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MARKET DEVELOPMENT IN ACTION:

THE CASE OF MSME IN CAMBODIA

**CASE STUDY #3: EXPANDING POLITICAL SPACE TO IMPROVE
ECONOMIC GOVERNANCE AND GROWTH**

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CASE STUDY #3: EXPANDING POLITICAL SPACE TO IMPROVE ECONOMIC GOVERNANCE AND GROWTH

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INTRODUCTION

One of DAI's recent successes with the Making Markets Work for the Poor (M4P) approach to design and implementation is the USAID Strengthening Micro Small and Medium Enterprise Project (MSME) in Cambodia.

WHAT IS M4P?

M4P is an overarching approach to development that provides agencies and governments with the direction required to achieve large-scale, sustainable change in different contexts. M4P is focused on the underlying constraints that prevent the effective development of market systems around poor people.

The focus of M4P is on developing market systems, assessed with respect to different market functions and players, public and private, formal and informal. This systemic character of M4P defines many of its most important features.

By addressing underlying causes (rather than symptoms) of weak performance, M4P aims to unleash large-scale change. Interventions may be small in themselves, but they should continually strive to leverage the actions of key market players to bring about extensive and deep-seated systemic change.

Sustainability is a prime concern of M4P. This means considering not just the existing alignment of key market functions and players but how they can work more effectively in the future, based on the incentives and capacities of players (government, private sector, associations, etc.) to play different roles.

M4P requires that agencies and governments play a facilitating role. As external players, they seek to catalyze others in the market system (while not becoming part of it themselves).

For governments, except where they are playing longer-term roles within the market system, and agencies, facilitation is inherently a temporary role.

Finally, as an overarching framework M4P does not necessarily replace other specific methodologies and tools but provides a transparent and multi-disciplinary framework within which they can be utilized and adapted in order to address their limitations and so enhance their efficacy. (from Tschumi and Hagan)

A guiding principle of the project's interventions is the strictly facilitative role – building relationships between actors in the target value chains and stimulating change in the market system, including the enabling environment, without taking a direct role in or becoming part of the system. To a great extent, MSME can be described as a culture change project that employed M4P best practices to achieve sustainability and scale. To improve private sector competitiveness and the business environment, the project's activities have promoted a systemic change in how private businesses interact with each other and in how the government interacts with the private sector.

MSME conducts activities in 17 of the 24 provinces of Cambodia across nine value chains, including swine, aquaculture, clay roof tiles, honey, tree resin, eco-tourism, potable water, household latrines, and garment industry. The project works across all levels of the value chain, as well the enabling environment (rules) and supporting environment (institutions) of the targeted sectors. It is a two-phased project, with a budget of \$26.5M over 7 years that has facilitated comprehensive assistance directly to more than 7,400 firms and 800 government officers. In fact, more than

