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THE BRAVE NEW WORLD OF BUSINESS DEVELOPMENT SERVICES

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Since 1970, DAI has been exploring alternative paths to development. DAI generates ideas through research, shares these ideas with the development community through publications, and tests the ideas in the crucible of development projects.

Developing Alternatives provides a forum for DAI's professional staff to expose their ideas to a wider audience. Articles treat policy issues of topical interest and aim at promoting broad discussion.

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THE BRAVE NEW WORLD OF BUSINESS DEVELOPMENT SERVICES

by David Knopp

Nietzsche, famous for his aphorisms, once quipped,

> The overthrow of beliefs is not immediately followed by the overthrow of institutions; rather, the new beliefs live for a long time in the now desolate and eerie houses of their predecessors, which they themselves preserve because of the housing shortage.

Sardonic tone aside, Nietzsche's insight has relevance for the field of business development services (BDS), the focus of this issue of *Developing Alternatives*. BDS can be defined as any non-financial support that improves an enterprise's ability to compete in a market-based economy. This support covers a wide range of services, such as training, marketing, research, business management, information, and accounting, as well as higher-end strategic services such as technical assistance, consulting, and product development.

As a practice area, we are entering a period of creative turbulence. The provider-centric perspective, so characteristic of the past decade, is giving way to more complex ideas about the development of BDS markets. Our view of BDS programs is broadening; old ways no longer satisfy. But newer beliefs—so full of promise—often still live inside yesterday's design, implementation, and performance measurement structures.

The challenge BDS practitioners face is the design and implementation of effective interventions that support the survival, growth, and competitiveness of small and medium-sized enterprises (SMEs),[1] a critical driver of economic growth in developing countries. However, our knowledge about how to do business development is continuing to evolve. This issue of *Developing Alternatives* examines the discussion and debate surrounding that evolution.

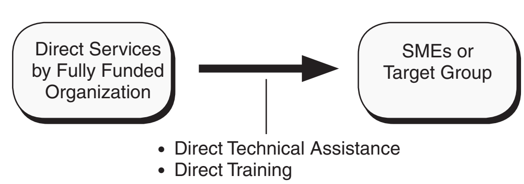
Evolving Models

Over the last 30 years, business development has undergone fundamental changes, from models of direct service provision to approaches emphasizing building the capacity of providers to more complex designs that address market development and the transformation of business systems.

The earliest and simplest model can be defined as the *service delivery model*. In this model, a funded intermediary organization determines the needs of an SME sector and provides direct services, often heavily subsidized, to clients. Although the service delivery framework ensures coverage among the target group, the lack of concern for the local supply of services, as well as the greater context in which the program operates, often leads to short-lived interventions that do not necessarily meet the needs of SMEs (Figure 1).

Throughout the early 1990s, donors struggled to integrate BDS into their development programs. One major problem was that, in many developing countries, a culture of entrepreneurship did not exist, much less a universe of BDS providers. To

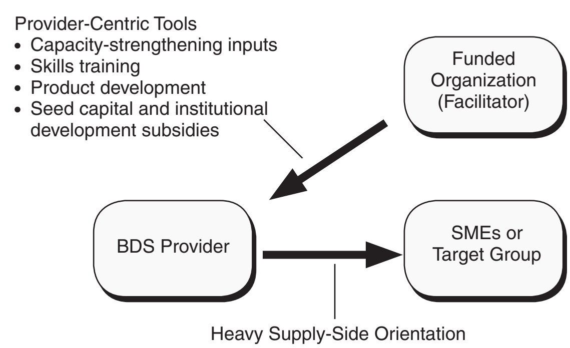
FIGURE 1. SERVICE DELIVERY MODEL



[1] There is no commonly accepted definition of micro, small, or medium-sized enterprises. Some definitions use the number of employees to differentiate among categories; others use assets or annual turnover. In this journal, we adopt a simplified approach, treating SMEs as formally registered firms with paid employees and microenterprises as primarily informal enterprises.

create a cadre of capable service providers, donors made major investments (that is, subsidies) in facilities and systems, while providing technical assistance directly to BDS providers. Providers were instructed to offer pre-defined courses to target populations at heavily (often 100 percent) subsidized rates. Donor financial support was often tied to strict reporting requirements, which narrowed the flexibility and nature of the services offered. In short, donor support reflected a heavily supply-side orientation. This is characteristic of the *provider-centric model* (Figure 2), where a donor agency provides funding to set up or strengthen a service provider (a nongovernmental organization or a private company), either directly or through an intermediary. The provider in turn supplies the "needed" or desired services to SMEs.

FIGURE 2. PROVIDER-CENTRIC MODEL



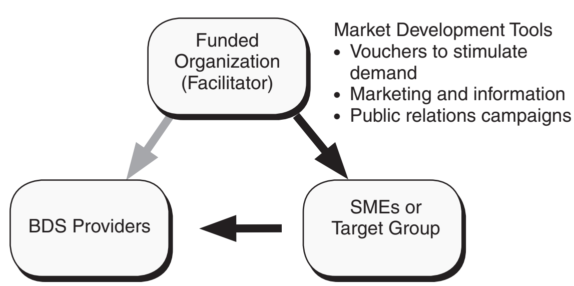
The predominately supply-side orientation of the provider-centric model had several distorting effects. It soon became apparent that providers were heavily dependent on subsidies, with the result that the donor rather than SME was viewed as the client. As a result, products were not always designed to meet client needs and many services were simply too expensive. Any BDS provider attempting to develop a service on commercial terms was unable to compete with the subsidized offering and, thus, was crowded out of the market. Moreover, because donor subsidies were linked with the achievement of milestones and performance targets, providers were given little incentive to innovate or refine their services. Perhaps most damaging was the disconnect in feedback between service providers and SMEs. Consumer preference was difficult to measure because courses were free or were offered at heavily subsidized rates.

The provider-centric model failed to take into account the development of markets at the systems level. It also failed to address some fundamental questions: How could BDS be made more affordable and genuinely address the needs of SMEs? What could be done to ensure quality in service delivery, as well as in outreach, to the SME sector? Could BDS be sustainable in a post-donor environment? How could donor distortion be avoided?

Questions such as these prompted the development community to come up with a new model. Microfinance practitioners had already established "best practices" that influenced the discussion. Microfinance had shown that the poor as well as SMEs will pay for the right service. Microfinance also had proved that a commercial approach, followed up with careful performance measurement, offered the best opportunity for a sustainable intervention. However, serious differences remained—microfinance methodology was based on a high volume of transactions and a standardized approach, which did not necessarily apply to the delivery of BDS.

Influenced by microfinance's commercial orientation, BDS shifted toward a more ambitious private-sector approach, with an emphasis on the market. This led to the evolution of the *market development model* (Figure 3), where the goal of an intervention is the creation, development, and continued evolution of a well-functioning BDS market. The approach stresses the importance of commercial transactions between suppliers and consumers, with

FIGURE 3. MARKET DEVELOPMENT MODEL



an emphasis on demand-side interventions to stimulate BDS markets.

The model assumes that BDS are private goods and, as such, are best provided commercially. Currently the preferred framework for donor intervention, the market development model has been further refined by a working group composed of members of the Committee of Donor Agencies for Small Enterprise Development. The group's work culminated in "Guidelines for Donor Intervention," which characterizes the BDS market development framework. A few of the paper's key recommendations are:

- Donors should strive for outreach at the industry level to develop the market rather than provide direct support to specific BDS providers. Development programs should encourage more market players offering a broader, yet more specialized, array of services.

- Subsidies must be designed for specific market development objectives. Subsidies should be used selectively and should support a gradual shift toward a commercial market.

- Unlike earlier views that assume SMEs would not buy services unless they were heavily subsidized, SMEs will pay the full cost of BDS they need if products are appropriate and affordable.

Through the market development paradigm, supply-side strengthening has been replaced with a demand-driven model that emphasizes commercial, business-like interventions.

Market Dynamics—A New Way of Thinking

The evolution of intervention models illustrates how we are still learning, testing, and developing appropriate levels and methods of BDS intervention. There has been a shift from tightly defined and controlled supplier interventions toward models that stress pure market-oriented transactions. But in our desire to draw clearer distinctions between the old and the new, we have created the mistaken impression that the old models have merely been set aside as failed ideas. Each new BDS approach in effect has vanquished the old.

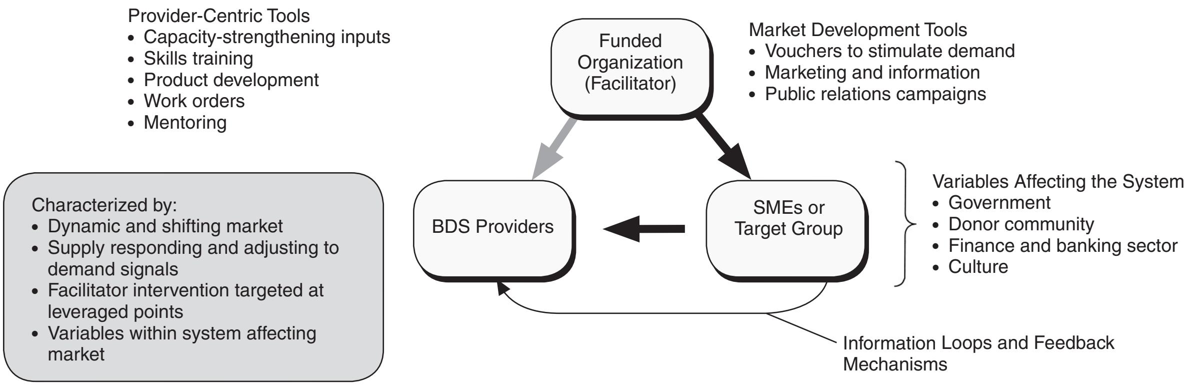
In this journal, we propose an alternative perspective. Insights learned from previous models should not be discarded outright but incorporated as useful tools in an expanded understanding of the problem. Just as Einstein's views on relativity did not negate Newtonian laws of physics but placed them in a new context, old BDS models can become special cases in a larger view of the problem at hand.

Some proponents of market development have failed to see that in certain cases supply-side interventions designed to build up BDS providers might still be a valid tool within a market development orientation if such an intervention is needed to accomplish the broader objective of BDS market development.

Markets are complex and dynamic systems. Rather than adopt a radical demand-side-only approach to market development, as some have done recently, I propose a more balanced view, one that I term the *market dynamics perspective*. In this view, absolutist prescriptions are replaced by a broader, more pragmatic systems approach to BDS interventions and market development employing a variety of tools and approaches. The market dynamics perspective builds on previous learning and integrates former models as tools (when appropriate) within this larger systems view. Thus, depending on the dynamics of a specific market under consideration, an intervention would use a specific mix of demand- and supply-side interventions to get the job done.

Figure 4 illustrates the market dynamics perspective, showing how a practitioner might approach the market with a combination of demand- and supply-side tools. These tools are best applied strategically at critical leverage points to reinforce the development and functioning of BDS markets. The market dynamics perspective relies on timely feedback to adjust its approach and to provide information to BDS suppliers and donors on market demand. This feedback allows them to adjust their products and tailor the services they offer to meet the effective demand.

