development. Although this conceptual framework is inspired by a wide range of theoretical and empirical works, its clearest foundations lie in the concept of systemic competitiveness.

This is based on the insight that business competitiveness does not rest only on the actions of individuals firms, but is influenced by their interactions within economic clusters and value chains and the wider environment in which they are embedded.[14] "Systemic competitiveness" uses the term "system" in two different ways. First, it asks how the economic system at national or territorial level shapes the evolution of economic development. It looks at how the behaviour of companies in markets and networks (micro level) is shaped by macroeconomic policy and institutions (macro level), but also "slow variables" such as the basic economic orientation (e.g. free market vs. etatism) and the strategic alignment among key groups in the society (meta level). It also addresses temporary and permanent interventions that are essential to make markets work and to sustain companies' efforts to build a competitive advantage (meso level). Second, it looks at the specific feedback loops between factors at different levels that shape the evolution of a given economy, be it a national or a local economy. This is related to the observation that successful economic development is never only the result of the invisible hand of the market, but also of the quite visible hand of societal actors who formulate and implement generic and selective interventions to promote economic development and to shape a competitive advantage.

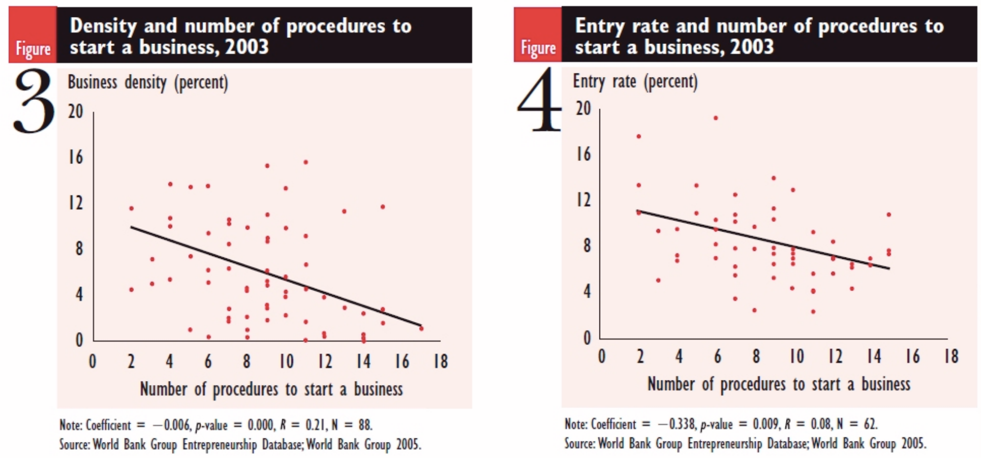
In contrast, the BE literature reviewed for this paper does not provide a clear conceptual underpinning for the approach advocated. In fact, authors like Altenburg and Drachenfels[15] question the underlying premises of the BE approach, pointing out that high growth countries like South Korea, China or India quite obviously do not comply, and have never complied, with the principles advocated by the BE approach. The BE approach is based on the premise that state regulation and bureaucratic administrative processes are the major inhibitors of business development, and in this respect it can be seen as an evolution of the 1970s and 1980s research that led to the "structural adjustment" approach. This approach, which guided policy develop-

14 Meyer-Stamer (2005). See page 10 for a table on authors and writings economics and other social sciences that have inspired the idea of systemic competitiveness.

15 Altenburg and Drachenfels (2005, 2006)

ment in many developing and transformation countries in the 1980s and 1990s, did not quite render the results that were expected in terms of growth and poverty alleviation.[16] For agencies like the World Bank, however, the consequence was not to question the approach but to ask how it might be intensified and deepened, and the BE approach was the answer.[17] The approach is based on the assumption that market failure is not a major issue, and that markets will work properly once government gets out of the way. There is good reason to question this assumption.[18] In fact, a recent World Bank publication which claims to substantiate the relationship between government-created red tape and lack of business dynamism shows pretty much the opposite, namely a rather loose correlation between the clumsiness of government and the deterrent effect this has on business start-ups (Figure 3).