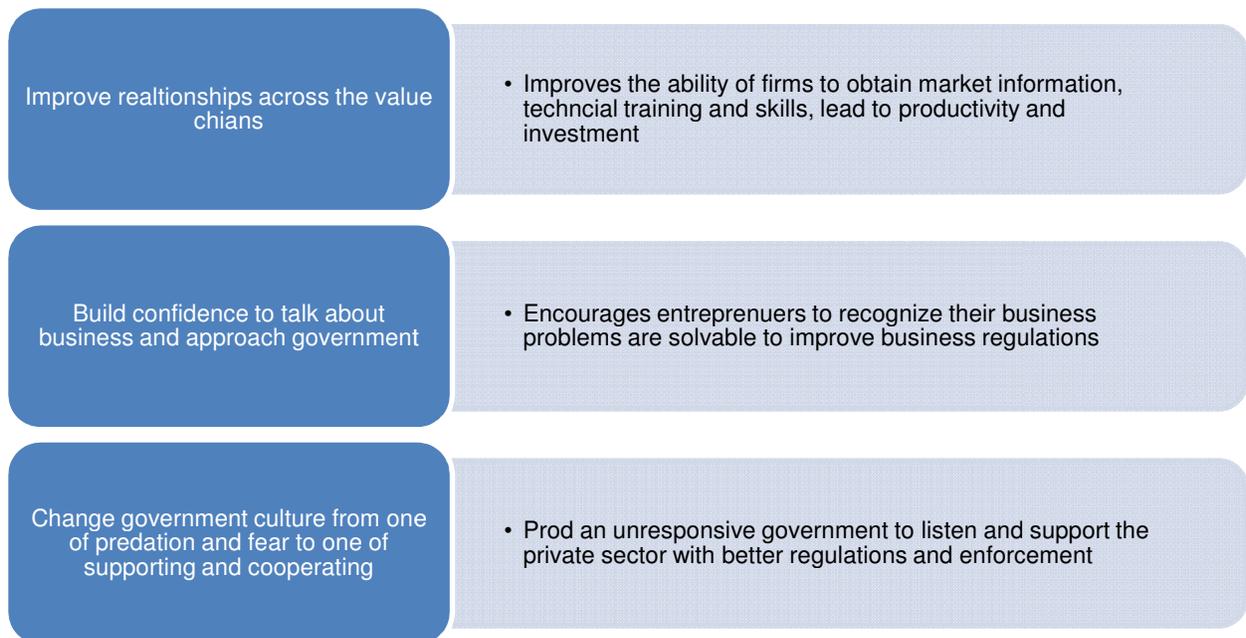
SYSTEMIC CHANGE

Although it is rarely possible to work with all firms in a system, the impact of interventions should reach beyond a few lead firms. Interventions should stimulate changes in the way the system works as a whole. Systemic change is a change in the underlying causes of market system performance – typically in the rules and supporting functions – that can bring about more effective, sustainable and inclusive functioning of the market system.

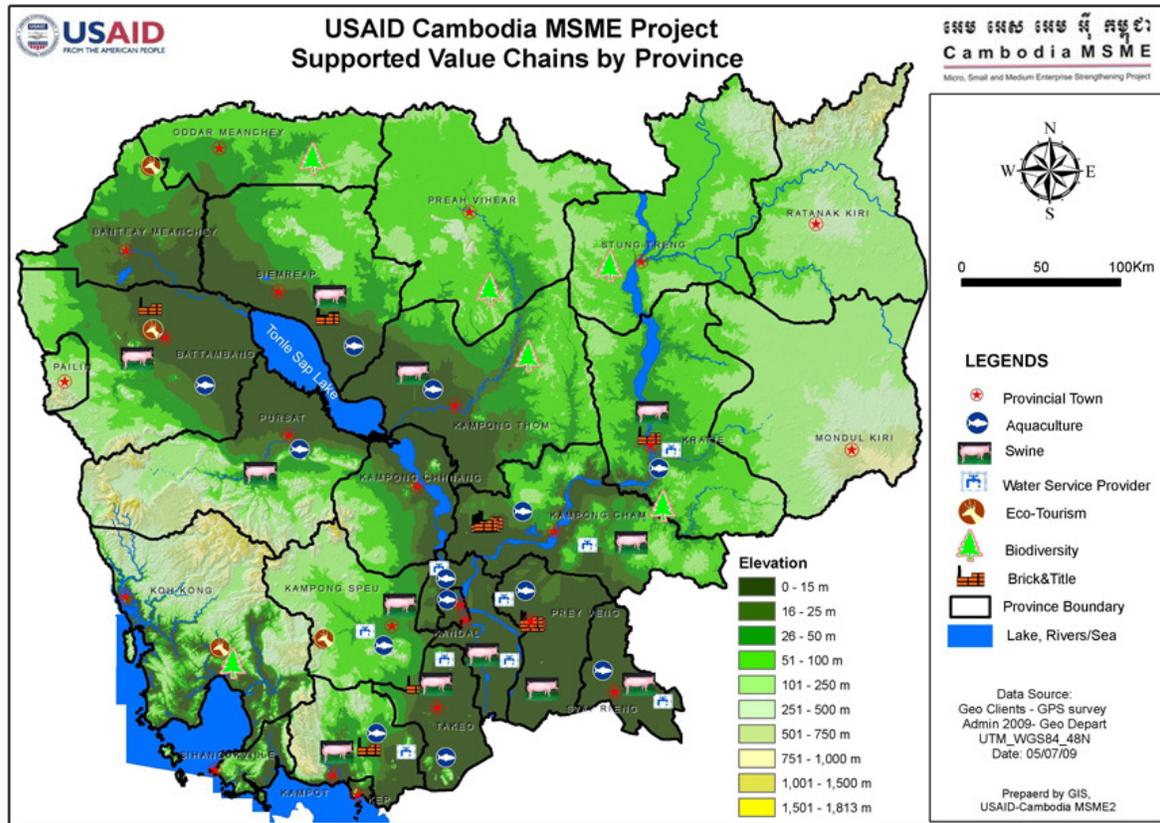
280,000 Cambodians directly benefited from project activities, and more than one million indirectly benefited.