FIGURE 4. MARKET DYNAMICS PERSPECTIVE



Market Dynamics and BDS Markets

The market dynamics perspective does not offer a prescriptive methodology or a new model for intervention. It recognizes the complexity within systems and concludes that no single model alone can advance the development of BDS markets. Instead, what is required is a careful examination of the market and environment, where a set of tools can be applied flexibly. How does flexibility and innovation translate into real world application? DAI asked four experts in the field to draw on their recent experience and examine how this perspective was applied to the development of BDS markets.

James Packard Winkler, in "Preparing Palestinian Business for Global Competition," looks at the challenges and opportunities that BDS interventions face in volatile and unstable environments. Winkler describes a three-phased project intervention that has moved from providing firm-level assistance to developing a national economic strategy that will allow Palestinian firms to compete successfully in global markets.

In "Market Development of BDS in Transition Economies," Michael Field illustrates how the systems perspective has been applied to a complex SME development project in Ukraine, using a balance of supply-side capacity-building interventions and demand-side vouchers. He examines the interrelationship between shifting market signals and supplier orientation and explains why information loops and feedback mechanisms are essential for reorienting business service providers to consumer demand.

C. Richard Hatch examines competition between small firms and highlights cooperation and networks as a rational strategy in "The Limits of BDS Market Development." He argues that BDS practitioners have erred by focusing only on firm performance and individual transactions rather than on strategic positioning within greater systems and competitive markets. What is needed is to help clusters of firms identify different strategies and then adopt the best one. Within such a network, SMEs may leverage their own capabilities with those of others to satisfy the rigorous production and innovation demands of the market.

Although practitioners may pilot-test new interventions and challenge current practice, donor performance measurement agendas and results frameworks tend to drive the direction of enterprise development. Donors and practitioners alike need to know what they are measuring before they venture too far into the unknown. *Developing Alternatives* ends with a discussion of performance measurement, an intensely debated aspect of the emerging practice of BDS. In "The Challenge of Measuring BDS Market Development," Paul Bundick examines the limitations of the current performance measurement framework, introduces ideas from complexity theory, and explores some challenges to developing new indicators. ◆

PREPARING PALESTINIAN BUSINESS FOR GLOBAL COMPETITION

by James Packard Winkler

Even amid the turmoil of the Intifada, many Palestinian businesses are working to build a viable and competitive economy. In such an environment, what kinds of BDS interventions are needed to help Palestinian businesses realize their aspirations to enter the global market? And what adjustments must the businesses make to adapt to intermittent periods of instability that undermine business gains?

Business development in Palestine is different from business development in most of the rest of the world. The Palestinian Territories face unique challenges. Palestine does not yet have clear economic sovereignty. It is an emerging market, but unlike most emerging markets, the Palestinian economy is embedded within the Israeli economy, a phenomenon established during 30 years of existence within Israel. Agreements struck in Paris, Madrid, and Oslo leading to the establishment of the Palestinian Authority in 1994 initiated the transition process to independent economic and political status. However, the ability of Palestinians to manage their economy remains limited. Israel still maintains control over monetary policy, borders and ports, the flow of labor into Israel, and critical land and water resources. Moreover, it captures three-fourths of the estimated $4 billion in annual trade between the two economies.

If Palestinian businesses are going to become competitive in global markets, they must overcome three inter-related challenges: (1) the inertia of Israeli control over the Palestinian economy, which contributes to a business environment that favors survival-oriented thinking and engenders instability; (2) serious market and sector fragmentation within the Palestinian economy; and (3) cultural and business practices established during long periods of occupation that do not support innovative leadership. The weakness of civil society and free market institutions in Palestinian society—a phenomenon noted throughout much of the Arab world—presents yet another challenge to attaining both economic growth and international political legitimacy to support the aspirations of Palestinian statehood and the birth of a new economic era. These challenges loom even larger during periods of conflict, such as the ongoing Al-Aqsa Intifada.

BDS in Unstable Environments: A Long-Term Phased Approach

DAI, working with the U.S. Agency for International Development, has been tackling business development problems in Palestine since 1994. The Small Business Support Project (SBSP) provided firm-level BDS from 1994 to 1999. The follow-on Market Access Program (MAP) is a five-year effort that strives to develop sustainable business associations and business-related organizations to improve economic competitiveness and performance. Both projects share the same objective of improving economic growth through measurable increases in profitability, efficiency, employment, market share, and export sales.

Initially, the business development approach under SBSP focused on improving the performance of individual firms through a business center model. A business center was able to provide services that changed the behavior of individual firms, but it did not make much progress in sorting out the larger issues that entangle most businesses operating in the Palestinian Territories. The shift in priorities from SBSP to MAP reflects a shift similar to the one referred to in David Knopp's article in this journal—a move from provider-centric models to concerns with how to foster more complex market development and the best way to address the larger problems in the economy that affect all businesses.

A SURVIVAL-FIRST MENTALITY MAKES SENSE IN AN UNSTABLE ENVIRONMENT BUT ISN'T THE BEST WAY TO TAKE ADVANTAGE OF THE OPPORTUNITIES PRESENTED BY TODAY'S GLOBAL ECONOMY.

At the same time, these larger issues could not be easily addressed until at least a modicum of trust existed between the business community and development practitioners. This called for a phased approach that begins with individual firms, leads to building associations among firms, and finally forges the collective will to address problems at the national level. Starting out at the market level (MAP's focus) would probably not have been successful without the strong SBSP foundation of firm-level support upon which MAP built. In retrospect, the SBSP-MAP intervention is following a three-phased approach, where the goal is to change the way firms do business and prepare them to compete in the global economy. The three intervention phases are: (1) improve firm performance, (2) foster cooperation and association development, and (3) forge alliances to develop a national economic strategy.

These three phases have a logical order of progression and are mutually reinforcing. The first phase is particularly crucial in building confidence and credibility through results. Results serve to reinforce new ways of thinking and doing. Naturally, suspicion runs high. Palestinian businesses did not welcome business development interventions in the early 1990s; in fact, businesses were resistant to any form of external influence. Tiny steps had to be taken initially to demonstrate results, gain acceptance from the business community, and build credibility.

- ***Phase 1: Improve Firm Performance***

When viewed over the long term, the goal of the first phase was to establish new practices and augment the perceived value of BDS among members of the business community. Business people don't have the patience to listen to abstract concepts; they want results. Effective firm-level BDS are the first step in transforming the business environment.

The leaders of the Palestinian business community came of age in the old economy—and a political reality where survival was the key. During 34 years of occupation, most family-owned firms came to rely on time-tested business practices. They invested their cash, shied away from banks (and the tax man), and worked primarily as subcontractors to Israeli firms. This survival-first mentality makes sense in an unstable environment but isn't the best way to take advantage of the opportunities presented by today's global economy.

SBSP, through its business center model, worked with more than 350 manufacturing firms from 1994 to 1999, providing fee-based consulting services to help firms restructure their management, adopt quality assurance systems, and enhance their marketing capabilities. The approach taken was unapologetic about "cherry-picking" the best firms, those that were willing to pay for services and change the way they did business. Initially, subsidies were higher when new services were introduced, but as business people began to understand the commercial value of a given service, subsidies were diminished and eventually eliminated altogether. SPSP focused on helping manufacturing firms achieve tangible results by improving profitability, increasing efficiency, and expanding sales. Eighty-two percent of SBSP-client firms improved their profitability.

One major issue faced when assisting firms is disentangling the issues of family ownership from professional management. This distinction is crucial to improving performance within firms and is a first step in transforming family-owned companies into world-class firms. As this distinction became clearer, business people came to see the advantage of buying management expertise. After completing a strategic assessment and developing a new business plan with SBSP assistance, a construction contractor in Gaza took the bold step of hiring an expatriate general manager, a rarity in family-owned firms. Under this new manager, the firm generated huge savings in operating efficiency, which in turn led to new performance and management expectations throughout Gaza.

Introducing quality assurance standards such as Good Management Practices (GMP) or ISO 9000 is another excellent way to improve performance at the firm level. To meet quality assurance standards, owners and managers must systematically assess their business practices and performance. By improving their standards, companies are then in a better position to engage in joint ventures with foreign firms. One Palestinian example is a pharmaceutical client in Ramallah, which entered into a joint venture with a $9 billion German pharmaceutical company. The new company included a 28 percent equity investment by the German partner, participation on the board by German representatives, a full-time German marketing manager, and access to technology and training to improve GMP-qualified systems. The firm is now licensed to manufacture and market 12 products in the Arab market. DAI worked with this client for two years to prepare the firm to meet GMP standards and encouraged the joint venture as an excellent way to reap the maximum business value and net worth for the owners.

Changing established business practices requires an intervention that delivers results—that is, a tangible and immediate improvement in the performance of a company's bottom line. Results also must be resilient enough to survive the ups and downs inherent in Palestine's unstable business environment. If you can help firms improve performance, you often can change attitudes and behaviors. In Palestine, the "value for service ethic" proved to be instrumental in moving the BDS intervention to the next level: cooperation among firms to tackle larger problems they could not tackle on their own.

Successes in improved business performance through firm-level BDS provided opportunities to design cluster or group BDS. Group BDS provide significant advantages for activities that require multiple firm participation, such as trade promotion, exhibitions, and trade missions, which cannot be undertaken by one firm. In addition, group BDS provide greater efficiencies through economies of scale for services that benefit many firms, such as market research, standards development, and policy advocacy.

- ***Phase Two: Foster Cooperation among Firms***

Fostering cooperation among firms is a major challenge in a politicized environment characterized by weak institutions and a lack of a strong tradition of working together. One lesson of DAI's involvement in Palestine over the last decade is not to try to organize firms into associations until they have first experienced the benefits of cooperation. Only after improvements in the bottom line are demonstrated and businesses see that cooperation leads to improved performance does it make sense to organize business associations with the aim of brokering more complex forms of BDS. This is particularly true in Palestine, where business organizations have a history of being fronts for political parties outlawed by the Israeli government.

Two important prerequisites for moving from providing firm-level assistance to helping firms work together and tackle what they cannot do alone are (1) economies of scale to cut costs and share risks and (2) a new organization and business model that ensures clear incentives and improved performance. Initially, SBSP and MAP provided both the business model and the organization for group BDS. Firms simply had to pay fees to participate. DAI selected association partners that understood the value of group BDS and developed their capacity to broker or organize such services.

Facilitating inter-firm cooperation is crucial to developing a new market dynamic. Exhibitions, properly organized, can have an enormous impact by creating a physical marketplace where competitors can gather to learn about industry trends, develop joint ventures, showcase new products and services, and explore new trade practices. Before 1997, Palestinian participation in exhibitions was politically motivated, and performance was poor. Some exhibitions resembled flea markets and reinforced negative images about Palestinian business in Arab and international markets. Participants were often fully subsidized by donor-financed projects and weren't prepared to meet global standards. There were no commercial incentives to drive the right kind of participation. How could this negative dynamic be changed?

Associations can be effective at brokering such services. In 1997, SBSP—under the rubric Paltrade, a virtual organization that later became a membership-based trade promotion organization—organized an exhibit at the Dubai Chamber of Commerce. Firms paid to participate, and their booths and marketing materials had to meet certain standards. This commercial approach injected self-selecting criteria for firm participation. Firms that didn't want to pay didn't participate. The ones that did pay expected value through networking, market exposure, and prospective sales.

