United Nations A/59/800

General Assembly

Distr.: General
19 May 2005

Original: English

Fifty-ninth session
Agenda item 84*
Follow-up to and implementation of the outcome of the International Conference on Financing for Development

Strengthening the role of the private sector and entrepreneurship in financing for development

Report of the Secretary-General

Summary

The present report outlines some of the key issues pertaining to the role of the private sector and entrepreneurship in financing for development. It responds to Economic and Social Council resolution 2004/64 of 16 September 2004, which requested the Secretary-General to submit a report to the fifty-ninth session of the General Assembly on the issue. The report examines issues relating to the creation of an enabling environment for business and to the strengthening of entrepreneurship and private sector actions to facilitate development. It draws widely from the report of the Commission on the Private Sector and Development and from the agreed principles and recommendations of the Monterrey Consensus of the International Conference on Financing for Development. It also draws on a variety of other sources, including reports and surveys by the World Bank, the United Nations Conference on Trade and Development, the United Nations Development Programme and the World Economic Forum. The report also draws on information obtained from workshops and consultations organized by the key business interlocutors in the United Nations financing for development process, on the academic literature on entrepreneurship and on research by business schools.

05-35160 (E) 210605
0535160

Contents

I. Introduction

1. The Economic and Social Council, in its resolution 2004/64 of 16 September 2004, requested the Secretary-General to submit a report to the General Assembly on financing for development pertaining to the role of the private sector, taking into consideration the report entitled *Unleashing Entrepreneurship: Making Business Work for the Poor*,[1] to be considered at its fifty-ninth session. The present report has been prepared in response to that request.

2. The report is divided into three parts. The first part examines the key requirements for improving the overall business environment in developing countries and, in doing so, looks at progress and obstacles in those areas. The second part is concerned with the underlying factors that help create healthy firms — that strengthen entrepreneurship in the economy — though the distinction between the conditions that allow healthy firms to flourish and the more specific factors that generate entrepreneurial skills is not clear cut, and the two issues are interlinked. The third segment of the report is concerned with the actions of the private sector to facilitate development, looking at multi-stakeholder partnerships, networks and business opportunities to provide goods and services to the poor.

II. Creating an enabling environment for business

3. While there are different views as to the factors that constitute an enabling environment for business, it is useful to focus on six broad conditions that have in general been accepted as important features of that environment: appropriate and enforceable regulations and laws, labour and related standards, availability of finance, infrastructure, information and an enabling domestic and international policy environment. In particular, those conditions are critical for the operations of small and medium enterprises (SMEs), which are responsible for most employment and income-generation opportunities and can be identified as a major driver of poverty alleviation.[2]

A. Legal and regulatory environment[3]

4. One of the purposes of laws and regulations is to safeguard the public interest. The other one is to protect citizens against themselves or against each other. Laws and regulations in the industrialized countries have evolved with changing social, political and cultural conditions. As a result, they tend to vary between countries. For example, certain aspects of the legal and regulatory environment relating to businesses in European countries can be quite different from those in the United States or Japan. There is no simple configuration of laws and regulations that can be termed as ideal for developing countries to adopt. Moreover, the ease with which aspects of the legal and regulatory environment can be applied, enforced and reformed may vary between countries and regions in line with their historical experience, culture and politics.

5. At the same time, it is well known that laws and regulations sometimes fail to meet the intended social objectives in many countries, including developing countries, and harm the business environment through imposing unnecessary costs,

increasing uncertainty and risks and by maintaining or erecting barriers to competition. There does therefore appear to be scope in many countries for reforming certain aspects of the regulatory and legal environment without compromising broader social goals. The degree to which it can be done will vary between countries and also depend on what in particular is being addressed. Nevertheless, three key areas are identified below in which the legal and regulatory framework could have a strong impact on the business environment.

6. The first of the areas relates to opening and closing a business. The World Bank suggests that the bureaucratic requirements to start a business in many countries are excessive and time consuming. Latin America and sub-Saharan Africa were found to be the regions in which it takes the most time to start a business. At the same time, improvements are happening in developing countries in all regions, as well as in many transition economies, including such notable examples as Argentina, Jordan, Morocco, Nepal and Sri Lanka.[4] With respect to closing businesses, laws and regulations exist in a number of developing countries that restrict the ability of enterprises to restructure or shut down. At the same time, in bankruptcies, it is important to safeguard productive assets. A number of countries have implemented reforms to bankruptcy law.

7. The second critical aspect of the legal and regulatory environment relates to property rights. In many developing countries, a large part of land property is not formally registered. Assigning titles to property can improve land values and access to credit (since land and capital can be used as collateral to obtain bank loans), especially for small enterprises and the informal sector. It also provides security for owners through reducing the risk of someone else laying a claim to their land. Nevertheless, property titling programmes need to be accompanied by a number of complementary measures if they are to be effective in achieving those objectives. Most important, titling needs to be accompanied by improvements in the cost and efficiency of property registry, otherwise property will continue to be bought and sold informally. The evidence suggests that, among developing countries, some East Asian countries have developed an efficient property registration system. In addition, complementary improvements are also required in collateral laws (which do not make it too expensive to mortgage property) and the legal system (which allows banks to seize collateral, if warranted, when a debtor defaults).

8. Thirdly, the effective enforcement of contracts and protection of creditor rights is of key importance to an enabling business environment. That, in turn, requires a well-functioning court system. The judicial procedure for resolving commercial disputes tends to be overly bureaucratic in a number of developing countries in comparison with industrialized countries. However, a number of countries have been implementing improvements in this area, especially Colombia, which cut the time to resolve a dispute by 30 per cent in 2003.[5] In addition, improvement of transparency and information can facilitate contract enforcement by enabling firms to learn in advance about their potential partners' business history and credit information. The issue of information will be explored further in section II.D. Collateral law reform, as mentioned previously, should also help enhance creditor rights.

9. Appropriate laws and regulations on the above fronts need to be backed by effective enforcement, which, in many respects, calls for a strengthening of the administrative infrastructure and the courts and for tackling the problem of

corruption. Moreover, regulations should not be over-complicated and need to be consistent with one another and simple to understand and apply.

