



**Office of Evaluation and Oversight, OVE  
Inter-American Development Bank**

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*RE-287*

***SYNTHESIS OF OVE  
EVALUATIONS OF BANK  
ACTION FOR PRIVATE  
SECTOR DEVELOPMENT***

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Office of Evaluation and Oversight

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### ACRONYMS

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## ACRONYMS

IIC	Inter-American Investment Corporation
ISI	Import Substitution Industrialization Model
MIF	Multilateral Investment Fund
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PAP	Processed Agricultural Products
PRI	Private Sector Department
SAP	Structural Adjustment Programs
SGR	Second Generation Reforms
SMEs	Small and Medium Enterprises

## INTRODUCTION

This report responds to a specific request made by the IDB's Board of Executive Directors to the Office of Evaluation and Oversight in July 2003, as Management embarked on designing a Private Sector Development Strategy. Pursuant to that request from the Board, this report briefly summarizes the main points arising out of OVE evaluations of Bank actions in private sector development over the past three years. It contains no new evaluative insights; rather, it seeks to pinpoint the principal strategic issues in earlier OVE papers that go beyond assessment of the impact of activities in specific areas. The following OVE reports were consulted in the preparation of this paper.

- Independent Evaluation Report to the IIC Board of Executive Directors: CII/RE-1, CII/RE-2, and CII/RE-3 (2001-2003).
- Independent Evaluation of the Multilateral Investment Fund (MIF): MIF/GN-78, MIF/GN-78-1, MIF/GN-78-2 (Alternative Dispute Resolution), MIF/GN-78-3 (Microfinance), MIF/GN-78-4 (Financial Reform and Capital Markets), MIF/GN-78-7 (Report to the Governors Annual Meeting, 2003), MIF/GN-78-8 (Human Resources and Labor Market Projects), and MIF/GN-78-9 (Private Participation in Infrastructure) (2001-2003).
- Evaluation of Bank Action and Strategy for Small and Medium Enterprise (1990-2000) (RE-273) (2002).
- Report of an Independent Consultant on the Development Impact and Credit Quality of the Private Sector Department Portfolio, presented at an informal meeting of the Board of Executive Directors (CS-3292-5) (2000).

Chapter 1 briefly outlines the private sector context over the past decade and the principal trends observed in each of the different evaluation reports. This is supplemented, in Chapter 2, by a summary of points of agreement found in the aforementioned evaluations of the Bank Group, aimed at providing insights and lessons that might prove useful for discussion of a private sector development strategy. The report concludes with a short review of a number of findings from the study of evaluations and analyses of best practices in strategic planning, yielding methodological and structural insights for a strategy capable of effectively shaping and supporting the Bank's efforts to bolster private sector development in the coming years.

## I. CONTEXT FOR BANK ACTION FOR PRIVATE SECTOR DEVELOPMENT

- 1.1 During the 1990s a new environment for private sector development in the region was created by:
- More open trade practices, to promote closer commercial ties among countries and stimulate competition;
  - Deregulation and financial openness, to encourage integration, new product development, and greater flows of funds among increasingly interdependent financial markets;
  - Less government involvement in economies as a result of privatization, deregulation, and the dismantling of monopolies, creating new opportunities for private sector service delivery and private sector jobs for former government employees;
  - Development of information technologies and telecommunications, bolstered by the spread of the Internet, which shortened distances, cut costs, and expedited business dealings;
  - Opening up to surging foreign direct investment with companies actively seeking out new opportunities for trade and service delivery;
  - The trend toward competitive specialization, forcing larger companies to focus on their core businesses and to outsource or shed nonessential lines of support services.
  - Shifts in consumer habits and lifestyles, leading to new ways of doing business and new kinds of services; and
  - Shifts in labor market dynamics toward greater labor mobility and lower opportunity costs, encouraging more and more people to start businesses.
- 1.2 The framework for these changes has been the implementation, since the early 1990s, of a macroeconomic model which has achieved, above all, a reduction in inflation and an increase in exports. This macroeconomic model crystallized as a set of recommendations that became known as the “Washington Consensus.” They were implemented through Structural Adjustment Programs (SAPs), which induced market-oriented reforms and trimmed state intervention in domestic economies.
- 1.3 This reform process prompted the authorities in the countries of the region to promote a strategic shift in their industrial policy, altering practices associated with the import substitution industrialization model, especially the tariff protection and subsidies that had dominated macroeconomic policy since World War II.
- 1.4 Implementation of this economic model is credited with two major achievements: lower inflation and higher volume of exports. Inflation fell from an annual average of 400 percent in the 1980s to 170 percent in the 1990s. By the end of the

1990s, it displayed a downward trend that reached its low point under 10 percent in 2000. It is noteworthy that these stabilization policies were, to a large extent, based on exchange rate interventions. Capital inflows lowered the rate, leading to currency appreciation and exchange rate fluctuations, combined with the high interest rates needed to attract foreign capital.<sup>1</sup>

- 1.5 Second, implementation of the model led to a major increase in exports. As a result of liberalization of the market, and despite higher rates of exchange brought on by financial liberalization and freer capital flows, the volume of exports grew by almost nine percent a year since the early 1990s, which is to say four times faster than the rate of growth achieved in the post-war period under import substitution policies (1945-80). However, the trade balance deteriorated because imports increased even faster, driven by the enhanced purchasing power generated by the rapid decline of inflation and boosted by trade and financial sector liberalization.

**Table 1.1: Economic Performance of Latin America and the Caribbean  
Annual Growth Rates (percentages)**

INDEXES	1945-1980	1980-1990	1990-2000	2000
Annual inflation rate	20	400	170	9.2
Rate of growth of exports	2.1	4.4	9.4	11.1
Rate of growth of imports	5.9	-0.8	12.8	12.3
Rate of growth of GNP	5.6	1.2	3.3	4.3
Rate of growth of per capita income	3.1	-1.8	1.6	2.2
Increase in productivity	3.1	-1.8	1.0 <sup>2</sup>	N/A

Source: *Desarrollo Productivo series, no. 103. Economic Commission for Latin America and the Caribbean (ECLAC-UN) Santiago, Chile, July 2001.*

- 1.6 Nevertheless, performance in terms of growth, competitiveness, and productivity was modest. In the 1990s, economic growth averaged 3.3 percent per annum, which was higher than the average for the 1980s, but well below rates achieved during the ISI period and below the 7.5 percent average annual growth of the Asian tigers. Furthermore, the labor productivity rate for the region grew only 1 percent a year, less than one third of the pace set in the ISI period.
- 1.7 One of the most salient aspects of this disappointing performance could be related to long-term trends of capital formation as a percentage of GDP. Indeed, the 1980s saw a marked drop in capital formation, which was not reversed by the recovery that began toward the end of that decade driven by private investment and the attraction of foreign direct investment to the region but could not be sustained after 1998 due to the impact of the Asian crisis. The investment rate hovered around 20 percent,<sup>3</sup> which was too low to guarantee robust rates of economic growth. Even more worrying are the signs that, over the past four decades, there has been a decline in the effectiveness of investment in the periods

<sup>1</sup> Trade and Development Report, UNCTAD, 2003.