The Palestinian companies that exhibited at Dubai developed pride and confidence in their ability to represent themselves as businesses. It was a dramatic change from the image established by the Palestinian Liberation Organization, which had previously set the standard. The exhibit's business-like atmosphere created a new image for Palestinian firms. The cooperation among businesses that paid to participate in the event created a demand for future exhibitions and a role for associations to broker such events on a commercial basis.

Since 1997, SBSP and MAP have organized, often in partnership with associations, more than 40 group BDS activities, including trade missions, professional training programs, policy advocacy workshops, exhibitions, and marketing events. Fees were charged for individual firm participation to cover costs and ensure value-added services were provided.

The lesson learned for BDS is that associations must provide value-added services that help business members serve their customers more effectively. Associations that rely on membership dues as a primary source of income generally lose their market focus and relevance. This is true not only in emerging markets but also in the United States. The "customer's customer" concept means that the association must be at least as concerned about market trends and the best interests of its members' customers as of its members themselves.

- ***Phase Three: Develop a National Economic Strategy***

The final phase, developing an economic strategy, is building on the first two—improved firm performance and cooperation among firms—to further improve cooperation between the government (the Palestinian Authority) and the private sector and to develop the capacity to trade successfully in the global economy. In the final phase, attention is focused on industries with comparative and competitive advantages for maximum economic impact and growth potential. SBSP selected the best companies but did not necessarily focus on the sectors with the greatest potential for growth. Under MAP, tourism, information technology, stone and marble, and trade receive priority attention and support as sectors with great growth potential. Business development is best designed within a sector growth strategy that focuses BDS investments for maximum leverage. For example, an economic strategy for tourism, often called the "oil of the Palestinian economy," should focus on linking firms together in key subsectors—such as tour operators and hotels—that want to improve the performance of the sector.

Economic transformation cannot be achieved only by improving one sector through a successful industry trade association. A network of cooperating business associations and new public-private partnerships should be integrated into an overall business development approach that supports a new economic strategy. Assisting Palestine in joining the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO) provides the rigor for retooling the economy and gaining acceptance in the global market. Under MAP, DAI designed a National Policy Dialogue Program in cooperation with Paltrade and the Ministry of Economy and Trade, engaging business and policy leaders in a year-long policy analysis of priority issues for the private sector. A national conference in May 2000 brought five ministers and 300 participants together to discuss the private sector agenda and demonstrated the usefulness of organized advocacy through "networked" associations. MAP is now working with the ministry to create a technical advisory team of 20 private and public sector professionals who will be trained in WTO and WIPO requirements.

Simple BDS models focusing only on firms or trade associations are inadequate to overcome the almost insurmountable challenges presented by Palestine's unstable environment. An effective business development strategy is one where appropriate interventions must build on the momentum of change and combine policy and legislative reform, new commercial services, and new institutional arrangements to assist the private sector in creating a more competitive investment environment and reaching new levels of economic growth. At the same time, Palestine's participation in the information economy requires a clear understanding among policy makers and business leaders about telecommunications, intellectual property rights, and the power of the Internet. It also requires new institutions to support the Internet and companies that utilize e-business solutions provided by appropriate BDS providers.

Growth strategies for key industries and the economy become increasingly important to build consensus among policy makers and business executives on business and economic models that are viable within the Palestinian market. MAP is using corporate and economic planning methodologies to develop new strategies for client associations and business-related organizations. Such strategies also are necessary to support collective action and to rationalize the allocation of scarce BDS resources. Working together with financial institutions and other service providers, associations and business-related organizations must help firms understand new ways of doing business and provide services for fees or access to markets that change performance.

The Intifada: Danger and Opportunity

The three-phased model discussed above should not be interpreted as merely a simple stage theory moving step by step toward progress. Development usually occurs in fits and starts. Experience demonstrates how events usually overshadow plans. The eruption of new violence may require new firm-level interventions that are appropriate to continually changing circumstances. Because of the most recent flare-up of the Intifada, every facet of business and daily life is disrupted. Many firms face financial disaster as a result of being partially or temporarily closed. The dangers are that many businesses that have managed to improve their performance may be forced to close down permanently, and the best entrepreneurs may lose hope and leave the Territories.

But there may be a silver lining in this cloud. Crisis also provides opportunity. In crises, people often come together if opportunities present themselves and problems are framed in a new light. The best Palestinian firms may be forced to rethink their corporate strategies and consider moving away from the old ways of doing business. Circumstances may force Palestinian business leaders to work together to solve common problems that cannot be solved at the firm level. In short, the current crisis may help speed up, rather than slow down, the transformation of the Palestinian economy.

Companies facing financial disaster tend to rethink their business models. Financial services, for example, are key commercial drivers that change business performance. Progressive firms that expanded operations in response to promising market opportunities before the Intifada now need assistance in refinancing outstanding loans and downsizing oper-

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ations as they await a return to more favorable market conditions.

MAP is taking two complementary steps in this area. First, MAP is assisting financial institutions in raising funds and providing new and effective financial services to support firms as they upgrade to meet international standards. The effective performance of financial institutions is a critical factor in business growth. In this light, financial services are an important BDS, when seen from the perspective of a firm rather than of a donor.

Second, a pipeline of e-service start-ups and restructured companies are being developed to attract foreign investment and global partners. The Internet is very important during closures and crisis periods as a means for companies to maintain contact with buyers and suppliers and for trade associations to communicate with the media about the economic and business consequences of the conflict.

Amid all the strife, the challenge in the Palestinian Territories remains to keep businesses focusing on opportunities.

Threats and Opportunities

Crisis creates threats and opportunities both for businesses and for BDS projects serving the private sector. Many of the rules of BDS, however, don't change, even during crises. Charging fees for services forces a market discipline on BDS providers. Giving away services is easy, but the market acid test of value is absent or not maximized. The rule in business development is that if businesses don't pay there is no real value in whatever service is being offered. Even in the midst of chaos, MAP still charges for services at 45 percent of real cost on average.

Innovation and commercial incentives are important drivers to change the Palestinian market dynamic. Even during the Intifada, serious business people want to improve their businesses. New business organizations, an economic strategy, and value-added services must respond to changes in an unstable market that may continue for the foreseeable future. When instability and conflict recur, business must have the supporting services to divest, refinance, or restructure their holdings. These services should be targeted and selective, however, because many firms that go bankrupt during the intense economic pressures associated with the Intifada probably would not have survived over time because they are unwilling or unable to adjust to competition.

Business development initiatives in the Palestinian Territories cannot solve the entrenched conflict: a final peace deal requires a political solution. However, a sound economic and business strategy geared toward global practices will build the necessary political credibility for a new Palestinian market economy that will support a future peace. ◆

MARKET DEVELOPMENT OF BDS IN TRANSITION ECONOMIES
A Balanced Approach

by Michael Field

As made clear throughout this issue of *Developing Alternatives*, business development services have undergone a major change in the last decade. The driving force behind this change has been the realization that markets matter—markets that SMEs work in and markets for BDS.

Although much has been done recently to promote demand-side interventions, it is equally important to continue delivering capacity-building support to suppliers, particularly in transition economies where BDS suppliers are not well developed. To avoid the excesses of our provider-centric past, however, practitioners need to approach capacity-building interventions with the same goals, analytic rigor, and market understanding as those who argue for demand-side interventions.

In this article, I describe how a conventional supply-side business center project in the Ukraine evolved into a cutting-edge, market-oriented activity employing principles of both supply-side and demand-led interventions. The article ends with lessons gleaned from this experimental process and makes an appeal for us to move beyond the ideology of using only one approach and adopt a broader, more practical view to develop a vibrant BDS market.

Donor Distortion vs. Market Orientation

The aim of the NewBizNet project[1] was to foster business centers in different parts of Ukraine so they could better assist SMEs. The designers initially concluded that, to be sustainable, these centers had to be commercially viable and should not rely on donor funding. The project selected a handful of centers and assessed their capabilities through a competitive bidding process. One center was chosen in each region of the country to ensure geographic coverage. The designers' strategy was to pick market leaders and make them into market innovators—a common justification for supply side-only interventions within an underdeveloped BDS market like that of the Ukraine. After selection, the project provided substantial amounts of technical assistance and resources to bring center operations up to Western standards.

While upgrading the centers, the project covered almost 100 percent of their costs. As a result, the centers ended up taking their market signals from the donor, USAID, rather than from their clients. This, of course, was not the intended result. In response, the project developed and implemented an incentive plan to change the subsidy from direct funding to a bonus linked to revenues. This bonus system was the first step taken toward commercialization.

However sound the concept, implementation fell short of the mark. The project based its approach and monitoring systems on Western business practices, not on local market conditions in Ukraine. For example, the project imposed financial reporting and client management systems based on open management principles, equitable practices in resolving disputes between government and business, and business incentives that encouraged investment and growth. Ukrainian businesses found these incentives and practices highly risky because of irregularities in the way the government enforces regulations. In

[1] Most of the work described in this article was completed under the USAID-funded NewBizNet project (1994-1999). The USAID follow-on activity, BIZPRO (2000-2003), is building on NewBizNet's demand- and supply-side interventions.

reporting requirements merely as a price they had to pay to receive subsidies. Again, the donor, rather than the market, was driving behavior.

At this point, the project made a concerted effort to restructure its approach based upon an analysis of the specific characteristics and needs of Ukrainian SMEs. From the information gathered, it became apparent that Ukraine was both distinct from and typical of many former Soviet republics. Although larger and wealthier than most of its former sister republics, it still evinced traits common to those countries: over-regulation, little clear direction for reform, and the rapid growth of the informal sector in response to government corruption. Other characteristics also emerged: (1) competition in the BDS market was highly regional; (2) the market for BDS was weak but growing; (3) there appeared to be a latent demand for services, particularly training; (4) Ukrainians placed a high value on training but saw training as a never-ending process; and (5) inadequate policy reform and poor implementation had skewed the incentive structure for SMEs and business service providers (BSPs).

As a result of this information, the project stopped directly subsidizing centers and, instead, began to design tools that fostered competition and pushed business centers, as well as other BSPs,[1] to look to SMEs for their market signals. This strategy combined demand- and supply-side interventions, supported by a continuous flow of market information to strengthen market signals and provider-user communication.

Demand

Few tools are specifically designed to create demand for BDS, largely because practitioners find it difficult to obtain adequate leverage when working directly with SMEs. Donors usually have had more success leveraging economic growth by targeted assistance to individual firms, based on their potential for growth, business risk, market opportunities, and the like. But such targeting has rarely translated into corresponding growth in effective support services; the opposite usually happens. The one demand tool that appears to offer real leverage is vouchers. Vouchers provide leverage through partial subsidies, an improved flow of information, and the use of effective market incentives.

As a part of the shift to a more market-oriented strategy, the project considered launching a pilot voucher program. At that time, voucher methodology was based primarily on the pioneering work of GAMA in Latin America. The standard model was designed to effect change in training markets through the use of vouchers only—that is, without other types of interventions. A key assumption of the model was the relatively long period of time needed—usually from one to three years—to develop the market.

The NewBizNet project modified the approach taken in Latin America. Because Ukrainians value training and education, they often are willing to pay the full cost of high-quality training. There was also evidence that some BDS providers were already selling training services at full cost. The project wanted to move away from merely stimulating demand to increasing outreach, triggering the creation of innovative courses, and assisting BSPs in building credible training services.