B. Labour and related standards

10. Labour standards are especially important in economies that do not have established social security systems. They are generally designed to protect workers from the arbitrary actions of employers. However, such standards can sometimes become over-stringent: for instance, in some countries, employers may be hindered by unnecessary reporting and excessively detailed rules that do not achieve their intended effect and really serve only to stifle the growth of private businesses and, by association, new job creation. Most disturbingly, they may also significantly contribute to the expansion of the informal sector where workers most usually have no protection.

11. It has been argued that it is possible for some countries to frame more flexible employment standards while still ensuring adequate social protection for workers,[6] though the ability to do this will depend upon existing economic, social and political conditions. A number of transition economies in Europe introduced more flexible employment regulation last year.[7] However, while moving towards greater flexibility in labour standards, countries should ensure that some degree of employment stability remains. Evidence exists that stability of employment (tenure) is positively related to productivity gains; it can increase the gains of learning by doing, as well as increase the incentives for firms to invest in training.[8] Thus, a balance needs to be struck between flexibility and stability.

12. There is also a need for appropriate standards on the social and environmental fronts. In addition, adequate health and safety requirements should be maintained within the workplace. Finally, it is important to have appropriate environmental standards that monitor and set controls on adverse externalities generated by firms.

C. Access to finance

13. Various surveys rate obtaining finance as a major obstacle for businesses in a number of developing countries, especially for small and medium enterprises (SMEs). SMEs are affected the most owing to the higher risks and transaction costs, especially compared to loan size, associated with lending to them. Those in turn are largely a function of a lack of information on enterprises, weak legal protection of creditors and poorly enforced or inadequate property rights. Some of the key policies to address these shortcomings are addressed in sections II.E and II.A. They include measures to make information on SMEs more available, including establishing credit information bureaux and services to help them prepare business plans; strengthening laws and their enforcement in areas such as contracts and use of collateral; strengthening the capacity of financial institutions in cost-effective credit evaluation; and reducing barriers to entry to institutions providing finance for SMEs through, for example, more flexible regulations.

14. At the same time, additional initiatives have been taken to increase the access to finance of credit-worthy enterprises. For instance, loan guarantee schemes have been set up by Governments and such multilateral agencies as the International Finance Corporation (IFC) with the purpose of covering a percentage of possible

losses through default, thereby reducing the perceived risks of lending to smaller enterprises. However, there is not complete agreement on the effectiveness of loan guarantee schemes, and they have been criticized for a number of weaknesses such as moral hazard, adverse selection problems and high administrative costs. Another policy initiative has been to promote leasing arrangements to help SMEs meet their needs for business equipment. For example, in Pakistan, the Swiss Agency for Development and Cooperation (SDC) has supported leasing to small and microenterprises. However, leasing also has its limitations and may not be suitable for all enterprises.[9]

15. There have also been public-private initiatives to generate new and additional sources of financing for smaller firms. There are a number of development-oriented venture capital funds, and there has also been a trend among international and national development finance institutions to set up venture capital funds in developing countries. The Commonwealth Development Corporation, the Netherlands Development Finance Company and the Asian Development Bank are among the numerous agencies involved in those activities. Venture capital, which is willing to accept higher risks and does not require collateral from borrowers, may be especially suitable in providing finance for small innovative firms in developing countries. At the same time, however, its actual role has been limited owing to the lack of investment opportunities and limited "exit mechanisms" (a result of underdeveloped capital markets). There have also been initiatives in some countries to increase bond financing options for SMEs. For example, the Republic of Korea has undertaken measures to encourage the issuance of bonds by SMEs.[10] One objective of the Asian bond market initiative[11] is to increase bond financing options for smaller companies in Asia.

D. Infrastructure

16. Limitations in physical infrastructure — especially power, telecommunications and transport — are a major obstacle for the activities of enterprises in developing countries.

17. Those shortcomings are common across developing regions and are especially severe in sub-Saharan Africa and South Asia.[12] While public provision of infrastructure remains fundamental, it has been argued that private participation in and financing of infrastructure projects has become increasingly advisable owing to the combination of rising financing needs and fiscal pressures facing Governments. However, the viability of private participation in infrastructure may vary widely across sectors, countries, and regions within countries. It has been especially successful in the telecommunications sector where the cutting edge technology and experience of private operators gives them a clear advantage. The private sector can also have an important role to play in financing and participating in the power sector. Some countries have also implemented public-private models to finance, build and operate road and water systems, as regulated concessions. However, private considerations do not always adequately capture the broader externalities generated by infrastructure.[13] Where that is the case, the public sector has an essential role to play in the financing and provision of these public goods. It may also make sense for multilateral development banks to be more active in financing such projects.[14]

18. Despite the increasing need for private financing of infrastructure projects in such areas as power, private funding of developing country infrastructure projects has declined sharply in recent years.[15] Given that, business participants and interlocutors[16] in the United Nations financing for development process have created an expert group on infrastructure finance to facilitate a public-private dialogue on ways to mitigate the risks facing both foreign and local investors in infrastructure projects. Members of the group have also participated in ongoing multi-stakeholder consultations on the issue organized by the World Economic Forum as part of the financing for development process. Some of the ideas discussed during the consultations include suggestions for mechanisms to mitigate regulatory risk; to increase the role of the World Bank and regional development banks in risk mitigation through increasing the leverage for their guarantees; and to strengthen local currency lending. Those and other proposals, however, still require further critical evaluation, discussion and development. In addition, there is no agreement as to what extent the private investors in infrastructure projects should have their risks covered. It is widely felt that normal market risks, including currency devaluation risk, should be borne by the private sector and that only those factors out of their control, such as regulatory risks and force majeur, should be covered by the public sector.[17]

E. Information

19. Lack of, and deficiencies in, information can affect businesses in different ways. For a start, financial institutions and investors are more reluctant to lend in such an environment. Shortcomings in information mean that businesses themselves have limited data on opportunities and risks. Those problems can be addressed to an extent through the establishment of credit information systems and/or government-owned reporting agencies. Credit information systems were established in Armenia, Bulgaria, India, Latvia and Slovakia during the last two years and improved in another 20 countries. Government-owned reporting agencies have also been established in a number of countries, including Bangladesh, Bolivia and Nigeria.[18] Efforts to upgrade accounting and disclosure standards have also been undertaken in some countries.

20. The importance of information demands accuracy, credibility and timeliness in its provision. While there have been a number of international and national initiatives to implement improvements in this area, business representatives to the financing for development process have, in hearings and workshops, called for public-private collaboration to strengthen the provision of credible sector-based information in developing countries. The same representatives have also recommended capacity-building to enhance the use of technology and the Internet to disseminate information and to facilitate online dialogue between businesses, investment promotion agencies and other relevant government officials.