The project facilitates MSMEs to organize effectively among themselves through interest groups, working groups, agricultural cooperatives or associations and to improve competitiveness and then to engage with national and provincial government representatives to improve their business enabling environment. By design, fostering these linkages among private sector actors has also created incentives for upgrading and capital investment without project support, thus enabling the sustainable growth of the target value chains. MSME also works with the public sector to demonstrate the economic value of better regulation, facilitating a change of the government culture from one of predation and intimidation to one of cooperation and support. The project works with provincial authorities to improve business and investment climate and with the national-level government counterparts to improve their ability to draft and implement good legislation and effectively communicate with other government agencies and the private sector. In addition to provincial authorities in each of the seventeen provinces, MSME engages with 10 national-level Government of Cambodia (RGC) counterpart agencies.

The chart below illustrates the rationale behind the project's interventions.



MSME was the first USAID-funded project focused exclusively on economic growth in Cambodia. The first phase began in 2005 as a three-year, \$5M project working in four economically poor provinces. By 2008, the project was successful in demonstrating the potential of the private sector to open political as well as economic space, and USAID funded Phase 2 with a more comprehensive mandate to explicitly include the government in the development of the targeted value chains. The second phase of the project also drew on lessons learned from past program experience – more than \$450 million in donor funds had been spent on improving agricultural production in Cambodia, with little or no investment in relationship building among the targeted value chains. Once these donor projects ended, growth stopped and the value chain actors lacked support to continue improving on their own. As a result, MSME has been firmly committed to strengthening relationships and building linkages to improve value chains without project



support – even at the expense of short term gains – remaining patient for growth, but impatient for sustainability. In fact, MSME has defined six key principles that all interventions must satisfy:

- **Market First** – prioritize the market by expanding access for firms with commercial surplus and products to sell
- **Non-invasive Subsidies** – facilitate, don't participate
- **Simple and Sustainable Design** – design with simplicity to ensure sustainability
- **Affordable Activities** – ensure that all activities are affordable without donor assistance
- **Broad Benefits** – aim to benefit multiple firms across the value chain to gain value
- **Sustainable Growth** – by building relationships, knowledge, and skills

Now in its final year of implementation, there is clear evidence of the project's impact. Some of the key results from Phase II are highlighted below.

The project’s success in mending fractured value chains supports several key M4P assumptions. First, MSME illustrates that reducing, removing, and improving on supply chain constraints not only requires an understanding of what the constraints are, but also why these constraints exist in the first place – a key feature of the M4P approach. Tackling these issues at their core demands systemic solutions that address incentives and disincentives for behavior change. As a result, the project has overcome a number of challenges (including mistrust and a lack of confidence among firms in the private sector, lack of interest from the public sector, and limited political voice and advocacy power of businesses) by facilitating a change of culture in the public and private sectors. Furthermore, these changes can only be accomplished by improving the functioning of the system as a whole, rather than only improving the performance of specific firms. Finally, MSME also demonstrates how a donor-funded intervention can facilitate change in a market system without providing direct technical assistance that crowds out private sector businesses and sustainable contributions from the public sector. Technical assistance at every level has continually, and now increasingly, come from other private sector actors in the value chain.