Based upon these critical differences, a multiyear voucher program was deemed inappropriate. In addition, there was no need to treat the voucher as a stand-alone tool. The Ukrainian pilot voucher program resulted not only in a new methodology for the use of vouchers but also in a concomitant shift in their benefits and limitations. Table 1 highlights critical differences between the standard model developed in Latin America and the one employed in Ukraine.

[1] The shift in definition from "business center" to "business service provider" represented the project's reconceptualization from a narrow audience to a larger audience. "Business center" was the term for NewBizNet entities, whereas BSPs was the catch-all phrase for any service provider.

TABLE 1. COMPARISON OF LATIN AMERICA AND UKRAINE VOUCHER METHODOLOGIES

BENEFIT/LIMITATION	STANDARD MODEL	UKRAINE APPROACH
Voucher Administration	The number of vouchers and length of the program require more stable and sophisticated administrative tools, which are more expensive and require more time to bring on line.	Easy to set up and initiate—can be called a rolling voucher program because it is designed to start and run for shorter periods than in the standard model.
Scale (number of trainees) and Depth (number of repeat trainees)	This program, because of its time frame and openness for SMEs to use multiple vouchers, delivers scale and depth. In particular, depth can be accomplished only over time, which is why this program is so effective.	Scale can be achieved, but depth is left to the BDS provider to achieve.
Targeting	This program, because of time frame and openness of training firm participation, focuses on the lower end of the market (i.e., micro-entrepreneurs).	Can be highly targeted because the methodology mimics a manufacturing coupon structure—the openness is defined by which firms sign agreements to participate.
Market Incentives	Based strongly on market incentives, but the length of the subsidy creates questions about a possible mismatch between value (demand) and pricing (supply) and needs to be considered during design.	Based strongly on market incentives, but the potential for targeting can limit competition if not considered.
Market Information	The time frame and administrative tools allow for substantial opportunities to establish information channels that can make the market better informed and, as a result, more competitive and dynamic. Essentially, this model delivers an ongoing learning model that often develops internal market information channels. This model also assumes the government has a role in ensuring that information is accurate, comprehensive, and understood by the largest number of firms.	The shorter time frame and less-sophisticated administrative needs limit the potential to establish information channels, but the structure allows for re-introduction of vouchers after aggregate information is funneled back into the market. Essentially, this model provides an information injection, an assessment period, and then a decision to repeat or not. It is more limited in establishing internal market information channels because it limits the intervention time.
Supply-Side Integration	The initial design was to affect supply through the empowerment of demand. As a result, it was not designed to integrate with a supply-side intervention. However, the development of information channels and ongoing support for demand provide excellent hooks for supply-side intervention. The issue is how to match supply-side interventions with the services being purchased.	Designed to integrate with a supply-side intervention during and after the voucher delivery. Improvements in the market have to be viewed over time so that spikes and drops can be understood.

To complement the voucher program, the project adopted a supply-side strategy. It decided not to focus on individual firms but to effect change at the market level. The project directed resources to improve skills to design, deliver, and market new business skill services; manage firms delivering the services; and introduce new products into the market to spark innovation. The project designed supply-side assistance that addressed training needs as defined by the BSPs themselves as well as information from market signals through the voucher program.

The project designers were particularly interested in increasing the supply of business skill services such as finance, accounting, management, and marketing to SMEs while achieving a certain scale and depth of outreach in the market. We know from experience in Latin America that the demand for business skills training tends to decline with the size of the firm. Smaller firms usually seek specialized production-based training—for example, how to make shoes or bake bread—that doesn't have much market potential. Because the standard voucher model focuses on the lower end of the market, it would not mesh well with the supply-side intervention and would have little chance of achieving large-scale outreach.

The solution was to establish a hybrid voucher program for generalized services that could be guided by using incentives and then supplemented by a "rolling" voucher program for higher-end specialized services (where scale and depth were less of a focus). The project selected local organizations that it viewed could administer the voucher program—those with clear internal incentives to promote vouchers to SMEs (as opposed to microenterprises). The project also sought to spark the demand for business skills services through a public relations campaign that highlighted the benefits of such training. It must be emphasized, however, that this process sought to nudge rather than direct demand because the project wanted to minimize the potential bias that could arise in the demand indicators—for example, usage trends and satisfaction ratings.

An important lesson gleaned from our experience with demand-side activities in Ukraine is that markets are indeed dynamic; thus, market development interventions also must be dynamic. Dynamism does not mean chaos, but constant rational adjustments to new information. The practical application of this principle is the establishment of sound management information systems to ensure ongoing monitoring, assessment, and adjustment of project interventions.

Supply

Demand-side interventions are difficult because they are relatively new to BDS programs. Supply-side interventions perhaps suffer from the opposite problem: there is too much history to misinterpret. This has certainly proven true in Ukraine.

Much of the resistance by donors to a market development approach was based on a misconception that sustainable markets require sustainable organizations. Actually, markets are stronger when there are robust cycles of failures and start-ups. Robust cycles allow firms to reorganize into smarter and more capable outfits. Once this was realized, there was a shift away from the idea of organizational sustainability to sustainability of the market (defined by service type).

At the BSP level, the project took its first step toward a market development approach by restructuring the way organizational subsidies were handled. The first tool was a work order, a financing mechanism whereby the project utilized the capacities of local service providers through competitive tenders. The work order mechanism introduced competition, restructured the donor-BSP relationship, allowed greater project flexibility to deliver services to underserved SME groups such as women and displaced people, and pushed BSPs to be more commercial.

Although work orders still relied partially on the donor, the approach did shift funding away from a pure overhead subsidy to a pay-for-services relationship. At the same time, donor funding became available to a wider range of BSPs, thereby breaking away from the single organization approach. The effect was to make donor funds more effective by maintaining the ability of BSPs to deliver services to underserved segments of the SME market while the project delivered the funds through a mechanism that encouraged competition and re-enforced market principles. The approach also reoriented BSPs toward private sector clients by eliminating their principal source of funds and forcing them to promote and sell their services directly to SMEs.

Work orders also were effective in leveraging previous capacity-building efforts by allowing highly skilled BSPs to transfer specific skills to other BSPs outside of their competitive region. The size of Ukraine allowed for a lot of this type of activity because BSPs in the country rarely compete with other BSPs for clients outside their markets. However, there are limits to this type of capacity building, given the lack of sophisticated skills, minimal product innovation, and little industry depth. Overcoming these limitations was the next step in the evolving supply-side intervention.

Improving human resource and product inputs turned out to be straightforward because almost all the training tools were applicable after modifications were made. These modifications included removing BSP affiliation requirements and designing an underlying structure that could be easily transferred to local organizations. With these modifications, training efforts began to be more effective at encouraging innovation and improving service delivery. Another effort to strengthen product development delivered high-quality raw products—training products with limited tailoring or local subject matter—to BSPs, which they then modified and sold to their clients. Similar to the voucher concept, the partial subsidization of the product development process encouraged entrepreneurial BSPs to test new products and fostered brand differentiation. The main objectives here were to build local capacity to design and launch new products and to deepen the industry by encouraging specialized firms to produce products and train staff for other BSPs.

Building industry depth is critical to future industry growth and market sustainability in Ukraine. The BSP industry will continue to grow only if the process of specialization pushes new providers to deliver new products that satisfy latent demand. The catalyst for commercializing providers will be trade fairs and other techniques designed to make the process of specialization more credible. This effort will be paired with tools, such as websites and newsletters, to improve the flow of information at the industry level. These two vehicles will provide local organizations platforms to deliver information and analysis on demand trends to BSPs, and will create more exchange among BSPs. Eventually, the website and newsletters will be transferred, if financially viable, to local organizations. The objective is to create not only vertical depth and specialization in the BSP industry but also a sense of professionalism that can help speed up a self-reinforcing maturation process.

Lessons Learned

Although the BDS strategy in Ukraine has evolved based on the latest international knowledge and local experience, the results of this thinking are not yet fully measurable. Implementation is still ongoing, and effective measurements at the market level have been difficult to define in a way that can be cost-effectively monitored. However, there are lessons to be learned by reviewing the thought processes that led to the current project design.

SMEs must be the focus. At key points in the process, one simple question was asked: How will the intervention improve the situation for SMEs? By continually asking this fundamental question, the project designers began to understand the limitations of the project design. For example, when the organizational focus was on a single regional provider, the question provoked a discussion of the costs and benefits of trying to sustain only one provider. The answer to the question—it didn't make any sense in terms of developing SMEs—forced the project to shift its focus to the industry level, with mechanisms such as work orders and vouchers.

SMEs are rational. One clear lesson is SMEs generally act rationally, given the information available on their operating environment. In most transition economies, the regulatory burden SMEs must bear remains heavy. SMEs find it almost impossible to produce or sell goods and services without avoiding or disregarding numerous laws and regulations. What's worse, corruption is rampant in a system in which government salaries are next to nothing. Finally, the general belief that you have to be told what is legal encourages SMEs to assume it is safer to be non-transparent and secretive.

Interventions that attempt to facilitate commercial BDS cannot counter this market reality directly.

However, interventions that are developed taking into account the client's needs and perspective can build from a base of credibility and bring about innovation and change over time, slowly making the market freer and more competitive. In the current design, the project is seeking to speed up the maturation process by focusing on two areas. The first area is to push innovative products that are commercially viable and that counter constraints. A good example is in Donetsk, where a commercial service bundles accounting, financial consulting, tax inspection management, and legal counsel for tax disputes. Through this service, the entire dynamic between SMEs and tax inspectors can be changed, encouraging SMEs to take a longer-term view and act more transparently. The project is facilitating the replication of this initiative by encouraging other BSPs to offer similar services. The second area is to feed information on market activity back to BSPs and SMEs to foster a freer and more competitive environment.

SMEs benefit from a rich mix of quality services. The major lesson drawn here was how to design supply-side tools for a whole industry rather than a particular organization. The current project design seeks to accomplish this by improving inputs to the industry and macro-level industry support structures. The inputs include human resources and products. The macro-level support structures are related primarily to the flow of information to and from BSPs (for example, website portals) and mechanisms to facilitate exchanges and cooperation (such as roundtables). A key pilot activity is testing a commercially oriented training program for professional trainers and consultants. Developing commercially viable input suppliers (trainer of trainers and consultants) can build depth into the industry by encouraging innovation and the development of new products. Improving industry-wide support structures will facilitate the flow of information about changing market dynamics so BSPs can work together to overcome common constraints.

Changing the incentives within the local commercial environment creates a greater multiplier effect. Initially, the Ukraine project rationalized working with individual BSPs in order to create a multiplier effect. The idea was that the support given to one BSP would be transferred to hundreds of SMEs through the services the BSP sold. However, the services defined by the donor and the effect on how the BSP defined its market signals worked against the commercial incentives at play. The project then established work orders and vouchers that reoriented BSPs, facilitated the creation of innovative services that SMEs wanted to buy, and improved the commercial environment by making it more open and rational. By reworking the intervention to fit within the Ukrainian incentive structure—secretive, short-term profit maximization—and then changing those incentives incrementally to favor freer, more open business practices, the project was able to deliver positive results that were self-reinforcing. Thus, the move toward a more commercially oriented market strategy maintains and even expands the multiplier effect by improving the overall efficiency of the market to deliver more services to more SMEs over a sustained period of time.

