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## Enterprise Growth Initiatives: Where Now? What Next?

Promoting the growth of private enterprises is one of the most important ways to boost per capita income, create jobs, and reduce poverty in developing countries. Not surprisingly, international donors such as USAID and the World Bank have supported enterprise growth initiatives—although with mixed success—and they want to know what works, what doesn't, and what qualifies as state-of-the-art thinking on this issue.

That's where DAI comes in. Working closely with USAID, over the past year we have distilled the essential literature on enterprise growth, reviewed 40 to 50 formal evaluations of enterprise growth initiatives, and conducted personal interviews with a comprehensive group of stakeholders. The resulting study, *Enterprise Growth Initiatives: Strategic Directions and Options*, is the basis for a series of worldwide enterprise growth workshops for USAID officials.

So, what did we find? More than we could possibly squeeze into this summary, of course, so we encourage you to download the full study from [www.dai.com/publications/publications\\_fs.htm](http://www.dai.com/publications/publications_fs.htm) (a 20-page executive summary also is available). But we did confirm the starting point of the exercise: enterprise growth *is* critical to achieving growth in average incomes and jobs, and to reducing poverty—all of which lead to improvements in people's lives. And the good news is that enterprise growth initiatives certainly have the potential to promote such growth.

It bears mentioning up front, however, that the lack of systematic monitoring and evaluation in existing

programs makes it much harder than it should be to assess and construct these initiatives. This finding reveals a quick win that donors and their partners would do well to recognize.

Given this important caveat, what can we say about the characteristics of successful initiatives? First, private enterprise growth is a dynamic, often messy process—messy in the sense that enterprises are born, grow, thrive, or die in a fluid “churn” process determined by the marketplace, a context in which the success of a particular enterprise is less important than the vitality and growth of the enterprise sector writ large. Second, this churn process is increasingly driven by the global marketplace and by access to innovation and technology.

But while embracing the winnowing effect of the market, effective initiatives also recognize that markets do not work in a vacuum (they are influenced by the legal, social, political, and cultural settings of particular countries) and that markets fail. Indeed, market failures are the most compelling argument for donor-financed enterprise growth interventions.

### Improving Access to Markets

- High-impact projects improve access to product markets to provide new profit opportunities as incentives to improve enterprise performance.
- Direct firm-level assistance is more expensive than industry cluster or policy reform initiatives, but can be appropriate in high-risk environments—such as conflict and post-conflict situations.
- Global benchmarking in competitive markets improves enterprise productivity in poorly performing economies.



## Improving Access to Capital

- Financial services are crucial. Donors should support research into innovative financial services that support dynamic growth.
- Supporting profitable financial institutions and competitive financial services industries is more important than supporting lending programs to small and medium-sized enterprises.
- Closing the financing gap—for enterprises too large to qualify for donor-sponsored microfinance programs or too small for high-collateral commercial lending requirements—is an important way to accelerate enterprise growth.
- Perceptions of a financing gap, however, often mask more fundamental problems at the firm level or in the legal and regulatory environment in which the financial sector operates.
- Donor programs should support more innovative services for the dynamic growth of enterprises, including mixed equity and debt instruments combined with consulting services that assist risk-taking enterprises.
- In some cases, direct firm-level assistance to establish a new or revitalized financial institution can have a profound impact on upgrading competitive standards and the overall performance of the financial sector.

Historically, enterprise growth initiatives have been guided by two broad schools of thought. The first concentrates on improving the business environment to strengthen incentives and reduce transaction costs, the second on stimulating the private sector response to existing market opportunities by improving firms' access to markets, finance, and business services. But the most effective approach addresses market imperfections in a manner consistent with the country context. In some settings, one or the other approach may be appropriate; in many settings a combination of both approaches will be best. Strategic management of that mix and meticulous ongoing evaluation and adjustment to market dynamics are essential.

## Taking Stock

At the “10,000-foot level,” we found that effective enterprise growth initiatives entail four elements:

- Multiple levels of engagement, operating at national, sectoral, and enterprise levels to revitalize enterprise performance and build coalitions in the private sector to transform market institutions and improve the business environment.

- Rigorous market approaches, focused on increasing market demand to increase profit opportunities in promising sectors.
- Simultaneous interventions, focused on leveraging improved private sector performance to support policy reform.
- Strategic fit, tailored to the environment, development phase, and political and economic variables in each country.