In the following briefs, different aspects of the project’s successful market development approach will be explored in more detail:

1. Stimulating Client Self-Selection– this brief describes how the project employed the M4P principles of self-selection and crowding-in to select clients
2. Improving Competitiveness to Expand Economic Space – this brief describes how the project fostered a culture of collaboration among rural businesses in the targeted value chains
3. Expanding Political Space to Improve Economic Governance and Growth – this brief describes how the public and private sectors can be motivated to work together to improve the business environment

Highlights from MSME Phase II

- MSME facilitates comprehensive assistance to more than 7,439 firms and 833 government officers – more than 280,000 Cambodians benefit from project activities.
- MSME project works directly with more than 7,439 enterprises across 9 value chains in 17 Cambodian provinces.
- As a result of MSME assistance, 7 national laws and regulations have been reviewed or revised with private sector input (through private sector meetings, workshops, or PPD) and over 4,019 enterprises and government officials at all levels are now participating in policy advocacy meetings and public-private dialogues.
- In addition, through MSME support to public sector organizations at the national and provincial level, 28 laws and regulations have been reviewed, analyzed or modified to improve the business enabling environment. 833 public sector officials at the national and provincial levels have improved their skills and knowledge required for effective regulatory drafting, communications, investment promotion and public-private dialogue.
- MSME improved communication and trust between members of the public and private sectors through exposure trips; conducted 124 cross-provincial trips with a total of 2,099 participants and led 13 international governance and technology exposure missions for 194 participants to Thailand, Vietnam, Malaysia, Philippines, Indonesia and the United States. (results up to September 2011)
- 20 cooperatives and working groups have been established with MSME assistance.

CASE STUDY #3: EXPANDING POLITICAL SPACE TO IMPROVE ECONOMIC GOVERNANCE AND GROWTH

PROBLEM: LACK OF COLLABORATION

Cambodia's civil war ended in 1998 after thirty years, leaving nearly all relationships destroyed and the rural economy in shambles with embedded distrust in communities and transactions. When the MSME project began in 2005, there were no operational rural-based associations, cooperatives, or working groups in any of the targeted sectors. Because the value chains were so fractured and relationships among the actors so weak, common problems were not discussed locally and the private sector lacked confidence to demand resolution from the government. In addition, there were no formal platforms or national dialogue for micro and small rural-based firms to surface, discuss, and resolve business issues. The public sector was not engaged to develop the private sector, and government officers operated as if they were in a command economy. In fact, when the project first met with senior officials from the Ministry of Agriculture, Fisheries, and Forestry in 2008, the government was fiercely against collaborating with the private sector saying, "We are the government; we make the laws, and the private sector follows them. We don't need their input into our laws and regulations and we don't need USAID or MSME to help us facilitate discussions." This common attitude among government officials also led to rent-seeking behavior as all commerce was heavily taxed due to poorly written regulations, there were significant licensing requirements for nearly all business functions, and many unofficial fees were charged to commerce during transport and market delivery.