Market information makes both BSPs and SMEs more effective. Market information in Ukraine is often distorted or nonexistent. Not surprisingly, the decisions Ukrainian businesspeople make are often poor. By improving the quality and flow of market information, the project is facilitating a more informed, transparent, and competitive marketplace for both BSPs and SMEs. Tools such as website portals, newsletters, roundtables, and public information campaigns will be used to ensure that information is pushed back into the market.

Focusing solely on demand, similar to focusing only on supply, limits the potential impact of an intervention. In Ukraine, engaging supply was never the problem. Instead, the problems lay in the manner in which supply was engaged and the fact that demand was not even considered. In countries making the transition to freer and more open markets, a flexible yet balanced approach is needed. ◆

THE LIMITS OF BDS MARKET DEVELOPMENT
Or Why We Need Network Strategies

by C. Richard Hatch

Poverty alleviation, employment growth, and private sector development are at the top of the development agenda and with them an emphasis on micro and small enterprises (MSEs). The success of microfinance institutions everywhere has led to an international effort to redefine BDS, which are seen as critical to the entry, survival, and growth of MSEs. In the words of the Committee of Donor Agencies for Small Enterprise Development, "Motivating the search for a 'new paradigm' for BDS was the shared recognition that traditional interventions . . . have not achieved the objectives of donors and governments."

In the Committee's view, BDS include training, consultancy and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion. It is assumed that these services are needed (and wanted) by MSEs. The problem is that they have rarely been done right. Too many projects have been supply driven, with donors and governments offering what they believe MSEs ought to have. At the same time, projects have little stability, waxing and waning in response to enterprise development fashions and the availability of funds. Sustainability remains a receding target as donor and government subsidies distort both the demand and supply sides of the BDS market. Entrepreneurs come to expect low fees (and learn to accept low quality in compensation). The solution, according to the Committee's guidelines, is markets for BDS led by the private sector.

The argument for BDS market development is straightforward: poverty alleviation requires private sector development, which requires MSE development, which requires business services, which require the development of BDS markets. The aim of governments should be to create "an environment conducive to MSE development." Such environments provide "relevant, differentiated services" that meet the range of needs critical to MSE success. These needs "can be understood as basic, practical questions such as 'how to,' 'who with,' 'where to,' and 'what about' in relation to basic business functions." Financial services, although acknowledged to be important, are excluded from the definition of BDS. Other important services crucial to product differentiation and MSE competitiveness are overlooked.

Charity is out. Services are to be provided via business transactions between buyers and sellers—exchanges between supply and demand at market prices. Even microentrepreneurs, we are told, are or can be "discerning consumers" of services. Market development is defined as the process of stimulating demand through education and exposure to peers, then encouraging suppliers to compete for MSE business. In the future, supply-side interventions are to be limited to occasional help with developing products and upgrading technical skills. Elimination of distortions caused by ill-conceived government and donor interventions can be counted on to induce an adequate supply of services with the right content, quality, and price. Low rates of BDS utilization and impact in the past are laid entirely to the absence of free-market price signals. Under the BDS market development paradigm, once the invisible hand replaces the heavy hand of bureaucracy, the stage is set for BDS to lead MSEs into the realm of higher revenues, employment levels, and wages.

Although many donor- and government-sponsored business assistance programs have had serious flaws, there is no evidence to support the BDS market theorists' main claim. If they were correct in saying that undistorted markets will direct BDS resources to poor microentrepreneurs, we should expect to find flourishing BDS markets in regions where there

THE REAL WORLD OF BUSINESS IS NOT MUCH LIKE THE MICROECONOMIST'S MODEL OF ATOMISTIC FIRMS IN HOBBESIAN COMPETITION.

has been little or no public sector assistance for small enterprises, but we do not. It is worth noting that in developed countries where small-scale entrepreneurs are subjected to a great deal of "education" concerning the value of business services and generally have money to spend, BDS provision continues to require public subsidies, and supply does not appear to create adequate demand. The European Commission must spend a great deal every year to keep its small business information center and technology transfer programs going. In the United States, the nationwide system of Manufacturing Extension Partnership (MSE service) centers provides a cautionary tale. Established under matching grants to industry-led nonprofit organizations and designed to be demand driven, these centers are still unable to break even after 10 years of operation. Although many have adopted what is called a deep-pockets strategy—shifting the focus from firms in greatest need to those with the greatest financial resources—the high cost of sales continues to make sustainability elusive. BDS market development proposals also tend to ignore entrepreneurs (quite possible the majority) who do not generate adequate demand and are unfortunate enough to live in places where supply is nonexistent.

Clearly, there are problems. Governments and donors are not very good at BDS provision, and even if they were, there is no way public funds could be stretched to cover the needs of tens of millions of MSEs in the developing world. Small firms are important to poverty alleviation, but markets cannot be counted on to provide the services they need. In many places, services are simply not available. If this were all, it might be possible to tweak the familiar models and find a way out of the dilemma. But something fundamental is amiss in the discussions of BDS market development, and it is the emphasis on transactions, an emphasis that keeps policy makers, facilitators, and providers focused intently on the individual firm. There are several reasons why this traditional service delivery model should be re-examined:

1. Individual service delivery is expensive and makes inefficient use of scarce factors, including consulting capabilities and MSE investments. It is often also unwise.

2. BDS providers with an eye only on their immediate clients' interests often encourage firms to take the low road to competitiveness—competition based on price alone. In this process, labor is de-skilled, wages are squeezed, and jobs are eliminated. Although the individual bottom line is improved, the overall economy suffers.

3. The real world of business is not much like the microeconomist's model of atomistic firms in Hobbesian competition. In reality, firms—small and large—compete by cooperating in groups. These groups are more and less conscious and vary in complexity, from local chains of value added to the supply systems of auto makers and the global alliances in the electronics industry. Only if small companies position themselves in the right networks or systems of firms can they leverage their own capabilities with those of others to achieve the levels of productivity, flexibility, and innovation the market demands.

As we will see, the way out involves the best parts of the market development paradigm, a revised view of what is required for MSEs (especially microenterprises) to become and remain competitive, along with mechanisms to promote inter-firm cooperation.

MSEs at Risk

There is no question that small firms are at risk in increasingly turbulent markets. The television- and movie-influenced convergence of consumer tastes and the increased flexibility of multinational corporations are crowding out traditional suppliers and traditional goods in many markets. Liberalization policies and World Trade Organization rules are radically changing business environments. In India, where I am conducting an action research project under the USAID-funded Microenterprise Best Practices (MBP) Project, import restrictions no longer protect the industrial "engines" that drive a national economy. At the same time, subsidies are being withdrawn even from the Gandhi-inspired handicraft sectors that employ hundreds of thousands of workers.

In many villages and cities, low barriers to entry have attracted large numbers of small-scale entrepreneurs into nearly identical businesses. The availability of microfinance programs contributes to the trend. In Dakshinpuri, a resettlement colony on the distant edge of Delhi, 54 women-owned microenterprises compete for orders for Salwar suits (a woman's garment) from the several hundred neighborhood households. Their fabrics come from the same market stalls. The design of the clothes they make is fixed by tradition. The Salwar suit market may be growing, but NGO-led microfinance and entrepreneurship development programs add rapidly to the number of competitors. The result is a saturated market, shrinking margins, price-based competition—and self-exploitation.

Farther west in the Aligarh, a cluster of several thousand microenterprises has supplied India with locks for generations. These little firms make their own tooling and use hand-operated machines to manufacture the intricate brass parts from which a vast variety of padlocks, bicycle locks, and mortise locks are made. Although these firms have links to large customers and national markets, they are not much better off than the apparel makers in the Delhi slums. In Aligarh, unequal bargaining power enables traders and wholesalers to make tiny suppliers bid against one another, forcing price concessions and keeping downward pressure on wages. To make matters worse, Taiwanese firms have now entered the Indian market. With modern lock designs and automated production technologies, they undersell and outsell Aligarh. The tiny firms there, like those in Dakshinpuri, are unable to respond to their competitive challenges.

It seems reasonably clear that traditional BDS will not be effective in situations like these. Even if firms could see the usefulness of BDS, they can afford little of them. More to the point, these firms do not need services to help them do what they now do better; they need to do different things, quite differently. The fundamental needs of the firms in Dakshinpuri and Aligarh are product differentiation to improve margins, greater productivity to increase revenues, and internal specialization to make productivity growth possible. BDS alone can't produce these changes. The familiar limitations of small firm size—shallow management depth, lack of research and development capacity, inability to master alternative markets, and restricted access to capital—are handicaps too great for individual tiny enterprises to overcome. Only by networking their skills and equipment can they confront their problems.

Overcoming the Limitations of Size

Networks—groups of firms that cooperate in order to compete—are a singularly effective, collaborative means of escaping from the inherent limitations of small size. Over time, a learned propensity to network dramatically improves the adaptive capacity of entire clusters. In addition, network collaboration often reveals gaps in local system capabilities, turning clusters into natural incubators, internally generating the services the group needs for competitiveness.

We know from experience in developed countries that networks coalesce around common needs and opportunities. Through participation in *service networks*, dozens or even hundreds of firms can share the costs of market intelligence, quality testing and certification, materials purchasing, and financial management. (In this context, we might refer to these as BDS networks.) Out of these service networks blossom *production networks* in which MSEs cooperate to supply profitable markets.

FORMER ITALIAN PRIME MINISTER ROMANO PRODI APTLY LIKENED THE EFFICIENT SYSTEM OF PRODUCTION THAT THESE MSES CREATED TO "A MAGNIFICENT TINKERTOY."

In general terms, networks have three important business functions: they reconfigure enterprise value chains, they increase internal specialization, and they generate management economies.

- ***Networks reconfigure enterprise value chains, creating economies of scope.***

In networks, complementary capabilities can be melded to produce new product lines. In a network program for Denmark several years ago, we concentrated on organizing networks to create new products and services for export markets. Here are two examples out of several hundred. Eleven apparel manufacturers formed CD-Line to exploit their complementary capabilities in the production of suits, shirts, accessories, and knitwear. The manufacturers successfully market an integrated line of what they call "image clothing" (uniforms) to large European companies. Seven companies engaged in shipbuilding, marine fittings, fishing equipment, and electronic navigation systems networked with a bank and a private research center to develop a state-of-the-art trawler for the international market.

- ***Networks increase internal specialization, enabling MSEs to achieve scale economies.***

Specialization within networks improves overall factor productivity. In a project with agricultural equipment companies in northern Argentina, networks were organized to develop farm implements for the difficult soil conditions found in the nearby Brazilian province of Mato Grosso. The joint market research and engineering design exercises led to the realization that the small firms were too highly integrated vertically and almost no production process reached minimum efficient scale. This soon led to greater manufacturing specialization, increased subcontracting, competitive prices, and solid export sales.

- ***Networks generate management economies.***

By sharing costs within a network, small firms can afford quality services (making BDS markets possible). Economic theory locates the large firm's advantages in "management economies"—the ability to spread the high cost of sophisticated administrative, financial, and marketing activities over a large volume of business transactions. Although the decentralized production of goods and services can be efficient, isolated owner-managers are nowhere near as effective as a diversified management team. Networks built around joint management services are the only way most tiny companies can use BDS to improve internal operations and achieve focus. CITER, which serves the knitwear industry in Italy's Emilia-Romagna region, is perhaps the best-known example. This 600-member network routinely brings the most sophisticated international market research to a cluster of MSEs located in an agricultural area far from major fashion centers. CITER also negotiates for its members with the multinational corporations upon which these MSEs depend for the fibers and machinery they use in their work.

