Commission on the Private Sector & Development

REPORT TO THE SECRETARY-GENERAL OF THE UNITED NATIONS

UNLEASHING ENTREPRENEURSHIP





MAKING BUSINESS WORK FOR THE POOR

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1 March 2004

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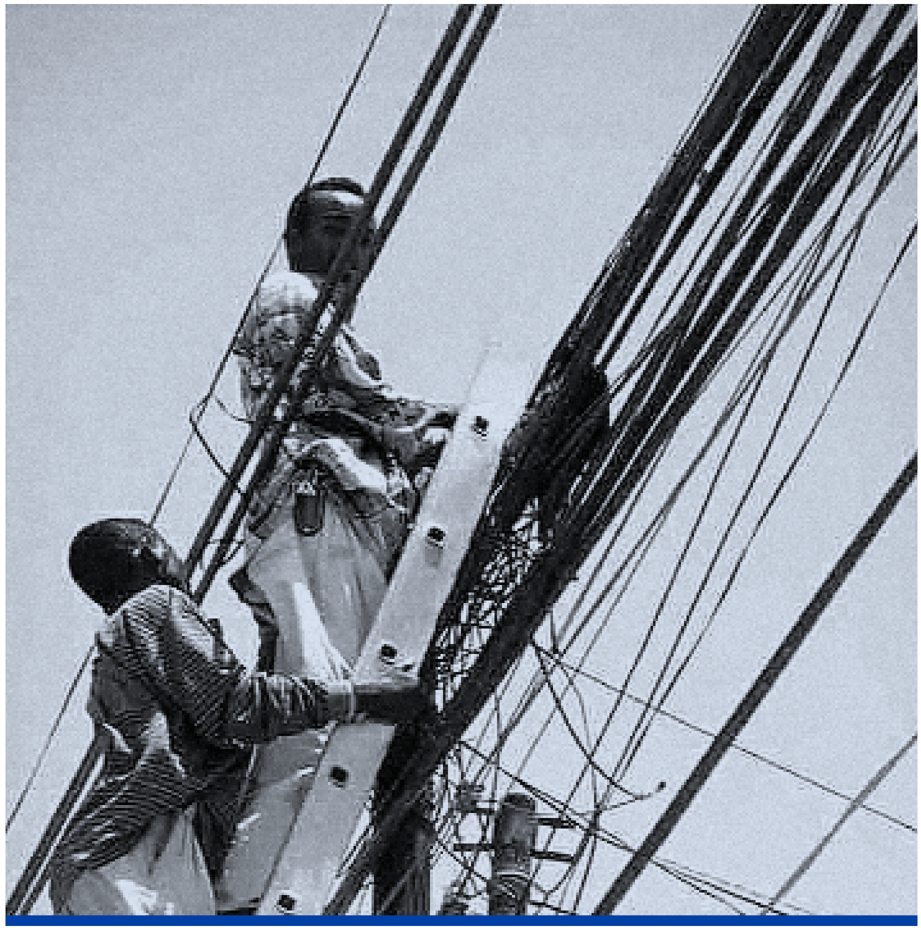


FOREWORD

Ending poverty, the aspiration of the Millennium Development Goals, is the overriding developmental objective of the 21st century. Despite great progress in the past 50 years, 1.2 billion people—one-fifth of the people on Earth—live on less than US $1 a day, without access to many of the social services basic to a decent human life. Their plight requires a global response making full use of all the financial, intellectual and organizational resources that we can muster.

It is against this urgent background that Secretary-General Kofi Annan asked us to convene the Commission on the Private Sector and Development to answer two questions. How can the potential of the private sector and entrepreneurship be unleashed in developing countries? And how can the existing private sector be engaged in meeting that challenge? This report is our responses to these questions.

The report offers recommendations on how the major actors—governments, public development institutions, the private sector and civil society organizations—can modify their actions and approaches to significantly enhance the ability of the private sector to advance the development process. The objective of poverty alleviation leads us to focus on developing businesses that create domestic employment and wealth—by unleashing the capacity of local entrepreneurs.

We set an ambitious time limit for our work, which has been completed in a little more than half a year since our first meeting in June 2003. Our intention was not to carry out basic research. Much work on the subject is already under way, and major development agencies, private foundations and academic institutions are already focusing their energies on the private sector's contributions to development. Instead, our approach has been to understand and assimilate the work already carried out by all parts of the development coalition, including business, civil society and labour organizations, and to integrate that thinking in the framework presented here.

The Commission's work has been heavily influenced by the voices of entrepreneurs, expressed through their actions and through their responses to wide-ranging surveys launched to understand what most affects their ability to be productive and to grow. It is the capacity, drive and innovation of entrepreneurs that increase the impact of a broadly constituted private sector. Entrepreneurship encompasses the actions of small, informal, village-based individuals as much as it does that of the managers and innovators in multinational corporations and large local companies. It is their voices that we have heard the loudest.

The Commission has also attempted to highlight a broad range of good practices that show how the capabilities of the private sector can best be harnessed for the cause of development and poverty alleviation. The cases include successful approaches that originate with the traditional development players, such as the multilateral development institutions and bilateral aid agencies. But more often they include lesser known but innovative approaches implemented by the private sector—both by companies and civil society organizations. Those approaches rely on market mechanisms and private sector incentives and thus lend themselves much more to the replicability and scalability that we believe needed. One of our key observations is the lack of knowledge about best practices and the great need for more sustained research and analysis of what works and what doesn't.

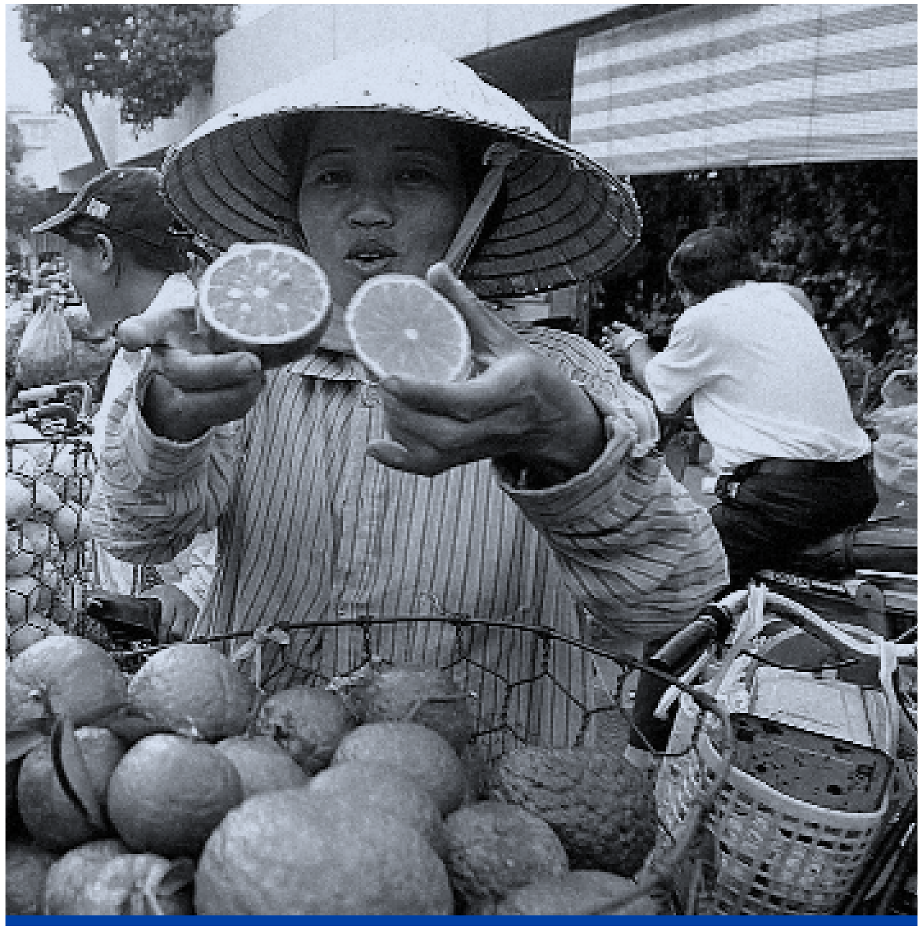
We concluded at the outset that it would not be enough for this Commission to produce a traditional report voicing opinions and urging others to take action. Instead, we believe that it is critical to develop a set of pilot actions and initiatives that would test the main observations and conclusions of our work—so that their relevance to the real world of development could be demonstrated on the ground. That is why the report ends with an illustrative portfolio of actions that will be developed in greater detail over the next few months—actions that could be implemented on a pilot basis shortly thereafter. Some of them could be driven by the UN system, and some by other partners and stakeholders.

These initiatives are far from enough. We put them out to all of you as indicative of the types of actions that we believe can and should be replicated for the widest possible impact. Nor do we believe that each of them is a perfect model. Country differences require modifying the initiatives—as well as some of our overall recommendations—to fit particular circumstances. Our ideas and conclusions are presented as directional, to elicit reaction and constructive dialogue. The intent is to catalyze a renewed coalition of the major stakeholders—focused more clearly on the challenges outlined here. Such a coalition is essential to unleashing the capacity of the private sector, to achieving the Millennium Development Goals and to alleviating poverty.

Paul Martin
Co-Chair

Ernesto Zedillo
Co-Chair

Photo: Luc Anh/UNDP



ACKNOWLEDGEMENTS

The Commission's work would not have been possible without the input and assistance of many individuals and organizations. We are deeply grateful to all those listed here.

A SPECIAL THANKS...

To McKinsey & Company, who provided input and counsel to the Commission and its Secretariat throughout the project. The team of Maria Blair, Michael Monson and Mark Templeton was led by Tilman Ehrbeck, Diana Farrell, Jeremy Oppenheim and Les Silverman.

To Jennifer Barsky, Prabal Chakrabarti and Irene Philippi who also provided vital inputs to the work of the Secretariat.

READERS AND EXPERTS

Our work has been informed by many who have gone before, and a number of them generously gave of their time and expertise to help shape our thinking. These include: Adrian Hodges, International Business Leaders Forum;

Lalita Gupte, Mahdav Kalyan and K. V. Kamath, ICICI Bank; Nandan Nilekani and Sanjay Purohit, Infosys Ltd.; Percy S. Mistry, Oxford International Group; Richard Frank, Bob Graffam, Julio Lastres and Alexander Schwedelheim, Darby Overseas Investments Ltd; Michael Barth, Netherlands Development Finance Company; Nancy Bearg, Enterprise Works; Gary Bond, Noreen Doyle and Michael McCullough, the European Bank for Reconstruction and Development; Cameron Rennie, the World Business Council for Sustainable Development; Enrique Ferraro, Jim Kaddaras and Maria Otero, Accion; Jide Zeitlin, Goldman Sachs; Masood Ahmed, David Stanton and Adrian Wood, the U.K. Department for International Development; Professors Michael Chu, Calestous Juma, Tarun Khanna, George Lodge, Michael E. Porter, Iqbal Quadir and Deborah Spar, Harvard University; Michael Fairbanks, On the Frontier; Craig Wilson, DeltaPearl; Elli Kaplan; Benjamin Krutzinna; Neysan Rassekh; Alex Shakow; George Ivanov; Eleonore Kopera, Business Humanitarian Forum; Barbara Samuels, Samuels Associates; Donald Snodgrass, Development Alternatives, Inc.; Elizabeth Littlefield, CGAP; Bill Kramer, Water Research Institute; Hugh Locke, Locke Associates; Bill Draper, DraperRichards; Joaquim Boborquez; Maria Cattaui Livanos and William Stibravy, the International Chamber of Commerce; Robert Litan, Robert Chernow, The Ewing Marion Kauffman Foundation; Professors John McMillan and Paul Milgrom, Stanford University; Christopher Woodruff, University of California, San Diego; Professor Jonathan Morduch, New York University; Jeb Brugman and Craig Cohon, GlobalLegacy; Bob Fitch, Enterplan; Daniel Zelikow, JP Morgan; Kenny Pegram and Ray Smilor, the Foundation for Enterprise Development; Sunil Sinha, Emerging Market Economics; Roland Dominicé and Jean-Philippe de Schrevel, BlueOrchard; Professor Roger Leeds, Johns Hopkins University; Professor Ted London, the Base of the Pyramid Learning Laboratory at the University of North Carolina; John Richardson and Sevdalina Rukanova, the European Foundations Centre; Kenneth Borghese, John E. Wasielewski, the United States Agency for International Development; S. Aftab Ahmed, Sabine Durier, Mariann Kurtz, Guy Pfeffermann, Harold Rosen, Thomas Schipani, Bernard Sheahan and Udayan Wagle, the International Finance Corporation; Gerard Byam, Cesare Calari, Gerard Caprio, Arvind Gupta, Jemal-ud-din Kassum, Michael Klein, Khalid Mirza, Francois Nankobogo, Neil Roger, Marilou Uy and Dileep Wagle, the World Bank; Gerald T. West, the Multilateral Investment Guarantee Agency; Jonathan Fiechter and Prakash Loungani, the International Monetary Fund; Karen Decker and Arvind Mathur, the Asian Development Bank; Nancy Boswell, Transparency International; Antonio Vives, the Inter-American Development Bank; and Ric Cameron and Arthur Saper, the Canadian International Development Agency.

CONSULTATIONS

The Commission Secretariat conducted four formal consultations with international labour representatives; European foundations, academics, and Canadian civil society organizations. Our thanks to the hosts of these consultations, including the International Labour Organization and the European Foundations Centre, as well as to participants of these consultations, who included: Bob Kyloh, workers' relations branch, the International Labour Organization; Raul Requena, Union Network International; Wendy Caird, Public Services International; Carla Coletti, the International Metalworkers' Federation; Esther Busser, the International Confederation of Free Trade Unions; Sándor Köles, the Carpathian Foundation;

Matthieu Vanhove, Cera Holding; William White, the Charles Stewart Mott Foundation; Dario Disegni, Compagnia di San Paolo; Charles Buchanan, the Luso-American Foundation; Michael Brophy, Help for All Trust; Luc Tayart de Borms, the King Baudouin Foundation; Michel Bourges Maunaury, the Madariaga European Foundation; Raymond Georis and Alexandre Kirchberger, the Network of European Foundations for Innovative Cooperation; Ineke Derkzen, the Rabobank Foundation; John Mroz, the EastWest Institute; Charles Maynes, the Eurasia Foundation; John Wyn Owen, the Nuffield Trust; David Dollar, the World Bank; Michael Klein, the World Bank Group; Raymond Fisman, Columbia University; Florencio Lopez-de-Silanes, Yale University; Nazeer Aziz Ladhani, the Aga Khan Foundation; Gerry Barr, the Canadian Council for International Co-operation; John Watson of Cooperative for Assistance and Relief Everywhere (CARE) Canada; Patricia McCullagh, Ric Cameron and Arthur Saper, the Canadian International Development Agency; Michel Chaurette, the Canadian Centre for International Studies and Cooperation; Pam Foster, the Halifax Initiative; Molly Kane, Inter Pares; Robert Letendre, the Canadian Catholic Organization for Development and Peace; Mark Fried and Rieky Stuart, OXFAM Canada; Roy Culpeper, the North-South Institute; and Kathy Vandergrift, World Vision Canada.

UNITED NATIONS

Many within the extended UN family gave generously of their time and expertise, including Michael Henriques and Stephen Pursey at the International Labour Organization; Wilfried Luetkenhorst and his team at the United Nations Industrial Development Organization; Georg Kell and his team, Global Compact; and Antti Piispanen, Lorraine Ruffing, Karl Sauvant and the team at the United Nations Conference on Trade and Development. Our thanks also to John McArthur and his team of the Millennium Project; and colleagues in the United Nations Development Programme (UNDP): Zéphirin Diabré, Associate Administrator; Bruce Jenks of the Bureau of Resources and Strategic Partnerships, who provided the overall UNDP guidance to the project; Sanjay Gandhi, Connie Gratil, Sirkka Korpela and Casper Sonesson, also of the Bureau of Resources and Strategic Partnerships; Kalman Mizsei of the Bureau for Europe and CIS; Shoji Nishimoto of the Bureau for Development Policy; Hafiz Pasha of the Bureau for Asia and the Pacific; the staff of the Office of the Administrator, particularly Gilbert Houngbo, Lauren Canning, Alan J. Lee and Mark Suzman; Djibril Diallo, Victor Arango, Carmen Higa, Hyacinth Morgan and William Orme in the Communications Office of the Administrator; Christina Barrineau, Normand Lauzon and Peter Kooi of the United Nations Capital Development Fund; and Bibi Amina Khan and Golda Kruss who provided assistance to the Commission Secretariat.

EDITING, DESIGN AND PRODUCTION

Last but not least, we thank wholeheartedly those who have helped us with the editing, production and translation, working under very tight deadlines: Bruce Ross-Larson and Meta de Coquereaumont, Elizabeth McCrocklin, Thomas Roncoli and Christopher Trott of Communications Development, Inc.; Julia Dudnik-Ptasznik of Colonial Communications; Michel Coclet; Edward Ranney Carta of EurOz Technologies; Thomas Barbush and the team at Moore Wallace-Hoechstetter Printing; Kaika Clubwala of A.K. Office Supplies and Elizabeth Scott Andrews, Naeem Arastu, Sokhna Diouf, Françoise Gerber, Rajeswary Iruthayanathan, Maureen Lynch and Jeremy Owens of UNDP.

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Photo: Pedro Cote/UNDP

HIGHLIGHTS

The Commission believes that any approach to private sector development—and the policy and action recommendations that accompany it—should be grounded in the realization that the savings, investment and innovation that lead to development are undertaken largely by private individuals, corporations and communities.

The private sector can alleviate poverty by contributing to economic growth, job creation and poor people's incomes. It can also empower poor people by providing a broad range of products and services at lower prices.

Small and medium enterprises can be engines of job creation—seedbeds for innovation and entrepreneurship. But in many poor countries, small and medium enterprises are marginal in the domestic ecosystem. Many operate outside the formal legal system, contributing to widespread informality and low productivity. They lack access to financing and long-term capital, the base that companies are built on.