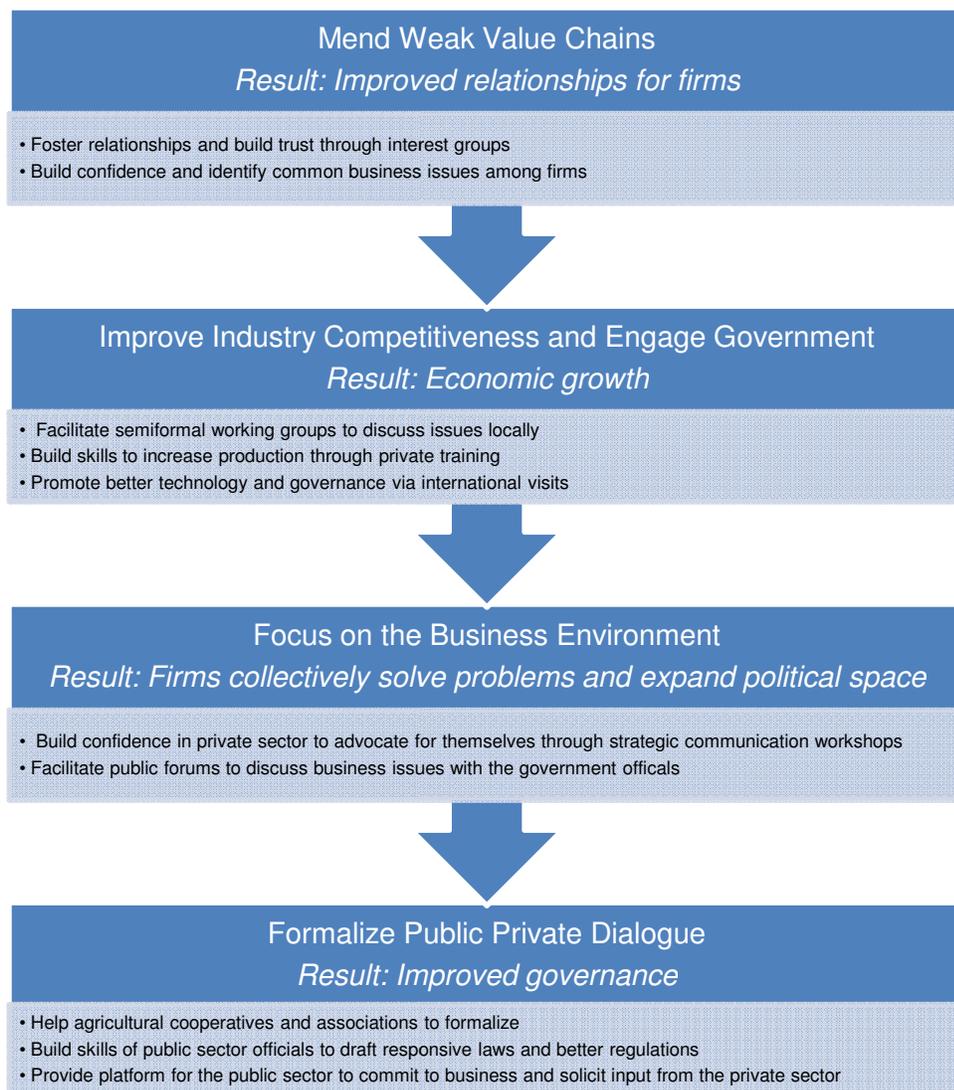
Clearly, the project was faced with an immense challenge – one that was deeply rooted in the disempowerment of the private sector and the predatory practices of the public sector. For MSME, improving the business and regulatory environment in Cambodia was a phased process that began with empowering the private sector to view themselves as partners to solve business issues together and as a united and anonymous entity to advocate for resolution from the government. By design, mending the weak value chains also created incentives for technical upgrading, skills advancement, and capital investment, ultimately leading to improved competitiveness. Details of how the project improved private sector relationships to build competitiveness are described in Brief #2. As firms continued to gain competitiveness and increase commercial surplus and market interactions, they began to experience common business problems, such as unofficial fees to conduct any business activities, requirements to obtain various licenses for transport and sale, and a host of other business environment problems.

Therefore, the project's first step for improving the business environment was to encourage firms to collaborate to understand their problems in working groups, gain the confidence to address them, and then systematically present their issues for resolution. In keeping with the project's guiding principle of sustainable growth, MSME avoided promoting formal associations, choosing instead to wait until the community working groups had reached the point where they realized the benefit of working together in a more formal manner. Simultaneously, the project involved the government in all activities, encouraged

the public sector to seek the advice of the private sector, and provided a platform for productive interaction.

For MSME, increasing firm-level competitiveness was a key driver of business environment improvements. As Mr. Veng Nam, a brick and tile producer in Cheung Prey District described, “My previous experiences with advocacy were not successful. The private sector was assembled in groups, they came with their demands, but no solutions were developed. This is not advocacy. What has been different with MSME is the focus on improving production. Now I can compete with imported and local products – on both price and quality. Other projects have just focused on policy and advocacy without improving the way the business functions. This upgrading and improvement of my business has moved the discussion with the public sector forward.” The project’s phased approach to improving the business environment is summarized in the chart below. More information on the specific interventions employed by the project is detailed in the following section.

CHART 1: MSME PHASED APPROACH TO INCREASING ECONOMIC SPACE, EXPANDING POLITICAL SPACE, AND IMPROVING GOVERNANCE IN CAMBODIA



PROJECT INTERVENTIONS

MSME implemented a series of interventions to build the confidence of the private sector, foster business relationships, market linkages and trust between public and private sector actors, and provide a culturally-acceptable and sustainable platform for public-private dialogue (PPD) on business environment issues. These activities facilitated a culture change among actors in the private and public sectors to see one another as partners both equally engaged in improving the business environment and growing the Cambodian economy.