F. Domestic and international policy environment

21. An adequate degree of macroeconomic stability is important for the effective functioning of businesses. However, macroeconomic stability needs to be understood in a broad sense, which includes not only price stability and sound fiscal policies, but also smoother business cycles, competitive exchange rates, sound

external debt portfolios, and healthy domestic financial systems and private sector balance sheets.[19] Those variables are not necessarily highly correlated and, consequently, policymakers need to strike a balance between them. For example, low and stable rates of inflation enable firms to have longer-term horizons in planning their investments. However, over-zealousness on the part of policymakers to further decrease already low rates of inflation can lead to high interest rates that discourage investment and curb aggregate demand and that may affect private sector balance sheets.

22. It is also important to have enabling production-sector strategies, including those addressing rural development. Within the framework of World Trade Organization rules, policymakers have an important role in identifying and encouraging the development of new sectors and activities in which a country, or a region within a country, may possess a potential comparative advantage. As part of the package of enabling measures, there need to be policies to strengthen technological development and encourage innovation and learning.[20] There is also a need to look closely at the development of complementarities and networks such as production sector clusters that enhance the diffusion and impact of technical and organizational change.[21] They would all aim to strengthen entrepreneurship and develop competitive firms in dynamic sectors that would generate economy-wide benefits and provide an impetus to growth and development. The analysis of those issues in chapter III and section IV.B of the present report stresses the fact that there is no one configuration of production sector strategies for developing countries and that the requisite policies would need to vary in accordance with the stage of economic development of the economy or region.

23. While strengthening the enabling environment for business is first and foremost the responsibility of developing countries, assistance can also be provided at the international level. For instance, technical assistance by multilateral and bilateral aid organizations can play an important role in enabling developing countries to reform laws and regulations, strengthen the legal system, improve the availability of information, facilitate investment in infrastructure and support the design of appropriate production-sector strategies. Moreover, the international environment can also be made more conducive to developing country enterprises through better coordinating aid and the activities of the main multilateral and bilateral donor organizations. The international community would also benefit from reform of the global trading system to provide fairer opportunities to exporters from developing countries and stability and predictability in rules and procedures. Finally, it is critical to ensure a stable global macroeconomic environment, including, in particular, the avoidance of large and abrupt changes in international interest rates and exchange rates.

III. Strengthening entrepreneurship

24. While the focus so far has been on the broader enabling environment that allows healthy and competitive firms to thrive, chapter III is concerned with the underlying factors that create healthy firms and strengthen entrepreneurship in the economy. As such, it examines some of the factors that may more directly affect entrepreneurship, focusing in particular on conditions relating to the acquisition of skills and learning. Of course, there is a close interrelationship between the two

issues. Therefore, the broader business environment variables affect the quality of entrepreneurship and vice versa.

25. The present chapter does not attempt to cover the entire range of thinking on entrepreneurship. Rather, its purpose is to consider some of the interesting ideas that have been articulated on this issue that have either been applied or have implications for policy.

A. Elements of entrepreneurship and its relationship with economic development

26. Entrepreneurship is responsible for much of the competition and innovation in the business world and is also held as central to nations trying to attain competitiveness in international markets. According to the economist Joseph Schumpeter, this is achieved through a process of “creative destruction” whereby the innovations introduced by entrepreneurs challenge and render obsolete the technologies and products of existing industries. Innovation here is defined in a broad sense and includes the introduction of new goods and services, the development of new production methods or marketing strategies, the opening up of new markets, the discovery of new sources of raw materials or the exploitation of previously known resources and the establishment of new industrial structures in a given sector.[22] The three most frequently mentioned functional roles of entrepreneurs are: risk seeking (i.e. willingness to undertake risks and face uncertainty), innovativeness (i.e. generating, disseminating and applying innovative ideas) and opportunity seeking (identifying and seizing new profit opportunities).[23]

27. The Global Entrepreneurship Monitor (GEM) model posits a U-shaped relationship between the entrepreneurial activity in an economy or region and national income.[24] Entrepreneurs are divided into “necessity entrepreneurs” (i.e. those trying to start a business because they have no job options) and “opportunity entrepreneurs” (i.e. entrepreneurs fulfilling the traditional functional roles of risk seeking, innovativeness and opportunity seeking). In low income countries and regions, the levels of entrepreneurial activity are high but are often generated by high rates of necessity entrepreneurship. Thus, business start-ups in those circumstances tend to use older technologies and do not offer much in the way of innovation. As a country or region becomes wealthier, approaching and eventually entering the middle-income bracket, a decrease in overall entrepreneurial activity is usually first observed as a result of falling necessity entrepreneurship rates (owing to an increasing number of job opportunities in larger domestic and foreign establishments). Higher-income countries and regions experience an increase in total entrepreneurial activity related primarily to increasing rates of opportunity entrepreneurship, which requires better infrastructure and technology development.[25]

28. The key implication of the preceding observations is that entrepreneurs in countries (or regions) with different levels of economic development face different challenges, and policies and conditions favourable to entrepreneurship in one country (or region) at a given point in time may not necessarily be favourable in another. This point is considered further in the following section, which explores theories for strengthening entrepreneurship.

B. Some theories for strengthening entrepreneurship

1. Entrepreneurial framework conditions

29. The Global Entrepreneurship Monitor model postulates that economic growth is the result of two parallel sets of interrelated activities. The first set of activities is associated with the operations of larger established firms that influence economic growth primarily through advancing market opportunities for smaller enterprises, which in turn create jobs.[26] Those are influenced by general business conditions termed the "general national framework conditions". However, the ability of smaller firms to seize upon those opportunities depends upon their competitiveness and dynamism. This leads to the second set of activities driving economic growth — namely the role of entrepreneurship in the creation and growth of firms. Those activities are influenced by additional characteristics within the existing business environment, referred to as "entrepreneurial framework conditions".[27] Those conditions determine a country's capacity to encourage start-ups and, combined with the skills and motivations of those who wish to establish firms, influence the entrepreneurial process. The successful combination of the general national framework and entrepreneurial framework conditions should lead to offshoot businesses that will in turn lead to innovation and competition in the marketplace and, in the end, help to generate economic growth.