The Commission believes that the primary responsibility for achieving growth and equitable development lies with developing countries. This responsibility includes creating the conditions that make it possible to secure the needed financial resources for investment.

Those conditions—the state of governance, macroeconomic and microeconomic policies, public finances, the financial system and other basic elements of a country's economic environment—are largely determined by the actions of domestic policymakers. Their challenge is to capitalize on advances in macroeconomic stability and democracy and to launch reforms that bring about further changes in institutional frameworks to unleash and foster the private sector.

Most of the recommended actions involve more than one of the actors working together. Where governments are implementing policy change, it is often with the direct support and involvement of multilateral development institutions. Where the private sector is taking a more active stance on sustainable development, it is often with civil society raising the profile of this issue. Where governments are implementing regulatory reform, it may be in direct consultation with representatives of the private sector. The individual actions identified here should be seen in the framework of this broader cooperation—needed even more to reduce poverty.

Our interest lies in three areas:

1. **In the public sphere,** promoting the reform of laws, regulations and other barriers to growth.
2. **In the public-private sphere,** facilitating cooperation and partnerships between public and private players to enhance access to such key factors as financing, skills and basic services.
3. **In the private sphere,** encouraging the development of business models that can be scaled up and copied and that are commercially sustainable.

ACTIONS IN THE PUBLIC SPHERE: CREATE AN ENABLING ENVIRONMENT

Creating an enabling environment involves steps to reduce the share of the informal sector in an economy, through reform of the overall enabling environment for the formal economy.

For developing country governments

Reform regulations and strengthen the rule of law. Developing country governments have to make a strong and unambiguous policy commitment to sustainable private sector development—and combine that with a genuine commitment to reform the regulatory environment by eliminating artificial and policy-induced constraints to strong economic growth.

Formalize the economy. Developing country governments need to focus on creating the conditions to reduce informality and change the composition of the private sector ecosystem over time.

Engage the private sector in the policy process. Governments need to create a real partnership with representatives of the domestic private sector to implement changes and ensure that the voice of the private sector includes small and medium enterprises and microenterprises.

For developed country governments

Foster a conducive international macroeconomic environment and trade regime. Increasing the flow of development aid and reforming the global trading system to provide fair economic opportunities to producers from developing countries are essential for promoting rapid growth in domestic private investment.

Redirect the operational strategies of multilateral and bilateral development institutions and agencies. In encouraging sustainable private sector development developed countries need to ensure that the collective actions of these agencies are better coordinated—to improve their efficiency and to reduce the pressures on the administrative capacity of developing country governments.

Untie aid. Changes in the administrative rules controlling tied funds would permit more effective use and delivery of technical assistance to stimulate private sector development.

For multilateral development institutions

Apply the Monterrey recommendation of specialization and partnership to private sector development activities. The extent of overlapping activities is counterproductive and needs to be urgently addressed.

Address informality in developing countries. Some pioneering work is underway to map the structure of the informal sector, and a global effort to expand the coverage of this work is likely to yield significant benefits.

ACTIONS IN THE PUBLIC-PRIVATE SPHERE: PARTNER AND INNOVATE

The Commission believes that all stakeholders need to make concerted efforts in finance, skills and public-private partnerships for the delivery of basic services.

Facilitate access to broader financing options. We envision continuing development of domestic financial markets coupled with skill-building for regulators and private financial institutions.

Assist skill and knowledge development. Skill-building activities could range from programs for top public and private leadership to training microentrepreneurs to joint efforts with public authorities and unions to improve workforce skills.

Make possible sustainable delivery of basic services, particularly energy and water. The Commission sees the need to develop innovative models for partnerships of governmental service providers, multinational companies and local companies.

ACTIONS IN THE PRIVATE SPHERE: MOBILIZE CAPABILITIES AND RESOURCES

The Commission believes that the private sector, particularly large local companies and multinational corporations, must realize that it can contribute to accelerated economic development and to poverty alleviation.

For the private sector

Channel private initiative into development efforts. We believe that the private sector has tremendous potential to contribute to development through its knowledge, expertise, resources and relationships.

Develop linkages with multinational and large domestic companies to nurture smaller companies. Linkages between different types of firms in developing countries provide an effective channel for local companies to gain access to markets, financing, skills and know-how.

Pursue business opportunities in bottom-of-pyramid markets. Recognizing the needs of bottom-of-the-pyramid markets (the 4 billion people who are earning less than $1,500 a year) and creating innovative solutions to meet these needs are other vital actions required from the private sector, both domestic and international.

Set standards. The private sector needs to make a genuine commitment to sustainable development—with a sharp focus on corporate governance and transparency.

For civil society and labour organizations

The Commission believes that civil society and labour organizations have to continue as critical observers of the development agenda—and as facilitators and supporters of innovative approaches for meeting the Millennium Development Goals and improving the quality of life for poor people.

Increase accountability in the system. This is a core part of the work of civil society organizations, as is their leadership in pushing forward the concept of sustainable development. This work should be strengthened.

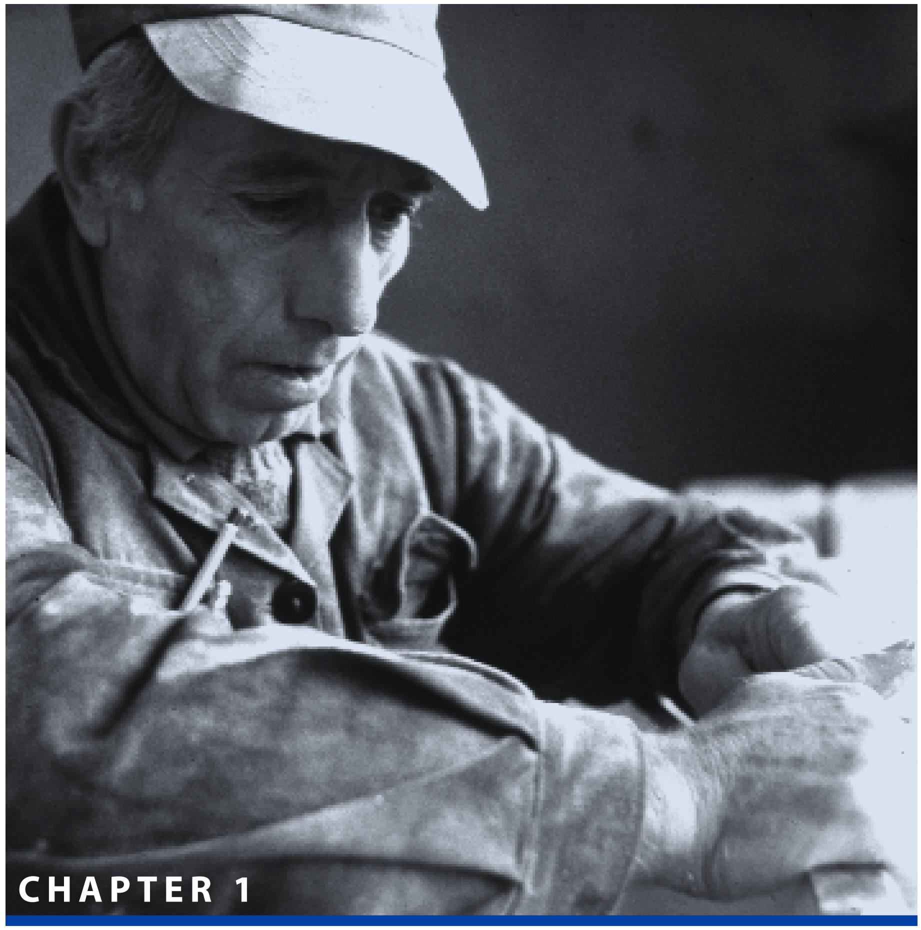
Develop new partnerships and relationships to achieve common objectives. Civil society organizations are closest to the base of the pyramid. They also are often proxies for experimenting with new technologies for solving problems.

LOOKING FORWARD

To promote progress, the Commission recommends that the United Nations sponsor the tracking of private sector development. An annual progress report would maintain the prominence of the Commission's overall recommendations and ensure the commitment to addressing the many issues identified here.

The Commission is assembling a first set of actionable initiatives to facilitate transformations in individual countries and to provide the tools for governments and the private sector to supplement available resources and begin rapidly implementing a programme of change. These first actions are intended to stimulate a collaborative response from potential partners who read this report. Our message to all of you is: join us.

Photo: Boris Missirkov



CHAPTER 1

WHY THE PRIVATE SECTOR IS SO IMPORTANT IN ALLEVIATING POVERTY

This report is about walking into the poorest village on market day and seeing entrepreneurs at work. It is about realizing that the poor entrepreneur is as important a part of the private sector as the multinational corporation. It is about acknowledging that the private sector is already central to the lives of the poor and has the power to make those lives better. It is about using the managerial, organizational and technological innovation that resides in the private sector to improve the lives of the poor. It is about unleashing the power of local entrepreneurs to reduce poverty in their communities and nations.

The Millennium Development Goals, ambitious in scale and scope, can be achieved only through committed application of best knowledge and practice. The problem is huge, with a fifth of the planet's people living on less than $1 a day. But some encouraging examples show how private enterprise can alleviate poverty. Consider garment exports in Bangladesh, information technology in Costa Rica and cut flowers in Kenya—new industries creating jobs, boosting incomes, lifting hopes. And consider the following successes, ranging from modern multinationals to domestic entrepreneurs, demonstrating the potential of private return to boost development.

- Cemex, the Mexican cement firm, has become one of the world's leading producers and innovators in the industry, employing thousands.
- Casas Bahia in Brazil has developed a unique business model providing efficient retail services aimed at poorer customers.
- Infosys, an Indian information technology services firm, grew from less than $10 million in sales in the early 1990s to become a leading global player with almost $800 million in sales today. Along the way, it has also been setting international standards for corporate governance and creating a new partnership for development with local and central government.
- ICICI Bank, also in India, is applying technology and a comprehensive approach to the full range of its client base—particularly in rural markets and to small and medium enterprises and microentrepreneurs.
- In Cambodia hundreds of small private providers offer services ranging from battery recharging to fully metered electricity provision for entire communities. These providers now serve an estimated 115,000 customers—more than one-third of electricity customers nationwide.
- Fierce competition between private locally owned mobile phone companies in Somalia has driven costs on international phone calls to less than $1 a minute, about a sixth that in many other African countries. This, in a country where there is no official banking or postal system and where many do not have regular running water or electricity.
- In Guatemala the Confederation of Agricultural Cooperatives formed a joint venture with a Canadian firm. The enterprise now exports vegetables worth more than $3 million a year to Canada, providing steady income for 100 indigenous women and supporting more than 1,000 farmers.
- In Mozambique a farmer bought an oilseed press on credit. Now as the owner of four presses, he has organized nine other press operators into a small cooperative association, bargaining with local banks and customers as a group.
- In India small-scale soybean farmers use a village Internet kiosk to check spot prices for their products on the Chicago Board of Trade's website, bypassing local intermediaries and getting better prices.

These examples are not just success stories—they are stories about the successes of the domestic private sector. They are what this report is about. But moving from example to broad achievement requires thinking freshly about development, unconstrained by ideology, unhinged from tired debate.

DEEP POVERTY REMAINS INTRACTABLE

Despite great progress in some countries and regions, deep poverty remains a stubborn and intractable problem across much of the world. Substantial gains in some countries have been accompanied by deep losses in others, and far too many people still earn less than $1 a day, suffer from hunger and lack access to water, sanitation and energy. The latest *Human Development Report* of the United Nations Development Programme reports that the proportion of people in extreme poverty fell to 23.2% in 1999 from 29.6% in 1990. But the number of people living on $1 a day slipped only to 1.17 billion from 1.29 billion a decade earlier. Moreover, if the dramatic improvement in China's poverty indicators is excluded, the number of people living in absolute poverty actually increased.

In recent years poverty alleviation has moved to the centre of the global dialogue as the primary overriding objective of development—not a derived outcome. The Millennium Declaration was an unprecedented expression of solidarity and determination to rid the world of poverty, committing countries, rich and poor, to eradicate poverty, promote human dignity and equality and achieve peace and environmental sustainability. It led to agreement on the Millennium Development Goals (box 1.1).

Yet progress is more than possible—and it occurs with regularity under the right conditions. Economic growth has lifted hundreds of millions of people out of subsistence agriculture into manufacturing and service employment, increasing wealth and reducing poverty. Witness the

BOX 1.1 THE MILLENNIUM DEVELOPMENT GOALS

1. Eradicate extreme poverty and hunger: reduce by half the proportion of people living on less than $1 a day; reduce by half the proportion of people who suffer from hunger.

2. Achieve universal primary education: ensure that all boys and girls complete a full course of primary schooling.

3. Promote gender equality and empower women: eliminate gender disparity in primary and secondary education by 2005, and at all levels of education by 2015.

4. Reduce child mortality: reduce by two-thirds the mortality rate for children under five.

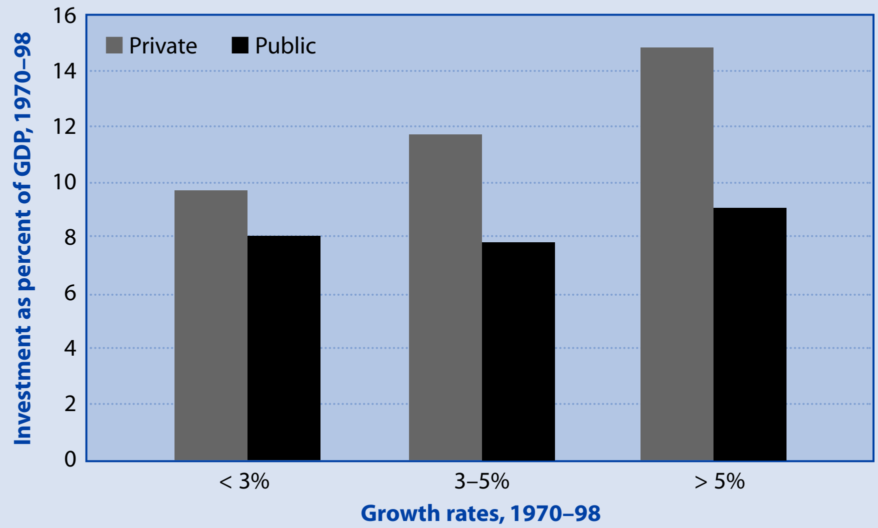
5. Improve maternal health: reduce by three-quarters the maternal mortality ratio.

6. Combat HIV/AIDS, malaria and other diseases: halt and begin to reverse the spread of HIV/AIDS; halt and begin to reverse the incidence of malaria and other major diseases.

7. Ensure environmental sustainability: integrate the principles of sustainable development into country policies and programmes; reverse the loss of environmental resources; reduce by half the proportion of people without sustainable access to safe drinking water and basic sanitation; achieve significant improvement in the lives of at least 100 million slum dwellers by 2020.

8. Develop a global partnership for development.

FIGURE 1.1 MORE INVESTMENT—MORE GROWTH



Source: Bouton and Sumilinski (2000)

dramatic improvement in the living standards in East Asian countries, including Indonesia, The Republic of Korea, Malaysia and Thailand, and the sizable reduction in the number of people in poverty in China.

The impact of economic growth, overall, on poverty depends on a range of factors that influence the nature of this growth, but the empirical evidence is compelling. In East Asia and the Pacific, the region with the strongest growth in the 1990s, annual per capita GDP growth of 6.4% resulted in a 15% decline in the rate of poverty (using the $2 a day criterion), and in South Asia 3.3% annual growth led to an 8.4% decline. In contrast, the slow growth of 1.6% in Latin America and the Caribbean and 1.0% in the Middle East and North Africa caused a marginal deterioration in poverty rates. More dramatically, negative growth rates increased poverty rates by 1.6% in Sub-Saharan Africa and 13.5% in Europe and Central Asia.

The message is clear: sustained economic growth reduces poverty. The link is equally clear between economic growth and strong private investment. A study of 50 developing countries from 1970 to 1998 examined the relationship between private and public investment and growth and incomes. Countries with higher growth featured higher private investment (figure 1.1).

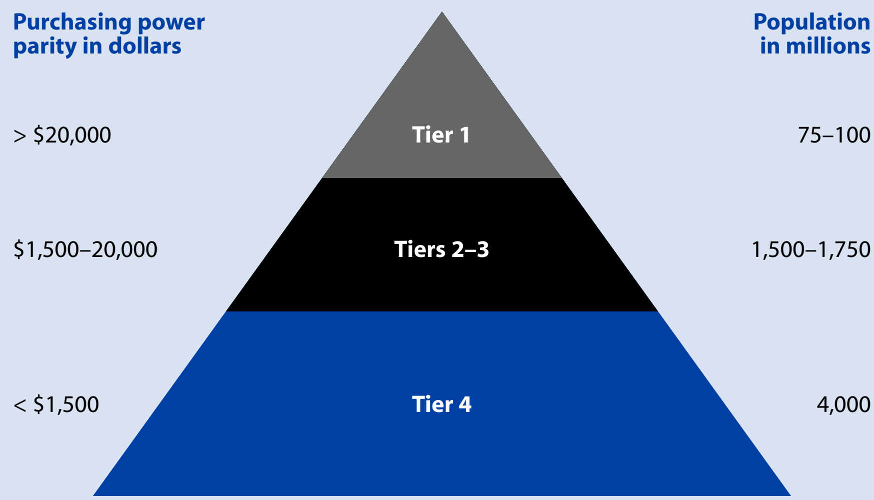
But for output growth to contribute to poverty alleviation, it must translate into incomes of the poor. For wage labourers and salaried workers, the quantity of employment and the rate of pay are crucial. For the self-employed, productivity and returns are important, influenced by technology, inputs and prices. Employment is thus the key link between output growth and poverty alleviation.