Learning from Europe

The study of networks and efforts to derive lessons for economic development practice had its start in the early 1980s when the rapid growth of Emilia-Romagna came to the attention of European and U.S. researchers. In a single generation, this region had changed from a low-wage agricultural area into a center of internationally competitive manufacturing. Particularly striking was the fact that the sharpest rise in wealth and greatest fall in unemployment followed a period of crisis in which small firms replaced large ones as drivers of the economy.

The tens of thousands of small enterprises created in the 1970s quickly figured out how to link diverse capabilities to serve high-end markets. Romano Prodi, economist and former Italian Prime Minister, aptly likened the efficient system of production that these MSEs created to "a magnificent tinkertoy," able to shift nimbly from market to market as specialized firms formed and re-formed networks in response to changing customer demand. Study revealed that the combination of strong business associations, technological prowess, and a learned propensity to cooperate in networks was behind the unexpected phenomenon.

With more and more countries coming to depend on the small firm sector for employment growth, the good news from northern Italy soon led to a series of experiments aimed at promoting inter-firm cooperation. The earliest were in the United States, but the best known is the Danish national network project launched in 1989.

In 1989, the removal of trade barriers and the coming of the European Community's Single Market were just three years off. Denmark's trade deficit, however, was large and growing. Business investment was low; unemployment was high. The Danes had reason to worry about the coming competition from powerful German firms just across the border. The government's policy focused on promoting mergers to create critical mass. After surveying clusters of small companies scattered across the agricultural provinces of Denmark, I became convinced that the strategies seen in the manufacturing centers of northern Italy represented an alternate route to critical mass for Danish industry. If Denmark lacked industrial engines, it did have 7,300 small- and mid-sized manufacturers of high quality. The following case was put to the Ministry of Trade and Industry and representatives of Danish business:

> There are two choices: build big firms—and do it quickly, before open competition in Europe puts the cost of gaining initial shares of new markets beyond reach—or make existing, largely small, firms perform like the best of big ones. Both of these policies aim at the same end result—sufficient production, marketing, and financial strength in enough industrial sectors to stand up to the competition we can all see coming down the road. The strategies these policies require are, however, vastly different. In my view, small firm dominance of manufacturing does not preclude building a world-class economy. It is not size that counts, but competence and cooperation. If individual small firms are weak and vulnerable, networks give them strength.

In March 1989, the Danish Ministry of Trade and Industry announced its plan for establishing network cooperation in small- and medium-sized enterprises. The key objective was to increase SME exports. The network program's principal features included a press and television campaign to make networks a part of the country's business discourse; use of business leaders to legitimate an unfamiliar practice; matching grants for networks developing new products or entering new markets; and a training program for a new kind of BDS provider, the network brokers that were to lead SMEs into cooperation.

Steps one and two in creating a culture of cooperation in business are participation and information. The ministry's operating arm, the Agency for Industry and Commerce, began by organizing a private sector steering committee. The steering committee selected 40 people drawn from private consulting firms, accounting firms, technology transfer centers, local economic development organizations, trade associations, and commercial banks for training as network brokers. They were chosen on the basis of their knowledge of small business and their commitment to the network project's goals—and they paid substantial tuition to enter the program. Broker training consisted of four- to six-week periods of practical fieldwork punctuated by intensive, two-day seminars. At the heart of the seminars

IN 1992, THE MINISTRY WITHDREW FROM ACTIVE PARTICIPATION, STATING FLATLY THAT "NETWORKING HAS TAKEN ON A LIFE OF ITS OWN IN DENMARK."

were case studies dealing with network structures and functions, organizing techniques, conflict resolution, group strategic planning, and market development. The objective of the fieldwork was to turn knowledge quickly into action, building pilot networks to convince skeptical manufacturers.

In less than 18 months, more than 3,000 of Denmark's 7,300 manufacturing firms were actively involved in one or more networks. Some networks involved few firms, some many. They were active in food processing, clothing, furniture, metalworking, and machinery and in many other sectors. Both formal (joint ventures) and informal networks were created.[1] In 1992, the ministry withdrew from active participation, stating flatly that "networking has taken on a life of its own in Denmark." Because the Danish network program was able to introduce cooperation into a resistant business culture in a surprisingly short time, most later projects in industrialized countries have used its basic design, including challenge grants and the training of network brokers. Our task now is to adapt network strategies to the developing world.

Networks for India

The situation of MSEs in India is different from that in Italy and Denmark. Firms, by and large, are not nearly as skilled or well equipped. The large informal sector is cut off from government business assistance. Except for the most basic private services, like trucking and commission sales, BDS are essentially unknown. In this setting, networks that encourage entrepreneurs to exchange information, become more productive, and reduce operating expenses are even more important than in Europe, where the tools and strategies were originally perfected.

The MBP project in India works with NGO partners, drawing on their experience and access to MSE clusters. Preference is given to those interested in testing and developing a new BDS product (network brokering) that they can offer on a sustainable basis in the future. Our tasks include research, training curriculum and materials, advice, and evaluation. The key objective is the development of a replicable model. Partners are responsible for training and mentoring network brokers. These brokers work with target entrepreneurs to define common problems and opportunities.

Our research over the past months has shown us that microentrepreneurs in India know a great deal about their problems. Given a chance to increase profits without excessive risk, they will do so. Despite repeated stories about entrepreneurs' distrust of one another and the class, caste, and sectarian differences that are supposed to make cooperation difficult at best, we have found that it is common, even among competitors and people of different backgrounds.[2] There is a modicum of trust based on social ties and repeated business transactions even in competitive settings. Network brokers build on this base of trust to encourage collaborative experimentation. With care, they can transform these fragile ties into strategic cooperation—the ability to see solutions to business problems in terms of partners and networks.

One major function of networks in settings like these is to make BDS into routine parts of enterprise operations. Rather than ask individual entrepreneurs to master all aspects of modern business management, we encourage them to invest their time and resources where returns are highest and to utilize external BDS providers for other business functions.

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[1] Among the more unusual networks created under the program was one in which small landscape contractors teamed up to develop golf courses in Eastern Europe. A more common model is the kitchen cabinet network, which agreed to modular dimensions and finishes to encourage mixing and matching, and then invested jointly in a showroom in Germany.

[2] Manoj Taneja is a case in point. This young man set up a tiny leather plant with money from his family a few years ago. When he found that big customers wanted more production in less time than he could manage on his own, he formed a production network to fill their orders. Taneja is Hindu; the partners he brought in as the business grew are Muslim. Now that the order books are full, Taneja spends less time making goods and is moving toward specializing in sourcing leather and marketing the network's capabilities.

This increased use of BDS becomes feasible through cost sharing—and the larger the group, the lower the individual cost. At the same time, by aggregating enterprise purchasing power, the project's networks create more attractive markets for BDS providers. Trained network brokers act first as intermediaries, linking firms to common services. Then, as budding entrepreneurs, they look for ways to create permanent employment for themselves by filling the gaps in the array of services available. The fact that brokers are drawn from the entrepreneurs' milieu minimizes culture conflicts and difficulties arising from differences in income expectations. When sophisticated inputs are needed, brokers and networks can turn to partner organizations and their access to the broader BDS community. Small challenge grants are available to encourage experimentation.

A Network + BDS Market Model

In Dakshinpuri, product differentiation and additional marketing channels must be developed. In Aligarh, entirely new products suited to existing skills and equipment are needed. In both places, we began with inventories of skills and equipment and then asked partners and brokers to study the business systems in use. The business systems diagrams they prepared show us where and how materials are procured, how production operations are carried out, and through what channels goods reach their markets. From these diagrams, we can identify benchmark processes and alternative markets. We also learn a lot about the challenges these firms face, enabling us to think about network functions and sources of business services. Table 1 is an example of the results of these local research efforts.

TABLE 1. CHALLENGES SMALL BUSINESSES IN DAKSHINPURI AND ALIGARH FACE

COMPETITIVE CHALLENGE	NETWORK FUNCTIONS	OPTIMAL NETWORK SIZE	BROKER'S ROLE
		Dakshinpuri	
Local Market Saturation	Combine production capacity and expand market	Large	Investigate alternative channels; sell on commission
Identical Products	Differentiate standard product by using better fabrics and adding features	Several, small	Purchase in groups; organize manufacturing services—e.g., dyeing, embroidery
Available Equipment (sewing machine types) Makes It Difficult to Respond to Changing Styles and Demand for Other Apparel	Enter market for children's and men's clothing; add needed equipment in specialized firms	Several, mid-sized	Provide samples of styles that sell well; recruit specialists to consult on production operations and quality control on a cost-shared basis
		Aligarh	
Unequal Bargaining Power	Share market intelligence and contract information	Large	Follow market developments and customer strategies; bring in additional buyers
Foreign Competition	Alternative product development and marketing	Many small	Profile firms in terms of capabilities; manage teams of engineers, product designers, and marketing consultants; attract specialized manufacturing services to enrich mix of capabilities

TABLE 2. MARKET RELATIONSHIPS

SELLER	PRODUCTS	BUYER	PAYMENT SOURCES
Private Sector Partner	Training; mentoring in network brokering and BDS operations; marketing assistance	Local network brokers (under- and unemployed people)	Microloan proceeds; percent of sales; franchise fees to training organization
Local Network Brokers	Network management, group BDS	MSE cluster	Commissions on sales and purchases; markups on external BDS services delivered to groups of firms; new fee-based services
MSEs	Garments (Dakshinpuri), metal products (Aligarh)	Wholesalers, distributors, consumers	Small challenge grants to create demonstration networks; revenue growth from network cooperation
Private Sector Partner	Tools, training, consulting, marketing assistance	Regional and national BDS facilitators and providers	Donor and government funding; percent of revenues; franchise fees

Another way to look at this emerging model is to focus on the revenue flows that enable sustainability—a network market development model, if you will. As shown in Table 2, each service is designed as a market relationship involving a seller and a buyer, with at least one source of cash to transform needs into effective demand.

Building Networks on Elements of Trust

Given the overwhelming scale of the problem—there are more than 16 million MSEs in India—it is clear that any enterprise development intervention must be planned with early sustainability in mind and an eye to leverage. Because so many of these firms are making products for which there is too much or too little demand or both, an effective program also must be capable of promoting specialization, productivity, and differentiation. India's small businesses need strategies before they need services, and the strategies they need involve cooperation with other firms. Networks are a fundamental step in MSE development and a necessary tool for poverty alleviation.

The economist Kenneth Arrow once wrote, "Every commercial transaction has within itself an element of trust." But he also said, "It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence." The network project in India is an effort to set in motion a process that breeds the mutual confidence that can overcome backwardness. In the network model, entrepreneurial self-interest leads to inter-firm cooperation. Repeated exchanges encourage a norm of generalized reciprocity. Dense networks contribute not only to the economic goals of entrepreneurs but also to the accumulation of social capital and the creation of a basis for long-term growth. But that's a topic for another article. ◆

THE CHALLENGE OF MEASURING BDS MARKET DEVELOPMENT

Complexity and Formal Causation

by Paul Bundick

For the last several years, donor agencies, consultants, and practitioner organizations have been involved in the long and sometimes arduous process of developing a new performance measurement framework for BDS interventions.[1] The goal is to develop meaningful and commonly accepted performance indicators that can be applied across all types of BDS interventions—be they demand-side voucher schemes or supply-side business training projects. It is hoped the framework will bring some measure of coherence and eventual standards to the diverse BDS field.