<sup>2</sup> This is the percentage for 1990-1998.

<sup>3</sup> Individual country trends support this figure, albeit with variations.

- following the debt crises. Despite the reforms of the past decade, aimed at improved allocation and use of resources, each percentage point of the increase in gross capital formation in the 1990s was associated with lower growth than in the 1960s and 1970s.<sup>4</sup>
- 1.8 Three bank and financial sector crises left their mark on the 1990s and had a major impact on the development of financial markets thereafter. The first was the so-called “tequila effect,” which began with the devaluation of the Mexican peso in December 1994. The second was the East Asian and Russian crisis, which began in 1997-1998. Then a new banking and financial sector crisis erupted in 2000-2002 in Argentina, spreading to Paraguay and Uruguay.
  - 1.9 A review of standard economic stability paradigms reveals that, in their understanding of volatility, the models used attributed little or no importance to variables related to the financial sector and capital markets. Some empirical studies indicate that financial variables explain much of the up and downs and the chances of a downturn in the economic cycle.<sup>5</sup> At the same time, recent research stresses that stabilization policies, defined as fiscal prudence and sound monetary policy, do not even guarantee stability, inasmuch as sudden changes in investor sentiment may lead, via an open capital account, to massive capital flight and major economic disruption.<sup>6</sup> It has also been observed that this may happen in countries with moderately well developed institutions, but that it is particularly the case in countries that have only weak financial oversight and lack social safety nets. Premature liberalization of capital markets, without following a proper sequence of measures, may, as some examples in the region have shown, expose countries to high levels of risk that they may not be able to shed.
  - 1.10 These crises triggered efforts, starting in the mid-1990s, to deepen the reform program through what are now known as “Second Generation Reforms” (SGRs),<sup>7</sup> which do not modify the broad macroeconomic thrust of the SAPs but rather add to them by placing more emphasis on meso- and microeconomic factors, and on limited State participation to promote business development.
  - 1.11 Table 1.2 compares the objectives, tools, assumptions, and typical policies associated with these economic development models.

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<sup>4</sup> According to recent UNCTAD studies, a strong link between imports of machinery and GDP, and an increase in the investment ratio and GDP, constitute a virtuous circle in the investment dynamics of Asian countries. For Latin America these studies frequently associate higher investment with sectors such as construction and housing, combined with a sharp drop in investment in public infrastructure.

<sup>5</sup> Eastery, William et al, “Shaken and Stirred: Explaining Growth Volatility”, The World Bank, 2000.

<sup>6</sup> Stiglitz, Joseph, “Development Policies in a World of Globalization,” paper presented at the “New International Trends for Economic Development” seminar organized by Brazil’s National Economic and Social Development Bank, 2002.

<sup>7</sup> The Second Generation Reforms include a major shift not only in industrial policy, but also in areas such as health and education, as well as a renewed emphasis on poverty reduction programs.

**Table 1.2: Comparison of Economic Development Models**

<b>Models</b>	<b>Import Substitution Industrialization (ISI)</b>	<b>Structural Adjustment Program (SAP) “New Economic Model”</b>	<b>Second Generation Reforms (SGR)</b>
<b>Strategic objective</b>	<i>Independence from foreign markets</i>	<i>Macroeconomic stability</i>	<i>Increased competitiveness</i>
<b>Resource allocation mechanism</b>	<i>Government intervention</i>	<i>Free market</i>	<i>Free market with selective government intervention</i>
<b>Development driver</b>	<i>Public sector</i>	<i>Private sector</i>	<i>Combined efforts of the public and private sectors</i>
<b>Typical macroeconomic policies</b>	<p><i>Concept of the public interest related to goods and services</i></p> <p><i>Strong governments, involved in the production of goods and services</i></p> <p><i>Trend toward national control of production factors</i></p> <p><i>Price, exchange rate, and interest rate controls</i></p> <p><i>Industrial policy: vertical policies promoting “top priority” sectors, with obvious competitive advantages)</i></p> <p><i>Preferred sectors protected a) by tariff barriers and import quotas; (b) preferential rate loans, (c) government contracts.</i></p> <p><i>Horizontal policies: (supplementing vertical policies): financing training programs; preferential loans for SMEs; supply-side oriented research and development policy.</i></p>	<p><i>Structural Adjustment Policies:</i></p> <p><i>Fiscal discipline</i></p> <p><i>Free trade</i></p> <p><i>Price and interest rate liberalization</i></p> <p><i>Privatization</i></p> <p><i>Liberalization of direct investment</i></p> <p><i>Elimination of subsidies</i></p> <p><i>Reaffirmation of private property rights and protection of private investment</i></p> <p><i>Shift of industrial policy focus: elimination of vertical policies, support for horizontal policies (training and loans for SMEs , but with limited resources.</i></p> <p><i>Shift in technological development policy to more demand- and private-sector-oriented issues.</i></p>	<p><i>Shift in emphasis from industrial policy to a competitiveness-oriented policy.</i></p> <p><i>Build on the macroeconomic reforms of the SAP model, while deepening measures at the meso- and microeconomic levels.</i></p> <p><i>At the meso-economic level, these reforms seek to strengthen markets for factors that are vital for competitiveness. Policies to strengthen such markets include: increasing public and private savings; investing those savings (improving the financial intermediation system); investment in human resources as the driver of growth; reform of the labor market in order to increase labor productivity; and an emphasis on trade policy.</i></p> <p><i>At the microeconomic level, second generation reforms promote higher productivity at companies in sectors identified as having good competitive potential through assistance with the identification of technologies and promotion of licensing, and the identification of practices best suited to local conditions; together with advice on how to transfer, adapt, assimilate, and disseminate their use in the economy.</i></p>

Source: World Development Vol. 28, No.9, pp. 1703-1717, 2000. Policy Directions for the New Economic Modeling Latin America. Joseph Ramos, University of Santiago, Chile.