THE PRIVATE SECTOR IS IMPORTANT FOR THE POOR—AND OFTEN IS THE POOR

The private sector is central to the lives of the poor. First, all poor people are consumers. Across the world the story is the same—poor consumers pay more than rich consumers for basic services. In Mumbai, slum-dwellers in Dharavi pay 1.2 times more for rice, 10 times more for medicine and 3.5 times more for water than do middle class people living at the other end of the city on Bhulabhai Desai Road.

Fully 4 billion people in the world—those who earn less than $1,500 a year—make up the "bottom of the pyramid" markets (figure 1.2).

FIGURE 1.2 **FOUR BILLION PEOPLE AT THE BOTTOM OF THE PYRAMID**



Source: Prahalad and Hammond (2002)

The quality of goods that poor people purchase—whether food, water or financial services—is almost always substandard. Often, an informal private sector fills the gaps with goods of higher prices and varying quality. It serves an important need, for informal economies sustain the majority of poor families in many countries. Yet the advantages of economies of scale and scope are missing from the lives of people at the bottom of the pyramid. Some of the barriers are poor marketing and poor distribution.

The private sector is already meeting the needs of poor people in places governments do not reach. In some countries, for example, the government has little impact on the poor. In the slums there are no health services, no public education and no infrastructure. This story repeats itself across the developing world. In many cases, where services exist, they are provided by private sources. Anywhere from 15% to 90% of primary education is provided in private schools. Some 63% of health care expenditures in the poorest countries are private, almost twice the 33% in high income countries that belong to the Organisation for Economic Co-operation and Development.

With the right attention and regulatory requirements, privately provided services can help meet the needs of poor people. Recent data on the distribution of new water connections by income quintile from three countries in Latin America show that 25–30% of the network expansion was targeted at the lowest fifth of the income profile.

Put simply, an innovative private sector can find ways to deliver low-cost (even sophisticated) goods and services to demanding consumers across all income ranges. It can sell to the urban distressed area as well as the poor rural village or town. It can develop distribution links to the consumer in the village and so be better able to harness knowledge about the actual needs of this segment of the market. It can keep costs low through outsourcing, for greater flexibility.

The private sector can thus alleviate poverty by:

- Contributing to economic growth.
- Empowering poor people by providing them with services and consumer products, increasing choices and reducing prices.

The first creates employment and income growth. The second improves the quality of life for the poor. And the greater interaction between those at the base of the pyramid and the private sector creates opportunities for direct involvement in the market economy.

WHO ARE ALL THE ENTREPRENEURS?

The Commission takes an expansive view of the private sector. Large companies are a vital part of the private economy, but the poor are an equally important part. They are often entrepreneurs themselves—frequently of necessity, operating informally, trapped in subscale enterprises. We endorse the view that market-oriented business ecosystems comprise many forms of private enterprise coexisting in a symbiotic relationship. The ecosystem generally includes multinational corporations, large domestic companies, cooperatives, small and medium enterprises and microenterprises, with formal and informal players. It thus encompasses the farmer in the field as much as the multinational company.

Agriculture is of particular interest because 75% of the people living on less than $1 a day are in rural areas, with livelihoods dependent on mostly subsistence production. In Africa agriculture supports more than 70% of the population, contributing an average of 30% of GDP. Providing inputs to the agricultural sector and the value added processing and marketing of agricultural goods are important parts of private sector development. The critical importance of agriculture in alleviating poverty reinforces the need for urgent progress on eliminating subsidies for producers in developed markets, and on trade reform.

In many developing countries, women constitute the majority of microentrepreneurs in the informal economy and a significant percentage of the formal sector. Many of them are illiterate and live in poor rural communities. And setting up their own enterprises—generally microenterprises—is usually the only possibility for them to be employed and earn an income on their own. In Latin America and the Caribbean between 25% and 35% of formal sector micro-enterprises and small and medium enterprises are owned and operated by women. In the Philippines women own 44% of the microenterprises, more than 80% in rural areas. In Zimbabwe women run the majority of microenterprises and small enterprises (67%), while enterprises run by men tend to provide proportionally more of the household income and have more employees.

Entrepreneurship exists in large companies, where individual executives take the initiative to innovate and expand the business. This report highlights many instances of large companies that have targeted bottom-of-the-pyramid markets and developed products and processes to serve the poor profitably or to operate sustainably in very challenging environments. Entrepreneurship by individual engineers and executives is often at the root of such moves by big corporations, which can have a major positive impact on development.

Entrepreneurship also drives many civil society organizations, and it exists in government and public administrations. Individuals in these organizations have the drive to innovate and pursue opportunities with the passion and dedication of an entrepreneur, albeit with little if any pecuniary reward.

Entrepreneurship flourishes perhaps most in small and medium firms with significant potential to grow and innovate. This dynamic segment is typically the hotbed of entrepreneurship and innovation. It can drive economic growth, create jobs and foster competition, innovation and productivity.

A FOCUS ON THE DOMESTIC PRIVATE SECTOR

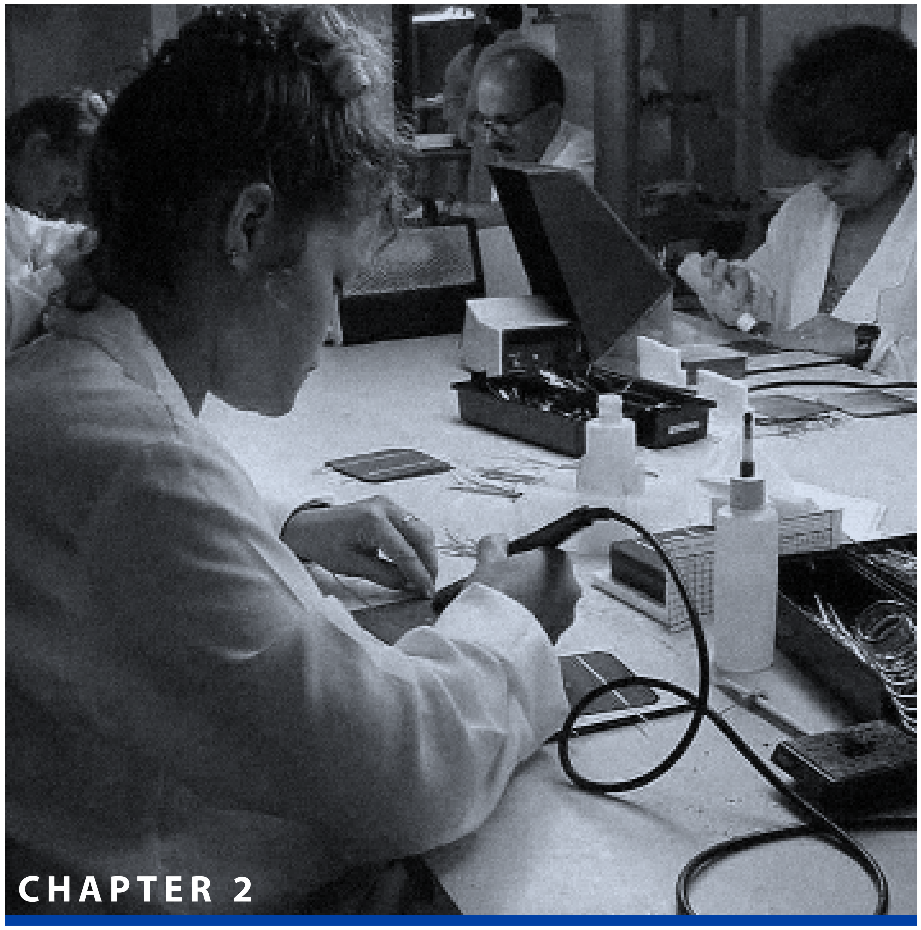
We focus here on the domestic private sector—for three main reasons. First, domestic resources are much larger than actual or potential external resources. Domestic private investment averaged 10–12% of GDP in the 1990s, compared with 7% for domestic public investment and 2–5% for foreign direct investment (FDI). Second, when informal resources are examined, such as the potential value of land, the domestic assets that can be tapped are significantly larger than the cumulative FDI or private portfolio flows. Third, unleashing the domestic resources in an economy—both financial and entrepreneurial—is likely to create a more stable and sustainable pattern of growth.

Estimates of the informal assets in developing countries range as high as $9.4 trillion, many multiples of cumulative portfolio flows or of FDI flows to developing countries over the past 15 years. These comparisons are illustrative only, comparing flows and stocks of assets.

Converting informal assets into financial resources will require a broad programme of reform that will enable these assets to be used as collateral in the banking system. But keep in mind the size of these assets. Recent work in Egypt, for example, concludes that the country has a large and vibrant extra-legal economy that employs over 8 million people (about 40% of the workforce) and has assets of almost $250 billion, 30 times the market value of all companies registered on the Cairo Stock Exchange.

This focus on the domestic private sector does not diminish the importance of FDI. Beyond the financial resources that FDI brings, its infusion of a corporate culture can change the way business is done, bring managerial know-how and best practices, provide access to international markets, transfer technology and innovation, introduce competitive pressures in previously closed markets and be the principal driver for the growth of local business. In these situations, FDI can improve the overall investment climate.

Photo: UNDP Cuba



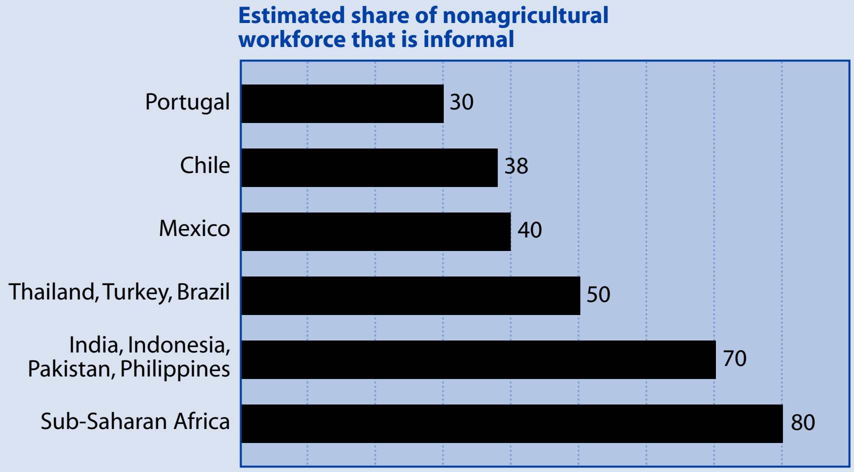
CHAPTER 2

CONSTRAINTS ON THE PRIVATE SECTOR IN DEVELOPING COUNTRIES

Developing countries have remarkable energy and assets, and all segments of the private sector have demonstrated the ability to respond when empowered. But the Commission finds that three major structural challenges confront the private sector in all developing countries, to varying degrees.

- Microenterprises and many small and medium enterprises operate informally.
- Many small and medium enterprises have barriers to growth.
- A lack of competitive pressure shields larger firms from market forces and the need to innovate and become more productive.

FIGURE 2.1 **INFORMALITY THRIVES IN POORER COUNTRIES**



Source: World Bank and International Labour Organization

WIDESPREAD INFORMALITY FOR MICROENTERPRISES

Microentrepreneurship is a common form of employment in many developing countries (figure 2.1). Almost all microenterprises operate outside the formal legal system, contributing to widespread informality.

Informality provides some benefits in some circumstances. It can act as a form of employment substitution for labourers who have difficulty finding jobs. For example, urban dwellers in Thailand who lost their jobs during the economic crisis of the late 1990s supported themselves by turning to informal street-vending opportunities. In societies that limit the economic role of women, home-based enterprises provide women with opportunities to earn money. If the formal rules, enforcement systems and cultural conditions in a country are so restrictive that most entrepreneurs cannot use their talents, the economy may benefit if they operate informally.

Difficulties in getting finance also trap developing country entrepreneurs in subscale operations. Entrepreneurs and enterprises that operate informally cannot borrow at a reasonable cost because they do not have legal status or title to the land they occupy. Frequently, the only option for access to capital is through illegal moneylenders who charge high rates and who may be able to lend only small sums relative to the needs of a growing enterprise.

The access of businesses that operate informally to the formal legal system and its benefits are limited. In general, the formal legal system should enforce contracts and protect property rights more fairly than informal enforcement systems do. Predictable rules and dispute resolution mechanisms are essential for entrepreneurs to engage in the long-term arrangements that enable them to innovate, to scale up and to diffuse their knowledge and benefits. Side payments to officials that increase predictability in an uncertain world reduce income that could otherwise be invested in making operations more productive.

Cruel and arbitrary informal enforcement systems limit the ability of entrepreneurs to be productive as well. Local debtor prisons and mafia-like punishments can hurt an entrepreneur's full access to crucial human inputs. According to Hernando de Soto, a third of debtors who obtained credit informally in Egypt spent some time in private jails because they did not pay back what they owed.

Entrepreneurs who operate formally are hurt by the implicit subsidies that informal enterprises receive through uneven enforcement and by poor mechanisms for protecting property and contracts, both of which distort competition. Both aspects create an uneven playing field and reduce formal entrepreneurs' access to inputs and markets, discouraging entrepreneurs who operate formally from making investments to increase productivity.

Informal firms can charge less because they avoid paying taxes or complying with other regulations. More productive formal firms have difficulty capturing market share from informal firms because the formal firms pay taxes and other contributions, which increases their costs significantly. More productive firms are less able to drive the less competitive informal firms out of business. So, poor enforcement permits the informal firms to continue to exist, holding back the productive firms from reaching maximum scale. Yet, given the significant productivity advantage held by formal firms, the inability to compete may reflect an unwillingness to serve some parts of the market rather than the cost advantages offered by informality.

Moreover, worker rights and protections in the informal sector stand up poorly to those in the formal sector. And consumers—able to purchase only goods of inappropriate quality and safety standards—do not have access to the greater choice and lower prices in truly competitive consumer markets.

There are many constraints on entering the formal sector. The over-arching issue is one of costs versus benefits for the individual entrepreneur who has to choose between formal and informal operations.

In most developing countries it is costly to be formal. Formal players are often overtaxed (a vicious circle, since they are overtaxed because a few formal companies carry most of the tax weight). Registering a business can be a long and expensive proposition (in Angola it takes 146 days and more than 8 times the per capita income). Regulations and government requirements are complex—and compliance costs high. The opportunities for bribery increase with the complexity of regulations, exposing smaller players who lack the legal resources to defend themselves.

Entrepreneurs also see little benefit in going formal. While formal businesses in developed countries can raise capital by mortgaging their assets, this is often not possible in many developing countries where mortgage laws are weak and banks prove reluctant to finance small players. In theory, being formal would facilitate selling beyond geographic boundaries, but poor local infrastructure and customs abuse limit the opportunities. And bankruptcy laws, which protect formal players in developed countries, are often ineffective in developing countries, exposing formal entrepreneurs to even more risks (due to more visibility) than if they remained informal.

FEW COMPETITIVE SMALL AND MEDIUM ENTERPRISES

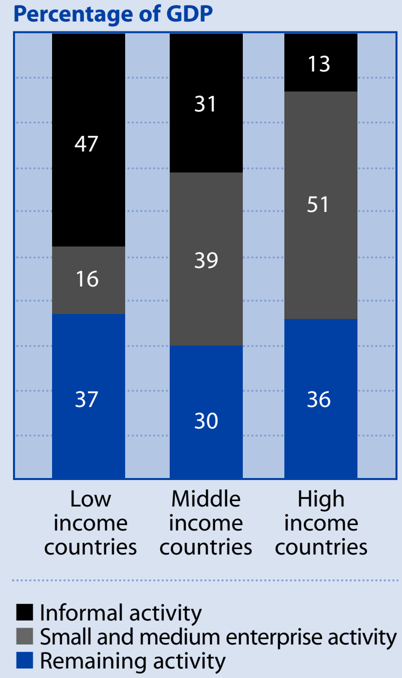
Small and medium enterprises tend to be engines of job creation—seedbeds for innovation and entrepreneurship. By providing new entry and competition, they can boost efficiency and growth and lead to economic development.

Indeed, recent research indicates that economic growth in poor countries is accompanied by a more than proportional growth in the share of the formal small and medium enterprise sector. In low income countries the share of formal small and medium enterprises in employment is about 30% and in GDP about 17%, while in high income countries the shares are about 60% and 50%. Indeed, richer countries see far less informal and much more small and medium enterprise activity (figure 2.2).

The reality in many poor countries, especially in Sub-Saharan Africa, is that the small and medium enterprise sector is relatively marginal in the domestic ecosystem. Why are small and medium enterprises not able to "graduate" to the ranks of larger companies?

For this evolution to be possible, it is essential that a reasonably level playing field and supporting institutional structures exist between (often larger) incumbents and (often smaller) new entrants.

FIGURE 2.2 **SMALL AND MEDIUM ENTERPRISES BECOME MORE IMPORTANT AND INFORMALITY LESS IMPORTANT AS COUNTRIES BECOME WEALTHIER**



Source: Ayyagari, Beck, and Demirguc-Kunt (2003)

Rules that constrain market entry and expansion have a chilling effect on small and medium enterprises at the expense of established larger firms. Small and medium enterprises often could compete effectively in niche markets, but the advantages that accrue to established large players fend off competition from the small and medium enterprise sector. Without the reasonable compliance costs that exist only in a fairer system of competition, small and medium enterprises cannot grow and become more productive. Ineffective or arbitrary tax laws, onerous business regulations and other restrictions penalize them.

Widespread informality and the lack of skills also affect the ability of entrepreneurs to scale up a business. While often animated by innovative ideas or addressing untapped markets, small and medium enterprises suffer from lower total factor productivity, by using older technologies or employing inferior workforce practices. The cost of business services is often more than small and medium enterprises can pay, or is not in tune with their needs. Lower export sales from small and medium enterprises come in large part from lack of access to knowledge about foreign standards of quality.