30. The policy implications of the GEM model can be derived by combining the above analysis with its posited conceptual relationship between entrepreneurial activities and economic development (described in paras. 27 and 28). In the case of low income countries or regions, where necessity entrepreneurship rates are high and start-ups offer little in the way of adopting new techniques or innovations, policies need to focus especially on the general enabling conditions that trigger entrepreneurship. In other words, the first priority would be to strengthen the conditions for companies to develop, which is necessary to generate major investments that will, in turn, create market opportunities for smaller firms. The employment generated by the larger firms would also reduce the levels of necessity entrepreneurship. However, as the economy develops and market opportunities start to increase for smaller enterprises, policies should increasingly focus on strengthening the entrepreneurial framework conditions in order to strengthen the foundations for opportunity entrepreneurship.[28] These policies should also incorporate efforts to strengthen the provision of business development services, by both public and private operators, to raise the entrepreneurial skills and competitiveness of small and medium enterprises in areas such as technology, marketing, research and development.[29]

2. Traits approach

31. The entrepreneurial framework conditions aim to enhance the skills and motivations of individual entrepreneurs. However, some of the key entrepreneurial qualities can be described as "traits" and sharpening them may require policies over and above business education and training programmes. One approach to strengthening entrepreneurship has been to enhance the entrepreneurial traits of individual business persons. David McClelland identifies 10 personal competencies for detecting and strengthening entrepreneurial potential that are common across countries.[30]

32. The Empretec programme of UNCTAD follows the "traits approach" and was developed in response to research that pointed out the importance of the behaviour and performance of the individual entrepreneur and the need for mechanisms that, in addition to developing the technical and managerial aspects of small firms, would also strengthen entrepreneurial traits. The purpose of Empretec is to help foster entrepreneurial capabilities and the growth of internationally competitive SMEs in developing countries. At the country level, the programme identifies promising entrepreneurs and provides them with training to strengthen their entrepreneurial talents (i.e. based on personal qualities such as the entrepreneurial traits referred to above) and business skills. It also assists the entrepreneurs in gaining access to financing and business ventures, in linking up with larger established companies and in establishing systems to facilitate growth. An evaluation in 2002 that examined the impact of the Empretec programme in Brazil pointed to its success in generating better-performing companies.[31]

3. Organizational learning

33. It has been argued that, in many of the advanced economies, development was spurred by an organizational learning process within companies that stimulated innovation and competitiveness. Innovation in that sense also refers to the successful adoption of new techniques of organization and production that have been developed elsewhere. Of key importance are the conditions under which enterprises can allocate resources in ways that generate higher-quality and lower-cost products, which in turn can enhance economic growth.[32] The organization of production within companies can stimulate learning and the adoption of new techniques that improve cost efficiency, productivity and quality.

34. According to an expert,[33] the existing developed markets in finance, labour and capital in the developed economies are more the outcome than the cause of economic development. Economic development was driven by an "organizational learning process" (i.e. by corporations), often encouraged by the State, that stimulated innovation and competitiveness. The enabling conditions for the process were organizational integration, financial commitment and strategic control. Organizational integration refers to incentives for people to apply their skills and efforts to engage in interactive learning in pursuit of organizational goals. Financial commitment refers to having a stable source of finance to sustain the process of organizational learning until the returns materialize. Strategic control refers to the exercise of control over resources in the organization by managers who are organizationally integrated (i.e. their individual success is bound up with the success of the organization) and have access to financial commitment.

35. The policy implications of this reasoning add value to current thinking. Notions of organizational integration suggest that, when rearranging the balance between security and flexibility, reforms to labour laws should not lose sight of the importance of stability and corporate loyalty in triggering interactive learning and innovativeness. With respect to financial commitment, it has been argued that the source of stable finance necessary to generate organizational learning is just as, if not more, likely to come from relationship banking (based on familiarity and trust) and similar financial arrangements as from purely market sources of finance. For established businesses, retained earnings are the key source of finance but, beyond this, the need to leverage their own resources requires organizational relations with the banking system. Those relations support the enterprise by allocating finance

based on a company's long-run prospects for sales revenues rather than on short-run cash-flow problems. In fact, organizational control over revenues and relationship bank finance helped fuel to an important degree the post-war recoveries of Japan and Germany.[34] Finally, strategic control implies that it is important for decision-making power to rest in the hands of organizationally integrated managers who are able to take longer-term decisions rather than with portfolio investors with shorter horizons.[35]

36. Theories of organizational learning need to be seen as adding value to, rather than conflicting with, existing market-oriented views of development. The implication for developing countries is that when liberalizing capital, labour and product markets, they would need to ensure that the incentives for companies to undertake organizational learning are not adversely affected and that stable sources of finance for existing and new ventures exist. Within that framework, the State can play a supportive role in ensuring that the preceding conditions are satisfied (as it did when the advanced countries were developing).[36] An interesting example from the developing world comes from the Republic of Korea, where the *chaebol* system of horizontal industrial organization proved to have a comparative advantage in managing the process of learning, replicating and adapting existing technologies to local conditions and local resources, and then operating efficiently enough to compete in international markets.[37]

C. Implications for public policy

37. A coherent set of public policy implications related to strengthening entrepreneurship can be brought together from the theories set out in section III.B. As described above, according to the GEM model, policies need to evolve in accordance with an economy or region's stage of development. At all stages, though, there should be complementary measures to facilitate organizational learning, not only by ensuring long-term and stable sources of finance[38] but also by ensuring that reforms are consistent with the conditions for corporations to allocate resources in a manner that increases efficiency, productivity and quality. In particular, measures to facilitate organizational learning should encapsulate actions to strengthen the access of newer and smaller enterprises to finance through the measures described in section II.C. Moreover, complementary policies to strengthen entrepreneurial traits and skills, such as those being carried out by the Empretec programme, should also be implemented.

IV. Private sector actions to facilitate development

38. As the Commission on the Private Sector and Development has pointed out, private actions to further development fall into two categories.[39] They can be commercial transactions driven by market incentives, developed as part of a corporation's strategy, which nonetheless have strong implications for development — for example, investment that creates jobs, enhances opportunities for smaller firms and ancillary industries, and transfers best practices. Alternatively, they can be specifically structured as innovative efforts to apply private sector principles and approaches to development problems — for example, ensuring that local communities benefit from major development projects, building national

business coalitions for education, supporting microfinance schemes, setting standards for best business practices and so on. The motivations for private companies to undertake such initiatives include maintaining a good reputation, ensuring a sound and secure operating environment by reducing political and social concerns, creating a healthy and competent workforce, responding to investor and host Government requirements that increasingly incorporate social and environmental factors and addressing governance-related problems that impact upon the operations of their businesses.[40] Both categories of private sector actions to further development are covered below, with section IV.A focusing more on the latter category of initiatives and IV.B and IV.C on the former.