Specific findings in the three major categories of enterprise growth initiatives—improving access to markets, capital, and services—are illustrated in the text boxes in this brief. In addition, we found that across all three categories, effective projects share certain traits. They:

- Focus on strategic sectors, value chains, and industry clusters, rather than on firm size. Projects that focus on firm size often fail to leverage and support dynamic growth. This effort to improve the private sector supply response is complemented by efforts to improve the business environment.
- Adhere to commercial principles, leverage market opportunities for growth, avoid subsidies that create dependency and market distortions, and judiciously weigh the creation of new enterprise incentives.
- Are long enough (5 to 10 years) to establish credibility and strategic partnerships.
- Use qualified local staff and local service providers and support commercial relationships between local service providers and enterprises.
- Select counterparts and local service providers transparently to avoid political agendas and reinforce sound commercial practices.
- Build in learning processes to improve policy initiatives in the private sector.
- Identify champions in the public and private sectors to lead reform initiatives.
- Invest in R&D to learn about the churn effect and the appropriate framework—such as tax and bankruptcy laws—to support enterprise.

## Strategy and Design

As noted above, one of the key elements in fashioning effective interventions is “strategic fit”—tailoring the initiative to its host environment.

*Enterprise Growth Initiatives: Strategic Directions and Options* lays out a series of recommended intervention strategies that vary according to the economic and political variables—and the development phases and conditions—of each country. Likewise, we review the important strategic issues policy makers should address, such as the extent to which entrenched political and economic interests will constrain enterprise growth projects, or the scope for innovation in key industries such as financial and business services.

## Multilevel, Simultaneous Interventions

In considering how to design programs that achieve lasting impact, we saw five broad categories of intervention options: direct firm-level technical assistance, industry cluster initiatives, sector-level initiatives, policy reform to improve the business environment, and global integration efforts.

In the past, these interventions have been made sequentially. Increasingly, however, programs are combining interventions, in line with the four key elements outlined above, and if this combination is managed effectively, it can create greater opportunities for strategic impact and return on donor investment. Although combinations of interventions can increase program complexity and risk, the complementary characteristics of each intervention generate important benefits.

- *Direct firm-level technical assistance* offers the lowest potential impact and is more costly than other interventions but can be the right choice in high-risk environments, such as conflict and post-conflict situations, and in higher-impact activities that require partnerships between the -public and private sectors. Reform initiatives require champions, and donor projects build credibility and buy-in by demonstrating bottom-line success at the enterprise level.
- *Industry cluster initiatives* work with a wide range of actors—small producers, transporters, large processors and exporters, labor groups, universities, government agencies, trade associations, related R&D institutions, and so on—to boost productivity by integrating previously fragmented industries. Often, critical policy issues, such as intellectual property rights or trade agreements, require collective action to pass and effectively enforce laws to achieve economic benefits. Cluster initiatives achieve greater impact

## Improving Access to Services

- **Building commercially viable business services, such as quality assurance and production improvement, accounting and audit, management consulting, Internet services, and market research, can increase productivity in all sectors, much like financial services.**
- **Effective demand—the willingness of enterprises to pay fees for business services—is crucial to developing services that improve productivity and accelerate enterprise growth.**
- **Successful projects broker commercial relationships between local service providers and enterprises in services that improve productivity.**

when they align policies with global standards to increase enterprise competitiveness at the national level.

- *Sector initiatives* in strategic sectors of the economy—such as exports, agriculture, and financial services—have far-reaching economic impact. It's important to support more profitable, sustainable financial institutions, for example, which in turn requires reforms such as improved bank supervision and liberalization.
- *Policy reform* at the macro- and microeconomic levels reduces transaction costs and offers the private sector new incentives to increase sustained value-added productivity. It has enormous impact on enterprise growth by affecting a large number of enterprises.
- *Global integration* into the international marketplace will ultimately allow enterprises to achieve the greatest growth. For many countries, this is not easily achieved without shocks to sectors of the economy previously protected from open competition. Behind-the-border work to prepare enterprises, industries, and countries to understand competitive forces is crucial.

## The Imperative for Change

The global market is a ruthless and efficient arbiter, rewarding enterprises that can compete and eliminating firms that fail to grasp market demand, market trends, and buyer requirements. Most enterprises that operate in the unfavorable business environments typical of developing countries are at a disadvantage compared with enterprises in countries with lower transaction costs, more business-friendly

environments, and higher rates of innovation and productivity.

For donor organizations, contractors, and other stakeholders seeking to create such environments and improve lives in poor countries, the challenges are great. But it's clear that properly conceived and rigorously managed enterprise growth initiatives can assist private and public sector leaders, representative business organizations, and public-private partnerships in revitalizing their underperforming economies and raising living standards.

Encouragingly, the self-interest of private (and public) sector leaders in host countries should favor such initiatives. Higher standards of living serve the interests of enterprise owners because markets function best when people have the incomes, consumption, and savings patterns associated with healthy, growing economies. We believe better understanding and implementation of enterprise growth initiatives will enhance their chances of success.

USAID has been a leader in donor efforts to promote the growth of private enterprises and is well positioned to build on its experience and maintain its leadership role. To do so, it must continue to learn about what approaches work best in different kinds of settings and use that learning to apply a continuously improving definition of best practice for this important area of development.

Questions? Comments?  
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