**Figure 3: The correlation between red tape and business dynamism**




Source: Klapper (2006)

Where the approaches differ most is in their dealing with issues of structure on the one hand and process on the other. The BE approach emphasises the need to address structure, i.e. the existing body of legislation. Based on our experience with LED, we would rather suggest putting a strong emphasis on process, i.e. the way in which the existing laws and regulations are implemented. Regarding the process of implementing change, the various stages in BE & LED processes are set out in Table 2 and illustrated in Figure 4 further below.

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16 See, for instance, Rodrik (2006).

17 See, for instance, Palmade (2005).

18 See, for instance, Hoff and Stiglitz (2000) and Rodrik (2004).

**Table 2: Comparing processes**

| Business Environment | Participatory LED approaches |
|---|---|
| Diagnosis<br>• External expert based<br>• Documentary sources & survey methods<br>• Lengthy, slow and costly<br>• Diagnostic capacity not transferred substantially to local actors | Diagnosis<br>• Little attention to traditional research methods<br>• Participatory appraisal of competitive advantage<br>• Rapid, low cost, high capacity transfer to local actors |
| Dialogue<br>• Seen as a distinct stage following diagnosis<br>• No clear follow up strategy to ensure action | Dialogue<br>• Not seen as a distinct stage in process<br>• Built into all phases from diagnosis to M&E |
| Prioritisation of actions<br>• Experts provide recommendations<br>• Experts provide detailed reform plans | Prioritisation of actions<br>• Participatory<br>• Flows from diagnosis<br>• Involves local actors<br>• Based on quick, visible results |
| Implementation<br>• Carrying out of detailed plans<br>• Reliance on external expertise<br>• Time consuming | Implementation<br>• Action flows directly from diagnosis<br>• Incremental, cumulative, self re-enforcing change |
| Monitoring & evaluation<br>• Objective indicators tied to plans<br>• Amendments to plan based on indicators | Monitoring & evaluation<br>• Participatory<br>• Focus on learning<br>• Continuous feed back & adjustment |

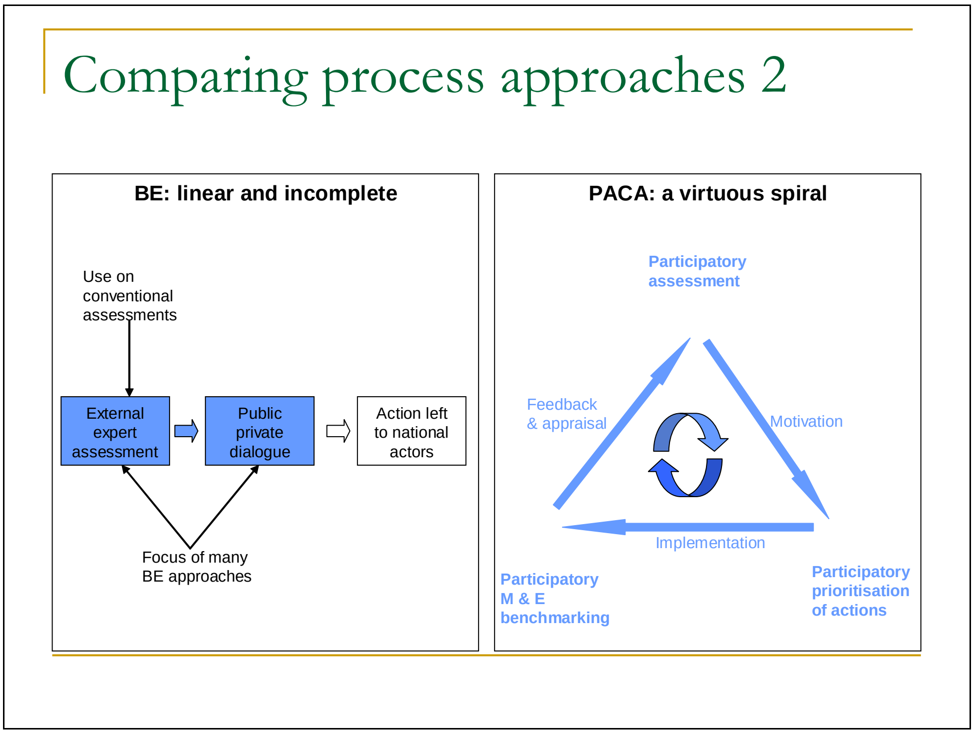
The BE approach is strongly expert driven during all stages. This is evident from the way in which diagnosis is undertaken which makes use of external experts who use conventional documentary and survey research methods to derive findings and recommendations. Public-private participation is conceived as a distinct process that follows this diagnosis and is shaped by the findings and recommendations based on it. The actions that follow are based on detailed reform plans, also drawn up by external experts. This contrasts sharply with participatory approaches, where a rapid diagnosis leads directly to action. The focus is not only on improving the environment for business in general, but also and in particular on increasing the competitive advantage of the location and the businesses within it, which sharpens the diagnostic process. Dialogue is not seen as a distinct phase but rather built into the entire process in a structured way. External specialists act as facilitators rather than consultants, using tools that enable structured interaction between local players.