A. Private initiatives to further development

1. Multi-stakeholder partnerships to further development

39. There are different definitions of public-private partnerships. The United Nations Foundation and the World Economic Forum refer to them as being "about shared agendas as well as combined resources, risks and rewards. They are voluntary collaborations that build on the respective strengths and core competencies of each partner, optimize the allocation of resources and achieve mutually beneficial results over a sustained period. They imply linkages that increase resources, scale and impact".[41] Multi-stakeholder partnerships — involving private companies, Governments, international organizations and civil society — have in recent years grown in numbers and scope. The partnerships include business alliances, philanthropy and public policy dialogue, and include local community projects, nationwide initiatives and global projects (see sect. IV.A.2). In many cases, they are a response to market failures or weaknesses in governance and public administration (where both the market and Government are unable to deliver crucial public goods or address social and environmental problems).[42]

40. The Global Corporate Citizenship Initiative (GCCI) of the World Economic Forum profiles over 40 diverse partnerships and lists 15 practical ways in which companies can and have engaged in coalitions with other stakeholders to address key development challenges. They include helping to strengthen public institutions and administrative capacity, investing in youth entrepreneurship and employment, providing access to clean energy, mobilizing resources and technology for education and building capacity in public health systems. For example, in South Africa the Education Quality Improvement Partnership, which was initiated by the National Business Initiative, works with education ministries, individual school administrators, parent-teacher associations and non-governmental organizations to improve the quality of education in government schools. Similarly, in Bangalore, India, a partnership has been initiated between Government and information technology companies to improve civic management of the city (including water, power, transport, telecommunications, administration and police).[43]

41. Many of the partnerships are at an early stage of development, and it is still too soon fully to assess their impact. Moreover, there is need for further analysis of the conditions under which partnerships are likely to succeed and the requirements for their success. In that respect, the World Economic Forum, in collaboration with the Financing for Development Office of the Department of Economic and Social Affairs and with the support of various donors is coordinating a series of multi-

stakeholder consultations focused on the usefulness of public-private partnerships in improving the effectiveness of development assistance. The consultations are centred on water, health and education, and the initial findings will be reported to the General Assembly in 2005.[44]

2. Global public-private partnerships

42. Multi-stakeholder alliances at a global level are growing and try to address global public concerns (e.g., environmental degradation, AIDS). According to the Office of Development Studies of the United Nations Development Programme the alliances can be divided into business ventures (seeking private gain), double bottom-line ventures (seeking to combine private returns with social goals) and social ventures (pursuing as a primary objective public interest concerns such as poverty reduction).[45] Examples of business ventures include environmental partnerships (such as the Climate Investment Partnership, which aims to familiarize public and private investors with carbon markets, and includes Governments, development finance agencies and private banks, companies and associations) and bodies that design and strengthen norms and standards (described in sect. IV.A.3). Double bottom-line ventures invest primarily in SMEs and include development venture capital funds where the public sector helps to cover the risks that might deter private investors while the private partner manages the investments. Examples of such initiatives were given in section II.C. Examples of social ventures abound, especially in the health arena, and include the Global Business Coalition on HIV/AIDS, a public-private partnership led by the private sector.

43. There exists the need to strengthen relations to further coherence and complementarities between global public-private partnerships and multilateral organizations since they could replicate work being undertaken by the multilaterals and divert resources away from other needs. Thus, international organizations may find it increasingly useful to review which of their tasks could be best contracted out to global public-private partnerships.[46]

3. Setting standards

44. As mentioned previously, global public-private partnerships include bodies that design and set norms and standards that are compatible with sustainable development. They form part of a growing trend towards corporate social responsibility and self-regulation and include the Ethical Trading Initiative, the Global Reporting Initiative, and the Global Compact initiated by the Secretary-General of the United Nations. The Global Compact has become an extensive multi-stakeholder network with active participation by some 1,300 companies from around the world, United Nations agencies, labour unions, civil society organizations and Governments. The Global Compact invites businesses to subscribe to 10 universally agreed principles in the areas of environment, labour, human rights and anti-corruption and to mainstream them in their activities. There is evidence that commitment to those principles is spreading from large firms to the firms in their supply chains and catalysing a variety of development projects. The Global Compact has led to the establishment of over 40 national networks, many of them in developing countries.

B. Networks of private businesses: clusters and linkages

45. Private sector networks comprising vertical supply-chain linkages and horizontal clustering generate opportunities for smaller enterprises and also facilitate the transfer of skills, technology and information to them. They can serve to strengthen entrepreneurship and can also have a direct and profound impact on development at the local and regional levels. Experience of vertical linkages and clusters has been growing in developing countries such as Brazil, China, India and Malaysia.[47]

46. Michael Porter, writing in the World Economic Forum *Global Competitiveness Report, 2004-2005*, defines clusters as “geographically proximate groups of interconnected companies, suppliers, service providers, and associated institutions in a particular field, linked by commonalities and complementarities”.[48] They are often concentrated in a particular region or town, for example the software industry in India and the shoemaking industry in Italy. Moreover, in a given field, an array of clusters can often be found in different locations and with different levels of sophistication and specialization. The different clusters may be interlinked, with some driving innovation and others specializing in services or assembly. Firms in the advanced clusters can enhance other clusters as they disperse activities to reduce costs and risks.[49] An example is the outsourcing of information technology-related tasks to Bangalore in India.