- 1.12 The modest rate of growth in Latin America and the Caribbean reflects both the sluggish accumulation of production factors and the low level of productivity in the economy. That being so, businesses responded in different ways to structural reforms. Privatized activities (utilities and financial services) responded best to the reforms, as measured by both productivity and growth. In these activities, as in the retail sector (i.e. supermarkets and large stores), transnational enterprises and domestic conglomerates play a preponderant role. These major enterprises were best positioned to take advantage of opportunities for expansion in the region as markets opened up, inflation fell, and exchange rate appreciation boosted purchasing power.
- 1.13 As part of infrastructure reform, several countries began breaking up State services and either selling stakes in the newly formed companies or granting service provider concessions to the private sector. These reforms made rapid headway in telecommunications, energy, and gas, but were somewhat more intermittent in water, sanitation, and road works. At the same time, in a bid to economize use of the scant public funds available, new infrastructure projects in every sector were opened up to private investment, mainly under build, operate, and transfer or build, operate, and own arrangements. In addition, a pay-per-use system was introduced for road improvements financed by the private sector, which meant that some investment outlays could be recouped by charging toll fees. A similar arrangement was used to construct new power plants, transmission lines, gas pipelines, wastewater treatment plants, and other facilities.
- 1.14 To pave the way for the new institutional model, in almost all countries sectoral laws had to be amended and new regulatory and institutional frameworks promulgated. The required laws were designed, on the one hand, to permit private participation in sectors that until then had been monopolized by state-owned utilities or reserved by law exclusively for the public domain, and, on the other, to establish new principles to guide private sector development and provide a regulatory framework for new private sector activities. Generally speaking, the telecommunications and electricity sectors have progressed most with regard to regulatory reform: more than half the countries in the region have adopted a specific law for each sector, while another quarter have a multisectoral law covering these areas. Nevertheless, in practice, in implementing those laws there have been widespread difficulties in achieving and maintaining the independence of the regulatory bodies.
- 1.15 Despite certain positive impacts of privatization with respect to coverage and quality of services and to fiscal stability, public disapproval of it has been growing in the region. In 2001 the disapproval rating reached 64 percent for the region as a whole, and as much as 78 percent in Argentina and Colombia.<sup>8</sup> By and large, the public acknowledges that services have improved, both quantitatively and qualitatively. However, the principal grounds for dissatisfaction are the increases in utility rates, which may make it harder for businesses to compete and

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<sup>8</sup> The source of these data is Latinbarómetro.

- cause hardship for low-income users; layoffs of workers from the enterprises providing the services; the perception that those enterprises earn excessively high profits; and corruption in the privatization processes. Moreover, recession, the banking crisis, and the collapse of financial markets came hard on the heels of the reforms, and, in the public's perception, could be related to them. Some researchers<sup>9</sup> stress that failure to pay sufficient attention to the political and social dimensions of the reform process was one of its principal shortcomings.
- 1.16 One of the sectors that did respond positively was manufacturing, which saw an increase in exports as integration processes opened up external market opportunities. Nevertheless, processed agricultural products encountered serious obstacles, despite substantial investment in new technology, and had to face falling prices, increasing domestic costs due mainly to exchange rate appreciation, and barriers to access in distorted markets, including protection mechanisms in developed countries.
- 1.17 For industry as a whole, overall productivity fell or stagnated, with the exception of Mexico, where it increased slightly. Such improvements stemmed from payroll cutbacks rather than from investment.<sup>10</sup> In most countries of the region the low level of investment curtailed increases in productivity and technological advancement. The rapid opening up of the economy to international competition and the influx of foreign direct investment induced a structural change in output that favored sectors producing or processing natural resources over those with the greatest potential for productivity gains. The demand for labor also fell as capital investments increased in natural resources-based branches of manufacturing. Several countries experienced a particularly sharp decline in the productivity of traditionally labor-intensive sectors, such as the textile industry. Meanwhile, in industrial branches in which investment increased as a result of integration with international production “clusters,” the technology component also increased. At the same time, research-intensive sectors saw their productivity gap widen still further vis-à-vis more developed countries.
- 1.18 It comes as a surprise that in a period of swift technological change, such as the 1990s, when output and trade opportunities were expanding vigorously, there was also a widespread decline in productivity levels. This would appear to reflect a broadening of the productivity gap between the more developed countries and poor countries: a pattern reproduced within the region, where the productivity gap also widened between countries, with only a few showing gains—notably Chile, Argentina, and Uruguay—while in the rest productivity actually fell.<sup>11</sup>
- 1.19 The aforementioned outcomes at the national and industrial levels were even more marked at the small and medium-sized enterprise (SME) level,<sup>12</sup> a business

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<sup>9</sup> Stiglitz, 2002.

<sup>10</sup> Trade and Development Report, UNCTAD, 2003.

<sup>11</sup> *Competitividad—El Motor del Crecimiento*, IPES 2001, Inter-American Development Bank.

<sup>12</sup> This paper uses, like the Bank Group itself in its dealings with different countries, a flexible definition of small and medium-sized enterprises (SME). This flexibility is justified because it is impossible to isolate

segment of the greatest importance in the economy but which found it difficult to take advantage of the opportunities afforded by the new environment. Most enterprises in this category found themselves in a double bind: rising domestic costs on the one hand and, on the other, deterioration of both domestic and external prices for their products. Domestic costs increased in relative terms, for instance in U.S. dollars, as local currencies appreciated. By the same token, the possibilities of sustaining the prices of their goods and services became more remote in a context of significant deterioration in the terms of trade. Competition in domestic markets soared as trade barriers came down, bringing huge volumes of imports to compete with tradable goods and increased concentration of purchasing power in the hands of large-scale enterprises and distributors. Meanwhile, in foreign markets, barriers to access and price distortions continued to hurt processed agricultural products, which still constitute a fundamental part of the region's regular exports.