Perhaps most important, small and medium enterprises lack access to financing and long-term capital, the base that companies are built on. High risks associated with small and medium enterprises, whether real or perceived, exist in the absence of financial instruments that manage and diversify the risk. Banks also face high costs or cannot acquire information that they can trust, even when small and medium enterprises are credit-worthy. These factors raise interest rates and reduce lending volumes, setting up price and quantity barriers to small and medium enterprise growth. Small and medium enterprises have to resort to financing from networks of family or friends, from retained earnings, or from short-term credit from other small buyers or suppliers, rather than from larger institutions providing dedicated long-term financing vehicles for specific purposes.

LACK OF COMPETITIVE PRESSURE ON LARGE COMPANIES

Large companies form the hub of networks and clusters and, by the virtue of their size and range of business activities, provide the spark for the private sector ecosystem. But in many developing countries large incumbent companies can also stifle entrepreneurial energy and initiative. Too often, they can take advantage of weak institutional environments to raise anticompetitive barriers and protect their dominant position. While local informal markets can often function without much regulation, more mature and complex markets need appropriate regulations to function effectively.

A dynamic financial sector, in which new entrants and incumbents can get finance under competitive terms, is also important for creating competitive pressures in the market. But companies with a protected position in these markets often have strong incentives to use their lobbying power to slow government progress in improving the institutional infrastructure for markets.

Such practices directly hurt poor people, through higher prices and lower quality products. Poor people benefited from the opening of competitive markets in India in the early 1990s. Until then the population was effectively subsidizing a large part of the private sector, which was selling low quality products at high prices—made possible by controls on entry by domestic competitors and severe quotas and high tariffs on imports. Such anticompetitive policies are often perpetuated by an unlikely alliance between large protected incumbents and poor people, who fear a loss of jobs in competitive markets.

Corruption combined with weak and arbitrary legal enforcement buttresses incumbent firms at the expense of potentially more competitive ones. Specifically, incumbents might receive subsidies, special licenses or other privileges that preserve their position and dampen the incentive to innovate and reduce prices. Such firms may respond to perverse incentives to strip assets or dole out contracts to uncompetitive suppliers even when more efficient providers exist. The poor domestic macro environment encourages wasteful rent-seeking and retards the growth of competitive firms based on productivity.

These firms might also indirectly starve competitors from receiving capital by contributing to an environment that keeps finance underdeveloped. Large firms thus command the lion's share of resources in an underdeveloped financial system.

FOUNDATIONS FOR ENTREPRENEURSHIP—NOT YET IN PLACE

Building a sound private sector requires a strong foundation in the global and domestic macro environments, physical and social infrastructure and rule of law (figure 2.3).

Global macro environment

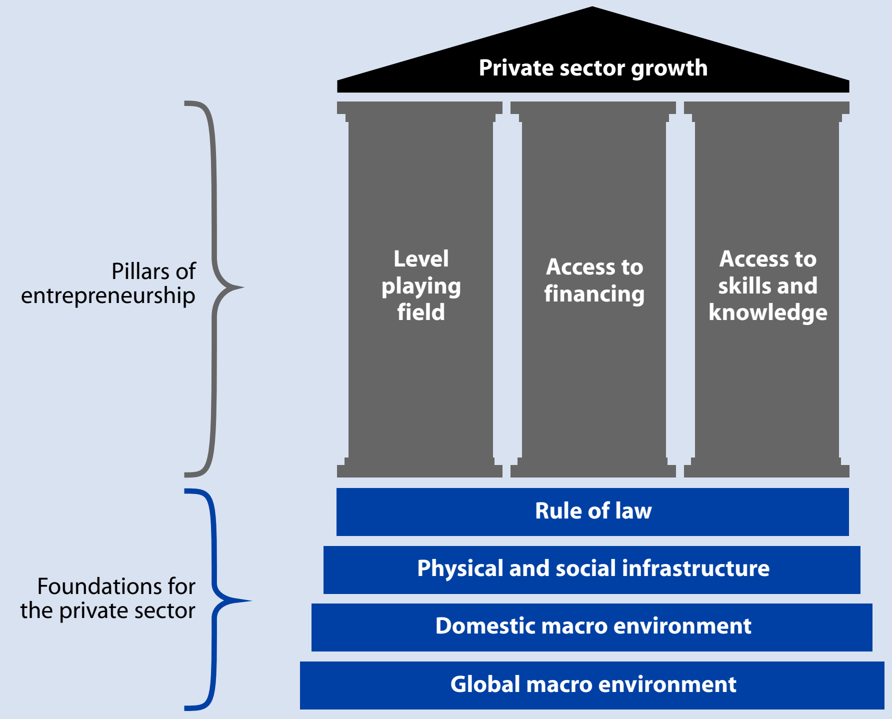
The foundations for growth in the private sector start with a well-functioning global macro business environment involving a dynamic global economy that provides markets, as well as adequate trade rules that enable competitive access to market opportunities. The open exchange of goods, capital and information—and the transfer of technology and ideas—stimulates private sector development. This occurs through several mechanisms: open markets, good-quality foreign investment, effective development aid and efficient transfers of technology and knowledge. It requires such reforms as dismantling the agricultural subsidies and other forms of protection that so evidently impede export-oriented private sector development in the rural areas of developing countries.

There is broad agreement that open markets have supported economic growth. The advantages, while well catalogued, merit repeating. An open trade policy fosters productivity growth by opening the private sector to competition. Free trade helps countries allocate their resources towards their most productive areas of comparative advantage. Cheaper imports raise the domestic standard of living and allow for the use of lower cost inputs as the private sector produces for domestic or foreign customers. Such a regime provides open market access through lower tariff and nontariff barriers.

Domestic macro environment

The central elements of a strong domestic macro environment for business include peace and political stability, good governance with policy predictability, transparency and accountability, and sound macroeconomic policies. For businesses, internal or external conflict increases cost and uncertainty, deterring both domestic and foreign investment. Worse, conflict forestalls private sector development, because it often leads to the tragic destruction of

FIGURE 2.3 **FOUNDATIONS FOR THE PRIVATE SECTOR AND PILLARS OF ENTREPRENEURSHIP**



human capital, the misallocation of scarce public funds, the devastation of land, the seizure of natural resources and the elimination of market access.

Physical and social infrastructure

A country's physical and social infrastructure includes roads, power, ports, water and telecommunications as well as basic education and health. Building up these basic services has a dual benefit: improving the lives of poor people directly and enabling the growth of businesses.

Technical inefficiencies in roads, railways, power and water alone caused an estimated $55 billion a year in losses in the early 1990s—an amount equal to 1% of the GDP of developing countries or twice the annual budget for financing infrastructure in the developing world. These losses fall on firms large and small—and on individuals, especially the poorest.

Low quality roads can shut small producers off from regional markets—and encumber large producers with shortages of critical inputs.

Well-maintained infrastructure improves commerce by speeding the transport of goods and raw materials, sustaining energy-intensive production and making information readily accessible and communication timely. Poor physical infrastructure often precludes business activity.

Ensuring connectivity through telecommunications and information technology has become particularly important in recent years, helping to overcome some of the barriers of inadequate physical infrastructure. Efficient access to information is clearly a vital part of the basic infrastructure need of modern economies.

Maintaining high quality physical infrastructure is largely, but not solely, a matter of capital investment. Efficient contracting, open bidding, regulatory credibility and private and public managerial capability carry weight as well.

Studies demonstrating the social and private returns from investments in education and health spotlight their efficacy. High levels of investment in human capital, especially in education and health, lay the groundwork for private sector growth. A healthy, educated workforce is a productive workforce. One need look only at countries ravaged by poor health or disease to see the deleterious effects of an underfinanced or inadequate health infrastructure on previously productive economies. Private firms profit from investments in education, from primary to university, from universal to targeted. Ensuring that such education is appropriate for a future workforce is a core task of a well-functioning education infrastructure. Educating women has particularly positive effects on their future earnings—and society's.

Investments in health and education involve both the public and private sectors, and counter to conventional belief, many education and health services in developing countries are delivered through private initiatives, including cooperatives and mutual health insurance organizations. In some systems 70–80% of health care expenditures are through private actors. Often, but not always, private involvement is a response to government underinvestments.

Improving the social infrastructure and ensuring that those surviving on the lowest incomes have access to affordable and high quality health and education services is an important foundation for private sector development.

The rule of law

The rule of law means that government decisions are made according to a set of written laws and rules, to be followed by every citizen. The rules are applied consistently, administered by a professional bureaucracy and adjudicated by a fair and transparent judiciary that is adequately compensated. In nearly all cases, courts provide reasons for their decisions based on the law, through some form of due process. Countries may subscribe to different legal systems arising from different political and social cultures, but the fair administration and enforcement of a just system of laws is a cardinal principle. Both elements matter—laws and their administration.

Laws form an intrinsic layer of the foundation for a robust private sector. Without a transparent legal framework and a fair judicial and administrative system, other efforts to foster private sector development cannot work as intended, and may even do harm. Home governments must establish the "rules of the game", a system that reduces transaction costs by making them predictable and enforceable. Legal and administrative systems influence whether and how transactions take place.

The rule of law manifests itself in the private sector with commercial laws, customs laws and contract laws, among others. Critically, the assignment and protection of property rights circumscribe private sector behaviour. Confusing and contradictory legal systems make formal business practices difficult and push businesses to become or remain informal. Poor legislation buttresses oligarchic and corrupt firms against competitive forces, often at the expense of small and medium enterprises. Cosy relationships between business and regulator impair the development of open, free market competition. The poor are likely to be the first victims of lawlessness.

Even though a written set of laws may exist, the legal system in many developing countries works informally. In the shift from informal to formal systems, many countries have old and new systems coexisting, often in conflict. The loser is often the more formal new system, implemented in a shallow and ineffective manner. One estimate suggests that as many as 80% of the legal issues facing the poor are addressed through customary or informal systems.

Corruption and confusion over the enforcement of rules are often to blame for high compliance costs. Bureaucratic red tape, backlogs, arbitrary decisionmaking and other onerous requirements and inefficient practices hamper private activity. Arbitrary or corrupt enforcement subvert laws intended as benevolent protections, including laws for worker safety, environmental protection and consumer safety. And corrupt practices distort prices and markets, and hinder free and fair competition.

The World Bank estimates that corruption can reduce a country's growth rate by 0.5 to 1.0 percentage points a year. Transparency International's Corruption Perception Index could, with very few exceptions, almost be ordered by income—poorer countries are almost universally rated more corrupt, though there is plenty of recent evidence that corruption is not limited to lower income categories.

THREE PILLARS OF ENTREPRENEURSHIP—TOO OFTEN MISSING

Even with strong macroeconomic and institutional foundations, three additional factors are indispensable for entrepreneurship and the private sector to flourish in an economy: a level playing field, access to finance, and knowledge and skills.

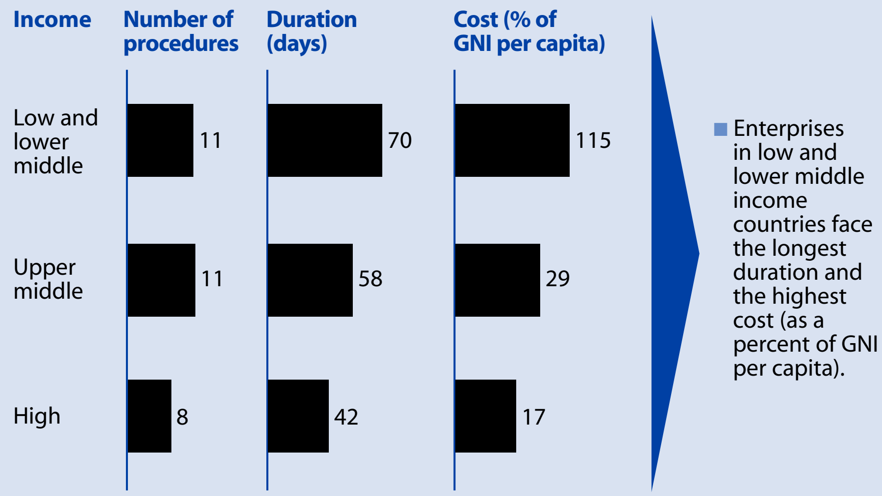
A level playing field—with fair rules, fairly enforced

Perhaps most important in allowing entrepreneurship and the private sector to blossom is a level playing field for firms competing in the domestic market. That can be created only by a system of rules and enforcement mechanisms that is fair, trustworthy and effective. Predictable rules ensure that entrepreneurs have open access to markets and can do business efficiently. And basic trust in the system encourages entrepreneurship and attracts talent (local, foreign and diaspora) to embark on entrepreneurial ventures.

Good rules are a critical element in creating a level playing field, and effective regulations are essential for the market economy. Rules, if excessively complex and incorrectly applied, can turn into significant barriers for enterprises and hamper business growth. This applies to rules for entry, operating, market and exit.

Entry rules. Excessive procedural requirements for business registration and licensing procedures raise the cost of entry into the formal sector and tilt the playing field in many developing countries (figure 2.4). For example, the World Bank's Cost of Doing Business survey estimates that starting a business requires $5,531 in Angola (more than eight times the per capita income) and about $28 in New Zealand (far less than 1% of the per capita income). Cumbersome entry regulations are directly correlated with lower productivity. When countries are ranked by ease of starting a business, the top quartile of countries has labour productivity of about $40 per worker, almost twice that of the bottom quartile. Longer registration processes are directly associated with higher levels of corruption.

FIGURE 2.4 **ENTERPRISES IN LOW INCOME COUNTRIES FACE MANY MORE BURDENS WHEN REGISTERING**



Note: Low and lower middle-income countries had GDP per capita (purchasing power parity) of less than $2,976 in 2001, upper middle-income countries were between $2,976 and $9,205, and high income countries were above $9,205.

Source: World Bank (2003a)

Operating rules. Disclosure requirements can have a positive impact at the industry and business environment by giving consumers and investors the information they need to make choices about the products they purchase and the capital they allocate. Labour market rules are critical to protecting employees from exploitation. But a number of developing countries have excessively complex labour rules, more than wealthier countries. For laying off employees, companies in middle and low income nations face higher barriers on average than their counterparts in developed economies. The mechanisms for social dialogue to find ways of mitigating the effects of layoffs, and safety nets to protect the poor are often weak or non-existent in most developing countries. Moreover, rigid employment regulations are associated with higher female unemployment. Note, however, that few of these rules are regularly enforced, making the case for simpler rules with better enforcement. Complex tax rules and structures also impose high costs that fall more on small and medium enterprises than on large enterprises, which can afford tax experts.

Credit rules. Many countries lack rules for sharing credit information, which makes it virtually impossible for creditors to check how indebted a potential client already is. In addition, creditors have limited protection in the case of default, significantly lessening their willingness to assume the risks associated with small and medium enterprise lending.

Tax rules. High tax rates and complex tax administration is a significant constraint for small and medium enterprises and can lead them to the informal sector if tax burdens become excessive.

A large informal economy can mean lower government revenues and higher taxes for firms in the formal economy, creating more incentives for informal operation. For example, in Brazil the informal economy grew as tax revenues increased from 24% of GDP in 1991 to 29% in 1999.

Market rules. Barriers in the land market are high in many nations. For example, it takes about 168 steps, involving 53 public and private agencies and 13–25 years to acquire "informal" land and receive legal title to it in the Philippines. This arduous process discourages people from formally purchasing land, making it impossible to use land as collateral for getting credit, one of the main sources of capital in developed countries.

Product market barriers also stifle growth. Subsidies and trade barriers in the developed world are the biggest culprits. But many developing countries also raise barriers to entry—say, by forbidding small companies to distribute electricity in rural areas, even when state monopolies do not serve those areas.

Restrictions on pricing can also cloud the business environment. For example, many governments charge excessively high prices for fixed-line domestic and international telecommunications services. The monopolies that operate in these conditions are highly profitable as a result, but their capital and labour productivity are low. The high prices provide few incentives for telecommunications players to use their resources more effectively.

Exit rules. Inadequate bankruptcy rules and protections can create additional hurdles for financing enterprises. Countries with better insolvency regulations tend to have more and cheaper lending.

Poor enforcement by formal institutions permits enterprises to avoid some or all of these rules, advantaging some of them over others. Breakdowns in formal institutions occur when officials do not have the skill or will to carry out their oversight functions. Government officials may not have the will to enforce the laws because the institutions they work for do not provide the right incentives. The institutions may not reward officials for applying the law fairly and equally, and the organizations may lack transparency and may not supervise officials sufficiently. In addition, government officials may not have the skills and resources they need to enforce the laws. They often require additional training or tools.

Access to financing

While foreign direct investment has had an essential role in the development process, it is impossible for a country to progress without domestic investment based on domestic savings. This requires domestic financial institutions that can efficiently manage risk and allocate capital to productive investments. Many developing countries have had weak, state-dominated financial sectors unable to act as a catalyst for development. But where genuine reform has been implemented, the benefits have been quick and evident, even if creating and restructuring an efficient domestic financial sector is a long task.

Large companies are well served by existing banking systems, and there has been good progress in microfinance over the last 10 years—with 41 million poor people served in more than 65 countries. But the progress on small and medium enterprise financing has been slow at best. It is not only about money needed, though. Small and medium enterprises are risky ventures. They require risk capital, but the sources of such capital are difficult to tap. So small and medium enterprises generally have to turn to classic debt financing. This can be difficult for them, because few entrepreneurs in developing countries can leverage assets as collateral the way they do in developed countries. Why? Mainly because of informal property rights and the lack of mortgage markets. Collateral requirements act as a screen that selects wealthy borrowers and crowds out many entrepreneurs with high growth potential.

Most emerging markets finance up to 90% of their investments locally, although for Sub-Saharan Africa the figure is closer to 65% (and most productive enterprises generate revenue in local currency, so the reliance on local financing is sustainable). Private credit as a percentage of GDP rises from 12% in low income countries to 25% in lower middle-income countries, 30% in upper middle-income countries and 85% in high income countries.

A web of factors is at work, more than just the lack of capital.