Implementation is also conceived very differently in the two approaches. Within the BE approach implementation is based on a detailed plan that flows from the research and recommendations undertaken by external experts. It is conceived as a comprehensive and lengthy process. Local people are trained up as experts to carry the process through, but remain dependent on external experts for advice. In a rapid participatory process, actions are prioritised by local actors involved in the research process and checked with other local stakeholders. The choice of actions is determined by three criteria: whether they can be undertaken with local resources, whether they can be implemented swiftly, and whether they will have a visible impact. The aim is not to tackle reform of the location on a broad front, but to identify key action that set up an incremental, cumulative dynamic for change. On the basis of small initial successes the scope for reform should widen to include more people, greater resources and larger and more complex interventions. The capacities of local actors are built up bit by bit through their involvement in all stages of the process. Local actors champion this process and determine its fate, while external consultants offer impartial facilitation and provide light-touch support if and when this is needed as the process develops. The result is an iterative process of diagnosis, action, reflection and adjustment.

Monitoring and evaluation are also conceived differently. In the BE approach, M & E plays its orthodox role of enabling those managing the process to check whether outcomes in practice meet those anticipated in the plan and that project finances (mostly donor sourced) have been used for the intended purposes. It relies on objectively verifiable indicators which are used as a mechanism of control over the use of resources, more than as a means of learning and adjustment. In the PACA approach M & E is conceived as a participatory process. The indicators of success are chosen by local actors on the basis of what they see as important for development in their localities, and how to measure it. The accent is less on control over the process according to a pre-determined set of expected outputs than it is on drawing lessons from the actions taking place. Participatory M & E creates a feed back loop that promotes continuous learning and innovation.

Finally the processes taken as a whole differ markedly. Chart 2 provides an illustration of these. The typical BE approach may be described as linear and incomplete. Effort is expended mainly on assessment and dialogue. Whether action takes place will depend on the will of national and local actors, but there is no clearly developed process to ensure this, except through the continuing support of external experts, using external funding. The participatory approach creates a virtuous circle of development. It begins, ends and begins again with participatory assessment. Incremental, cumulative changes driven by local actors using mainly local resources and responding to local opportunities enable larger, more ambitious initiatives to be undertaken as personal and institutional capacities are built in the process.

**Figure 4: Comparing process approaches**




Source: Hindson D & Meyer-Stamer J, (2007) "Improving the Local Environment for Business in Mozambique: A Suggested Approach". (Forthcoming)

# 7 Implications

It is too soon to talk about drawing lessons for future work on the LBE based on the few initiatives reviewed here (for details see the Annex). Instead, this paper ends by emphasising a number of issues that we believe are important in conceiving and implementing LBE and LED initiatives.