- 1.20 It is worth pointing out that the SMEs lacked the accrued capital or borrowing capacity needed for long-term investment. Their high structural birth and mortality rate made them unlikely candidates for long-term credit, quite apart from the problems they had in accessing a series of factors vital for their competitive development (i.e. technology and skilled human resources). The SMEs also faced competition from millions of workers displaced by productivity gains at large public and private corporations, who were forced to become "entrepreneurs," operating under conditions that, from a tax and labor law point of view, were barely formal. Furthermore, the need to balance the budget placed an even greater tax burden on formal sector enterprises, thereby creating an additional incentive to go or remain "informal."
- 1.21 These outcomes showed that, to induce more favorable responses by the productive sector to structural reforms, more emphasis was needed on the meso- and micro-economic levels in enhancing the productivity and competitiveness of local enterprises. This need was first grasped in the mid-1990s, when a noticeable shift in economic policies began to get under way with the introduction of the SGRs and increasing awareness in decision-making centers that the SAP reforms were not delivering the promised results.
- 1.22 That was when "new competitiveness policies" began to be explored, without, however, undermining the importance of macroeconomic stability, which by that stage was perceived as a necessary but insufficient condition for the growth of investment and modernization of industry. The new policies seek to make domestic products more competitive on the world market and to correct market shortcomings by providing public goods and using government intervention to encourage the supply of goods with beneficial externalities. Some recent studies that aim to illustrate opportunities for supporting the private sector through

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the effects of the Bank's actions with respect to the business sector in general, and also because different thresholds are used in the different countries of the region to distinguish microenterprises (e.g. over 10 employees, billing over US\$150,000) from large enterprises (e.g. more than 150 employees, billing over US\$20 million).

policies that encourage competitiveness, underscore the externalities achieved by entrepreneurs who discover in a given country a competitive way of producing a product already available on the world market. This work draw a parallel of the role of entrepreneurs in developing countries with inventors in mature economies, although the former are subject to fierce competition because of the innovation's limited appropriability.<sup>13</sup>

- 1.23 The quest for competitiveness is fraught with challenges and efforts to overcome them still fall short in most countries. From the entrepreneurs' point of view,<sup>14</sup> loans for businesses are scarce and expensive, there are too many taxes and regulations, and both economic policy and the legal framework are still unstable. Despite the progress in achieving macroeconomic stability shown in the figures, inflation is still perceived to be an obstacle in business circles. Add to that, in some countries, crime and corruption-related problems and major infrastructure shortcomings, which hamper business development and limit productivity. Businesspeople consider that the greatest obstacles to business operations and expansion are those related to financing and the regulatory framework, followed by excessive taxation and regulations, political instability, and, to a lesser extent, inflation and the exchange rate.
- 1.24 Improvements in the conditions that directly affect business transactions are vital when it comes to promoting new business initiatives. A recent OECD study<sup>15</sup> for a large group of countries and different periods of time consistently found that increases in entrepreneurial activity result in subsequent increases in economic growth and lower unemployment. Coinciding with that finding, Global Entrepreneurship Monitor<sup>16</sup> discovered for several years—in one of the world's most extensive and in-depth ongoing study of the business sector in 29 countries—a statistically significant association between entrepreneurial activity and national economic growth.
- 1.25 Private sector development in an enabling business environment is an increasingly important driver of growth and employment in the region. Its future is inextricably linked to the ability to overcome specific obstacles to competitiveness in business operating costs and to the exploitation of the comparative advantages needed to compete more successfully in world markets. This presupposes close collaboration between the public and private sectors, including academic circles, research institutes, and workers with a view to finding specific solutions for individual countries, territories, and/or sectors. This quest

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<sup>13</sup> Ricardo Hausmann and Dani Rodrik, "Economic Development as Self Discovery," National Bureau of Economic Research, 2002.

<sup>14</sup> Business climate survey conducted jointly by the World Bank and the IDB in 1999-2000. Other studies and papers monitoring business sector needs in the region, albeit on a much smaller scale, point to the same set of basic needs as the aforementioned survey.

<sup>15</sup> David Audretsch et al, "Linking Entrepreneurship to Growth," OECD STI Working Paper, 2001/2.

<sup>16</sup> Global Entrepreneurship Monitor is a research program begun in 1999 that seeks to measure the differences in levels of entrepreneurial activity from country to country, and how they relate to economic growth and national characteristics. It is run jointly by Babson College (USA), IBM, London Business School (United Kingdom) and the Kauffman Center for Entrepreneurial Leadership (USA).

for a social environment fostering innovation, investment, specialization in business “clusters,” and incentives for entrepreneurs could prove to be a significant factor on the road to competitiveness and growth. In addition, much remains to be done in the way of institutional development, especially in the financial and infrastructure sectors, in terms of confidence-building measures and factors supporting a higher level of competitiveness.<sup>17</sup>

- 1.26 The analysis of the context in which the private sector operated, points to major challenges ahead. Despite significant progress toward a more market-oriented business climate, performance has been disappointing. We would appear to have entered a post-Washington-Consensus era, in which consolidating gains made in the previous decade while simultaneously meeting pressing private-sector needs will require a more flexible approach to intervention, with greater attention to risk. This approach could exploit the advantages of greater openness, strengthen new regulatory and institutional frameworks still rooted in the past, and, at the same time, focus in particular on areas previously overlooked.<sup>18</sup> The experience gained over the past decade teaches us some important lessons, when it comes to drawing up a new strategy that allows for more flexible responses tailored to the challenges that emerged in the 1990s. The widely varying conditions within countries and from subregion to subregion demand such flexibility. This calls for considerable investment in research and close dialogue with the private sector to understand its needs, promoting the involvement of the public sector and other segments of society in efforts to overcome obstacles to development.

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<sup>17</sup> Laffont, Jean-Jacques, “Competition, Information, and Development,” The World Bank, 1998.

<sup>18</sup> In *After the Washington Consensus*, a book published this year, John Williamson argues that the new agenda should begin by completing the still unfinished first generation reforms, crisis proofing the region’s economies, supplementing growth with a concern for poverty and income distribution, and correct problems arising from the reforms. Chief among the problems that need addressing are: (i) at the macro level, cyclical stabilization and premature capital account opening (with, in reference to reserve requirements, “limited strategic outflows from an open capital account”); (ii) at the micro level, correct mistakes made in privatization processes, which ought to provide net benefits to the general public under a previously established regulatory framework, unless an enterprise is sold to operate in a competitive market, and eschewing corruption; and (iii) at the trade level, make the economy more open to imports in a context of a competitive exchange rate, meaningful access to export markets, and policies designed to increase competitiveness in such a way as to offset job losses in industries hit by imports.