- Rules and their enforcement are often at the core. Most countries have weak property rights, making the use of assets as collateral difficult. Even when property rights are well defined, the enforcement of mortgage contracts is often impossible, for both political and judicial reasons. In addition, bankruptcy laws are typically lacking, increasing the risk to creditors and further deterring them from investing in small and medium enterprises.
- Poor financial institutions are also a problem. Domestic financial institutions can operate in oligopolistic or monopolistic conditions, with limited shareholder pressure to enter new and more difficult markets, such as lending to small and medium enterprises. Added to the lack of incentives is the public borrowing that crowds out private borrowing.
- Even when financial institutions have the will, they often lack the skills for small and medium enterprise lending. Banks are accustomed to full-blown risk assessments working with large clients—too costly for small and medium enterprises.
  At the other end of the spectrum microfinance institutions lend with very limited analysis, relying mostly on social networks for repayment. This does not work well for the larger amounts that small and medium enterprises require.
- A lack of reliable credit information also hampers the growth of small and medium enterprise lending—usually because there are no credit information agencies and disclosure requirements are weak or not enforced.
- Investors lack exit opportunities. Capital markets are absent or highly illiquid in many poor countries, making public offerings impossible. Private offerings can work, but most markets are far from liquid, with very few transaction opportunities.
- Entrepreneurs often lack the skill and the will for receiving risk capital. On skill, management talent is limited. On will, private equity investors report the reluctance of small and medium enterprises to open their books to outsiders in environments where parallel accounting is widespread.

Access to skills and knowledge

Technological innovations and the shift towards knowledge-based economies make human capital investment a prerequisite for sustained economic growth and central to the start-up, growth and productivity of firms. Human capital can determine the potential for a firm's growth and survival. It contributes directly to a firm's productivity by enabling the adoption of innovative technologies and processes. A firm's competitive advantage comes from its entrepreneurial capabilities; its management and technical know-how, including labour-management relations; and the skills, education and adaptability of its employees.

The level of education matters, and the skills of employees need to be continually upgraded through on-the-job training to increase the firm's productivity and its ability to absorb new technologies. In Costa Rica, Mauritius and Singapore the private sector has benefited from a virtuous cycle with formal education reinforced by on-the-job learning and training. Costa Rica has the most software exports per capita in Latin America, making it a technological hub in the region, thanks to its investments in both basic education (producing one of the highest literacy rates) and technical education.

Many developing countries suffer from low levels of human capital investment, aggravated by the outward migration of highly skilled professionals. The cumulative "brain drain" since 1990 has been estimated at 15% for Central America, 6% for Africa, 5% for Asia and 3% for South America. The International Organization for Migration estimates that some 300,000 professionals from the African continent live and work in Europe and North America.

By some estimates up to a third of R&D professionals from the developing world reside in OECD countries.

This persistent brain drain deprives developing countries of the know-how of thousands of their most talented people. It reduces the stock of human capital at home, erodes the domestic tax base and shrinks the educated middle class, a stabilizing factor in most societies.

The migration of talented risk-seeking entrepreneurs from the developing world seeking opportunities in more entrepreneurially minded societies spotlights the obstacles to starting and scaling up businesses in their native countries. The underlying cause is a disabling social environment that limits both the number of potential entrepreneurs and the degree to which they can unfold their potential.

■ ■ ■

This diagnosis of the structure of the private sector and the constraints to its rapid growth applies in differing degrees across a wide range of developing countries. The balance among the different factors varies with income, institutional development and the composition of the private sector. Addressing the constraints to unleash the potential of the private sector will require programmes tailored to the needs of individual countries, but the underlying approaches will be broadly similar. We turn to them now.

Photo: Evan Schneider/UNDP

CHAPTER 3

UNLEASHING THE POTENTIAL OF THE PRIVATE SECTOR

The Commission acknowledges that the constraints on developing a sustainable private sector are widely known—and generally accepted. So are the key elements of policies for addressing them. The big challenge is moving from an understanding of the broad constraints to putting together specific, country packages. Now the focus must shift from determining "what" the constraints are to "how" they are to be lifted and "who" is to lift them. Here we examine the policies and administrative steps that can alleviate these constraints and help create the capacity needed to govern transactions, capacity that is vital to the development of the private sector and to the efficient functioning of a market economy.

The Commission has emphasized that the private sector is important to the poor in many ways. If the benefits of reform are clearly articulated and the results of reform are quickly evident, constructive approaches to private sector development can translate into greater political support. And the momentum and consensus for change that this creates can provide the springboard for a comprehensive programme of reform and change.

FIGURE 3.1 **STRENGTHENING THE EFFECTIVENESS OF TRADITIONAL PRIVATE SECTOR DEVELOPMENT ACTIVITIES**

	Targeted at public sector players	**Targeted at private sector players**
Driven by private sector players ■ Companies ■ Civil society organizations ■ Foundations	■ Setting broader standards (industry norms, sustainability, corporate governance) ■ Lobbying for policy changes ■ Promoting participatory processes through social dialogue	■ Business linkages and partnerships ■ Investment, including foreign direct investment ■ Mentorship for entrepreneurs
Driven by public sector players ■ Local governments ■ Donor governments ■ Development agencies	■ **Policy reform** ■ **Policy advice** ■ **Funding and delivering technical assistance for public sector reforms** ■ **Financial transfers (aid, loans)**	■ Public-private partnerships, for example, for basic service delivery ■ Public-private consultative bodies ■ Privatization or contracting ■ Investment promotion ■ Direct business development services ■ Direct financing

Some broad lessons of experience:

- Successful policy reforms have generally been those in which concerned governments and policymakers have made strong and voluntary commitments to change.
- Reforms linked to conditionality rarely succeed when implementing governments are not committed to them.
- Significant changes often occur when countries are faced with major economic crisis (India in 1991, East Asia in the late 1990s), and the response to these changes can be rapid. Of course, it is better not to wait for a crisis to reform.
- Changes can also follow major shifts in basic economic philosophy (China, Vietnam and Eastern Europe).
- New governments that replace previous regimes with a history of poor governance (Kenya, Nigeria in the past few years) can often use the impetus of change to implement reforms.
- Changes almost always include new roles for the local private sector and civil society organizations, including employer and worker organizations.
- Technology is the agent for much of the needed change, and new technology enables change to be implemented much faster than might generally be expected.

Support to private sector development—both global and national—can involve economic research, macro and sector policy advice, technical assistance and direct financial support to specific private sector projects. Barring the latter, the bulk of these interventions involve governments and public institutions directing their support to governments and public institutions in developing countries (figure 3.1).

The main public players in this field are the World Bank Group (including the International Finance Corporation and the Multilateral Investment Guarantee Agency) and the International Monetary Fund. The regional development banks, including the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development and the Inter-American Development Bank, are also focused on helping to create the enabling environment for entrepreneurial development in their respective regions. Important roles are also being played by the Organisation for Economic Co-operation and Development in research and policy, and by the major UN specialized organizations such as the United Nations Industrial Development Organization, the United Nations Conference on Trade and Development, the International Labour Organization and the United Nations Development Programme. Bilateral agencies and institutions (such as the United States Agency for International Development, the U.K. Department for International Development, the Canadian International Development Agency and the Netherlands Development Finance Company) are also focused on important elements of the task, including enhancing access to capital and supporting the development of micro entrepreneurs and small and medium enterprises.

The Commission believes that any approach to private sector development—and the policy and action recommendations that accompany it—needs to be grounded in the realization that the savings, investment and innovation that lead to development are undertaken primarily by private individuals, corporations and communities. Governments should thus act as facilitators of private sector development and avoid actions that impede it. Governments and intergovernmental agencies can facilitate private sector development only by fostering properly functioning competitive markets.

- Providing conducive operating and investment environments in which all private enterprise (domestic, foreign, politically connected or otherwise) can flourish without fear or favour. This involves an overall social context that is politically stable and predictable, with appropriate procompetition rules and effective enforcement and sound macroeconomic fundamentals, including a fiscal policy conducive to the development of the formal private sector and adequate to the financing of the required human and physical infrastructure.
- Establishing properly functioning legal and judicial systems for protecting property rights and resolving contractual disputes—systems seen to operate credibly and efficiently when judged by international (not national) standards.
- Facilitating the movement of private capital of all kinds, not just foreign direct investment, through the progressive development of national capital markets and their links to regional and global capital markets. Liberalization of financial capital flows requires great prudence, however. A sound financial system with good regulations and enforcement is required before proceeding to full liberalization.
- Influencing national, regional and global risk perceptions favourably through better information dissemination in real time (rather than simply through promotional marketing of investment opportunities) and encouraging government behaviour that excites and supports rather than turns off investors, whether domestic or foreign.
- Targeting subsidies and tax incentives where clearly needed to address market imperfections, and moving away from broader reliance on measures that may be politically attractive in the short run but are generally counterproductive for sound private sector development in the long run.
- Providing or enabling the private provision of essential infrastructure (power, water, communications, transport) through public-private partnerships, innovative regulatory models and other means to ensure that private enterprises are not put at a competitive disadvantage.

BUILDING THE FOUNDATIONS

Chapter 2 discussed the global and domestic macro environment and the availability of physical and social infrastructure. We focus here on more specific actions relating to fostering the rule of law and creating a level playing field for entrepreneurs. We also address the broad principles that need to be applied to improve access to financing and the availability of skills and knowledge. Effective implementation of these policies can help private entrepreneurs enter into transactions with confidence that the contractual underpinnings of these transactions can be enforced. In any economy, a strong capacity to govern transactions is needed to unleash domestic entrepreneurial energy.

Strengthening the rule of law

For private enterprises the rule of law provides the foundation for a predictable regulatory framework and capacity to govern transactions between private parties. Ensuring the rule of law is not only about having or introducing the appropriate set of laws—it is about ensuring that laws can be enforced, fairly.

The overriding need is to ensure integrity in public service, which requires governments to:

- Establish and use transparent, public, open, nonexclusionary and objective procedures in public procurement contracts.
- Establish open, transparent, efficient and fair employment systems for public officials to ensure efficiency and good service and avoid patronage, nepotism and favouritism.
- Provide education, training, supervision, incentive structures and codes of conduct that breed and reward integrity and professionalism.
- Establish a system to avoid conflicts of interest and improper influence on officials and to provide mechanisms for officials to report such misconduct without endangering their safety and professional status.

Related to ensuring integrity in public service is ensuring accountability and transparency in the actions of public officials. This requires governments to:

- Build a broad base of support by running well publicized, participatory anticorruption campaigns addressing the public and private sectors.
- Establish appropriate auditing procedures for public administration and the public sector, and measures and systems to provide timely public reporting on performance and decisionmaking.
- Ensure transparent procedures for public procurement, privatization, state projects, state licenses, state commissions, national bank loans, other government guaranteed loans, budget allocations and tax breaks. These procedures should promote fair competition and deter corrupt activity. They should also establish adequate simplified regulatory environments by abolishing overlapping, ambiguous or excessive regulations that burden business.
- Promote systems for access to information about public expenditure.
- Strengthen antibribery actions and promote integrity in business operations.

Enforcing property rights

There is also evidence that governments do too little to protect property rights. The best-practice countries build efficient courts and support laws and institutions that define the rights of citizens and businesses to their property. Yet, the institutions that define and enforce property rights in many developing countries—the court system, property registries and law enforcement agencies—are often the least modern and least funded of all public institutions.

Business property rights can often be protected by providing alternative channels for resolving disputes with other businesses, customers, suppliers and government officials.

- Alternative dispute resolution systems provide a substitute for slow and expensive formal courts in their ability to provide predictable legal protection for the contracts and property of small entrepreneurs. Argentina piloted such a system, with 66% of 32,000 commercial cases resolved in an average of 2 months (not the typical 3–4 years).
- Automated assignment of cases, involving random computerized assignment of individual cases to judges, increases a judiciary's efficiency and reduces corruption. In a Slovakian pilot case the time between the filing and the first hearing fell from 73 days to 28, with the number of steps in case processing reduced from 23 to 6.
- Specialized debt collection courts resolve claims faster because those who preside over them have more command over the law and have responsibility for the entire debt collection system, from seizure to auctioning of property, if necessary. In Colombia a specialized debt collection court increased the number of cases filed from 4,000 a year to 11,000 (1996–2000), with 75% of cases resolved in a year and the number of pending cases falling by 5,000.

ERECTING THE PILLARS

Chapter 2 also described the three pillars that are indispensable for entrepreneurship and the private sector to flourish: a level playing field, access to finance, and knowledge and skills.

Creating a level playing field

Creating and defending a level playing field for companies requires a system of rules and enforcement that inspires trust and reasonably limits the cost and burden on enterprises. In recent years this area has received more attention from private and public players in development. One focus has been on improving legislation and regulation. In Vietnam a new enterprise law helped create a million new jobs. A level playing field also requires strengthening the institutions that implement and enforce regulations. The content of the solution seems clear—overcoming the entrenched behaviour that led to poor regulation in the first place. Someone benefits from every rule, and finding out how to overcome resistance by those who benefit is the first step in effective reform.

Simplifying regulations. An important element for a level playing field is simplifying regulations affecting the entry, operation and exit of private enterprises. The approach to resolving these issues is simple, and the experience is well demonstrated—needed is the will to implement change. The basic steps involve adopting best practices for business registration, for changes of ownership and closures and for the governance of transactions. Illustrative action programmes include:

- Kiosks and one-stop shops that simplify business and title registration make registration more efficient, and the greater transparency minimizes corruption at all levels. In Tanzania the Business Registration and Licensing Agency reduced the time to register a business from 90 days to about 3. In India electronic title registration in the state of Andhra Pradesh reduced the process from 7–15 days to a few hours.
- Single business permits enable governments to consolidate registering businesses so that entrepreneurs need secure only one permit to own and operate a business, rather than different ones at each level of government. In Kenya the single business permit reduced the costs to small enterprises and increased government revenues by 30–40%.
- Unified tax authorities are responsible for tax collection (including customs duties) and inspections for all levels of government. In Zambia such a system eliminated duplicate inspections and investigations while improving overall customer service and compliance.

Many of these changes could greatly reduce informality in most economies, particularly if accompanied by country efforts to fully understand the characteristics of informal firms. But informality is so pervasive that a special approach is needed.

Finding ways to increase the benefits of formalization is one such approach. It can be accomplished in part by opening public contracts to informal players willing to formalize if they win the contract, and improving market access through organizing trade fairs and creating links with international buyers. Affordable business development services for boosting management skills, productivity and quality are a demonstrated way of supporting formal small and medium enterprises.

Much of this rests on increasing awareness of the costs of informality—and on shifting mindsets. Public dialogue can be fostered through public awareness campaigns. And lobbying groups that represent small businesses can be strengthened.

Creating competitive markets. Creating a competitive market and reducing the influence of incumbents are critical ways to level the playing field. Where incumbents have already taken hold, three levers can open markets—technological innovation, financial development and freer trade and capital flows. Technological change fosters competition and relaxes the pressure for entry restrictions. By bringing in competitive pressure from outside, technology helps erode barriers to entry and creates a constituency for the further freeing of market entry restrictions. A well developed financial market promotes competition by making debt capital and equity financing available to firms without connections or access to subsidies. Trade and capital flows also reduce the ability of incumbents to influence governance by creating competition between domestic and foreign firms.

Competition creates winners and losers, a source of great tension between markets and democracy. Some of those employed in inefficient firms might bear the downside of change, particularly when social safety nets are not in place. So, opening markets to competition may best happen in phases, with full openness occurring after a strong set of market institutions is in place. A safety net focused on people, not firms, is needed to provide socio-economic security for those left behind.

To keep this process going despite these tensions, the costs of uncompetitive markets should be made transparent. The public should be able to understand when it benefits from rules that keep politicians and incumbents in check. A simple way to accomplish this might be to demonstrate quality and price differences between goods in protected economies and that of goods in roughly comparable open economies. Another might be to show the amounts of subsidies that go to protected firms.

Reforming taxes—simplicity, clarity, stability. Creating a positive and enabling business environment for small and medium business requires a tax policy that responds to business needs, encourages new businesses to start and helps existing businesses to expand. Governments need to develop tax policies in partnership with small and medium businesses, simplifying the rules applied to these businesses, reducing the burden of compliance and promoting transparency and stability.

Governments also need formal mechanisms for regular briefings and consultations to ensure that small business representatives are kept up to date on changes in tax codes and can give their views on proposals. To help small and medium businesses comply with the rules and ensure common interpretations across the country, tax officials need to be trained on the substance of tax rules and procedures.

Reforming finance and access to capital

Creating efficient domestic financial markets and increasing the access of domestic businesses to credit have been major goals of the multilateral development banks and bilateral development agencies. Their activities are mainly geared towards fixing the business environment and strengthening financial institutions.

The big issue with today's interventions, working through many intermediaries of varying effectiveness, is that they are not always demand driven. Successful models have taken a multiple-stakeholder approach to developing functioning markets. Consider the IFC's efforts to develop the leasing sector across countries—a model also applicable to micro-finance and housing finance. The model involves a coalition of market players including governments and regulators, international leasing companies, local financial institutions and experts in the legal, regulatory and tax aspects of leasing.

Governments should play a key role in creating and building long-term and sustainable financial institutions and infrastructure, strengthening the banking system to make it competitive. In the process, governments must ensure that public financial assistance programmes complement rather than compete with private financing that could be available on commercial terms.

Policymakers should concentrate on reducing barriers to access to finance, recognizing that access is generally more important than the cost of financing. They should recognize that subsidized credit programmes are unsustainable and unnecessary and that reducing transaction costs and increasing innovation and productivity among financial service providers are more important. They should also reform financial market rules and build enforcement capabilities, introducing new legal structures and removing obstructive caps and ceilings. Legal conditions and well-functioning implementation systems need to be established to address bankruptcy, registration and collateral and the regulations for leasing. Such measures can have benefits far more important than targeted credit programmes.

Strengthening the range and operational capabilities of financial institutions will better serve the needs of smaller businesses. Subject to appropriate regulation, nonbank financial institutions should become more prevalent. New financial products and liquidity vehicles would allow them to better serve small and medium enterprises with tailored insurance, lending and savings products.