## 7.1 What are the most important elements in the BE?

The regulatory system and the administrative processes by which it is administered are taken by the donors and their government partners as the most important aspect of the BE to business. This may well be so in many localities in developing countries, but needs to be verified case by case, based in particular on the views of the businesses concerned. Other factors such as infrastructure and government service provision, as well as a functioning business service market, are also high on the list of concerns of business. In some cases weak private sector institutions, including markets, and the level of development of value chains and their governance systems may be as important as governance and public service provision issues. The advantage of a participatory diagnosis is that the actual concerns of local business come to the fore and help shape the reform agenda from the inside, whereas expert driven processes may impose priorities that do not accord with those of local businesses.

### 7.2 Who should lead the BE reform process?

There may be no one right answer to this question either between places or over time within any one place. Donors are currently initiating and, in some places, driving the reform process, at least in its first stages. If local actors do not take charge early on, this holds the danger of perpetuating external dependence for both guidance and resources. It also involves the risk that the reform effort subsides as soon as donors' interest vanes.

It is clear that government needs to take a leading role in reforming itself, i.e. its system of regulation and administrative practice. It is unlikely, though, that state-led state reform will focus on the aspects most important to business unless the latter gives continuous inputs into the process – which is where PPD is important. However reforms within value chains and the markets for goods and services is probably best driven by the private sector. Note that the creation of red tape is not a government monopoly, but many businesses, especially large corporations, are also quite "good" at it. The answer to the question who should lead is probably that actors from the public, private and NGO sector should lead in their own spheres, but that dialogue between them is needed to improve the reform process overall.

One of the trickiest issues relates to the fact that laws and regulations, and inefficient implementation of them, may be linked to illegitimate interests of public sector officials or private companies. For public sector officials, issuing a permit and similar activities are often an opportunity to demand a bribe, as is the timely execution of a process, such as paying a bill. There is, thus, a strong interest on the part of public officials to leave things as they are. For instance, cutting the number of procedures involved in registering a business from 15 to five implies that several government offices may lose an important source of bribes. For private companies, arcane, unpredictable or inefficient procedures can be an important source of rents. For instance, taxi operators who are already in business have absolutely no interest in removing regulations that hinder the entrance of additional operators.

One would want to address the process of creating a more favourable business environment as a win-win-game, but that is not necessarily easy to achieve. If streamlining regulations and processes involves a win-lose-game, it is crucial to assure high level political support to make any progress.

### 7.3 External and local experts and other resources

The use of experts in promoting development can have a debilitating effect on local initiative. The IFC approach, which is fairly typical of the way many donor organisations operate, tends to perpetuate this, which may explain why it gives so much attention to the training of local expertise.[19] However, the resource intensive nature of both the external expertise and the training of local expertise may make it costly to replicate this approach, especially in poorer countries. Rapid, participatory appraisal approaches are less resource intensive and less likely to create and perpetuate local dependency on external expertise, yet their applicability to economically very poor and institutionally incapacitated countries and areas within them faces challenges given that they depend on local champions and the use of local institutions. Are there pre-conditions in terms of economic potential and institutional capacity of localities that underlie the success of these two approaches? Are there ways in which the two approaches can be adapted to meet a wider range of locational conditions? These are questions that call for further investigation.

### 7.4 Capacity building and training

Expert-intensive processes such as that being applied by the IFC may create and perpetuate dependence. Specialised training of local experts to replace them may simply reproduce the problem in another form, in particular in those countries and locations where officials and specialists are job-hopping all the time and/or where a change in government implies a major wave of

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19 The authors of IFC's recent "Toolkit" would obviously not agree with this statement. However, in our experience organisations like IFC tend to confuse teaching and learning. Running a training course for domestic role players where they are informed that too much Red Tape is bad is teaching. Running an exercise where local government officials for the first time see administrative processes through the eyes of a private business owner is learning.

replacements in public sector employees. The other way of tackling capacity shortages is to identify the individuals within a location who have potential and to build their skills in the processes of both diagnosis and in action, relying much more on learning-by-doing and on coaching rather than training. This approach has the advantage of mobilising local knowledge and expertise, which makes further skills development easier, and directly linked to performance.