## II. IDEAS AND LESSONS LEARNED FROM OVE EVALUATIONS AS POSSIBLE INPUTS FOR A PRIVATE SECTOR STRATEGY

- 2.1 What follows is a brief summary of key ideas and lessons learned from OVE evaluations over the past three years of Bank Group action to promote the private sector. The main focus is on issues that could be considered in a new strategy, rather than on specific findings in the evaluations regarding the effects of Bank Group activities.
- A. Shared Diagnostic Assessment**
- 2.2 **Experience gained in evaluations of the various areas of the Bank Group concerned with the private sector shows that the issues they raise cannot be dealt with solely at the aggregate level.** Meso- and microeconomic measures are needed, which presupposes in-depth knowledge of each sector and segment to be addressed. That level of familiarity with the issues will facilitate changes in underlying structures. Hence the need for diagnostic assessments, for each country and as a prerequisite for any actions to be taken, on which the different areas in the Bank Group agree and which pinpoint the main obstacles faced by the private sector in its business environment. Evaluation of the Bank's activities with respect to SMEs, for instance, revealed that such a diagnostic assessment was lacking for all but a minority of countries, and that country documents failed to reflect a coordinated vision of the different "windows" supporting the private sector.
- 2.3 **The IIC evaluation showed that the projects were not adequately supported in terms of the rationale for intervention in the sectors and countries of execution.** The grounds given for interventions were based not so much on solid assessments or analysis of sector issues in which the Bank has special expertise (such as the financial or agribusiness sectors), as on self-selected, specific, project-related targets relating to job creation, generation of foreign exchange, added value, and the projected economic rate of return.
- 2.4 **Evaluation of the various Bank Group programs revealed a failure to compile and order the key indicator data needed to gauge the investment climate for private sector development.** During preparation of the first annual action plan for the C & D countries, coordinated, on instructions from the Board, by the Office of the Executive Vice President, OVE worked with Management to develop a set of performance indicators. That greatly assisted coordination efforts and the preparation of sector indicators based on sources already available in the region, in addition to a series of indicators for internal coordination within the Bank Group. Thus, information began to be gathered that would help sharpen the focus on the development objectives of projects and throw light on the value added by the work of the Bank Group as a whole. Nevertheless, much remains to be done to ensure that information on key sectors is produced. The MIF evaluations underscored the importance at this time of working with regulatory bodies to develop indicators that can enhance transparency and serve as better

“benchmarks” for regulated sectors. Another recommendation, at the individual project level, is to ensure that a project’s development objectives tie in with definite improvements in levels of competitiveness with, for instance, specific references to the price, volume, and quality of key services.

- 2.5 **OVE also detected shortcomings with respect to the identification and mitigation of risks during ex ante evaluation of the capacity of sponsors, markets, competitive environments, and costs, particularly in the case of the IIC.** These shortcomings impaired the way projects were structured and resulted in cost overruns and difficulties due to limited management capabilities and lack of competitiveness in the companies involved. Although it is difficult to determine the causes of these problems, they certainly coincided with a lack of familiarity with the country and the sector concerned.

## **B. Coordination**

- 2.6 **One of the leitmotifs of all the evaluations was the limited degree of coordination of the Bank’s private sector-related activities.** This is, undoubtedly, no easy task given that the demands for actions that boost that sector’s development cover a wide range of issues, making horizontal coordination extremely difficult. This means that the needs to be addressed cut across sectors and across the functions assigned to different areas within the Bank Group’s organizational structure.

- 2.7 **Despite the momentum provided by new Bank strategies sponsored by the Department of Sustainable Development, such as the small and medium-sized enterprise strategy, the delivery of services at the operational level was a complex task.** One fact worth noting is that the reorganization of the Bank in 1994 helped to boost the “country focus,” thereby raising the level of sensitivity to countries’ needs. Responding to the more prominent role of the private sector in their economies, countries stepped up their requests for assistance over the past decade but found it difficult to elicit prompt attention from the Bank Group, due to the latter’s internal coordination shortcomings. As observed in the evaluation of activities on behalf of SMEs, although the Private Sector Coordination Committee was a key body for coordinating and facilitating action, as per the Eighth Replenishment in 1994, it really only began active functioning in 2002.

- 2.8 **In practice, the strategy showed signs of marked operational fragmentation. There was, in fact, no clearly established strategic focus; the diagnostic assessments supporting the rationale for the actions undertaken were deficient; and/or there was no clear perception of “market flaws.”** This fragmentation was exacerbated, as of the mid-1990s, by the proliferation of private sector agents that the Bank dealt with directly, through the Multilateral Investment Fund (MIF), and through activities carried out by the Private Sector Department (PRI). In addition, there were interventions through the Inter-American Investment Corporation (IIC) and in the Bank’s regular programs

(principally, its multisector credit, science, and technology programs and sectoral investment programs.

- 2.9 **Thus, the evaluation of private sector-related projects reveals that there was a surprising number of professional staff in the Bank either directly or indirectly involved with the subject, as well as numerous units, divisions, departments, and agencies.** Obviously, this translated into a plethora of operations, even within a single sector or a country, for which no *ex ante* shared diagnostic assessment were considered and no joint efforts were made to achieve complementary planning. This, in turn, led to scant coordination of the activities that then became “projects” (the Bank, MIF) or “deals” (PRI, IIC) with private individuals or entities, but which did not form part of a broader action “program” of the Bank Group. They were only remotely tied in with development objectives and diagnostic surveys.
- 2.10 **Fragmentation means that activities are less effective, because sequencing opportunities and synergies between projects may be lost and risks taken that could otherwise be mitigated by conducting prior or complementary projects.** This is especially important in the case of private projects without a sovereign guarantee, such as those of the IIC, the PRI, or the MIF’s Facility III-B. For example, in the financial sector, IIC activities would have benefited from access to market information and could have taken on fewer risks had it worked more closely with divisions in the Bank specializing in financial matters.
- 2.11 **The evaluations also showed that fragmentation in the Bank’s work also impaired the Bank Group’s image, because it complicated most private sector agents’ perception of how they could access the wide gamut of programs and services available.** In interviews conducted in the countries in the course of evaluations, entrepreneurs appeared to be confused about how to access project financing and related services. Many mistakenly thought that the Private Sector Department was the channel for the Bank’s services for the private sector, when in fact it is only a part of the wide range of services that the Bank has to offer. Somewhat more worrying was the fact that within the Bank Group’s own organizational structure there was a lack of familiarity with the synergies available in the different areas and instruments at the Bank’s disposal for fostering private sector development.
- 2.12 **The complementarity of MIF actions in the provision of private infrastructure services with other actions of the IDB Group could have proved a key factor in achieving successful outcomes, but it was not fully exploited.** The Private Sector Department and the Inter-American Investment Corporation are branches of the Bank Group that share with the MIF a direct interest in promoting private investment in infrastructure. Nevertheless, in the evaluations of the MIF no infrastructure project was found to have initiated in any of those areas of the IDB Group, which means that there is ample room for more effective coordination. Moreover, even though the objectives and activities of numerous MIF projects in different countries are similar, very little