In some cases public finance might bridge the gaps in financing. But governments must ensure that public programmes complement rather than compete with private financing that could be available on commercial terms. Efforts should focus on using the existing banking and financial system to direct resources rather than creating dedicated state agencies, which have demonstrated for too long their inability to channel funds themselves. A Small Business Administration type of approach has been successful in the United States and may be useful as a model. The goal is to bring about a financial system that can catalyze growth for small and medium enterprises and allay the nonbusiness risk that entrepreneurs can do without.

Entrepreneurs should have the risk management tools that large private firms do. These tools include a range of savings and insurance products as well as more sophisticated products that minimize foreign exchange or inflation risks, for example. But networks and partnerships may matter even more. Funds may come from diasporas, nascent venture capitalists, equity funds or other types of firms or groups of individuals, commonly referred as "angels" who have made progress in the system and are willing to help others. Access to these funds can embed the entrepreneur in professional networks that use common standards for evaluating new firms. To the extent that access to these networks is formalized through institutions, even entrepreneurs who are poor can receive financing and manage risk.

The long-term goal should be to have private financial institutions supporting small and medium enterprises—and to encourage well-functioning capital markets. This will require putting into place and developing credit bureaus and other mechanisms to provide credit references—an effective way of strengthening financial systems.

Developing human skills and knowledge

More investment is needed in local business-related skills, including foreign languages, information technology skills and basic finance, economics and project management. Public-private partnerships that combine more practical training on the job with basic education could be the basis for viable apprenticeship models. Also effective are recent efforts to conduct more leadership training by pre-eminent educational and leadership institutions for top decision makers from developing countries. Of particular importance is building local training capacity by "teaching the teachers", the only way to meet the large demand for local (and developing country to developing country) training.

There are also opportunities to accelerate skill-building and foster entrepreneurship by using social ties to the developing country's private sector. A country's diaspora in advanced economies is well suited to mentoring local entrepreneurs—or becoming investors or entrepreneurs. Expatriates in developing countries may also have skills that could be tapped for coaching and motivating local entrepreneurs.

Additional steps for governments:

- Build entrepreneurial networks and associations for peer-to-peer learning. Networks can create an entrepreneurial climate for coaching, mentoring and learning and strengthen links between companies. Networks support indigenous and private systems of learning, so that entrepreneurs can be encouraged to learn from their peers.

BOX 3.1 COSTA RICA'S PRIVATE SECTOR—UNLEASHED

Costa Rica has attracted some leading information technology companies. Intel's $0.5 billion chip assembly and manufacturing plant now produces 25% of Intel's global output and 40% of Costa Rica's exports. This has made the country one of the top 30 software exporters worldwide and the highest per capita information technology exporter in Latin America. Between 1985 and 2002 Costa Rica's exports grew fivefold, from $1.1 billion to $5.1 billion. Foreign direct investment inflows grew more than tenfold, from $59 million in 1989 to $661 million in 2002.

Costa Rica has a 95.5% literacy rate, and 18.5% of the active labour force has completed university, technical or parauniversity studies. Government policy has upgraded the educational system by incorporating technical education and training in electronics, informatics and engineering. Costa Rica has 85 vocational high schools (educating more than 85,000 students a year), 4 state universities and 46 private universities, including one of Latin's America's best known business schools, INCAE. The government also set up a National Learning Institute, which offers technical training free of charge and has trained more than 127,000 people.

The private sector took the lead in attracting investment and creating a pro-business environment through an apolitical nonprofit organization, the Costa Rica Investment and Development Organization (CINDE) in 1983, with funding from international donors and strong support at the highest levels from the government. In the mid-1990s CINDE began to woo multinational corporations, and it played a key role in influencing Intel's decision to locate its first Latin American chip plant in Costa Rica, which was not originally on Intel's short list of countries. Intel was swayed by the open, business-friendly environment, with a stable political system, respect for the rule of law, low corruption and good infrastructure.

More than 30 multinational companies have relocated to Costa Rica, employing more than 10,000 people in the electronics industry. Multinational corporations like Intel have also directly contributed to the development of a skilled workforce through on-the-job training and support for formal education institutions. And Intel's presence has increased awareness of career opportunities in engineering and other technical fields.

Source: UNDP (2001)

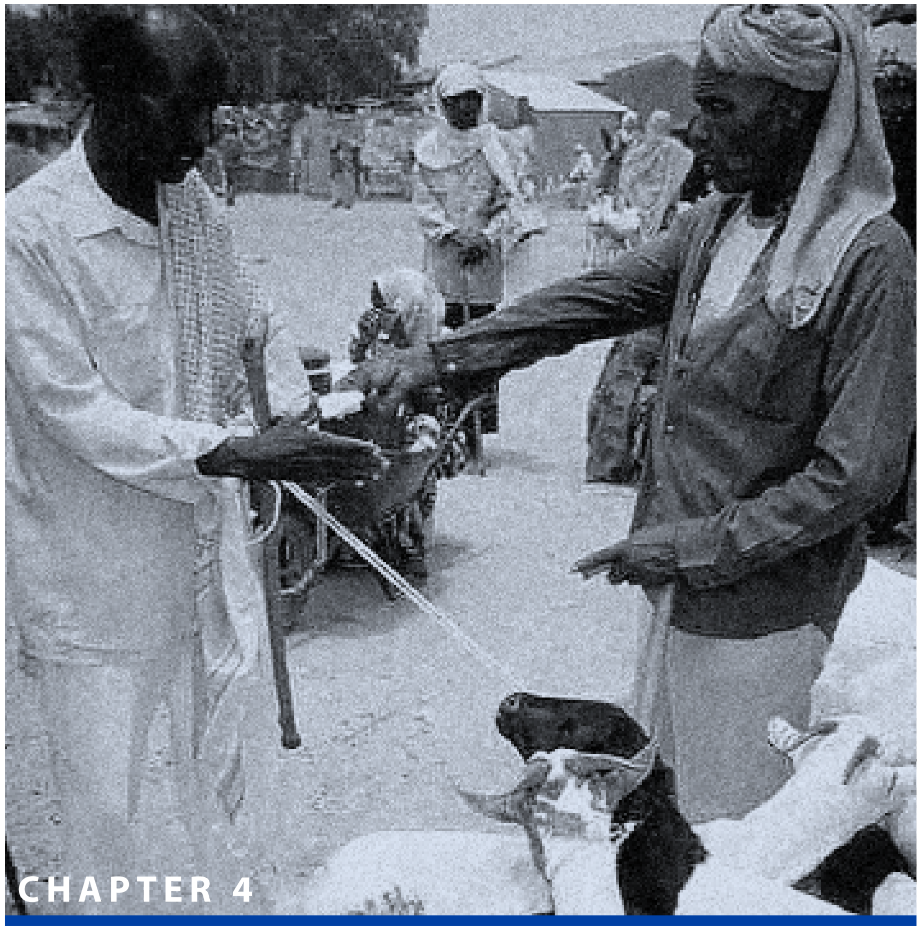
- Tap the private sector's potential to deliver on-the-job training and apprenticeships as a vital part of human capital development.
- Build an effective national system for training and skills development involving employer and worker organizations as key stakeholders.
- Develop institutions of management learning, including business schools, to develop a pool of local managerial talent.
- Conduct additional research on entrepreneurship in developing countries to better understand the interplay of entrepreneurial characteristics and the business environment.
- Develop government policies to encourage skilled emigrants to return home.

True involvement of relevant stakeholders in the process of change is useful only if accompanied by commitment from the top and confirmation of the belief that change is taking place. Particularly in the beginning of such a process, early evidence of victories and real change is vital to dispel the mood of scepticism and disbelief that often accompanies government announcements of change. And particularly where the changes involve administrative rules, the authorities generally already have the authority to implement newer approaches and to do so rapidly.

Building explicitly on successful models of change in other developing or neighbouring countries is likely to be particularly useful in ensuring support because it is more likely to be seen as applicable to local conditions. Thus, tapping the intellectual and implementation capacity of the domestic private sector will be particularly important where it is available, to be supplemented by international or developing country to developing country learning.

Poor people have repeatedly demonstrated the ability to use technology—so it should be a central element of any change programme, allowing the leap-frogging that is essential if progress is to be rapid. And working with civil society organizations to audit and monitor impact and extract lessons will continue the process of coalition building and lay the groundwork for future stages of reform.

Photo: Sonya Laurence Green/UNDP Somalia



CHAPTER 4

ENGAGING THE PRIVATE SECTOR IN DEVELOPMENT

Most efforts to address the constraints to sustainable private sector development originate in governments and public development institutions. But the Commission believes that to reach the needed level of change, it is essential to go farther and think about how better to engage the private sector in addressing the development challenge. Many critical resources for private sector development are under the radar screen of development, since they are not carried out by traditional development players and do not occur under the explicit label of development (box 4.1).

Private actions and public-private partnerships fall into two categories. They are commercial transactions driven by market incentives, developed as part of a corporation's evolving business and commercial strategy, which nonetheless have strong implications for development. Or they are specifically structured as innovative efforts to apply private sector principles and approaches to developmental problems (figure 4.1). From a different perspective, these innovative private sector activities are either purely private-private interactions or they fall more obviously into the area of public-private partnerships.

BOX 4.1 **RESOURCES UNDER THE RADAR SCREEN FOR PRIVATE SECTOR DEVELOPMENT**

Many private actors outside the traditional development community are addressing the challenges of development:

Companies
- Large corporations (both multinational and local) are leading private ecosystems that develop and strengthen the capabilities of local small and medium enterprises and microenterprises.
- Global financial institutions and emerging local financial institutions are developing innovative approaches and technologies to improve access to credit for the poor and for small and medium enterprises.
- Individual companies, generally multinational corporations but also some large local ones, are launching corporate social responsibility programmes to address specific development needs.
- Important local companies—alone or with domestic private sector associations—are broadening their strategy and reach from strictly lobbying for actions beneficial to the private sector to informing and influencing the development process.

Associations and foundations
- International private sector associations, such as the Council on Sustainable Development, International Chamber of Commerce, International Business Leaders Forum, World Economic Forum, International Organization of Employers and others at the regional level, such as the West African Business Network and the Commonwealth Business Forum, are focusing on various aspects of development. National business associations, such as the Confederation of Indian Industries and the Federation of Malaysian Manufacturers, have played a key role in national economic planning.
- Private foundations are engaging in the broader development process, with a focus on accountability and results.

Academic institutions
- Academic institutions (including management schools)—both in countries that are members of the Organisation for Economic Co-operation and Development and in some developing countries—are focusing more on private sector development and broader development issues.
- Leading business schools are working with African counterparts for the joint management training of local public officials and private sector leaders.

Networks of individuals
- Individuals are playing or wishing to play a bigger role in resolving global issues by contributing their know-how and services to various types of "developmental peace corps" organizations (retired senior executives, business administration students, financial sector experts).
- Expatriate executives of multinational corporations are mentoring local entrepreneurs or teaching business in schools where they are stationed.
- Diaspora members in North America and Europe are supporting entrepreneurs in their homelands with remittances, informal financing of small businesses, and business advice and mentorship. They are the mirror image of the brain drain discussed in chapter 2 and represent the potential brain bank that could play a bigger role as the changes in country policies discussed in chapter 3 begin to take hold.

SERVING MARKETS AT THE BOTTOM OF THE ECONOMIC PYRAMID

The vast emerging consumer market at the base of the pyramid—4 billion people with a per capita income of less than $1,500—provides multinationals and large local companies with an attractive market for their goods and services (box 4.2; see page 32). India has 700 million people in rural markets. China has a billion.

As today's advanced economies become a shrinking part of the world economy, the accompanying shifts in spending could provide significant opportunities for global companies. Being invested and involved in the right markets—particularly the right emerging markets—may become a much more important strategic choice. Indeed, many companies are already serving the world's poor in ways that generate strong revenues, lead to greater operating efficiencies and uncover new sources of innovation. For these companies—and for those following their lead—building businesses aimed at the bottom of the pyramid promises to provide competitive advantages as the 21st century unfolds. At the same time, it provides critical links to the marketplace for consumers at the bottom of the pyramid.

FORMING ECOSYSTEMS AND BUILDING NETWORKS

One of the most compelling ways to help firms succeed is by increasing the power of the linkages and networks they are part of. Many business ecosystems bypass weak regulatory environments by creating private capacity for regulation and enforcement within the network. This capacity can reduce asymmetries within networks and enhance the ability to enforce contracts, thus building trust in the system.

Networks can bring many benefits by:

- Enabling the transfer of skills, technology and quality.
- Ensuring that foreign direct investment has positive spillover effects.
- Bringing companies into the formal sector.

- Creating the capacity to govern transactions through commercial contracts.
- Opening markets and the supply of inputs to smaller firms through networks of larger partners.
- Improving the ability of small and medium enterprises in such networks to get financing on commercial terms.
- Increasing the wages, employment standards and productivity of local companies.
- Increasing the choice and lowering the prices for poor consumers by bringing a greater variety of goods to market.

These networks—which can include vertical supply-chain relationships and horizontal clustering—also have enormous potential. But so far their impact has been limited, concentrated in a few developing countries, such as Brazil, China, India and Malaysia. In Sub-Saharan African countries there are few commercial transactions between large multinationals and small local companies. A study of 5 foreign and 36 local companies in Kenya showed that none of the multinational affiliates engaged in local sourcing.

A good example of a business ecosystem at work is Hindustan Lever Ltd., a major producer of personal care and food products in India. Its ecosystem includes 80 manufacturing facilities, 150 small and medium enterprise suppliers employing up to 40,000 people, 7,250 exclusive stockists, 12,000 wholesalers and small retailers, 300,000 shop owners and 150,000 individual entrepreneurs in remote villages who sell its products, a number likely to grow to 1 million on current expectations.

FIGURE 4.1 **PRIVATE SECTOR CONTRIBUTIONS TO PRIVATE SECTOR DEVELOPMENT**

	Targeted at public sector players	**Targeted at private sector players**
Driven by private sector players - Companies - Civil society organizations - Foundations	**- Setting broader standards (industry norms, sustainability, corporate governance)** **- Lobbying for policy changes** **- Promoting participatory processes through social dialogue**	**- Business linkages and partnerships** **- Investment, including foreign direct investment** **- Mentorship for entrepreneurs**
Driven by public sector players - Local governments - Donor governments - Development agencies	- Policy reform - Policy advice - Funding and delivering technical assistance for public sector reforms - Financial transfers (aid, loans)	**- Public-private partnerships, for example, for basic service delivery** **- Public-private consultative bodies** - Privatization or contracting - Investment promotion - Direct business development services - Direct financing

Working with women entrepreneurs, Hindustan Lever is leveraging the ecosystem to target the potential of more than 200 million consumers in rural areas. These business women learn about products, prices and returns and advise the customers in their villages about the products they sell. Hindustan Lever has the potential to reach customers it could not effectively reach otherwise through normal distribution channels. This market-based ecosystem is a means of informing the poor about the benefits of transparency in transactions and the need to respect contracts—be they explicit or implicit with the company. This connection with national and global business systems reduces reliance on local moneylenders and slumlords.

Another example is the $2 billion garment export industry in Bangladesh, based on the power of spreading innovation. In view of the limits on Korean textile and garment exports to the United States, Daewoo started a joint venture with a local Bangladeshi company to produce garments for export and trained local employees in the latest production techniques. Over time, however, as many as 115 of the first 130 Korean-trained managers left with the knowledge and networks they had acquired to set up their own companies. The industry has grown to more than $2 billion in annual sales and accounts for more than half the country's exports.

Networks link entrepreneurs with potential sources of financing, human skills, partners, suppliers and information. Through such networks entrepreneurs share information and assessments of

BOX 4.2 SHOWING WHAT'S POSSIBLE AT THE BOTTOM OF THE PYRAMID

In the financial sector

ICICI Bank-India is offering innovative ways to deliver financial services to the poor. It has developed two models:

- The direct-access–bank-led model promotes and nurtures self-help groups, to create a savings pool. Once a pool reaches a certain size (few hundred U.S. dollars), ICICI will consider making loans of $5,000 with a distribution of $250 per individual. Group pressure is the best collateral, and repayment rates are 99.9%.
- In the indirect channel ICICI partners with microfinance institutions drawing on the advantages of each. The microfinance institution draws on its skills to contribute the social intermediation aspects, while the bank carries out the financial intermediation and bears the credit risk. This can effectively leverage the risk capital that already exists with banks and can be a potential solution to the capital constraints of microfinance institutions. This model reduces the cost of intermediation without affecting the quality of the portfolio.

The strategy has both made good business sense and had significant development impact. For example, the number of self-help groups has increased to over 10,000, allowing ICICI to substantially increase its market share in rural areas. Villagers have had a surge in financing opportunities. Interestingly, a study conducted independently has shown a strong surge in self- confidence of members in self-help groups.

In the retail sector

Casas Bahia, the largest retailer in Brazil, focuses almost entirely on poor consumers. It uses a carne, or passbook, system of financing that allows poor customers to buy on credit. Casas Bahia uses a proprietary system that does credit checks and applies common-sense rules to determine whether to offer financing to those without credit history.

Casas Bahia has 4.2 billion reais in revenues, 330 stores, 10 million customers and 20,000 employees. Some 70% of its customers have no formal or consistent income and are primarily maids, cooks, independent street vendors and construction workers whose average monthly income is two times the minimum wage. The poor now have access to a much broader range of products and benefit from better credit schemes than they previously had.

In the cement sector

CEMEX, Mexico's largest and the world's third largest cement company, created two key programmes to tap the large poor population of Mexico, where 60% of the people survive on less than $5 a day.

- *Patrimonio Hoy* targets the low income, do-it-yourself home-builder segment of the population. It is set up like a microcredit scheme, with small lending groups, but the savings are used to purchase cement and other building materials.
- *Construmex* is an innovative way of tapping the diaspora community so that money sent home for construction can be transferred directly to the cement company without paying financial intermediaries. The service allows Mexicans living in the United States to send their money and their orders directly to cement distributors in Mexico, who then deliver cement to the site of the person's future home or business.