BUILDING CONFIDENCE AND BUSINESS VISION

The project first began to interact with the private sector through **informal interest or working groups**. At the outset of the project, through discussion, observations, and referrals, the MSME team carefully identified those people who had ambition and desire to grow their business (details of the client selection process are described in Brief #1). The project typically invited about 30 members of the private sector within a relatively small geographic area, such as a village, to a facilitated meeting, called an “interest group” by the project, at one of the villagers’ homes or the local pagoda. In keeping with the project’s strict convention against subsidies, MSME did not offer any compensation for attending these meetings. Unlike many other players in the market system, the project did not attempt to entice participation through subsidies (such as free rice or per diem payments), and this practice served as a reliable recruiting tool for true entrepreneurs and ambitious members of the private sector.

The project then facilitated a **discussion around each of the firms’ business problems**, which largely, were the same for everyone: lack of technical skills, no linkages to markets, only one trader to sell to (whom they thought always cheated them), an inability to obtain high quality feeds, medicines and vaccines for their animals, and shortage of credit. For most of these villagers, these meetings offered the first opportunity to openly discuss business with one another and helped them to discover that they all suffered from the same problems. In many cases, this was a critical revelation to them and served to challenge the existing dogma about what was acceptable to discuss with other value chain actors and, most importantly, with the government.

Once the issues were surfaced and firms appreciated the common challenges they all faced in their businesses, the project facilitated **visioning exercises** around potential solutions and helped firms realize the value of working together. When the members of the very informal interest group decided to more formally organize the discussions on a regular basis, the project considered them a “working group.” As discussed in Brief #2, many of the business issues were related to the lack of technical skills and training in new technology. Others, however, required the engagement of the public sector. As Mr. Keat Kheng, a project client and fingerling producer in Prey Chhor District recalls, “Technology is not always the problem. Often the business environment is the problem.” The project leveraged the momentum gained from these first meetings and continued to facilitate activities to build confidence and empower the private sector to demand resolution from the government on the regulatory issues they faced. For instance, at **strategic communications workshops**, MSME invited agriculture cooperative, association, and working group leaders to practice organizing and presenting their issues. In August 2009, the MSME Project facilitated training for 25 provincial business association members from 11 provinces. This training program helped businessmen and women learn how to communicate their activities and goals to the government officers and the general public. Participants were given the basic tools to craft communication strategies about the issues that matter to them. Two days later, training was provided to

25 government officers from 13 provinces. The trainees were mostly directors of provincial agriculture departments and the secretary-generals of provincial halls. The training helped officials to better communicate government activities and goals to the business community, potential investors, and the general public. These activities helped participants gain confidence and served to reinforce relationships among the private sector actors. According to one participant, Mr. Keat Kheng, “The project guided me to stand alone during business discussions with government officials.”

When the project began, there was only one formal mechanism to discuss business issues in Cambodia – and it was more or less ineffective. Called the Government Private Sector Forum, it was completely designed and operated by the government and solved some problems only in Phnom Penh, but at a glacial pace, and normally only for very large and already business-savvy, organized business associations. There were no formal mechanisms for micro or small rural firms with very little confidence to address the government and resolve issues at the national level. In response, the project facilitated several different platforms for the private sector and the private sector to interact.

PROMOTING PUBLIC PRIVATE INTERACTION

Some of the most impactful interventions facilitated by MSME were **cross provincial study tours and exposure visits**. The primary objective of these missions was to expose actors from all parts of the supply chain to input suppliers, technologies, processes, and new traders and to build relationships with larger firms in and around the capital city and provincial towns or regional countries. In addition, the project always included government officers in these missions. For that reason, the missions allowed for relationships between the public and private sector to be formed as well and in many cases, galvanized support from the government on business issues. Furthermore, once the project identified a critical mass of interested firms who were investing in their businesses and government officers willing to help the firms to grow, MSME coordinated **international missions** to Vietnam and Thailand.

Again, while the stated purpose of these international exposure visits was to demonstrate advanced technologies in the target sectors, by design, the participants also witnessed how good governance can support business growth. Through these missions, the project demonstrated how effective government can work with the private sector to achieve its goals and stimulated demand for this type of relationship in the Cambodians. Experience demonstrates that joint participation in these missions generates new perceptions and practices. Government officers begin to understand and perform their roles as service providers rather than as controllers and to copy better governance practices they observed abroad. Private sector business persons feel more confident to discuss their problems with government officers they have met previously and to suggest changes that improve their competitiveness.

For instance, when provincial government officers from Kampong Cham visited Vietnam in 2007, they were motivated to replicate the success they saw and sought the project’s assistance to improve the investment climate in their provinces.

