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## **Unpacking the Business and Investment Climate (BIC)**

Identifying possible BIC intervention strategies with a special focus on  
local level contributions

by

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## Introduction

Improving the Business and Investment Climate (BIC) in developing countries has become a popular concept amongst donor agencies, as can be seen in the decision of the “Donor Committee on Small Enterprise Development” to dedicate its yearly conference to “Reforming the Business Environment” this year.

Most past donor efforts to increase the global competitiveness of developing economies have not been able to outweigh the negative effects of disadvantageous legal, political and institutional frameworks that characterize many regions of the world, especially Sub Sahara Africa. The new – or relatively new - BIC focus is based on the donor community’s hope to improve the outreach and structural impact of donor interventions in the area of private sector development by consequently influencing these hindering framework conditions to economic growth.

For this purpose, donors have recently come up with a number of concepts for defining and understanding the Business and Investment Climate, and numerous approaches and instruments are available nowadays for assessing it. Nevertheless, literature and guidelines on how to design interventions beyond the assessment phase are still rare. This article aims at contributing to the further practical elaboration of the BIC approach by asking two questions: “Which interventions make sense with regard to which BIC elements?” And “What contributions can local level interventions make to improving a country’s BIC?”

### 1. Unpacking the Business and Investment Climate

Since the World Bank started to promote the BIC approach by initializing a series of Investment Climate and Doing Business Surveys and Reports, the majority of bi- and multilateral donors have followed the trend. However, the concept still appears many times as a buzzword for a number of factors and elements not clearly defined. The following chapter will therefore unpack the BIC concept in its single elements and elaborate these elements further by putting them in the context of practical implementation.

#### 1.2. The different elements of the Business and Investment Climate

Due to the heterogeneous institutional and political framework of the different donors, the developed concepts and even wordings – ranking from Enabling Environment to Business Sector Development – differ quite significantly. However, the philosophy behind them and the strategic shifts away from “traditional” intervention models are very similar, and the guiding principles can be summarized as follows:

- concentrate more on state and institutional failure
- put stronger emphasis on the political economy
- decrease the direct support at enterprise level
- promote a much stronger role and representation of the private sector in political decision making processes

Also, a remarkable congruence can be found with regard to the definition of core elements of a favorable BIC. Most donors agree that the most relevant BIC elements are:

- Macroeconomic strategies
- Governance issues
- Policy, legal and regulatory framework
- Organizational framework<sup>1</sup>

Macroeconomic framework conditions have been in the focus of development co-operation since the implementation of Structural Adjustment Programmes (SAP) in the late 80s. Many empirical studies show that macroeconomic stability is a crucial ingredient of a favorable business and investment climate, and several countries have shown promising results with regard to stabilizing their macroeconomic indicators. However, the SAP initiative has also revealed that macroeconomic stability is a necessary, but not sufficient element of a favorable BIC.

Governance issues, the legal and regulatory environment and the organizational framework and capacity of developing countries have therefore entered the focus of the donor community. Although the promotion of Good Governance and Capacity and Institutional Development are common concepts of development cooperation, these concepts had never been adapted systematically to the area of private sector promotion. Moreover, the importance of the policy, legal and especially regulatory framework for a dynamic private sector development had been neglected by most donor programmes for a long time.

These three issues - governance, legal, policy and regulatory environment and the organizational framework for Private Sector Development - constitute the most innovative and thus defining elements of the new BIC approach and can be regarded as the main building blocks of the BIC in a narrower sense.

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<sup>1</sup> White (2005), p. ii

There is of course no doubt of the significance of macroeconomic policy for a favorable BIC. Also, the importance of other prerequisites for economic growth, such as functioning labor, capital and service markets, is not denied here. However, these aspects have formed part of the donor portfolio for quite some time, and might even - as in the case of functioning markets - be perceived as a possible result of effective legal, policy and regulatory reforms. In the following, macroeconomic strategy and functioning labour, finance and service markets will therefore be regarded as elements of the BIC in a wider sense.

## 1.2. Specific interventions for different BIC elements

Reforming the BIC puts donors into a number of new domains, many times located at more complex levels than most practitioners have gained experience in. Traditional approaches and instruments to private sector development might in many cases no longer fit to the requirements of a comprehensive BIC reform programme.