47. Clusters can increase productivity and opportunities for innovation and can also generate new business formation since barriers to entry are reduced by the presence of skilled and experienced workers and by access to necessary inputs. Moreover, they can generate positive externalities for the wider economy, contributing to a vibrant enterprise sector and increased economic activity. However, their success depends upon an overall healthy business environment and their development may often be more feasible for those countries and regions that are moving towards the middle-income bracket. With a few exceptions, clusters so far tend to be underdeveloped in developing countries. In the case of export-oriented clusters, foreign direct investment can play an important role in integrating them into global value chains and can help to strengthen their export capacity both from the production and distribution point of view.[50] More research is needed on the conditions under which simple agglomerations of small firms can be transformed into dynamic, innovative and competitive clusters in developing countries.[51]

48. Vertical supply-chain linkages can also provide an effective channel for local companies to gain access to markets, financing, skills and know-how. However, not all linkages are equally beneficial and the extent to which suppliers benefit from them depends on the nature of their relationship. For instance, suppliers of relatively simple, standardized low technology products and services may be highly vulnerable to market fluctuations and their linkages with larger foreign or domestic companies are unlikely to involve much exchange of information and knowledge. Moreover, the lack of efficient domestic suppliers has often been a key obstacle to the creation of local linkages by transnational corporations, who have on such occasions encouraged foreign suppliers to establish local facilities or preferred to produce in-house. On the other hand, where it is in their interests to obtain inputs locally, transnational corporations have established supplier development programmes in host countries and have often provided support through finance, training, technology transfer and the provision of information. For example, in

Brazil, Costa Rica, India, Malaysia, Poland and Viet Nam, transnational corporations have provided local suppliers with opportunities to participate in their internal training programmes.[52]

49. As in the case of clusters, the formation and benefits of supply-chain linkages depend upon the overall business environment, including appropriate regulatory settings, infrastructure and information about linkage opportunities. They also depend upon the quality of entrepreneurship in the economy since the availability and ability of local suppliers are important here.[53]

C. Pursuing opportunities in "bottom of the pyramid" markets

50. The term "bottom of the pyramid" mainly refers to the portion of poorest people in developing countries who tend in general to be ignored by multinationals and established domestic companies.[54] According to some academics and corporate strategists,[55] in addition to its ethical implications, the practice is an error on the part of the companies since in a number of developing countries there is a vast emerging market among the poor, who are eager to consume quality goods and services. Despite their low income levels, by virtue of their numbers, this group of persons, if targeted, could generate significant growth and activity for businesses. Such targeting would also have the effect of improving the quality of life of the group, reducing poverty and helping the achievement of the Millennium Development Goals.

51. However, to operate successfully in those markets, companies need to innovate, as traditional products, services and management processes may not be appropriate or desired. In particular, since the poorest persons tend to have very limited levels of income and cash, they need to be provided with opportunities for consumption of goods and services in a different way. For example, a rapidly evolving approach to facilitating consumption and choice at the bottom of the pyramid is to make unit packages that are small and affordable, such as "single-serve" packaging. In the case of the rural poor, having effective distribution mechanisms is also very important, and some efforts under way in India are well worth noting.[56] Prahalad's research suggests that poorer consumers can be just as "value conscious" as anyone else and, in order to serve them with affordable products, multinationals and established local companies need to concentrate on reducing costs and increasing the efficiency of their manufacturing and distribution processes. He argues that this is possible and cites numerous examples of companies that are serving poorer markets effectively and innovatively.

52. As mentioned previously, the poor can benefit in a multitude of ways. Residents in poor localities tend to pay higher costs for basic goods and services than those in richer areas — especially for credit, water and medication. For instance, research shows that people in the slum colony of Dharavi in Mumbai, India, pay significantly more for such basic goods and services than their counterparts in the wealthier locality of Warden Road in the same city.[57] The "poverty penalty" is the result of local monopolies, inadequate access, poor distribution and the presence of strong traditional intermediaries, and it can be overcome by the entry and competition of other businesses. At the same time, poorer consumers can achieve greater choice and "market power". Moreover, the finance, technology and linkages that larger companies bring with them can initiate

the growth of local subsidiaries, ancillary companies and small-scale enterprises in poorer localities, thereby generating higher levels of formal-sector-type employment and incomes.

53. As companies increasingly enter bottom of the pyramid markets, concerns rightfully arise regarding the protection of consumers and the environment. In that regard, many suggestions have been made for businesses to work together with civil society and Governments to find solutions and address particular issues and challenges. Non-governmental organizations and other civil society entities can play an important role in monitoring and ensuring good behaviour on the part of corporations. For example, there has been a proposal for a "consumer bill of rights" that corporations would have to sign in order to gain access to bottom of the pyramid markets.[58]

54. In more general terms, development always has to be seen as a cooperative process, where governments, businesses, civil society organizations and individuals all have a role to play. In that regard, the principles and commitments set out in the Monterrey Consensus, as well as those expressed in other development-related United Nations documents, should serve as the best guides for the tasks ahead.

Notes

[1] Sales No. E.04.III.B.4.

[2] United Nations Conference on Trade and Development, "Promoting the export competitiveness of SMEs", TD/B/COM.3/EM.23/2.

[3] The evidence in section II.A draws largely on recent surveys and analyses undertaken by the World Bank: see World Bank, *World Development Report 2005: A Better Investment Climate for Everyone* (Washington, D.C., 2004) and World Bank, *Doing Business in 2005: Removing Obstacles to Growth* (Washington, D.C., 2005).

[4] World Bank, *Doing Business in 2005: Removing Obstacles to Growth* (Washington, D.C., 2005).

[5] Ibid.

[6] A. Bonilla Garcia and J. V. Gruat, *Social Protection: A Life Cycle Continuum Investment for Social Justice, Poverty Reduction and Sustainable Development* (Geneva, International Labour Office, 2003).

[7] World Bank, *Doing Business in 2005: Removing Obstacles to Growth* (Washington, D.C., 2005).

[8] International Labour Office, *World Employment Report, 2004-05* (Geneva, 2005).

[9] UNCTAD, "Best practices in financial innovations for SMEs" (TD/B/COM.3/EM.13/2).

[10] Jae-kyoung Kim, "Korea seeks major role in Asian market integration", *Korea Times* (13 May 2004); and Nomura Securities Co., Ltd., press release (8 December 2004).

[11] The Asian Bond Market Initiative was endorsed at the ASEAN+3 Deputies Meeting held in Chiang Mai in December 2002. Its objective is to develop efficient bond markets in Asia.

[12] World Bank, Global Monitoring Report 2005; see figure 2.17 (Washington, D.C., 2005).

[13] For example, the longer-term economic and social benefits.

[14] The World Bank Infrastructure Action Plan, formulated in 2003, recognizes that the scope for private participation, and by implication the scale of engagement by multilateral institutions, varies between the different sectors (see "Strengthening the foundations for growth and private sector development: investment climate and infrastructure development", Washington, D.C., World Bank, 2004).