communication and almost no sharing of experiences was found between projects. In some sectors, such as electricity, telecommunications, or water, regional organizations of regulatory bodies have begun to form, affording an opportunity for the MIF to associate with them in the quest for regional synergies.

- 2.13 **The lack of coordination was also observed even within a single sector and country, resulting in financial intermediaries receiving different terms depending on which projects within the Bank were providing the funds.** These kinds of inconsistency create an image problem, because operators outside the Bank have difficulty grasping, for instance, the difference between the IIC's bank loans and the Bank's multisector credit programs. Thus, contradictions were frequently found in the terms on which they extended credit, which not only caused opportunities for synergies to be lost but also undermined principles that the Bank supports (i.e. avoiding disincentives to the raising of domestic savings by establishing a baseline cost for financial intermediaries equal to the cost of deposits). When the ICC's projects were evaluated, it was discovered that lines of credit were being negotiated with financial intermediaries that had already received lines under the Bank's multisector programs and, in 90 percent of the cases, at differing borrowing costs.
- 2.14 **Also detected was a substantial loss of efficiency in fragmented interventions due to duplicated analytical studies and project identification and planning outlays.** An interesting example of the potential that exists for coordination, targeting, and synergy-conscious use of the different tools available can be seen in the Bank's work in the development of microfinance. According to the findings of recent evaluation of the MIF, this area of the Bank Group leads the world in terms of the impact it has had on the region. A strategic approach and a sequenced and synergy-conscious deployment of the resources of the Bank Group's various "windows" were applied. This example also illustrated that interventions may achieve a degree of importance that goes beyond their relative size, by making a major impact and triggering a demonstration effect.

### **C. Preparing a Bank Group Menu of Products for Private Sector Development**

- 2.15 **During evaluation of the Bank's actions with respect to SMEs, it was found that the Bank's private sector products cycle needs to be updated, given that the main types of intervention are more than 10 years old and are ill-adapted to specific needs.** It is worth noting that the principal services products, such as the multisectoral credit and technological programs, have typically been neutral toward SMEs at a cost in terms of their effectiveness, according to the recent evaluation. The MIF's resources, for instance, have not been fully tapped as a "laboratory" of ideas and there has been only limited mainstreaming of pilot schemes by turning them into operations on a broader scale, replicating the interventions with the Bank's programs.
- 2.16 **The evaluations did not detect a clear assignment of responsibilities for organizing the development of products that could form part of a possible**

**private sector development menu, in such a way as to facilitate dialogue with countries and with the private sector.** The evaluation of Bank actions with respect to SMEs suggests that the Bank probably needs to extend smaller and more flexible loans than those traditionally provided and that they should be tailored to the principal needs of the segments that the Bank seeks to serve; learn from the experiences of pilot operations financed by the MIF; and focus on improving SME competitiveness.

#### **D. Dialogue with the Private Sector**

2.17 **The evaluation demonstrated the need and timeliness of the Bank establishing procedures for regular consultation with the private sector, capitalizing on experience gained in the social sectors and using the private sector operators network cultivated in the course of the MIF's prolific activities.** These more systematic dialogue arrangements were identified as a priority by entrepreneurs and representatives of the private sector during on-site evaluations. They were envisaged as a process for discovering innovative intervention approaches and at the same time for verifying the Bank's diagnostic assessments and checking the relevance of proposed actions.

#### **E. Marketing**

2.18 **The high degree of fragmentation and variety of private sector operators in the region calls for a considerable marketing effort on the part of the Bank, endowing its actions with "brandmark" status, as it has managed to in the microenterprise field.** Service delivery projects lacked well-structured communication components, with a budget to support them and information technology capable of identifying users, monitoring their needs, and verifying their satisfaction with the services provided. Nor was there any sign of shared marketing components for more than one project in a country, aimed at generating synergies and simultaneously facilitate entrepreneurs' access to the wide range of services available. Moreover, both in house and in outreach to borrowing countries, there appeared to be little clarity regarding the menu of options and ways to channel initiatives that originate in the countries.

#### **F. Evaluability**

2.19 **Both the overall private sector strategy and country-level and individual actions need to have built-in evaluation criteria that make it possible to evaluate them in terms of both outcomes and impact.** The studies carried out point to an improvement over time of levels of evaluability and to improvements in monitoring and evaluation systems, particularly in the case of the MIF and the IIC. The Office has drawn up an evaluability checklist to encourage inclusion of the necessary criteria in projects, such as prior diagnostic assessments, definition of objectives, logical structure, assumptions, risks, and product and outcome indicators, as well as a requirement to establish appropriate baselines for the indicators, and final and intermediate goals and benchmarks, as needed.

- 2.20 **The evaluations also involved developing a set of specific indicators that could serve as a guide to enhance the evaluability of future actions in the private sector.** It is important that programs contemplate from their inception systematic measurement of the key variables shaping the development of the dynamic basic input markets (e.g. financial services and business support services), in terms of coverage, quality, and costs, as a contribution to raising competitiveness, and also a means to acquiring a minimum degree of familiarity with what is needed for enterprises to improve their productivity. This was the kind of contribution that OVE offered to make to the action plan for IDB Group activities related to private sector development in C & D countries, included in the evaluation framework of the first follow-up report (GN-2193-5).
- 2.21 **One finding common to all the evaluations is that a strategic updating of the Bank's actions in the private sector needs to call for greater selectiveness and evaluability if those actions are to support regional, and especially country, programs.** For a strategy to have a chance of succeeding, there are a number of prerequisites that were analyzed in OVE's evaluation reports and that, by and large, are lacking in the strategies generated by the Bank. This is a problem that extends beyond the bounds of private sector issues, but one that should be borne in mind when it comes to putting together a new strategy. Nevertheless, what matters is that these factors be consistently incorporated in various key instruments in the strategic action framework: policies, sectoral strategies, country strategies and action plans. Details of how this could be done are outlined in the following chapter.