This gap has been partially filled over the last years with the development of numerous survey instruments for assessing the BIC. Most of these tools focus strongly on the analysis of the BIC and less on technical and managerial questions of facilitating reform, although several instruments have tried to integrate action-oriented approaches, incentives for reform such as benchmarking procedures or at least detailed recommendations for reform. Nevertheless, most tools still lack a systematic structure of how to motivate and facilitate the improvement of the BIC in all four phases of analysis, design of reforms, implementation of reforms and monitoring and evaluation of reforms, especially if the criteria of sustainability and local ownership are applied.

The following table therefore depicts the different BIC elements – as defined above – and analyses them according to the following questions:

- What are the key aspects of the specific BIC element?
- How could possible interventions look like?
- What are the intended results of an intervention in this BIC element?
- At which level does an intervention make sense?
- What possible instruments can be used and what are exemplary sources of information?

## Unpacking the Business and Investment Climate

Elements of Business Climate*	Key areas	Possible Interventions, Intended Results, Levels					Possible Instruments	Possible Sources
		Possible Interventions	Intended Results	National	Regional	Local		
Macroeconomic strategies*	exchange rate, inflation rate, interest rates etc.	macroeconomic policy and strategy advice	stable key macroeconomic indicators	yes	/	/	Investment Climate Survey including indicators on macroeconomic policy	ifo World Economic Survey, WEF Africa Competitiveness Survey
Governance issues*	rent-seeking mechanisms, corruption	awareness raising in public and private sector, improvement of public access to information, support to administrative reforms etc.	increased transparency and accountability in public administration	yes	yes	yes	Investment Climate Surveys including corruption indicators, Investors' Roadmap, publish information on correct procedures, organisational development	USAID Investors' Roadmap, GTZ/ASCCI Business Climate Survey
Policy, legal and regulatory framework*	property rights, business registration, employing, import and export, resolution of commercial disputes, taxation***	facilitate analysis of policy, legal and regulatory issues, facilitate design of reforms	sustainable mechanisms for the continuous analysis of policy, legal and regulatory are established, capacity and mechanisms for the design of reforms are developed	yes	?	yes	Investment Climate Surveys, Regulatory Impact Assessments, Investors' Roadmap, Red Tape Workshops	General: WEF Africa Competitiveness Survey; RIA: Kirkpatrick (2001), SBP (2005); SME: UNIDO Diagnostic study of the regulatory and administrative constraints; Local Level Assessments: ILO Vietnam
		facilitate consultation / participation of private sector in decision-making	effective public-private dialogue mechanisms around policy, legal and regulatory issues exist	yes	yes	yes	Red Tape Workshops, capacity development for BMOs, support to/development of dialogue mechanisms	GTZ Red Tape Initiative, ILO Business Climate Survey
		assist in implementation of reforms / streamlining of procedures	efficiency and transparency gains for public and private sector	yes	?	yes	Red Tape Workshops, action-focussed surveys	GTZ Red Tape Initiative, ILO Business Climate Survey, USAID Investor's Roadmap; Case Studies and Best Practice: Sander (Case study Uganda, 2003), de Sa (Concept Note, 2005); Sader (1-Stop-Shops, 2005); SBP Red Tape Report South Africa (2005)
		facilitating exchange and learning, set incentives for reform via benchmarking, assist in the installation of M&E mechanisms	policy, legal and regulatory framework reflects international best practices, reforms and new policies, laws and regulations are monitored	yes	yes	yes	local/national/international benchmarking, M&E system development	benchmarks for regulations: WB Doing Business (2005), Dollar et.al. City Competitiveness (2003)
Organisational framework*	capacity of public administration, capacity of advocacy institutions, institutional set-up of public and private sector institutions	capacity building in public sector with regard to service delivery	Increased efficiency and service orientation	yes	?	yes		
		strengthening BMOs	strong and adequate partners in private sector, demand for reforms	yes	yes	?	Business Climate Surveys with private sector partners, OD support to private sector institutions	White (October 2004), GTZ ASCCI (2005), EABC (2005)
		restructuring institutions	increased efficiency according to international Best Practice	yes	?	yes	benchmarking and Best Practice transfer	
Labor Force and Human Capital**		market development for demand-driven skills development	labour demand and supply are better matched					
Finance**		Financial System Development	Sustainable access to affordable finance established					
Support Services**		market development for services	sustainable access to affordable and effective services established					

\* Classification according to White (July 2004, p.ii)

\*\* Classification according to WB: Competitiveness and Private Sector Development in Africa (October 2004), White (July 2004, 21)