### 7.5 The role of institutions

Notwithstanding a widely held belief in development circles, institutionalising an activity provides no guarantee that this activity will be effectively implemented on a sustained basis. Creating new institutions such as one-stop-shops can absorb a great deal of time and money better spent on delivery (especially if the result is a one-more-stop-shop). It can create tension with existing service providers and stoke political conflict where the institution is seen as a basis for political power and patronage. For these reasons, it may be more effective to focus on building relationships and networks that support direct action and allowing these to develop into more formal structures if and when a clear need for this becomes evident and local actors support the idea.

### 7.6 Approaches to sustainability

If building institutions is no guarantee of sustainability, what is? Processes as much as institutions are important to sustainability. Structuring them in ways that create feed back loops of learning and innovation is one part of this. Understanding the determinants of sustainability in the economy, community and environment and identifying and exploiting the synergies between them as opportunities for business creates a positive dynamic that supports the sustainability of all spheres. Creating a logic of virtuous circles and virtuous spirals is more promising than the linear logic of many projects and programmes, as it opens the way for continuous improvement. To start a major BE reform process pre-supposes the availability of considerable resources, including funding for external experts and funds for training local experts. Starting small and building local momentum before taking on larger challenges is important to sustainability. It provides no guarantee, but does avoid the typical experience of externally resourced and foreign expert-driven development processes that start with a bang and all too often end with a whimper.

## 8 Conclusion: Enabling environment, locational quality and growth

The proponents of the business environment approach, which is effectively a "fighting red tape" approach, appear to be on the safe side. Making government more efficient, more transparent and more predictable in its interaction with business cannot possibly be wrong. The question is, though: How much effort should be spent on this, and what results can be expected?

The answers that we would tend to give are somewhat ironic. We would argue that it makes sense to distinguish two types of locations. First, there are locations which are thriving that are located in a country with a strong economy. Such a location does already have a favourable environment on the business side of things. If government in such a location becomes more efficient, there is a good chance that local businesses can grow faster (for instance because it takes much less time and effort to expand their operations). In this type of location, a red tape reduction programme can indeed create a competitive advantage to the extent that this local government moves quicker and further than local governments in other locations that compete for inward investment.

Second, there are locations where the local economy is not doing well. Many secondary towns in rural areas in low income countries would fall into this group. In this kind of place, reducing red tape and the associated tax burdens that small producers, in particular, find so crushing, would be important, but by no means sufficient to initiate a substantial growth process. It would help local businesses, but it would not create a competitive advantage relative, in particular, to international markets. In slowly growing or stagnant locations, the main problem is market failure, and the failure of government and/or collective actors to effectively address market failure. Developmental interventions need to be designed accordingly.

This is, then, the irony of local efforts to reduce red tape: They speed up the growth of locations that are already charging ahead, but they are unlikely to accelerate growth a great deal in locations that are stagnant. In other words, they may actually reinforce the strong trend towards growing regional disparities that most countries suffer from anyway. This is one of the reasons why we advocate the pursuit of a holistic LED approach. LED is much more than cutting red tape. Effectively pursued, LED has the ability to unleash endogenous potentials that generate a genuine growth dynamic, and thus create an environment where cutting red tape can, then, make a much bigger difference.

# 9 Annex

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## 9.2 Useful Websites

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www.doingbusiness.com

www.ifc.org

www.mesopartner.com

www.sedonors.org

## 9.3 Features of some Local BE initiatives

### Why the focus of BE is widening to include the local

While information sources on the BE are already huge and burgeoning, an Internet scan on the local business environment (LBE) throws up relatively few initiatives as yet.[20] This is likely to change as the importance of the local BE gains wider recognition.

There are a number of reasons why the focus is widening to include the local business environment. One is that efforts at improving national policy and regulatory frameworks have begun to gain acceptance in many countries and with the progress of reform at this level, obstacles to change at the local level have become more visible. At the same time, decentralisation processes have increased the powers and functions of local authorities, without, however, necessarily being accompanied by the resources or improvements in capacity that their successful execution requires.