## **G. In-House Capabilities**

- 2.22 One outcome of the evaluations was deeper insight into the Bank's strengths with respect to private sector development, especially from the clients' point of view. The Bank's principal competitive capabilities, detected in the course of the evaluations, include:
- Access to medium and long-term financing at rates that are lower than those countries can obtain with their country risk ratings.
  - Access to public and private best practices in countries of the region that are not borrowers.
  - Access to, and capacity to articulate actions with, public and private strategic partners in ways that would not be available for most countries and individual enterprises.
  - It is a solvent, forward-looking partner with a long-term commitment in the countries.
  - It is an operator that is not concerned with maximizing returns to itself, which means that it can commit to operations that purely private economic agents might not engage in.

- Profound knowledge of, and influence in, the countries of the region, with a direct presence in all the member states it lends to, plus a network of institutions and enterprises that are beneficiaries of the Bank's programs, which means that it can fine-tune its interventions.
- A large store of experience and knowledge at the middle and microeconomic level, acquired during many years of interaction with the private sector and matured in the 1990s thanks to MIF operations, which brought the Bank into contact with hundreds of business organizations and operators in the region.
- An extensive intervention toolbox, ranging from actions affecting the climate for investment via participation in discussions of sectoral policies and operations to technical cooperation and direct loans (without a sovereign guarantee) and indirect loans (with a sovereign guarantee) for actions at the individual enterprise level.

### III. STRATEGY RENEWAL

3.1 This section reviews the strategic tools at the Bank's disposal with a view to illustrating the potential role of a Private Sector Development Strategy. Second, it addresses certain factors that could be considered in a strategy definition process in this area.

#### A. The Bank's Strategic Tools

3.2 **Defining a new strategic framework for the Bank Group's private sector actions presupposes acquaintance with the particularities of the strategic tools at the Bank's disposal.** Consequently, it needs to be said that there is lack of complementarity in the instruments that could contribute to a strategy, beyond of the broad outlines provided in the Agreement Establishing the Bank, the current Replenishment, and the Institutional Strategy, by observing that there are a series of overlaps and failures to establish clear definitions.

3.3 **The Bank's set of tools consists, first, in hierarchical order, of the mandates of the Eighth Replenishment, followed by the Bank's policies, which are mandatory for operations.** Then, in an ill-defined ranking, given the lack of clarity in the Bank's sectoral strategy manuals and glossary, come the operational guidelines,<sup>19</sup> sector guidelines,<sup>20</sup> and plans of action. At the country level, strategies are established in country strategy papers.<sup>21</sup>

3.4 **Adoption of the Institutional Strategy in 2002 amounted to an update of the ongoing strategic validity of the last replenishment, and was an organizational leap forward as regards structuring the process of strategy formulation.** At the aggregate level, it realigned institutional objectives around four axes: (i) social sector reform; (ii) modernization of the State; (iii) competitiveness, and (iv) regional integration. This strategy also noted that "the Bank needs regular input from shareholders to keep fresh the goals and objectives of Bank interventions in the main sectors... through a regular review of the Bank's strategies and operational policies." The Institutional Strategy (GN-2077)<sup>22</sup> states that "[a] sense of purpose is essential to foster action within an organization," noting that "the Working Group conceived the institutional strategy not as a detailed plan, based on a forecast of what will happen in the future, but as

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<sup>19</sup> The IDB Glossary defines operational guidelines as: "A regularly updated operational document which provides technical and methodological guidelines for the design, evaluation and execution of programs of projects, but which does not have a regulatory role."

<sup>20</sup> The IDB Glossary defines sector guidelines as: "Guidelines which provide more refined selection criteria for Bank operations in the different sectors. They define common principles, suggest areas for further study, provide guidance based on experience, suggest tentative courses of action for creative programming, and encourage innovation and adaptation at the country level."

<sup>21</sup> The IDB Glossary defines a country strategy paper as: "A document which defines the Bank's operational strategy vis-à-vis a country for the programming period, usually three years, and provides economic and social analysis that serves as a frame of reference for policy dialogue and programming with country authorities."

<sup>22</sup> Paragraph 1.7.

- a set of guiding principles and key initiatives to improve the readiness of the Bank to make short-term decisions without losing sight of its medium-term objectives.”
- 3.5 **The Bank’s Institutional Strategy states<sup>23</sup> that “[s]ector strategies should be concise plans of action created to help accomplish key institutional goals set in response to the mandates of the Board of Governors,” and “[s]uch plans of action must be designed recognizing and exploiting the Bank’s institutional uniqueness, and identify: (i) a set of achievable goals; (ii) actions to be undertaken; (iii) instruments and resources required; (iv) assignment of responsibilities; and (v) a time frame for implementation and evaluation. However, it is worth pointing out that the Bank has still not included this definition of strategy in its operating manuals.**
- 3.6 **The Bank’s Operating Manual defines “policies”<sup>24</sup> as “directives that define the general lines of action of the Bank with regard to operations, administration, and personnel.” Sector policies “contribute to the development of a specific branch of the economy and provide a strategic framework for programming the Bank’s country and regional operations in that branch.”**
- 3.7 **Traditional practice at the Bank is that strategies are drawn up for matters below the policy level, such as a specific sphere of action within a wider whole defined by policy.** A second variant observed with respect to strategies is that they arise where there is insufficient consensus for adoption of a policy. In such cases, an effort is usually made to signal an institutional presence to those outside the Bank, while a few general guidelines are issued to those responsible for the area in question inside the Bank. The idea in this second variant would appear to be to avoid complex organizational changes, contributions of funds that can be quantified ex ante, or long-term commitments in dynamic areas that require extensive apprenticeship. More recently, in August 2003, seven sector strategies were added to the Bank’s manuals.<sup>25</sup>
- 3.8 **According to the mandate of the Meeting of the Board of Governors,<sup>26</sup> any private sector strategy definition for the whole of the Bank Group would have to be consistent with the principles of the Eighth Replenishment that**