Private sector firms also witnessed how other governments provided support and, in productive ways, were able to engage government officers on the mission to work with them – like the governments in Vietnam, Thailand, the Philippines, and Malaysia – to improve the business environment. It is important to note that these missions were all cost-shared with the project gradually reducing the amount contributed through USAID and increasing the contribution by the firms and government officers for these missions. In fact, many firms returned to Vietnam and Thailand at their own expense to buy products and contract for technical advice.

Provincial Investment Profiles

Profiles have been completed and published for each of the 12 target provinces. These profiles were developed in conjunction with Emerging Markets Consulting and with the participation of government and private enterprise stakeholders in each of the provinces. All 12 of these Provincial Investment Profiles can be found here.

After several years of working with provincial and national government “leaders” to stimulate interest in collaborating with the private sector, the public sector expressed a willingness to discuss regulatory and enforcement issues with the business community. In response, the project facilitated several **business forums** where national and provincial government leaders could engage in discussions with the private sector, learn about their concerns, and address their issues. MSME also facilitated **radio talk shows and televised panel discussions** about business issues. FM radio is a powerful tool in rural Cambodia for publicizing key project activities, themes and messages to micro, small and medium enterprises, as well as national, provincial and district government officials. The project works with media partner Equal Access and a network of FM radio stations, including Radio National Kampuchea and 12 provincial FM stations, to regularly broadcast the MSME's “Success Starts with You!” program. Content includes pre-recorded programs, live programs (call-in show and talk show) and public service announcements (now including PSAs for television). The estimated listening audience is 2 million Cambodians for each show, and the programs are broadcast in the Khmer language. These platforms served the dual purpose of empowering business people as worthy stakeholders as well as providing the government and private sector an opportunity to discuss business environment improvements openly.

FORMALIZING PUBLIC PRIVATE DIALOGUE

Both local and national government officers came to realize the value of obtaining advice from the private sector before crafting laws and regulations. Once MSME succeeded in promoting professional relationships between the national and provincial government officers, the project was invited to assist by facilitating dialogue on laws and regulations. As one district governor in Kampong Cham admitted, “I realized that the project’s goals and my goals are the same.” Once the government officers became comfortable with these discussions, the project found more and more ministries willing to engage. The project also encouraged cooperation by highlighting these successes and achievements through the publication of biweekly success stories, televised videos, and radio shows.

As a result, the project has facilitated several **legal and regulatory advisory forums**, where the public and private sectors come together to meet on draft laws that affect private enterprise. These meetings and the willingness of both parties to candidly discuss business issues and understand the need for regulations exemplifies the positive changes occurring in Cambodia's business and governance cultures. One example, in the aquaculture sector discussed below, is particularly telling.

Simultaneously, to build the skills of public sector officials, MSME has hosted several **highly interactive workshops on legal drafting** for national-level regulators. The structure of the training was designed to assist national rule makers to think “outside the box” about their important roles as regulators. Participants had to balance the requirements of the law, with the conflicting needs of business, good governmental administration, and lines of

In late 2011, the MSME Project, in collaboration with the Fisheries Administration (FiA) and more than 100 private sector firms, facilitated several milestone meetings. FiA's objective in participating was to improve the draft law by field testing the provisions and ensuring that, once the draft became a law, it could meet its objectives. During and after the meetings, the FiA drafting team made several changes to the draft law, including adding clear and transparent procedures for requiring and granting permits and licenses, ensuring longer terms for licenses, providing exemptions for family scale businesses, and reducing penalties. These meetings and the willingness of both parties to candidly discuss business issues and understand the need for regulation exemplifies the positive changes occurring in Cambodia's business and governance cultures.

authority among ministries. No salary supplements or travel allowances were paid and attendees came just to learn from MSME experts, and as importantly, from each other. In addition, the project is working to build a cohort of government and private sector experts to represent Cambodian interests on the international stage with WTO-compliant laws and practices by facilitating a comprehensive program, which includes on-going **training for the drafting team, assistance with writing laws, ensuring public input into the law and providing public information on it**. According to Mr. Thach Ratana, Chief of PDA in Svay Rieng, “MSME is a model for others to follow. The project facilitates consultation between the public and the private sectors with a single goal in mind: to improve the private sector. As a public servant, I have always had the desire to serve the private sector. But the project has facilitated me and shown me how to intervene in the right way.”