CEMEX knew that a significant part of the $10 billion in remittances to Mexico (about 10%) is used for construction of houses.

Patrimonio Hoy tripled the rate of cement consumed by its low income, do-it-yourself homebuilders. *Construmex* has reported $2.5 million in sales since it started in July 2001, mostly from emigrants in Los Angeles. With its U.S. sales potential estimated at $160 million a year, *Construmex* is planning to expand to other cities with large Mexican communities, including Chicago and Houston. Both programmes provide the poor with more cost-effective opportunities to build their homes and improve their livelihoods.

In the cellular network sector

GrameenPhone is the largest cellular operator in Bangladesh. Vodacom is a South African subsidiary of Vodafone and thelargest operator in South Africa. Both companies work with local entrepreneurs who acquire cellular phones and resell phone services within their villages. GrameenPhone combines this activity with microcredit for entrepreneurs and focuses mostly on women.

GrameenPhone has built the largest cellular network in the country, with investments exceeding $300 million and a subscriber base of more than 1 million. Its rural programme is already available in more than 35,000 villages, providing telephone access to more than 50 million people, while helping to create microentrepreneurs. The key to the success of the village phone has been a cadre of entrepreneurs, 95% of them women, who benefit from the opportunity to run their own microentreprises.

Vodacom provides more than 23,000 cellular lines at more than 4,400 locations throughout South Africa. The company has provided affordable communication services to millions of South Africans and empowered thousands of previously disadvantaged individuals with income-generating opportunities and lasting business skills. These accounts generate Vodacom's highest revenues.

Source: Prahalad (forthcoming)

markets and technology and lessons from their own experiences. They can also coalesce into groups to discuss issues of common interest and contribute more broadly to the communities they live in.

Informal entrepreneurial networks (often ethnic or religious in origin) predominate in developing countries. In the absence of clear legal enforcement of contractual obligations, these relationship-based networks—relying on trust, personal guarantees and informal contract enforcement—facilitate cross-border trade and business transactions and provide a source of financing. Best known is the extensive network of Chinese overseas entrepreneurs with predominantly family-owned businesses, found among the 50 million-strong Chinese diaspora.

It has played a key role in the economic transformation of China and emerged as a business force in Southeast Asia. Official Chinese statistics reveal that overseas Chinese entrepreneurs account for 70% of China's foreign direct investment—more than $50 billion recently.

The Indian diaspora has been less involved in direct investment back home than in making business connections between overseas investors and the local business community and in facilitating the faster development of private ecosystems.

With market development and the emergence of larger firms, informal ties based on personal ties are supplanted by formal networking organizations, such as chambers of commerce, alumni associations and incubators. These formal networking organizations have long been sources of mutual support in the developed world and are now providing the same in the developing world, playing a vital role in:

- Organizing and pooling resources to create shared institutions and capabilities.
- Creating relationships and levels of trust that make them more effective.
- Defining common standards.
- Conducting or facilitating collective action in procurement, information gathering and international marketing.
- Defining and communicating common beliefs and attitudes.
- Providing mechanisms to develop a common economic or regional agenda.

Business associations, especially trade and industry organizations, are representing the common interests of their members by coordinating activities, establishing self-regulatory standards, lobbying governments and providing direct services to members. Direct services include the promotion of linkages, training, information dissemination and access to markets. Business associations have taken the lead in improving the competitiveness of their members by:

- Lowering the costs of information.
- Establishing horizontal coordination (quota allocation, capacity reduction) and vertical coordination (upstream-downstream).
- Setting standards and upgrading quality.

FOSTERING PUBLIC-PRIVATE PARTNERSHIPS FOR SUSTAINABLE DEVELOPMENT

Important benefits can be obtained by fostering more effective public-private partnerships, particularly in the selective provision of such services as energy and water. Energy production and basic water supply projects can use the most effective ownership structure necessary, including public ownership. But final delivery to the rural customer or to the informal sector can often be managed by smaller domestic companies. Decentralized power production, through distributed energy of various kinds, can also be contracted to the private sector through agreements with the public sector grid. Solar power and small run-of-the-river hydro plants are examples.

Public-private partnerships are also effective in implementing sustainable development objectives. Noteworthy here are the United Nations' Global Compact—a voluntary corporate commitment to environmental, human rights and labour standards—and the International Finance Corporation's Equator Principles, an agreement by leading international financial institutions to observe global standards in environmental and social policies in all large projects they finance, regardless of whether these are jointly financed with public institutions that observe the same rigorous standards.

Similar public-private partnerships in corporate governance and transparency are attempting to influence private sector behaviour. The "Publish What You Pay" campaign aims to help citizens of resource-rich developing countries hold their governments accountable for how revenues from the oil, gas and mining industries are managed and distributed.

The campaign, backed by a worldwide coalition of more than 170 nongovernmental and civil society organizations, was founded by Global Witness, George Soros's Open Society Institute, CAFOD, Oxfam, Save the Children U.K. and Transparency International U.K.

The coalition calls for international regulation on the disclosure of net taxes, fees, royalties and other payments made by companies to developing country governments in all countries where they operate.

Because individual companies might be put at a disadvantage by disclosing information others fail to reveal, expecting voluntary disclosure might not be a viable option. Yet all companies and the investment community would benefit from a level playing field if regulators required disclosure. The importance of this approach is also reflected in the Extractive Industries Transparency Initiative developed by the U.K. government and recently endorsed by the World Bank.

In addition to setting standards for the private sector, a small but growing number of companies are driving standards higher themselves—to be the pacesetters for measuring other private companies. These newer trends provide a valuable complement to the traditional approach of a regulated private sector and a regulating government agency. Infosys in India is not only paving the way in this field but also engaging directly with governments to influence the broader reform and developmental agenda in its state of operations and in the country. This kind of role for the private sector is vital to the development effort.

IMPROVING CORPORATE GOVERNANCE

Corporate governance is a focal point in creating safeguards against corruption and mismanagement, limiting insider dealing and cronyism while promoting the values of a market economy in a democratic society. The values include accountability, transparency and the rule of law—as well as fairness, responsibility and ownership and protection for minority shareholders.

The benefits of committing to corporate governance mechanisms are less corruption, a healthier private sector, fairer markets and greater institutional development—all supporting a growing economy. Separate from corporate governance, which at its heart is the protection of shareholders rights, is the growing interest in corporate social responsibility. Companies are not only pressured by government, which adopts corporate governance regulations forcing codes of conduct on businesses, but also by public opinion galvanized by civil society and labour organizations. Self-regulating or voluntary codes of corporate behaviour prove that companies are willing to be good corporate citizens.

It is important for the public and private sectors to work together to develop a set of rules binding for all, establishing the ways companies have to govern themselves. Business associations, such as chambers of commerce and industry groups, should try encouraging their members to develop standards of corporate governance to protect shareholders and other constituents—and standards of social responsibility to respond to external stakeholders. Private sector task forces promoting corporate governance and business associations developing codes of corporate governance for its members are promising starting points.

ADVANCING RESPONSIBLE BUSINESS PRACTICES AND CORPORATE SOCIAL RESPONSIBILITY STANDARDS

To some extent the mainstreaming of what is now commonly referred to as “the triple bottom line”—reconciling respect for the environment, social equity and financial profitability—is good news for business. The triple bottom line focuses corporations not just on the economic value they add, but also on the environmental and social value they add—and destroy. The term captures the values, issues and processes that companies must address to minimize any harm from their activities and to create economic, social and environmental value. This involves being clear about the company’s purpose and taking into consideration the needs of all the company’s stakeholders—shareholders, customers, employees, business partners, governments, local communities and the public.

The possibilities of such an alignment, between social and commercial interests, remain largely untapped. The majority of companies that have taken an enlightened approach to sustainable development have been pushed and pulled in that direction: pushed by changing societal expectations and stakeholder demands, and pulled towards emerging markets by greater competition for market share in the mature markets of the developed world.

Most of the efforts have been concentrated in traditional philanthropic or charitable models: building schools and health clinics or supporting cultural and artistic organizations. Though valuable and perhaps necessary, this model is more window-dressing than a substantive or sustainable contribution to the lives of the poor. Because it lies outside the traditional business model, the benefits are measured in intangibles—such as reputation, risk reduction and license to operate—rather than the bottom line. It represents mainly short term, unquantifiable and unaccountable financial contributions. And commitments can come and go with changes in the business climate or management.

In the last decade there has been a growing body of evidence that pioneering companies that actively manage their impacts on sustainable development have better financial performance. Companies have been pushed by advocates, labour unions, the media and even shareholders to take the positive and negative impacts of their activities into far more consideration than they did before. They are building human rights, core labour standards and sustainable development into their corporate commitments. They are slowly learning to implement them through management systems and broader accounting standards. And they are reporting their successes and failures along the way to the public, using sophisticated corporate social responsibility reports.

Global partnerships to define standards in different sectors of industry have also facilitated private sector leadership and corporate governance attributes that reflect changing corporate behaviour. These include Responsible Care in the chemical industry, the Sustainable Forest Initiative, Sustainable Fisheries, and the Global Mining Initiative launched in 1998 by nine mining companies from around the world.

The global mining industry sought to redefine its role by demonstrating corporate commitments to stakeholder dialogue and sustainable development. The initiative led to an independent research project on mining, minerals and sustainable development and a multistakeholder conference in May 2002. The partnerships and research efforts that flowed from these initiatives continue through the International Council on Mining and Metals, the World Business Council for Sustainable Development and other industry associations and companies that share experience in promoting local growth through sustainability principles and standards.

The partnerships reflect the evolution of new voluntary standards for judging corporations. Some critics will point to these partnerships as corporate ways of avoiding binding regulations. Others see them as direct evidence of corporate commitment and understanding of the importance of taking a leadership role on sustainable development. Among the new standards are: AA1000 (developed by the Institute for Social and Ethical Accountability), ISO14001 (International Organization for Standardization) and Project Sigma (a sustainability management standard under development by the British Standards Institution, Forum for the Future and others).

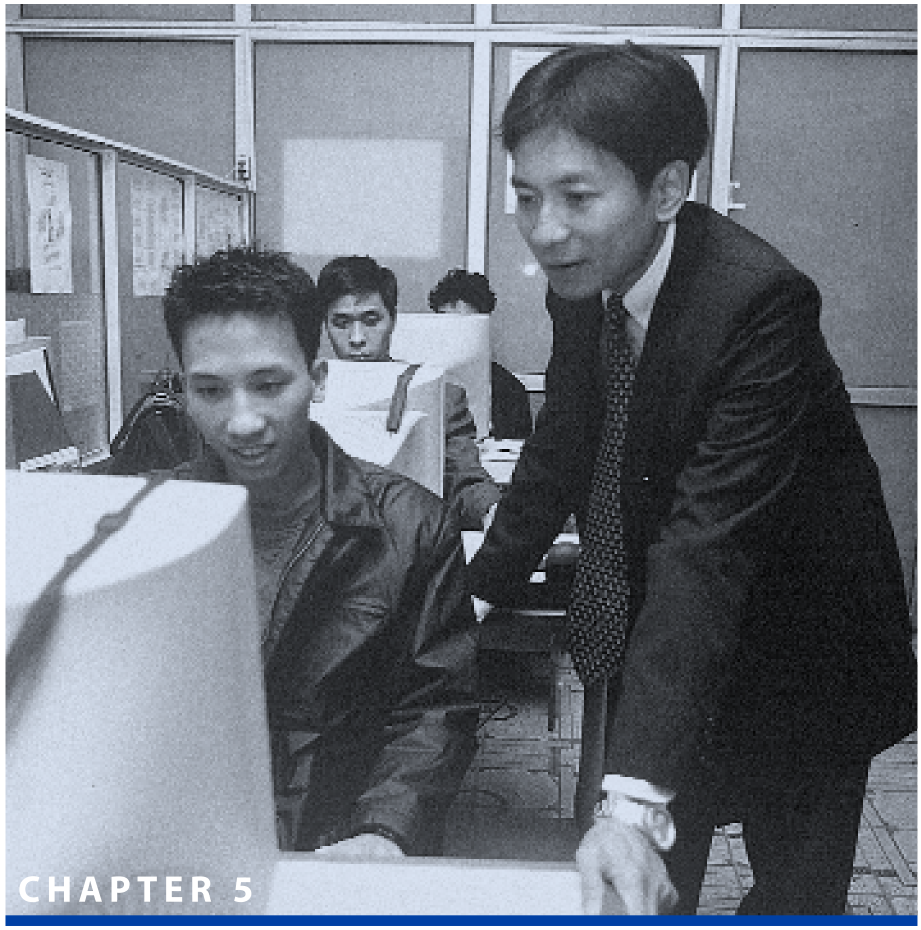
The development and improvement of indicators for development by international development agencies, such as the International Finance Corporation's Sustainability Framework, and by corporations, such as the Global Reporting Initiative, present unique opportunities to track private sector contributions to sustainable development. So does the scoring of corporate efforts to pursue the Millennium Development Goals, published through the World Economic Forum's Global Governance Initiative. Such quantitative tools will allow corporations to move beyond qualitative stories associated with traditional philanthropy towards strategic social investments with short, medium and long targets. Being able to budget and report on results will have the benefit of quantifying private sector contributions to international poverty reduction targets while simultaneously creating incentives for more proactive approaches to sustainable development. Standard indicators based on existing international frameworks also provide the tools for cost-benefit analysis of investments and the identification of effective models.

■ ■ ■

The Commission sees a distinct need for accelerating the dissemination of information on successful models, creating new ones or adapting existing ones to new environments, replicating them across geographies and scaling them up rapidly.

The private sector, particularly the management of large local and multinational companies, needs to make a much more serious commitment to capturing the opportunities—by researching bottom-of-the-pyramid markets, by advancing standards of sustainability and public trust and by thinking creatively about linking with other businesses locally or abroad for mutual benefit. Governments, from both developing and developed countries, can facilitate this, and international development institutions can assist them.

Photo: Chao Doan/UNDP



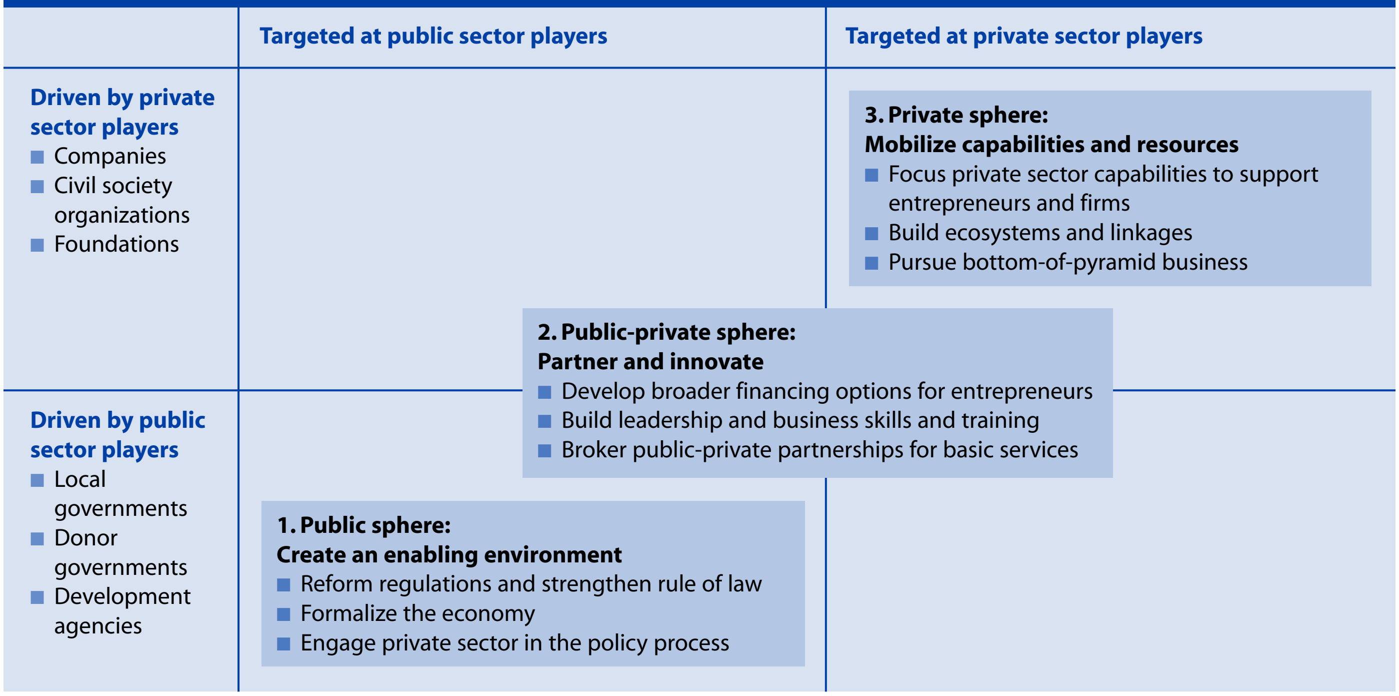
CHAPTER 5

RECOMMENDED ACTIONS

The Commission believes that the primary responsibility for achieving growth and equitable development lies with developing countries. This responsibility includes creating the conditions that make it possible to secure the needed financial resources for investment. And those conditions—the state of governance, macroeconomic and microeconomic policies, public finances, the financial system and other basic elements of a country's economic environment—are largely determined by the actions of domestic policymakers. Their challenge is to capitalize on advances in macroeconomic stability and democracy and to launch reforms that would bring about further changes in institutional frameworks to unleash and foster the private sector.

Most of the recommended actions involve more than one of the actors working together. Where governments are implementing policy change, it is often with the direct support and involvement of multilateral development institutions. Where the private sector is taking a more active stance on sustainable development, it is often with civil society raising the profile of this issue. Where governments are implementing regulatory reform, it may be in direct consultation with representatives of the private sector. The individual actions identified here should be seen in the framework of this

FIGURE 5.1 **ACTIONS IN THE THREE FOCUS AREAS**



broader cooperation—which is needed even more to reduce poverty.