More positively, it is increasingly recognised that local authorities are often better placed to inter-act with business given their spatial proximity. They are often businesses' first contact with government and this affects their perception of all of government. Being close to local businesses, local government is well placed to understand local business needs, particularly those of small business, and either to create or remove obstacles to its development. Local authorities are generally responsible for spatial planning, the implementation of environmental, health, safety and other forms of regulation and for provision of basic infrastructure and services that are important to businesses. Moreover, local authorities tend to formulate a variety of local by-laws. Local government also has important coordinating functions that are difficult for higher levels of government to undertake. These includes coordination of development and service programmes framed by national or regional level government departments, such as transportation, communications, housing, research and agricultural extension work.

### Comparing some local BE initiatives

What then is going on in the area of BE at the local level? The table below compares five recent donor-conceived and supported local BE initiatives in terms of the following variables: geographical and substantive scope, the actors involved and their roles, the approach to BE reform processes, the institutions involved and the approach take in regard to sustainability.

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20 The most important Website on the BE is probably www.businessenvironment.org

We emphasise again that our purpose here is not to provide a fine-grained, empirically substantiated evaluation of each of the initiatives, which would not be possible without more detailed research on each of them. Rather, it is to extract from the reported cases some key aspects of the approaches adopted and to reflect on their implications for local development practice.

| Features | GTZ-SA | IFC | ILO | GTZ – Indonesia | SNV- LAOS & VIETNAM |
|---|---|---|---|---|---|
| 1. Scope | | | | | |
| Geographical | Main economic centres in localities | Municipalities | Municipalities | Region & its districts | Provinces |
| Main factors considered | Red tape (in regulations & service delivery) | Regulations | Generic & sector specific regulations | All factors in the BE, local and sector | All government factors in the BE |
| 2. Actors | | | | | |
| Initiator | Donor | Donor | Donor | Donor | Prime Minister's Office via Ministry of Industry |
| Donor's partner | Government | Municipality | n.s. | Region | Ministry of Industry |
| Donor's main local partners | LG & business organisations | LG | LG | Region | Provinces |
| Drivers | LG & business | Donor followed by PP roundtable | n.s | Local partners | Ministry of Industry |
| Business involvement | Fully involved in all phases of red tape reduction process | Micro & small seen as primary beneficiaries & are actively engaged by IFC | n.s | Involved in assessment of competitive advantage & PPD | Involvement of small business is seen as essential to success |
| Facilitator | National consultants | External experts | n.s | External experts | SNV |
| Assessment specialists | Assessment undertaken by national facilitators in PPD context | International specialists who build local consultant capacity | ILO & other contracted specialists | International consultants who involve local specialists | International consultants who try to build capacity of local specialists |

| 3. Process | | | | | |
|---|---|---|---|---|---|
| Pre-conditions | Informal, emphasise PPD processes | Public agreement: political will backed by direct beneficiaries | n.s. | n.s | No preconditions set, but support of national government seen as important |
| Diagnosis/assessment | Participatory assessment involving LG & business | Detailed expert based diagnosis and assessment | Statistical data & "business climate" survey regional and local competitiveness | "Business climate survey" based on statistical data collection followed by enterprise surveys & interviews after PPD process | Quick scan of business environment using secondary data & PACA tools. |
| Dialogue | PPD initiates & sustains process | Public-private roundtables created following implementation to sustain implementation by overseeing reform & expanding the agenda | Follows surveys & is based on survey findings. Results in action plan for the following year | n.s. | Multi-stakeholder workshop using PACA tools is key element in process |
| Training | ToT given to national LED experts & local training to LG officials & preparatory training to stakeholders | Comprehensive training of local government officials advocated | | | Capacity building of local actors through their involvement in participatory appraisal |
| Approach to implementation | Tackles fairly substantial red tape issues from the outset | Large scale administrative engineering & legal change put to LG | n.s. | Strong focus on measuring regional and local competitiveness | Focus on quick wins to build momentum rather than comprehensive and detailed planning |