The project also provided opportunities for the public sector to show support for the private sector. In fact, one of the best examples of cooperation has been the **rural trade fairs**. The project facilitated these trade fairs, 29 in total, in collaboration with the local provincial authorities. By the project's second year, the trade fairs had generated a high level of support from provincial governments and caught the attention of Cambodia's Minister of Agriculture. This significantly raised the trade fair profile and the Minister urged all 23 of his provincial deputies to make the rural trade fairs a regular event in each of their provinces without the support of donors such as USAID, ensuring that the trade fairs are now a sustainable model for local product promotion.

RESULTS

Gradually, through the cross-provincial and international exposure missions, business forums, advisory forums, and many other events – where the private and public sectors were invited to discuss business and observe how businesses and government can effectively cooperate – the private sector and many government officers have realized the value of cooperation. This has led to improved governance in many respects and has compelled a hesitant public sector to engage with the private sector.

The project has also facilitated a culture change in how private sector actors behave and interact with each other. Firms have seen the value in working together to collectively solve problems, which has led to

expanded political space and improved advocacy. According to Mr. Chum Chandara, Chief of Prey Veng department of animal health and production, “The private sector did not always see themselves as a team. Now, with the assistance of USAID’s MSME Project, they are working together and see each other as allies.” Associations are now quick to raise issues, and more channels are open to dialogue with the government. For instance, a “monopoly” action by government was recently met by swift action of swine cooperatives, stopping a predatory law on animal health. Some of the project’s key results are highlighted below.

Expanded political space now exists for the private sector. Firms are collectively solving problems and community-based informal and formal organizations exist to advocate without project support.

- From a base of nearly zero working groups in 2006, **63 community-based working groups** exist today with **2,175 members**.
- **20 of these groups with 899 members** have become formally registered as agricultural cooperatives and associations, which give them status to discuss issues at all levels of the government and receive tax benefits when obtaining well-understood licenses and when transporting goods.
- Without project support, associations, cooperatives, and private sector actors are now confident to advocate, using evidence and data drawn from their businesses, with the national government.

Both the public and private sectors realize the value of cooperation, which has led to improved governance. The government now solicits input from the private sector when drafting laws and regularly engages with stakeholders without project support.

- MSME has helped to facilitate **188 events** where private businesses and government officers have discussed and often solved business issues. Many more events are now occurring without any project support.
- **More than 4,000 enterprises and government officials** at all levels now regularly participate in policy advocacy meetings and dialogues.
- **More than 790 public sector officials** have improved skills for effective regulatory drafting, communications, investment promotion and public-private dialogue.

Government acts as a champion for the private sector. Evidence indicates that the government officers not only respond, but often co-lead advocacy efforts with more senior officials. Also, an indicator of culture change is that a few government officers have recently been censured for assisting the private sector too much in advocating for a better business environment.

- **35 dedicated events** were held to discuss regulations before they were enacted by the government
- **Active solicitation of public comments** are sought before regulations are enacted
- **The government is now more aware of the power of industry associations and their political power to ask questions and demand solutions**

LESSONS LEARNED

- Do not force associations and cooperatives to formalize. In order for advocacy groups to be effective, members must realize the value of collaboration themselves. Remain patient for growth, but impatient for sustainability.

- Include public sector representation in all activities – and do not be discouraged by initial disinterest. The international study missions were as important to changing the behavior of the government officials – demonstration of good governance practices – as it was the private sector
- Do not underestimate a potential opportunity for building relationships and learning for the public sector officials
- Target change agents and government “leaders” initially, then use them to drive participation of the other ministries
- Recognize the value of public-private dialoguing to empower and build the confidence of the private sector
- Private sector can open up political as well as economic space
- Taking a culture change approach has proven effective for understanding why growth is or is not happening and has helped to promote systemic changes
- Trust and relationship building takes time but can be strengthened through substantive and, most importantly, engaging activities that involve both the public and private sectors equally as participants. Experience demonstrates that joint participation generates new perceptions and practices.
- In order to address business environment issues, take a practical approach and find ways to “coexist” with the public sector practice. Projects will fall short if the goal is to eliminate corruption completely