\*\*\* according to USAID investors' Roadmap, Nigeria

\*\*\*\* according to WB Doing Business Report 2004

### 1.3. Public-private interaction in the focus of BIC interventions

The term “Business and Investment Climate” becomes most concrete when being applied to the field of public-private interaction. The best answer to why to bother with the BIC is the argument that the BIC touches all areas in which private sector has to interact with public sector. If the BIC is favourable, this public-private relation – and the institutions underpinning the interactions – is characterized by a conducive and effective collaboration and a win-win orientation of both sectors, with positive development results for all stakeholders. In contrast, if the BIC is shaped by problematic governance patterns, cumbersome political guidelines, laws and regulations, and underperforming and ineffective organizations both on the public and private side, private and public sector will pay enormous and unnecessary costs with negative impact on economic growth patterns. Therefore, the impact and interdependence of the three core BIC elements - governance, regulatory environment and organizational framework - can best be observed when looking at the focal point of public-private interaction.

When asking private sector for typical reasons why to interact with government, the most common entries are:

- a. business registration
- b. building permits
- c. other permits (e.g. environmental issues, health and safety issues)
- d. issues related to the availability, use and acquisition of real estate
- e. issues related to environmental impact (accidents, complaints by neighbours etc.)
- f. taxes and fees, traffic related issues (availability and quality of roads, parking lots / parking permits, connection of business site to public transport, etc.)
- g. infrastructure related issues (availability and quality of water, electricity, and possibly other services)
- h. government as a customer / buyer, information and communication in general
- i. government-sponsored business promotion programmes

Most of these interaction patterns are mandated by certain policies, laws and regulations. Receiving a business permit, or closing down a business, is a typical process of public-private interaction. Aligning certain policies, simplifying laws and regulations and streamlining procedures can already add important value to an area’s BIC, as it reduces compliance costs and administrative costs in public-private, but also public-public interaction.

Nevertheless, any policy, legal and regulatory environment cannot be effective without integer governance structures. Rent-seeking and corrupt behaviour on both public and private side can render the best regulatory framework useless. A clearly communicated “Zero Tolerance” – policy against corruption from top government level as well as adequate sanctions in the case of noncompliance is therefore a crucial element of creating a favourable BIC. However, simplified procedures as a result of better policies, laws and regulations can already by themselves have a significant effect on curbing corruption by reducing the amount of paperwork required, regulatory grey areas and other entry points for corrupt behaviour in public-private interaction.

Another typical problem of private-public relations in the context of effectiveness and integrity is the information asymmetry with regard to policy and legal requirements and correct procedures. The less accessible such information is, the more compliance costs are usually produced for the private sector, and the better corruption can blossom. A competent and organized private sector can play an important role in overcoming such information asymmetry, as it can formulate clear demands to the public administration with regard to its information policy and act as advisor and multiplier for its members. Technical co-operation in organizational development of BMOs can assist the private sector in improving its capacity for self-organization and representation. However, a suboptimal information policy many times is not produced by bad intentions of the government, but by a lack of management capacity or an inadequate organizational structure. Organizational development and capacity building on the public sector side can therefore be another crucial intervention to substantially improve public-private interaction in the business environment.

Integrating interventions in the area of governance, regulatory environment and organizational framework this way can produce significant effects of the BIC by improving the public-private interaction process. Through such improvements, the costs of doing business on the private sector side are significantly reduced, while the public sector profits from an increased administrative efficiency.

## **2. Integrating the local level into reforms of the Business and Investment Climate**

The previous chapter has already highlighted the role of public-private interaction in the context of the BIC. Although this might vary from country to country according to different political and administrative systems, most surveys show that the majority of public-private interaction processes happen between private sector and local government officials. This requires specific attention to the local level when identifying feasible and holistic concepts for improving a country’s BIC.

## 2.1. Why the local level?

Giving attention to the local level does not imply that interventions at national level would not be well directed. One - very valid - argument to embark on the BIC approach was exactly to shift to upper administrative levels in order to increase effectiveness and outreach of interventions, as earlier concepts to private sector development focused too often on small scale, local level interventions.

Another very important argument for looking at the national level when improving the BIC is the fact that many issues that influence the BIC are not under local control. Labour laws, environmental standards etc. are in most cases topics of national legislature and regulation. Furthermore, national level plays an important role in the allocation of funds for private sector promotion policies and measures.