| | | | | | |
|---|---|---|---|---|---|
| Who is responsible | LG (+ facilitators) | LG + external experts | Under taken by local actors who can call on ILO for expert support | n.s. | Local actors are the implementers, supported where necessary by facilitators |
| M & E | Integrated into the process | Based on in-depth analysis and good indicators | n.s. | “Soft” & “hard” indicators provide basis for M&E | Importance of benchmarking mentioned but not developed in detail |
| Time horizon | Continuous | Project approach until one-stop-shop set up | Continuous process if taken up by local actors | n.s. | Continuous |
| Institutions | | | | | |
| Institutions | PPD forum | Stresses importance of host institution and role of one-stop-shop | n.s. | n.s. | n.s. |
| Sustainability | | | | | |
| Resources | Minimal external resources needed (1-2 facilitators) | Heavy use of external expertise | ILO and other donor resources for technical support | n.s. | Mainly local plus a donor funded facilitator |
| Sustainability | Sustained by dialogue process | Sustained by institution of one-stop-shop | Envisages a circular business climate survey process | n.s. | Sustainability rests on creating a virtuous circle beginning and ending with quick “business climate” scans |

Note: n.s. = not specified.

## Comparing the approaches

### *Scope*

With regard to geographical scope, the five initiatives all work within administrative boundaries - municipalities in four cases, and a province in one. The choice of geographical scope is probably influenced by the fact that these are donor initiatives in partnership with governments. With the exception of the GTZ initiative in Indonesia which includes “all factors” affecting the business environment, the substantive focus on these initiatives is government regulations and administrative practices, suggesting that, as in the case of most national BE approaches, market failure is not yet a strong focus of LBE initiatives either.

***The actors involved***

Donors are the main initiators of these BE exercises, though it is interesting that in the case of SNV in Laos and Vietnam, it was the Prime Minister's Office via the Ministry of Industry that approached the donor.

In all five cases, government actors are seen as the main national and local partners. Business is involved in some way in all cases, but mainly as participants in processes or as beneficiaries rather than drivers. In so far as they are identified as such, the main drivers of these LBE initiatives are local governments. Facilitation is a key element in all the cases and the facilitation is done by international experts,, except in the case of South Africa, where nationals are used. All cases report efforts to build local consultant capacity to undertake this work.

In all five LBE initiatives, the diagnostic phase is facilitated by external experts. Reliance on external experts for research and implementation is strongest, it seems, in the case of the IFC initiatives in Latin America, and weakest in the case of the SNV initiatives in Laos and Vietnam, where the PACA methodology strongly informed the process.

***The processes involved***

*Pre-conditions*

Some of the initiatives specify pre-conditions for BE exercises and others do not. The IFC insists on a publicly announced agreement by government backed by the support of the business community, before going ahead with an initiative. This may be understood in the light of other features of the IFC approach which include very comprehensive, expert-based assessments of the BE followed by ambitious, sustained reform programmes including policy, regulation and administration.

*Diagnosis*

There are substantial differences between the case studies' reports on the question of diagnosis. At the one end of the spectrum, the IFC gives greatest energy and resources to this phase, which is driven by external experts. At the other end lies the GTZ approach in South Africa, where diagnosis is undertaken by local government and business, guided by national facilitators. In Laos and Vietnam, the SNV has drawn on PACA tools to structure participatory diagnosis supplemented by use of a range of statistical indicators. Here efforts to improve the BE have been focussed on raising the competitiveness of districts and the businesses operating within them. For others such as the

ILO, “business climate” surveys, based on interviews with business actors have been the centre-piece of BE diagnosis.