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<sup>23</sup> Paragraph 6.16

<sup>24</sup> The Definitions section (OP-101) of the Bank’s Operational Policies and Strategies defines policies and requirements only in terms of content: “...should be expressed succinctly, clearly, and in concrete terms. A policy paper should include: (i) Background on the Bank’s experience and action in the area, and information and analysis for a better understanding of the proposed policy and the grounds therefore; (2) The policy itself, including: (a) the purpose and principle of the policy; (b) a description of the objective(s) of the proposed policy; (c) field(s) of activity and priorities chiefly applicable to sector policies; (d) criteria or basic guidelines to facilitate and clarify the application of the policy. Operational policy manuals should contain the policies themselves and specify the original policy document approved by the Board of Executive Directors.”

<sup>25</sup> Seven strategies were added: 1001 Sustainable Economic Growth Strategy, 1002 Poverty Reduction and Promotion of Social Equity Strategy, 1003 Social Development Strategy, 1004 Modernization of the State Strategy, 1005 Competitiveness Strategy, 1006 Regional Integration Strategy, 1007 Environment Strategy.

<sup>26</sup> AB-2148, 16 October 2001, Increase of IDB’s Private Sector Operations

were reaffirmed in the Institutional Strategy and with the requirements of the Bank's policies with regard to financing the private sector in a broad sense (e.g. from direct loans without a State guarantee to multisectoral financing, competitiveness, technological development, and infrastructure programs, etc), and at the same time tie in, in more specific matters, with sectoral strategies that continue to be important (SMEs, microenterprises, the financial sector, and so on).

- 3.9 **Pursuant to this same mandate of the Meeting, the new strategy must be accompanied by follow-up, evaluation, and accountability mechanisms that can be coordinated with actions planned at the regional and country level.** At the aggregate level, the action plan for private sector development in C & D countries should be expanded to include other countries receiving Bank loans, so that it can become the key factor for monitoring and executing the strategy, with the country strategies specifying the private sector actions envisaged for each country.

## **B. Considerations Regarding Strategy Formulation**

- 3.10 **This section lists a few key aspects to be taken into consideration in establishing a strategy.** They stem from the experience OVE acquired in its evaluation of the SME strategy, and other sectoral strategy evaluations,<sup>27</sup> and from comparison with best practices in strategic planning.<sup>28</sup>
- 3.11 **Thus it is important that the strategy to be devised add value to existing actions by the Bank Group to promote development of the private sector by establishing the following:**
- **Market.** Analysis of the targeted market, identifying private sector clients and their needs. This entails differentiating among principal business segments within the private sector in which the Bank can operate and being flexible enough to note differences between subregions and countries and the different levels of Bank action (e.g. interventions addressing the business climate or policy frameworks and regulatory institutions; massive programs or programs geared to developing services

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<sup>27</sup> OVE recently produced an "Overview of OVE's work on strategy evaluation" (AE-83), which reviews strategies in eight areas and suggests ways to enhance the importance, effectiveness, and efficiency of the Bank's strategic choices.

<sup>28</sup> Although strategy has been debated for centuries, the principal academic contributions to defining and applying it in companies stem from the major business schools that arose in the second half of the Twentieth Century. In this century, a new twist to the term has been given by military analysts, such as Carl von Clausewitz, but its use in connection with competition between enterprises dates back to the late 1950s. At that time Harvard University professor Kenneth Andrews argued that "each organization, each organizational unit, and even each individual should have a clearly defined set of objectives pushing them deliberately in one direction, and keeping them from veering off in unwanted directions." More recently, another Harvard professor, Robert Kaplan, pointed out that "without deliberate decisions as to what to do and what not to do, there is no strategy." One of the relatively recent studies to include a comprehensive analysis of the concept of strategy and how to produce one is "The Strategic Concept and Process. A Pragmatic Approach", Arnold C. Hax and Nicolas S. Majluf.(1996).

markets with intermediaries; and direct programs to finance infrastructure enterprises or corporations).

- **Organization.** An introspective look at the way the Bank Group is organized in order to assess its current capabilities and those that it could have to meet private sector development needs (the target market). This exercise in introspection would also help to consolidate unified and consistent actions by the Group, combining a division of labor with coordination mechanisms.
- **Choice.** A clear and reasoned rationale with respect to choices about which needs to satisfy and which not. On the one hand, such choices force those making them to disclose their priorities as they take into account the opportunities and risks revealed by analysis of the targeted market. On the other hand, analysis of the institutional capabilities needed for delivery of services points to the need to define the types of instruments and programs to be deployed.
- **Commitment.** A commitment regarding the means to be used to monitor and actually bring about delivery, in terms of human and financial resources, projects and the channels to be used.
- **Outcomes.** An indication of long-, medium-, and short-term goals, accompanied by product and expected outcome targets, throughout a specific period of time, aimed at satisfying identified needs.
- **Accountability and learning processes.** Establishment of commitments to inform on advances in project execution, including evaluation and learning processes. One of the requirements should be tracking of client needs and monitoring of the degree of satisfaction via mechanisms that facilitate dialogue with clients and obtain swift real time feedback from them at different levels of an intervention. This would help strengthen program planning, boost institutional capacity (with respect to both human and financial resources and organizational potential), and adjust the instruments employed, in such a way that the Bank can continue to play an important part in private sector development.
- **Communication.** The strategy must also be publicized and reach its target market by disseminating the Bank Group's image in the countries of the region, advising clients on the menu of products available and ways to accede to them, and offering greater transparency in actions undertaken. In-house, the strategy has to be communicated in such a way as to facilitate an adequate response capability, provide more coherence in actions undertaken, and ease the circulation of information needed for better coordinated and more efficient action by the different parts of the Bank Group.

3.12 **A broad strategy reflecting the Bank Group's vision with respect to development of the private sector and aiming to establish guidelines for actions does not necessarily have to combine and assume all the**



**aforementioned functions.** Nevertheless, such a strategy does need to articulate those functions coherently, even though they may be spread among the different components of the Bank Group's strategic toolbox for actions directed at the private sector, as mentioned in the first section of this chapter.