Nevertheless, it is mostly local officials who implement and control these policies or regulations, and it is local government which can make them very cumbersome by a lack of will, capacity or customer orientation. At the same time, it is local government which most of the time has to bear the biggest chunk of administrative costs as a result of an ineffective policy, regulatory or organizational framework, and which is the first target for a discontent business sector. Also, enterprises “on the ground” – including SMMEs in a distant local municipality – know best about the positive and negative characteristics of their area’s BIC.

Including the local level when aiming at an improved BIC therefore fulfills two important functions:

First, it is the most important implementation level for reforms, especially when it comes to wide-scaled capacity building and organizational development. Most improvements of policies and laws at national level will only show very limited effect if not complemented by technical assistance to local government structures with regard to implementation and communication.

Second, the local level is an important terrain for the identification of problematic BIC issues and potential solutions, and can operate as a crucial sounding board and feed-back source with regard to the success of BIC reforms.

Another argument for interventions at the local level can be added here: Reforms might be implemented as a result of vertical pressure and clear top-down policy guidelines. However, horizontal pressure in form of competition can be a similarly important incentive for improving the local BIC, and can thus kick-start endogenous reform processes with a strong buy-in from local level actors. Combining top-down reform initiatives with inter-local benchmarking processes can therefore play an important role in generating motivation and ownership beyond reformatory window-dressing of local actors – at the level where most public-private interactions take place.



## 2.2. Using BIC surveys to combine local and national level

The table in Chapter 2 highlights a number of BIC elements where local level interventions can make sense, including the three core BIC elements of governance, regulatory environment and organizational framework. However, BIC operations at local level are an inefficient allocation of development funds if not properly integrated into the national BIC framework. One way to integrate local and national level is applying the tool of BIC Surveys at different levels in an integrated way. BIC Surveys generate information that can be used for four purposes: the identification of problem areas, the strengthening of advocacy institutions, interregional comparison, and monitoring of reforms.

Most agencies have so far focused on the national level when developing and implementing BIC surveys. However, extending such surveys to the local level can be an excellent way to make optimal use of the local level potential to improving the BIC: One can benefit from the local business base with regard to their specific knowledge on problem areas and resort to this base when it comes to advocacy work and monitoring reforms. Second, local assessments can assist in the implementation of reforms as it provides a very specific and localized assessment of government shortcomings. Third, such assessments provide the ideal base for inter-regional benchmarking in order to increase the reforms' momentum.

An excellent example of how to include the local level in a national BIC survey system is provided by the German Chambers of Trade and Commerce.

The Deutsche Industrie- und Handelskammertag (DIHK) is the umbrella association of Germany's 81 regional Industrie- und Handelskammern (IHKs). The DIHK, which represents its members at national and European level, publishes a number of surveys each year, amongst others a triennial business cycle analysis. This national business cycle analysis is compiled of 81 regional analyses carried out by the members with the help of a standardized survey tool. The standardization of the tool is guaranteed by the so-called "Lautracher Erklärung", a document which contains the binding guidelines and methodology for the surveys.

In total, the IHKs are able to catch the opinion of 25 000 business people on a repeated basis, and thus provide very specific and localized information with regard to both cyclic and structural issues. The information on structural conditions is further deepened by additional surveys focusing on specific topics such as "infrastructure quality" or "customer orientation of the public sector". Furthermore, the dense network of chambers and their close relations to local business people allow the chambers to quickly start ad hoc polls with regard to current political questions, which can provide the national level with a representative entrepreneurial opinion on certain topics within 3 days.

With regard to the generation of detailed information for problem identification and analysis, lobbying, monitoring and benchmarking, the IHK system is exemplary, as it is able to provide this information at all different aggregation levels from local to national. Furthermore, the generation of the information is

embedded in a dense net of competent institutions which are not only able to generate, but also to interpret and use this information countrywide.

The information is fed directly into the national system of economic policy via the German Council of Economic Advisors. Also, national press conferences communicate the main findings of the surveys to the broader public. At meso level, the IHKs and other interested meso-institutions use the national and regional information provided for press communiqués, round tables and lobbying work with regard to regional and local decision makers. Finally, the information finds its way back to the micro level, as the participating businesses are provided with a report that can be used for intra-business discussions. Inter-regional benchmarking and timeline analyses form a generic part of the national and regional interpretation of the survey results.

Also, the survey results operate as direct promotion tools for locational marketing, as potential investors can be provided with quick and detailed BIC information on the respective region, and the survey staff within the chambers can competently provide consultancy to new as well as existing businesses.