Our interest lies in three areas:

1. **In the public sphere,** promoting the reform of laws, regulations and other barriers to growth.
2. **In the public-private sphere,** facilitating cooperation and partnerships between public and private players to enhance access to such key factors as financing, skills and basic services.
3. **In the private sphere,** encouraging the development of business models that can be scaled up and copied and that are commercially sustainable.

The broad range of actions in these three focus areas—necessary for a successful program of private sector development—flow from the analytical framework for unleashing the capacity of domestic entrepreneurs developed in chapters 2 and 3. These actions reinforce and leverage the contributions of the private sector to development, as outlined in chapter 4.

ACTIONS IN THE PUBLIC SPHERE: CREATE AN ENABLING ENVIRONMENT

Creating an enabling environment involves steps designed to reduce the share of the informal sector in an economy, through reform of the overall enabling environment for the formal economy. These steps should have the effect of both reducing the costs as well as increasing the benefits of formality.

Recommended actions by developing country governments

The Commission believes that developing country governments should undertake the following actions:

Reform regulations and strengthen the rule of law. Developing country governments have to make a strong and unambiguous policy commitment to sustainable private sector development—and combine that with a genuine commitment to reform the regulatory environment by eliminating artificial and policy-induced constraints to strong economic growth. Everything starts with the tone at the top. There is no reason, for example, for the cost of business registration in low income countries to be many multiples that of similar procedures in OECD countries. We emphasize a pragmatic, end-user perspective that focuses on actual improvements in an entrepreneur's dealings with public institutions or regulations. And as governments develop and enforce more effective formal rules and regulations, they need to understand the importance of private sector ecosystems in creating broader participation in the economy and in illustrating the value of the capacity to govern transactions.

Formalize the economy. Developing country governments need to focus on creating the conditions to reduce informality and change the composition of the private sector ecosystem over time. The focus should be on measurable outcomes. Since the composition of the private sector ecosystem in a country is a measure of its development progress (high levels of informality are associated with lower incomes), the objective should be to strive to change this composition in a specific and measurable way. Indicative targets should be set to increase the shares of formal enterprises and smaller enterprises in the economy, monitorable over a five to ten year horizon.

A clear recognition of the informal sector will need to be accompanied by rapid steps to analyze its local characteristics and put in place the measures to improve its access to finance and to support from the formal sector. We need to start by raising awareness and disseminating information about the prevalence of informality—and by diagnosing the problem in a country context. Remedies include reforms of specific government rules and their enforcement.

One area for urgent action is improving the rules and processes for registering and titling land, critical preconditions for financial access based on these assets. Needed here are practical, user-friendly processes to obtain and enforce property rights. As with any public reform process, consultative bodies need to steer reform efforts in a transparent way, involving informal entrepreneurs, cooperatives and civil society organizations.

Engage the private sector in the policy process. Governments need to create a real partnership with representatives of the domestic private sector to implement changes and ensure that the voice of the private sector includes small and medium enterprises and microenterprises. Government–private sector councils and advisory bodies are being set up. But the difference between notional collaboration and truly effective cooperation can be ensured only by governments and their private sector partners. When new arrangements are put in place, a few high-profile examples of successful cooperation can change the environment from mutual distrust to strategic partnership. Public-private consultative bodies, where public officials and private sector representatives share a voice are another key element. But the full spectrum of private sector players must be at the table, including informal and small entrepreneurs and workers' organizations.

Recommended actions by developed country governments

Developed country governments are the principal players in creating and maintaining a positive global environment.

Foster a conducive international macroeconomic environment and trade regime. The Commission believes that developed country governments have to foster a conducive international macro-economic and policy environment to unleash the full potential of entrepreneurs in developing countries. A robust international economy provides markets for goods from developing country companies. In addition, increasing the flow of development aid and reforming the global trading system to provide fair economic opportunities to producers from developing countries are essential for promoting rapid growth in domestic private investment.

Redirect the operational strategies of multilateral and bilateral development institutions and agencies. Developed countries are the primary shareholders of the multilateral development banks. They control most of the bilateral aid agencies and ministries active in the developmental arena. In encouraging sustainable private sector development, they need to ensure that the collective actions of these agencies are better coordinated—to improve their efficiency and to reduce the pressures on the administrative capacity of developing country governments. They also need to focus their support for private sector development in developing countries by creating the conditions to reduce informality and change the composition of the private sector ecosystem.

Untie aid. Developed country governments are also the main source of technical assistance funds used by multilateral development institutions to support policy and institutional reform in developing countries. Although some flexibility has been introduced in recent years, the major elements of these funds are tied. This can create unnecessary complications in how effectively funds can be deployed and can affect the quality of the advisory work that they support. Moreover, the bulk of the funds are provided to governments rather than more directly to the final recipients. Changes in the administrative rules controlling these funds would permit more effective use and delivery of technical assistance to stimulate private sector development.

Recommended actions by multilateral development institutions

The Monterrey Consensus explicitly acknowledged the role of private business in development. It touched on the need for improving the functioning and efficiency of global and bilateral development agencies. It recognized the limited absorptive capacity of many developing countries and the stretched administrative capability to deal with overlapping activities of development institutions. The Consensus Document thus encourages a fair degree of specialization and partnership in the development community to improve the overall impact of various forms of development assistance.

Apply the Monterrey recommendation of specialization and partnerships to private sector development activities. Many institutions are engaged in efforts to support the development of financial markets, provide business development services to small companies, advise on the enabling environment, improve corporate governance and enhance the focus on sustainability. While the choice of "supplier" is important to recipient countries, it is clear to us that these overlapping activities are counterproductive and need to be urgently addressed.

Address informality in developing countries. Some pioneering work is underway to map the structure of the informal sector, and a global effort to expand the coverage of this work is likely to yield significant benefits. A partnership to accelerate the pace of such work in Latin America has just been arranged by the Inter-American Development Bank in collaboration with the Institute for Leadership and Democracy of Peru. There is also great scope for facilitating linkages among multinational corporations and small and medium enterprises, given the importance of private sector ecosystems and the benefits from private-private partnerships.

ACTIONS IN THE PUBLIC-PRIVATE SPHERE: PARTNER AND INNOVATE

The Commission believes that all stakeholders need to make concerted efforts in finance, skills and public-private partnerships for the delivery of basic services. In each of these critical areas, developing country governments and private players need to develop viable partnership models that leverage their respective strengths. Various civil society organizations can add valuable skills and insights to such partnerships. Building sustainable partnerships requires sophisticated skills to assess competing interests and negotiate pragmatic agreements.

Multilateral development institutions can be neutral conveners and moderators. To be effective intermediaries they must build the skills to create partnerships that make economic sense for private players while being manageable for developing country public agencies. Different players may initiate and lead a partnership at different times. What matters most is that all parties approach partnerships with realistic expectations of each party's interests and capabilities. The Commission sees a distinct need for further innovation in this area to develop truly sustainable partnership models for developing countries.

Facilitate access to broader financing options. We envision continuing development of domestic financial markets coupled with skill-building for regulators and private financial institutions. We see great promise in facilitating the South-South transfer of expertise between financial institutions and public regulators. Broad alliances for microfinance, as part of the United Nations International Year of Microcredit 2005, and for small and medium enterprise lending could develop financially sustainable models. Innovative schemes are also needed to transform financial flows from the many diasporas into long-term productive investment in their home countries.

Assist skill and knowledge development. Skill-building activities could range from programs for top public and private leadership to training microentrepreneurs to joint efforts with public authorities and unions to improve workforce skills. The Commission envisions larger alliances with business and trade schools, public-private collaboration in professional education and training, and mentoring programs for entrepreneurs—all leveraging peers, expatriates and those in the diaspora. We see a large opportunity for organizational infrastructures that network private resources worldwide with aspiring entrepreneurs in developing countries. This includes formal programs of multinational companies to make their human resources and know-how available to developing country entrepreneurs.

Make possible sustainable delivery of basic services, particularly energy and water. The Commission sees the need to develop innovative models for partnerships of governmental service providers, multinational companies and local companies. The sustainable delivery of basic services depends on effective partnerships and other forms of public-private cooperation, which has proven to be difficult. Still to be developed are the sophisticated skills to implement lasting partnerships, where all players' incentives are well balanced and proper governance is in place. We see a clear need to create additional capacity to help overcome market dysfunctions and information asymmetries, provide hands-on operational support, fill knowledge gaps and act as neutral intermediary between competing interests. Effective brokering can make more transactions feasible because it can overcome the barriers that would otherwise impede action. We plan to follow up with public and private entities in this area to see how existing institutional capacity can be supplemented—and how poor people can be empowered to build businesses directly.

ACTIONS IN THE PRIVATE SPHERE: MOBILIZE CAPABILITIES AND RESOURCES

The Commission believes that the private sector, particularly large local companies and multinational corporations, should contribute to accelerated economic development and to poverty alleviation.

Recommended actions by the private sector

The required actions for the private sector are as laid out in chapter 4:

Channel private initiative into development efforts. We believe that the private sector has tremendous potential to contribute to development through its knowledge, expertise, resources and relationships. Unleashing this potential will require increasing the visibility of the broad range of private contributions (illustrated in chapter 4) that remain disparate and unnoted—and establishing an infrastructure to channel these contributions effectively. This could be accomplished through a new private focal point organization that would match private know-how, services and resources with the needs for such services in developing countries, primarily by the private sector but also by governmental agencies.

Develop linkages with multinational and large domestic companies to nurture smaller companies. Linkages between different types of firms in developing countries provide an effective channel for local companies to gain access to markets, financing, skills and know-how. There is an urgent need for multinational corporations to integrate better with local small and medium enterprises and to strengthen links with the domestic ecosystem, such as those between microenterprise distributors and large domestic companies. Many parties need to work together for this to happen, and the range of activities to make the links durable includes information, know-how and hands-on support.

Pursue business opportunities in bottom-of-the-pyramid markets. Recognizing the needs of bottom-of-the-pyramid markets and creating innovative solutions to meet these needs are vital actions required from the private sector, both domestic and international. Efforts should be driven mainly by the incentives of expanding markets and new business opportunities. The interplay in domestic ecosystems is likely to result in parallel changes in the economic behaviour of all those along the chain, from informal operators through small and medium enterprises and their financiers. This is important in empowering the poor. There could also be great value in creating a scorecard for multinationals and other large firms to measure their success in creating profitable markets for poor consumers.

Set standards. The private sector needs to make a genuine commitment to sustainable development—with a sharp focus on corporate governance and transparency. We have highlighted successful companies that have shifted the development debate within their economies and created a political consensus that eases the way for governments to facilitate the expansion and growth of a vibrant private sector. Such a shift will occur when pioneering managements realize the value of leading from the front, being responsive to social development needs and setting new standards that demonstrate the value of sustainability. Many large companies in developing countries today are also multinational in the sense that their business operations are no longer limited to their country of origin. Still, they do play a different role within their home economies—and are seen differently from multinationals in the traditional sense of the term. Where such high-profile local companies exist, they too will need to understand the broader framework of their operations and work actively to create the new consensus that we propose. Many of the sustainability initiatives discussed in this report tend to involve large multinationals. But similar initiatives or offshoots of global initiatives involving the local private sector could be very effective in redefining the roles of different stakeholders in the development process.

Recommended actions by civil society and labour organizations

The Commission believes that civil society and labour organizations have to continue as critical observers of the development agenda—and as facilitators and supporters of innovative approaches for meeting the Millennium Development Goals and improving the quality of life for poor people. Civil society organizations have a major part in a robust global alliance that builds on the strengths of each key player to meet the Goals.

Increase accountability in the system. This is a core part of the work of civil society organizations, as is their leadership in pushing forward the concept of sustainable development. This work should be strengthened.

Develop new partnerships and relationships to achieve common objectives. Numerous civil society organizations are also acting in direct partnership with the private sector to combine the management skills and financial capacity of private companies with their own know-how and contacts in bottom-of-the-pyramid markets. This can facilitate the kind of private sector–civil society organization collaboration that builds microcredit programmes on a commercial and sustainable basis. Civil society organizations are closest to the bottom of the pyramid. They also are often proxies for experimenting with new technologies for solving problems. And they, too, will need to measure their success in facilitating innovative private-private partnerships to address economic and social policy objectives.

LOOKING FORWARD

Recognizing the size and complexity of the challenge, the Commission concludes that it is necessary to channel private capabilities and resources into unleashing the private sector in developing countries. We believe that the energies and opportunities remain untapped because the needs in developing countries have not been appropriately matched with resources and interests around the globe. Our proposed programme of action is thus designed to catalyze the strong private response that is the main objective of our work.

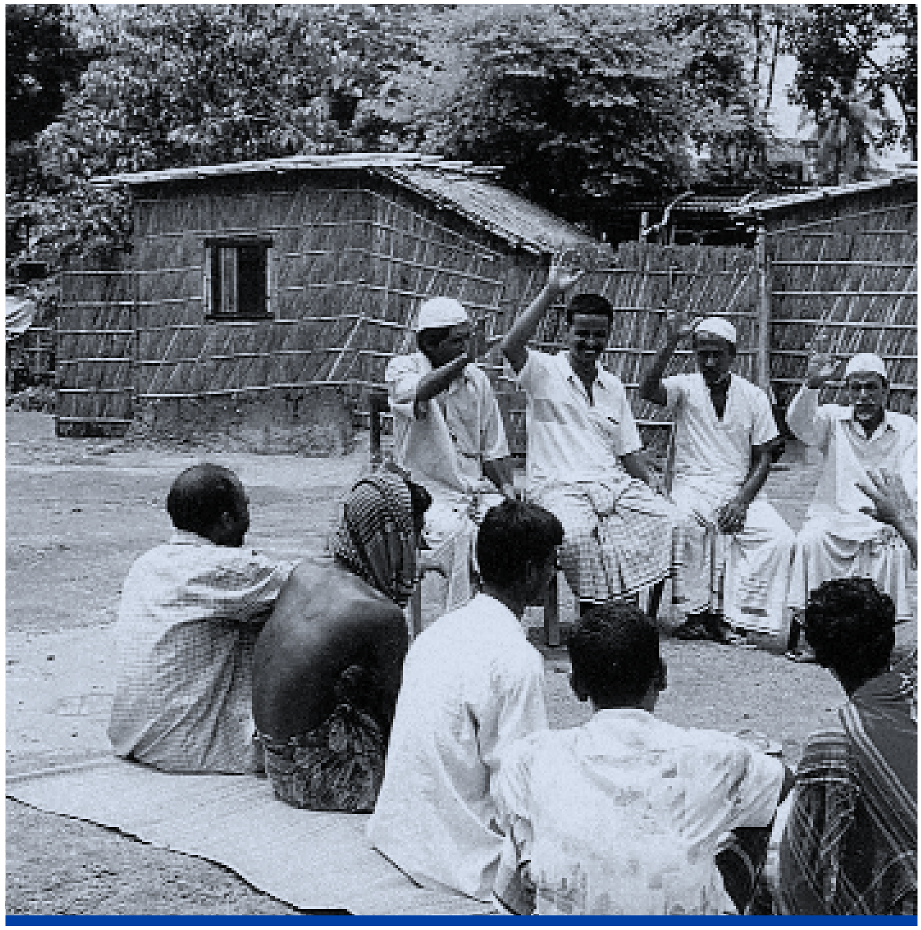
To promote progress, the Commission recommends that the United Nations sponsor the tracking of private sector development. An annual progress report would maintain the prominence of the Commission's overall recommendations and ensure the commitment to addressing the many issues identified here. The report would offer an opportunity to celebrate progress and expose obstacles to private sector development. It would be prepared with the support of a number of Commission members and development institutions.

As the main actors begin to work together towards common goals, a significant change will be required in the structure of economic and political interactions in many developing countries. Today's fractured and confrontational relationships will need to be gradually replaced by collaborative partnerships in which each player's actions are influenced and modified by larger challenges and by the capabilities of others.

To catalyze this process, the Commission is assembling a first set of actionable initiatives to facilitate transformations in individual countries and to provide the tools for governments and the private sector to supplement available resources and begin rapidly implementing a programme of change. These first actions are intended to stimulate a collaborative response from potential partners who read this report. Our message to all of you is: join us.

In the coming months we will be launching initiatives and consulting with the readers of this report to draw them into the undertaking. We invite the broad range of stakeholders identified in this report to heed our call and to work rapidly to convert initial ideas to specific business plans that can be launched within the coming six months. Only if we can generate an urgent sense of following up on our initial work can we hope to unleash the trapped entrepreneurial energy of the poor as a force for private sector growth.

Photo: Munira Morshed Munni/UNDP Bangladesh



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As indicated in the Bibliography that follows and in the detailed references cited below, this report draws on a wide range of documents and on numerous outside sources. Many people contributed a tremendous amount of time and energy to informing the Commission of their experiences and views, and they are identified in the Acknowledgements.

Institutional resources from the World Bank Group, including the International Finance Corporation and the Multilateral Investment Guarantee Agency, were an important source of information, as detailed in the chapter references below. The Bank's *Doing Business in 2004: Understanding Regulation* deserves special mention as the basis for a substantial amount of the analysis and conclusions in Chapters 2 and 3. The recommendations in chapter 3 are a synthesis of suggested policy interventions from a variety of sources and, in particular, also benefit from the private sector development work of the Organisation for Economic Co-operation and Development.

The Secretariat of the Commission also benefited from extensive discussions and interviews with Michael Barth, Richard Frank and Percy Mistry, and their influence is felt throughout this document. Similarly, K.V. Kamath, Lalita Gupte and Madhav Kalyan from ICICI Bank and Nandan Nilekani and Sanjay Purohit from Infosys provided broad insights into the management approaches of leading corporations in developing countries. Their perspectives have particular relevance for the developmental issues we address.

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Chapter 3 draws on De Soto 2000; IFC 1996; McKinsey and Co. 2003; OECD 1993; OECD and UNIDO 1999; Rajan and Zingales 2003; World Bank 2003a.

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Photo: Phillip Archer/UNDP

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