The first draft of this ambitious undertaking was presented at an international conference in Rio de Janeiro in March 1999. Since then, the framework has been revised several times, first by means of a virtual conference and then through applied case studies. Even more significant is the action research project now being carried out in a number of countries to test and refine the indicators and data collection methods. The action research is due to be completed in August 2001, at which time a new version of the performance measurement framework is expected.

The original impetus behind the performance measurement framework was to emulate the microfinance industry and develop comparable indicators across programs at the BDS provider or institutional level. The process started independent of the new market development thinking but soon was overtaken by it. Market development ideas were added to the framework after they had already been developed at the provider level. In my view, the performance measurement framework still retains this original provider-centric perspective.

The most recent version of the framework measures performance at three levels: customers or target clients, providers of BDS services, and BDS market development. Each level relates directly to one of the ideal typical intervention models[2] described by David Knopp in his introductory article in this journal. As BDS models have changed, not surprisingly, we also have incorporated new ways of measuring performance. Each new model has added important measures to the evolving performance measurement framework. We also have adopted new metaphors and more complex modes of systems thinking with each new type of intervention model. The performance measurement framework bears the stamp of our own BDS history.

The *service delivery model* provides direct subsidized services to a client or target group. The system logic embedded in the service delivery model tends to be linear, machine-like, and deterministic, typically framed in terms of mechanistic cause and effect: X acting on Y will cause Z results in some designated target population. The emphasis is on knowing and controlling relationships between independent and dependent variables. By control, I mean that an action is both necessary and sufficient to produce

[1] Development of a performance measurement framework is a research project carried out under the Microenterprise Best Practices Project, a USAID-funded research effort managed by DAI. MBP is working in collaboration with the Small Enterprise Education and Promotion Network and the Committee of Donor Agencies for Small Enterprise Development on the framework project.

[2] Ideal types are abstract constructs used to draw distinctions. They are neither ideal in a normative sense nor found in their pure form in reality.

the intended outcome. The image suggested by this model is a machine, which is controlled by an external manager and used, more or less predictably, to produce a desired result.

At a minimum, service delivery programs measure performance only in terms of outputs and the efficiency of producing them, such as how many services were provided. Increasingly, these programs measure their performance in terms of effects on the target group as well as measures of the overall costs and benefits of the intervention.

SERVICE DELIVERY MODEL

Service delivery interventions contribute two important and essential criteria to any integral BDS performance measurement framework:

- Benefits realized by the target group as a result of the services acquired
- Cost-effectiveness or cost-benefit of the overall public investment

The service delivery model never addressed (or needed to address) the crucial issues of sustainability of the service provider or the development of the BDS market. Moreover, such projects seldom look at the overall context in which the program operates. They assume stable environments or a contextual landscape that has little effect on project outcomes.

The *provider-centric model* is now the dominant BDS intervention model. In this model, a donor provides funding to set up or strengthen a service provider (a nongovernmental organization or private company), either directly or through an intermediary. The provider in turn supplies the "needed" or desired services to the SMEs. Fees are charged; sometimes the full operational cost is recovered, and in fewer cases, financial profitability is achieved. The goal is often to build up the capacity of the service provider (for example, a business center or an export-marketing company) to be more effective and eventually sustainable in delivering (selling) services to increasing numbers of a target group.

The provider-centric model is more flexible than the service delivery model, tending toward "open systems thinking" with its related concerns about strategy and adaptation to changing environments. It is less mechanistic than the service delivery approach and relies on learning and contingency-type strategies to make flexible changes when needed. The image evoked is one of an organism adapting to an environment rather than a manager operating a machine. There is increasing emphasis on building up the strategic and operational capacity of the provider to learn to innovate and adapt.

Measuring performance in provider-centric projects is more complex than in the previous model. The goals of the intervention incorporate the viability of the provider or the service that it is supplying while satisfying the objectives and interests of donor agencies and the needs of target groups. These goals are coupled with some degree of knowledge of a largely uncontrollable context, an environment that in turn helps shape project outcomes. Consequently, results are less predictable; the logic of contingency prevails. Actions are taken, control is exercised, and results are achieved within a plurality of interdependent variables and an appreciated environment.

Typically, when it comes to measuring the performance of provider-centric projects, the focus is on financial sustainability, at the level of the service transaction, the level of the organization providing the service, or some combination of the two. The notions of the client's willingness to pay for a service and customer satisfaction are added to the measures to assess client benefits (market research for strategy making), in addition to more standard measures such as improved business

PROVIDER-CENTRIC MODEL

Provider-centric interventions contribute two more sets of indicators to those already provided by the service delivery model.

- Provider Viability Measures
  - BDS-operational cost recovery
  - Financial viability of the provider
  - Managerial capacity of the provider
- Customer Measures (market information)
  - Willingness to pay
  - Satisfaction with service

practices achieved through the earlier service delivery model.

Most provider-centric programs measure provider viability in terms of financial outcomes alone. This misses an important point. Viability depends on the managerial capacity of an organization to strategize, innovate, and adapt to a changing environment, which cannot be measured by financial indicators only, at least in the short term. Viability also depends on the selection pressures in the environment and the dynamics of the industry in which the provider operates. True, these are reflected in financial indicators over the long term, but short-term profitability can be undermined quickly in volatile markets.

Growing numbers of BDS interventions are now emphasizing a market development approach, where the goal of an intervention is the creation, development, and continued evolution of a well-functioning BDS market. Alan Gibson and others argue that this approach is the best means of providing MSEs with an affordable mix of products and services they need and want on a sustainable basis. In these market-centric projects, the emphasis is on facilitating the growth of non-subsidized BDS transactions between suppliers and consumers, using both supply- and demand-side intervention strategies and tools to develop BDS markets.

The facilitator's primary role is to influence a development process by intervening sometimes directly, but more often indirectly, with MSEs (for example, by providing and brokering information) or by creating incentives for BDS providers to develop new products aimed at the target segment in question.

In market development interventions, we encounter serious complexity for the first time. No longer are we dealing with simple input-output mechanisms as in the service delivery model, where we exercise more control over outcomes. Nor are we dealing with a typical capacity-building exercise, helping a single organization adapt to a changing environment as in the provider-centric model. Markets are complex, co-evolving systems made up of numerous business entities (individuals, households, and organizations), each trying to improve itself relative to what everyone else is doing. Every entity finds itself in an environment at least partially co-produced by its interactions with other entities. The "moving ground" gives rise to nonlinear dynamics. Like an ecosystem, markets are always in transition, opening new niches and closing others. The very act of filling a niche by one company opens up more niches, so new opportunities are always being created through interactions. This inherent complexity in market dynamics gives rise to formal causes.

Formal Causation and Market Development

Aristotle delineated four types of causes: material, efficient, formal, and final. Any event in nature can have as its cause one or more of the four types, as shown in Table 1.[3]

TABLE 1. ARISTOTLE'S FOUR TYPES OF CAUSES

Cause	Description
Material	Substance, in which all other causes operate and out of which the thing is constituted—the inherent tendencies in specific types of material. Glass shatters and wood splinters. This refers to the way different materials behave or cause certain outcomes to happen.
Efficient	Action, external to the thing or event under discussion that allows the whole process to get under way—an outside force causing an effect in something else.
Formal	An inner-forming activity—not a mere force imposed from without but an ordered and structured emergent pattern of inner movement that is essential to the growth (or dynamics) of things.
Final	Usually considered to be "the design." In more modern vernacular, it refers to the imposition of system constraints and the contextual landscape for the other three causes; also includes both conscious and unconscious human intentions that channel system movement toward certain ends.

[3] In preparing this table, I have drawn on the work of the eminent physicist David Bohm from his book, *Wholeness and the Implicate Order* (London: Routledge & Kegan Paul, 1980).

MOST PROVIDER-CENTRIC PROGRAMS MEASURE PROVIDER VIABILITY IN TERMS OF FINANCIAL OUTCOMES ALONE. THIS MISSES AN IMPORTANT POINT.

Of the four causal types, efficient cause is the most familiar; it is our typical unidirectional view of causality. In development projects, we are used to thinking in terms of forces acting on something from the outside and causing an effect. For example, BDS services (forces) are provided to microenterprises (objects) and cause the desired changes (impact) to happen. We can see and measure the results. Most of our performance measures are framed in this way, as can be seen especially in service delivery-type interventions.

Material causes are less obvious but still employed in normal development parlance when we talk about capacity building of organizations, restructuring of a company, the composition of work teams, or the qualities of key personnel having the "right stuff." Every substantial form has its own qualities, strengths, and weaknesses that combine with efficient causes to affect outcomes. Resources, capability of personnel, composition of project elements, and structure of their coordination all denote types of material causation broadly defined. Action is taken (efficient cause), and the group responds in accordance with its inherent tendencies (material cause) to produce a predictable result.

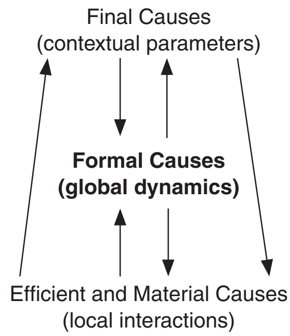
In development projects, we encounter final causes in the form of conditioning "landscapes" or environments made up of a myriad of forces and patterns, some of which are changeable, others that are not. Final causes impose limits, provide opportunity, and influence outcomes both directly and indirectly. Included in final causes are human intentions embodied in the "rules of the game" and in policies, institutions, thought patterns, and other contextual parameters. Final causes refer to the imposition of context and design. They first become apparent in our BDS interventions in provider-centric models—an institution adapting within contextual parameters.

When we arrive at market development projects, formal causes become dominant. They are less familiar and require more clarification. Textbooks often explain formal cause in relation to the development of biological forms (ontogeny), which is not strictly applicable to social processes like BDS interventions. In more recent years, however, formal causation has become associated with complexity theory and the interdisciplinary study of complex adaptive systems—everything from neural networks, anthills, financial markets, and the development of economies. Perhaps the most meaningful way to elucidate the notion of formal cause is to explore three interrelated concepts of complex adaptive systems—emergence, self-reinforcing feedback, and co-evolution—and relate them to market development themes.

Emergence refers to relational properties, which arise at global or systemic levels from local interaction; those properties in turn influence the behavior of those local actions. In neurobiology, it is now believed that consciousness is a global emergent property of the complex interaction of neurons in the brain that in turn influences the neural activity from which consciousness emerged. In economic systems, the actions of a large number of buyers and sellers give rise to the global behavior of the "invisible hand" of the market, which in turn influences these economic exchanges.

The concept of emergence draws attention to multiple levels of reality and the self-organizing properties of formal causes. The latter suggests that nothing extra—no external telos or designer—is required to cause this type of intra-forming behavior, although final causes are implied by the context in which this self-organizing behavior develops and efficient and material causes give rise to it from below but do not strictly determine it. The result is a threefold causal hierarchy as presented in Figure 1.