Most importantly, the regular surveys capacitate the regional chambers to be a competent dialogue partner in the interaction with public sector. Their position in regional forums is significantly enhanced, and political pressure as well as political legitimacy can be provided quickly via their dense business network and the survey methodology.

### **2.3. Local Red Tape Initiatives as a contribution to improve the overall regulatory environment**

Strengthening private sector as a dialogue partner is also a core topic of the “Local Red Tape Initiative” in South Africa. This initiative has started within the context of “Local Economic Development” and aims at improving the regulatory environment at local level. This initiative is embedded in a countrywide process of improving the service orientation of the public sector and reducing Red Tape in public administration.

Red Tape stands for regulations and rules, administrative processes and procedures which are not or no longer effective in achieving their policy goal, and which therefore produce suboptimal and undesired social outcomes. Many times, it is specifically the small and medium enterprises which have to pay the highest share of these costs<sup>2</sup>, as regulatory compliance with administrative rules, regulations and procedures involve important economies of scale.

In order to address public service issues countrywide, the national Department of Public Service and Administration (DPSA) has launched a programme called “Batho Pele” or “People First”, which sets incentives to government officials for improving their service delivery, e.g. via contests for the best

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<sup>2</sup> If measured as percentage of the turnover

proposals towards leaner administration procedures. The programme is strongly backed by all major actors, including the South African presidency.

Several institutions - public and private - have started to work along this initiative, including the Small Business Project (SBP), a major South African NGO in the context of private sector development. SBP has taken up the role of being the main advocacy institution at national level for regulatory reforms, and has embarked on a process to assess the regulatory environment countrywide, which has resulted in the publication of the report "Counting the Cost of Red Tape for business in South Africa".

This report provides public and private actors with important insights of the overall compliance costs of the different regulations in South Africa. The survey includes the assessment of a small number of local municipalities, but does not cover the local level countrywide. The data provided is useful for generic discussions and lobbying at wider scale, but – similar to other BIC assessments on South Africa so far - only produces limited information on regional or local differences, and hardly any differentiation according to the problems' root causes. An allocation of the costs to different causes such as the law or regulation itself, the procedures followed or the implementing staff is therefore not available, a fact that does impede the exact design of reform solutions.

The GTZ LED Project in South Africa has therefore decided to fill this gap by complementing its LED activities with a Local Red Tape Initiative. This Red Tape Reduction series is strongly based on the use of action-oriented and participatory methodologies and facilitation tools, and aims at using the public private dialogue for the analysis of the local BIC, the design of reform proposals, the implementation and monitoring of local reforms. Furthermore, Red Tape issues which are beyond local control are communicated to the responsible upper levels of government.

The most important added value of this local level initiative to the improvement of the country's BIC is twofold: First, it provides very detailed information on the character, causes and potential solutions for Red Tape problems. Problematic issues are classified according to the problem levels – law/regulation, procedure and service/interface - and according to the level of control – local, regional or national. Not only can this information be used for designing effective interventions in the locality itself, but it can be communicated, aggregated and summarized up to the national level. Beyond the local level, it therefore serves three purposes: Advocacy work at national level, inter-local benchmarking and best-practice exchange between localities, and the design of tailored regulatory reforms countrywide. These three purposes are fulfilled by feeding the information into SBP's survey results as well as into other communication channels, such as the South African LED practitioners' national website.

The second important contribution to the country's BIC is the continuous strengthening of the private sector as counterpart and dialogue partner for the local, provincial and national government. Through

the installation of dialogue mechanisms and co-operation patterns that increase the sustainability of the reform process, and the development of a network and sample base of businesses all across the country, competent input and political pressure from the private sector is enabled to play an important role in motivating continuous reforms of the BIC.

### Some closing remarks

Although the BIC concept does contain innovative elements and important new guiding principles, it does not imply a radical change of paradigm in the policy field of Private Sector Development. It is a framework that helps focusing efforts and interventions on important elements of state and institutional failure without losing sight of market failure issues. It combines new instruments such as BIC surveys with established concepts of institutional and organizational development.

There is also no justification to request a complete shift of intervention levels away from the local level. As shown in the two examples provided here, local level interventions can play a crucial role in the successful and sustainable improvement of a country's BIC, if integrated and aligned properly with national level activities. There is no doubt that the national level has to become the crucial level when aiming at an improved BIC, as it offers the most leverage factors. But established concepts and intervention designs for Private Sector Development at local and regional level are not redundant, but have to be combined properly with the BIC concept in order to maximize their outreach and impact.