[15] Investment in infrastructure projects with private participation has fallen from a peak of close to 130 billion dollars in 1997 to a little above 40 billion today. Private infrastructure developers and long-term investors essentially withdrew as Governments were unable to put in place sustainable policies that assured adequate and predictable returns, particularly in the politically contentious power and water sectors (World Bank, ibid.).

[16] The main business contributors have been AMBAC, Inc, Samuels and Associates and the Business Council for the United Nations. The International Chamber of Commerce and the World Economic Forum have also contributed towards assisting and publicizing this effort. Participants in the group include a wide range of companies and institutions.

[17] United Nations, Financing for Development Office, “Workshop on mobilizing private investment in developing countries” (2004).

[18] World Bank, *Doing Business in 2005: Removing Obstacles to Growth* (Washington, D.C., 2005).

[19] Jose Antonio Ocampo, “Beyond the Washington Consensus: what do we mean?”, *Journal of Post Keynesian Economics*, vol. 27, No. 2.

[20] For a more detailed presentation of innovation and technical change, see Giovanni Dosi, and others, editors, *Technical Change and Economic Theory* (London and New York, Pinter Publishers, 1988); Chris Freeman and Luc Soete, *The Economics of Industrial Innovation*, third edition (Cambridge, Massachusetts, MIT Press, 1997); Jorge Katz and Bernardo Kosacoff, “Technological Learning, Institution Building, and the Microeconomics of Import Substitution”, in *Economic History of Twentieth-Century Latin America*, Enrique Cardinas, Jose Antonio Ocampo and Rosemary Thorp, editors (New York, Palgrave Macmillan, 2001); and Richard Nelson, *The Sources of Economic Growth* (Cambridge, Massachusetts, Harvard University Press, 1996).

[21] Jose Antonio Ocampo, “The quest for dynamic efficiency: structural dynamics and economic growth in developing countries”, in *Beyond Reforms: Structural Dynamics and Macroeconomic Vulnerability*, Jose Antonio Ocampo, editor (Palo Alto, California, Stanford University Press, and the Economic Commission for Latin America and the Caribbean, 2005).

[22] Ibid.

[23] UNCTAD, “Entrepreneurship and economic development: the Empretec showcase” (Geneva, 2004).

[24] GEM is a research programme (founded and sponsored by Babson College and London Business School) that provides annual assessments of the level of entrepreneurial activity across nations. National entrepreneurial activity is calculated as the share of the labour force involved in starting a business or managing a new business that is less than 42 months old.

[25] Global Entrepreneurship Monitor, *GEM 2004 Executive Report* (Babson Park, Massachusetts, Babson College; and London Business School, 2004).

[26] The economic success of large enterprises tends to create new market opportunities for SMEs through an increase in demand for goods and services, technological spillovers, integration in supplier networks and so on. See UNCTAD, “Entrepreneurship and economic development: the Empretec showcase” (Geneva, 2004).

[27] The general national framework conditions include most of the factors outlined in section 2 but also management skills and role of government. The entrepreneurial framework conditions include government policies and programmes directed at strengthening entrepreneurship, education and training, research and development transfer, access to infrastructure, cultural/social norms, financial conditions and commercial and legal infrastructure. Aspects of the legal, financial and physical infrastructure are considered part of the general enabling business environment.

[28] Global Entrepreneurship Monitor, *GEM 2004 Executive Report* (Babson Park, Massachusetts, Babson College; and London Business School, 2004)

[29] UNCTAD, "Providing sustainable financial and non-financial services for SME development" (TD/B/COM.3/EM.7/2).

[30] The 10 personal competencies are opportunity seeking and initiative, risk taking, demand for efficiency and quality, persistence, commitment to the work contract, information seeking, goal setting, systematic planning and monitoring, persuasion and networking, independence and self-confidence (see David McClelland, *The Achieving Society* (Princeton, New Jersey, Van Nostrand, 1961)).

[31] UNCTAD, "Entrepreneurship and economic development: the Empretec showcase" (Geneva, 2004).

[32] William Lazonick, "Public and corporate governance: the institutional foundations of the market economy", paper presented to the Economic Commission for Europe (2001).

[33] William Lazonick, ibid., and INSEAD.

[34] Ibid. According to Lazonick, even in the United States and the United Kingdom, stock issues were relatively unimportant as sources of productive finance during the key periods of their economic development.

[35] Ibid.

[36] However, a distinction should be drawn between State support and excessive State intervention in the corporate sector. The latter should be avoided since this can lead to a misallocation of resources and to the formation of monopolistic markets, which may harm consumers.

[37] Jan Kregel, "Two views on the obstacles to development", *Social Research*, vol. 71, No. 2 (Summer 2004).

[38] For example, through strengthening institutions that provide long-term finance, such as development banks and, where appropriate, bond markets.

[39] See *Unleashing Entrepreneurship: Making Business Work for the Poor* (United Nations publication, Sales No. E.04.III.B.4).

[40] The World Economic Forum's Global Corporate Citizenship Initiative undertook a survey in which companies were asked to rank the three most important reasons to get engaged in partnerships to support sustainable development. The answers were similar to those mentioned in paragraph 38.

[41] World Economic Forum, *Partnering for Success: Business Perspectives on Multistakeholder Partnerships* (Geneva, 2005).

[42] Partnerships involving business associations can also address the problems of uncoordinated private investments brought to light by such theorists as Paul Rosenstein-Rodan (see Ha-Joon Chang, *The Political Economy of Industrial Policy*, second edition (London, Macmillan Press, 1994)).

[43] World Economic Forum, *Partnering for Success: Business Perspectives on Multistakeholder Partnerships* (Geneva, 2005).

[44] UNCTAD has also produced a survey of best practices for dialogue between the public and private sectors, which have been distilled from cross-country experiences (UNCTAD/ITE/TEB/4).

[45] United Nations Development Programme, "Between markets and States: international cooperation through global public-private partnerships", in *The New Public Finance: Responding to Global Challenges*, Inge Kaul and others, editors (New York, Oxford University Press, 2004).

[46] Ibid.

[47] See *Unleashing Entrepreneurship: Making Business Work for the Poor* (United Nations publication, Sales No. E.04.III.B.4).

[48] World Economic Forum, *The Global Competitiveness Report*, 2004-2005 (Geneva, 2004).