FIGURE 1. INTERPENETRATING CAUSAL LEVELS



Emergence should not be viewed as mysterious. It is a natural outcome of circular feedback loops[4] —feedback not only as generally understood in terms of cybernetic control theory but also as recursive patterns that characterize interactive networks and self-reinforcing processes. In economies, these self-reinforcing processes can derive from different sources, such as learning effects, coordination effects, and self-fulfilling prophecies. These processes include both growth-enhancing synergistic effects in the form of virtuous circles and downward spirals of vicious cycles.

An example of emergent properties and self-reinforcing learning effects in BDS programs can be seen in the formation of business networks (see C. Richard Hatch's article in this journal). Firms learn to cooperate, share knowledge, and commit dedicated resources for mutual gain. In this context, trust is an emergent property of a network, which arises from the learned interactions of the members and in turn influences subsequent local actions. Trust facilitates further investments in dedicated assets and knowledge sharing, which then serve to reinforce and give rise to more trust. This can develop into a virtuous self-reinforcing loop.

But self-reinforcing feedback loops also can give rise to vicious cycles. The opportunities we see are continually limited and reinforced by socially constructed learning processes, such as group think or cognitive lock-in. Industries often become functionally locked in to using inferior technology even when better options are available. Once a technical solution is adopted by an industry and becomes the standard, it often is difficult or even impossible to change. MSEs also become locked-in to low-margin trading systems that are difficult to break out of because they are constantly reinforced by local economic, social, and political dynamics.

Virtuous and vicious circles are crucial in understanding how markets develop. In both, the causes are decidedly not just efficient and material. The circles co-arise out of their own "inner forming activity" once a certain threshold is crossed. Once started (by an efficient cause), these processes become the cause of their own cause or the effect of their own effect—in other words, a formal cause.

The idea of co-evolution is fundamental to ecology, where species evolve in relation to one another. For example, certain flowers have evolved to be fertilized by bees, and bees have evolved to live off the nectar of flowers. The evolving relationship of mutual self-interest is the bee-flower symbiotic system—a convergent and emergent outcome of species interaction. Co-evolution also happens between predator and prey, where cheetahs evolve to chase down gazelles and gazelles evolve to escape from cheetahs. The concept of co-evolution draws attention to the shaping power of mutually causal interrelationships between two or more species. All evolutionary processes are really co-evolutionary.

[4] There are two essential types of feedback, those that are balancing (negative) and those that are self-reinforcing (positive). Balancing or negative feedback makes equilibrium in a system possible by calling forth adjustments when a change deviates too far from system parameters or variables, like a thermostat turning on and off a heater to keep a room within an acceptable range of temperatures. Self-reinforcing feedback, in contrast, amplifies the original change. Change goes through the system producing more change in the same direction, or if certain parameters are jumped, the process can even turn into chaos. Self-reinforcing change is required for all types of growth, development, and second-order change processes (change of change) called here formal causation. Balancing feedback is required for order and adjustment (change within the parameters of the system) or a combination of efficient and final causes.

In the development of BDS markets, co-evolution is a dominant motif. Suppliers and buyers of BDS co-evolve through interacting and pursuing their individual self-interest. The strategies of one shape the strategies of the other. Forms of collaboration emerge to enhance competitive advantages and reduce transaction costs (similar to the bee-flower system). Strategic differentiation arises to escape from competitive pressure (like the cheetah-gazelle system). Donor organizations co-evolve in relation to development practitioners. The interaction is both competitive and cooperative and is shaped by strategic mutual interplay.

Co-evolution occurs not only between organizations but also between production and consumption complements and their substitute products and services. Simply put, hammers co-evolve with nails and compete with screwdrivers and screws. Self-reinforcing processes create new economic niches. These give rise to new complementarities and greater diversity. Diversity begets diversity. Differentiation creates new opportunities for differentiation; change changes itself. This is formal causation.

Limitations of Current Market Development Measures

In measuring performance for market development interventions, one would expect the indicators to reflect these complex dynamics and co-evolutionary aspects of BDS markets. But, as seen in the text box at the right, these indicators refer mainly to provider-centric and service delivery-type interventions, not to the level of market development.

The first indicator, that of expanding markets or increasing market share (attaining scale), relates directly to a provider business strategy. This is clearly a good indicator for a specific business (or transforming nongovernmental organization) striving for high-volume markets, such as microfinance institutions or BDS providers of low-cost irrigation pumps. In my view, however, this proposed market development indicator and its related indicators fit better with provider-centric interventions—a business strategy in an appreciated environmental context—not a market development one. The indicator says little about the growing complexity of interaction in developing markets as a phenomenon in itself. In fact, large market share may in certain cases lower the intensity of competition and dampen diversity in the supply of services to customers, contradicting our third indicator.

CURRENT VERSION OF PERFORMANCE MEASUREMENT FRAMEWORK INDICATORS FOR MARKET DEVELOPMENT

1. Expanding the market for a given BDS as measured by the numbers of clients buying or procuring services; the amount of sales and the percent of potential market reached by the program

2. Deepening the market by increasing access to underserved groups as measured by the extent of access to services by the target group and the percentage of the potential target population reached

3. Developing a diverse and competitive market as measured by the number of BDS providers, the number of BDS products on offer, and the existence or not of a well-distributed and wide price range for services

In a similar vein, deepening the market for services to underserved groups (indicator 2) may be a worthwhile social indicator for public investment, but it refers more to measuring client benefits, an indicator developed under the earliest service delivery model. The number of people in the target population who acquire a given service operationally defines the term "market deepening"—an important social indicator but not a global-level indicator of market development taken on its own. The indicator says nothing about the processes of differentiation and growing complexity.

I suggest that indicators 1 and 2 in the current version of the performance measurement framework are not market-level indicators at all. They confuse levels and contradict what philosophers Whitehead and Russell termed the "theory of logical types." This axiom simply and profoundly states, Whatever involves all of a collection must not be one of the collection. As we have seen, markets are made up of an entire collection of interacting individuals, households, and organizations creating, producing, buying, and selling within a given boundary. The expansion of one organization or BDS program cannot be confused with the entire market. They are distinct logical levels—a system versus an element of the system.

Only the third indicator—developing a diverse and competitive market—is related to the level of market systems. The indicator suggests that the degree of BDS market development can be defined by the range of products and services at various prices on offer and by the intensity of competition between providers, as measured by counting the number of BDS providers within a defined market boundary. If we combine these measures with the number of buyer-seller transactions or exchanges (combination and revision of indicators 1 and 2 applied at the market level), we arrive at three general indicators for developing BDS markets. These are: (1) diversity of products and services on offer, (2) intensity of competition between providers, and (3) overall quantity of BDS transactions within the prescribed boundaries of the market. But are these sufficient to indicate real BDS market development?

Diversity is a measure of system variety. Diversity creates more diversity, which leads to complexity in the organization of the market. In the performance measurement framework, however, this diversity refers only to products and services being supplied by BDS providers and not to the underlying process of strategic differentiation itself. What is missing is any reference to MSEs on the demand side and the co-evolutionary relationship between buyers and suppliers.

In his article, Hatch convincingly argues that the demand for BDS arises from and co-develops with MSEs (our target group) pursuing a path of strategic differentiation and specialization of functions, focusing on their core businesses and acquiring BDS to fill in their business system. The BDS market emerges out of this mutual interaction and increasing differentiation between MSEs and BDS suppliers. MSEs co-develop in relation with BDS suppliers if they are indeed transacting. You can't have one without the other—it's a co-evolutionary relationship. Here, the performance measurement framework is silent.

Generally, as markets develop, the diversity of products increases. We know, however, some markets self-organize toward monopolistic situations as one technology displaces another and becomes an industry standard, as in the case of the triumph of VHS over Betamax in the video market. Market development can follow a path-dependent channel in which early chance occurrences (not necessarily based on best price or quality) can determine the winner between two competing products. As BDS markets develop, there is a strong likelihood that product diversity will increase, although it is not always so. Industry standards reduce choice and diversity, sometimes for the better, sometimes not.

The indicator of intensifying competition apparently assumes that as markets develop the number of BDS providers increases, thus intensifying competition among them. This in turn leads to more product diversity and more transactions. Intensifying competition usually reduces margins, however, something firms generally try to avoid. Thus, competition may actually decrease the number of transactions and diversity of products in a given BDS market unless firms respond to the competitive challenge by adopting new strategies to avoid hypercompetition. The response is what is critical. A number of strategies are possible, including cooperation, collusion, and diversification.

Intense competition also is characteristic of undeveloped markets. This is typical of many MSE clusters

DIVERSITY BEGETS DIVERSITY. DIFFERENTIATION CREATES NEW OPPORTUNITIES FOR DIFFERENTIATION; CHANGE CHANGES ITSELF. THIS IS FORMAL CAUSATION.

that show little product or organizational differentiation and encounter stiff competition because of low entry barriers. They tend to compete on price alone, which leads to reduced margins. Intensifying competition on its own is an insufficient indicator of market development; perhaps it is better seen as a reason for doing it or as an impetus to differentiate.

The number of transactions between BDS buyers and sellers appears, at first glance, to be a useful indicator. We are used to thinking about markets in terms of transactions or exchanges between atomized firms competing on price. But markets, as I have argued, are more than just transactions between individual firms; they are complex social phenomena in their own right with emergent global properties characterized by multicausal feedback loops. Individual BDS transactions may increase with growing markets, but such measures cannot adequately capture the co-evolutionary pathways and increasing complexity of developing markets.

Toward BDS Market Development Measures

If our goal is to create more dynamic, self-organizing and differentiating markets for BDS within a given population of MSEs, we need new success indicators focusing in at the level of formal causes.[5] Although the number of possible indicators abounds, I suggest two areas worthy of immediate exploration:

1. **Increasing differentiation and specialization in both MSEs and BDS providers arising from co-evolutionary interaction.** The concept of sustainable differentiation or self-organizing differentiation might be developed into a new meso or global performance indicator. In other words, how and to what extent have MSEs and BDS providers mutually shaped each other's strategies, organizational forms, and products on offer over distinct periods of time? If markets were developing, one would expect a distinctive movement toward differentiation on many levels in the system. The concept of sustainable (self-organizing) differentiation might be developed into a new performance indicator.

2. **Intensification of virtuous circles between BDS suppliers and MSEs.** Trust and other forms of social capital are emergent properties of interfirm cooperation; they are mutually self-reinforcing but also reinforce the process of strategic differentiation. Virtuous circles also can accelerate the process of knowledge creation among firms. Another measure might be the rate of entrepreneurial innovation and technological change in the system, which tends to destabilize vicious cycles and create new opportunities for the emergence of virtuous loops.

Performance indicators imply accountability and the ability to control outcomes that are being measured. As our BDS intervention models have shifted from direct provision to provider capacity building to market development facilitation, our level of control over outcomes has correspondingly diminished. Formal causes become self-reinforcing after a certain threshold is reached, but they need to be triggered to get them started or re-directed in a new way. In developing indicators at the level of market development, we must make room for the role of the facilitator rather than of the provider of services. We need measures to assess the skill and efficacy of triggering and guiding these market development processes.

Formal causes and complexity present real challenges for developing valid market development measures. There is still much work to be done in developing new constructs and in grounding them in practice before the market development approach gains full ascendancy in the BDS field. I hope this article serves as a small contribution toward that end. ◆

[5] Of course, formal causes are greatly influenced by contextual parameters, as seen in Figure 1. An adequate discussion of contextual parameters and final causes is beyond the scope of this paper.

FOR FURTHER READING

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