*Public-private dialogue*

Public-private dialogue (PPD) emerges as a key feature of the reform process in all but one of the initiatives. However, the way in which PPD is handled differs significantly from one initiative to the next. For the GTZ Local Red Tape Reduction Initiative in South Africa, facilitated PPD is seen where the process starts and maintaining the PPD process is seen as critical to maintaining the process. In the IFC and ILO initiatives, PPD follows and is informed by prior diagnosis undertaken by external experts. In both these initiatives, it is seen as a key factor that sustains and can widen the agenda for reform. The approach adopted by the SNV in Laos draws on PACA, in which analysis and prioritisation form part of a single process. Within the PACA approach, the point is not to promote dialogue for its own sake, but rather to focus on getting practical actions happening, which then calls for focussed dialogue between those parties who are able to make things happen. The establishment of policy networks and forums for dialogue are advocated only where there is a clear need for these, arising for example at a point where the diversity and complexity of actions taking place in a location could benefit from more systematic exchange between the actors.

***Approach to implementation***

There are two main ideas behind the implementation approaches represented in the case studies under consideration. The first is to work out a plan for what needs to be reformed in some detail based on prior research, muster the resources and then tackle the problem systematically over a pre-determined time period, while the second is to get a process of interaction going between the local actors, tackle issues which yield rapid, visible results and use the momentum created by small successes to take on larger challenges. The IFC approach is the best example of the former and the SNV Laos and Vietnam approach of the latter, while the other three cases seem to fall somewhere in between.

All the case studies conceive of either “local government” or “local actors” as the drivers of the BE reform process, but there are differences in the degree to which they rely on external experts, from the IFC at the one end, which gives external experts a central role throughout, to the SNV Laos and Vietnam initiatives which rely much more heavily on local actors to keep the momentum going. It should be noted that in the PACA approach, a central role is given to local champions, on whose shoulders rest the ultimate success of the process.

***Monitoring and evaluation***

The degree to which M & E is highlighted differs from one initiative to the next, as does the role it plays in the process. In the IFC approach, impact evaluation, using objective indicators, plays a central role both in measuring the success of initiatives and as the basis for decisions about further reform. At the other end of the spectrum the GTZ Red Tape Reduction initiative incorporates an M & E dimension and PPD is intended to throw up indicators for M & E. The GTZ Indonesia and SNV Laos and Vietnam initiatives also generate M & E indicators from the dialogue process. What does not come out clearly from the reports on these latter initiatives is the critical role of M & E in continuous learning and innovation, something that is at the heart of PACA.

***Institutions***

The information contained in the case studies does not enable us to say a great deal about the institutional arrangements for LBE reform. The GTZ South Africa Red Tape Reduction Initiative uses existing dialogue structures, where these exist, that enable business and local government to come together to discuss and prioritise reform initiatives. The IFC approach mentions the role of host institutions and emphasises that they should not only be committed to it, but also be in a position to provide resources. The other institution highlighted by the IFC is the one-stop-shop, which it sees as the institutional mechanism through which improved service provision by government for business will be provided. The other three case studies do not give much insight into this aspect. The PACA approach, which strongly influenced the SNV initiatives in Laos and Vietnam, advocates the use of existing institutions rather than the creation of new ones, except where there is a clear need for the latter and this is strongly supported by the local actors themselves.

***Sustainability***

The initiatives reported give only partial or indirect insights into the issue of sustainability in BE reform. For the IFC approach, it is the creation of an effective advisory council and the one-stop-shop, which are the guarantee of sustainability – i.e. institutions ensure it. The GTZ South Africa model sees the PPD process itself as securing sustainability – i.e. the process itself is the guarantee. The conception of sustainability is very different in the ILO and SNV approaches. Here it is the creation of circular, self-reinforcing processes, starting and ending with business climate surveys which provides the best guarantee of sustainability i.e. sustainability is guaranteed by the process, not an institution per se. This is similar to the PACA approach in which the guarantee of sustainability lies in continuous learning and innovation to improve the competitiveness of the location and the businesses operating within it, based on a process that begins with participatory diagnosis and ends with it leading to a higher level of development.

**mesopartner** is a consultancy partnership that specialises in territorial development, cluster promotion and value chain development. It was founded in December 2002 and registered in April 2003 by Dr Ulrich Harmes-Liedtke, Dr Jörg Meyer-Stamer and Christian Schoen. Frank Wältring joined in 2004.

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