[49] Ibid.

[50] UNCTAD, "Entrepreneurship and economic development: the Empretec showcase" (Geneva, 2004).

[51] Competitive enterprise clusters and networks are often the result of deliberate economic and social policies at the local, regional and national level. Beyond having a healthy business environment and a local physical and social infrastructure that facilitates the generation of common externalities and support structure, focused measures such as the creation of research and training centres, quality certification institutes and export promotion boards may also stimulate interactive learning, knowledge flows and innovation. Hence, a range of variables at the local and macro levels may interact to generate successful clusters (Torbjörn Fredriksson, "Forty years of UNCTAD research on FDI", *Transnational Corporations*, vol. 12, No. 3 (December 2003)).

[52] UNCTAD, World Investment Report 2001: Promoting Linkages (United Nations publication, Sales No. E.01.II.D).

[53] UNCTAD has assembled a roster of good practices to make linkages work (UNCTAD, "Business linkages: roster of good practices" (Geneva, 2004)).

[54] See *Unleashing Entrepreneurship: Making Business Work for the Poor* (United Nations publication, Sales No. E.04.III.B.4).

[55] In particular, this viewpoint is associated with C. K. Prahalad (see The *Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* (Upper Saddle River, New Jersey, Wharton School Publishing, 2004).

[56] Prahalad, ibid.

[57] Ibid.

[58] Nick Mathiason, "Big firms 'must sign bill of rights'", *The Observer* (19 December 2004).

References

Bonilla Garcia, A. and J. V. Gruat (2003). *Social Protection: A Life Cycle Continuum Investment for Social Justice, Poverty Reduction and Sustainable Development*. Geneva: International Labour Office.

Chang, Ha-Joon (1996). *The Political Economy of Industrial Policy*, second edition. London: Macmillan Press.

Dosi, Giovanni, and others, editors (1988). *Technical Change and Economic Theory*, Maastricht Economic Research Institute on Innovation and Technology/The International Federation of Institutes for Advanced Studies. London and New York: Pinter Publishers.

Fredriksson, Torbjörn (2003). Forty years of UNCTAD research on FDI. *Transnational Corporations*, vol. 12, No. 3 (December 2003).

Freeman, Chris, and Luc Soete (1997). *The Economics of Industrial Innovation*, third edition. Cambridge, Massachusetts: MIT Press.

Global Entrepreneurship Monitor (2004). *GEM 2004 Executive Report*. Babson Park, Massachusetts: Babson College; and London: London Business School.

International Finance Corporation (2004). *2004 Annual Review: Small Business Activities*. Washington, D.C.: World Bank.

International Labour Office (2005). *World Employment Report, 2004-05*. Geneva.

Katz, Jorge, and Bernardo Kosacoff (2000). Technological learning, institution-building, and the microeconomics of import substitution. In *Economic History of Twentieth-Century Latin America*, Enrique Cardinas, Jose Antonio Ocampo and Rosemary Thorp, editors. New York: Palgrave Macmillan.

Kim, Jae-kyoung (2004). Korea seeks major role in Asian market integration. *Korea Times* (13 May).

Kregel, Jan (2004). Two views on the obstacles to development. *Social Research*, vol. 71, No. 2 (Summer, 2004).

Lazonick, William (2001). Public and corporate governance: the institutional foundations of the market economy. Paper presented to the Economic Commission for Europe, May 2001.

Mathiason, Nick (2004). Big firms “must sign bill of rights”. *The Observer* (19 December).

McClelland, David (1961). *The Achieving Society.* Princeton, New Jersey: Van Nostrand.

Nelson, Richard R. (1996). *The Sources of Economic Growth*. Cambridge, Massachusetts: Harvard University Press.

Nomura Security Co., Ltd. (2004). Arrangement of Korean collateralized bond obligation. Press release (8 December).

Ocampo, Jose Antonio (2004). Beyond the Washington Consensus: what do we mean? *Journal of Post Keynesian Economics*, vol. 27, No. 2.

________________ (2005). The quest for dynamic efficiency: structural dynamics and economic growth in developing countries. In *Beyond Reforms: Structural Dynamics and Macroeconomic Vulnerability*, Jose Antonio Ocampo, editor. Palo Alto: Stanford University Press, and the ECLAC.

Prahalad, C. K. (2004). *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*. Upper Saddle River, New Jersey: Wharton School Publishing.

United Nations (2002). *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002*. Sales No. E.02.II.A.7.

_______________ (2004). *Unleashing Entrepreneurship: Making Business Work for the Poor*. Sales No. E.04.III.B.4.

United Nations Financing for Development Office (2004). Workshop on mobilizing private investment in developing countries.

United Nations Conference on Trade and Development (1999). Providing sustainable financial and non-financial services for SME development. TD/B/COM.3/EM.7/2.

_______________ (2000). Best practices in financial innovations for SMEs. TD/B/COM.3/EM.13/2.

_______________ (2001a). Survey of good practice in public-private sector dialogue. UNCTAD/ITE/TEB/4.

_______________ (2001b). *World Investment Report 2001: Promoting Linkages*. Sales No. E.01.II.D.

UNCTAD (2004a). Business linkages: roster of good practices. Geneva.

_______________ (2004b). “Entrepreneurship and economic development: the Empretec showcase. Geneva.

_______________ (2004c). *Empretec Newsletter* (December 2004).

_______________ (2004d). Promoting the export competitiveness of SMEs. TD/B/COM.3/EM.23/2.

United Nations Development Programme (2005). Between markets and States: international cooperation through global public-private partnerships. In *The New Public Finance: Responding to Global Challenges*, Inge Kaul and others, editors. New York: Oxford University Press.

World Bank (2004a). Strengthening the foundations for growth and private sector development: investment climate and infrastructure development. Report to the Development Committee. Washington, D.C.

_______________ (2004b). *World Development Report 2005: A Better Investment Climate for Everyone*. Washington, D.C.: World Bank; and New York: Oxford University Press.

_______________ (2005a). *Global Monitoring Report 2005*. Washington, D.C.

_______________ (2005b). *Doing Business in 2005: Removing Obstacles to Growth*. Washington, D.C.

World Economic Forum (2004). *The Global Competitiveness Report, 2004-2005*. Geneva.

_______________ (2005). *Partnering for Success: Business Perspectives on Multistakeholder Partnerships*. Geneva.