

Thematic
Evaluation Study

ADB Support for Strengthening the Enabling Environment for Private Sector Development



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NOTES

Note: In this report, "\$" refers to US dollars.

Director General	V. Thomas, Independent Evaluation Department
Director	H. Hettige, Independent Evaluation Division 2, IED
Team leader	H. Feig, Lead Evaluation Specialist (Financial Sector Operations), IED
Team members	N. Gamo, Senior Evaluation Officer, IED I. Garganta, Senior Evaluation Assistant, IED

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Abbreviations

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
ASEAN	–	Association of Southeast Asian Nations
ASYCUDA	–	Automated System for Customs Data
BAPPENAS	–	Badan Perencanaan dan Pembangunan Nasional (National Development Planning Agency)
CPS	–	country partnership strategy
DMC	–	developing member country
EBRD	–	European Bank for Reconstruction and Development
GCA	–	government contracting agency
GCI	–	Global Competitiveness Index
GDP	–	gross domestic product
IED	–	Independent Evaluation Department
IFC	–	International Finance Corporation
IIFCL	–	India Infrastructure Finance Company Limited
IIFF	–	Indonesia Infrastructure Financing Facility
IPP	–	independent power producer
Lao PDR	–	Lao People’s Democratic Republic
MSME	–	micro, small and medium enterprise
MWSS-RO	–	Metropolitan Waterworks and Sewerage Systems – Regulatory Office
OCR	–	ordinary capital resources
PPI	–	private participation in infrastructure
PPP	–	public-private partnership
PRC	–	People’s Republic of China
PSA	–	private sector assessment
PSD	–	private sector development
PSDS	–	Private Sector Development Strategy
PSO	–	private sector operations
PSOD	–	Private Sector Operations Department
PSP	–	private sector participation
RIA	–	regulatory impact assessment
SME	–	small and medium enterprise
SOE	–	state-owned enterprise
TA	–	technical assistance
VGf	–	viability gap funding
WTO	–	World Trade Organization

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Executive Summary

Introduction

Governments and, by implication, institutions such as the Asian Development Bank (ADB) can only do so much to promote economic development and inclusive growth through direct investments. Private sector investment and activity will ultimately have to generate sustained economic growth as well as increases in employment and reductions in poverty. Governments nevertheless have an important role to play in the creation of enabling conditions for private investment and production. ADB's long-term corporate strategy (Strategy 2020) appropriately identifies PSD as one of the drivers of change and states that ADB will invest in infrastructure and advise governments on the basics of a business-friendly environment, including reliable rules, regulations, and policies that do not disadvantage private enterprises.

This evaluation study by the Independent Evaluation Department (IED) reviews ADB's strategies and assistance programs over the last decade to assess: (i) the strategic relevance of support for strengthening the enabling environment as part of ADB's PSD efforts, and the responsiveness of this assistance to private sector concerns and government priorities, (ii) results of such support, and (iii) related ADB capacity to further improve its support in line with Strategy 2020 objectives. Strategic relevance is assessed based on a review of corporate and selected country strategies, portfolio analysis, and stakeholder feedback obtained in six case study countries. Project design issues and preliminary results of ADB's PSD enabling support are assessed based on available evaluation studies, literature review, and desk and selective in-country review of projects seeking to promote public sector management and governance, financial sector development, trade and investment, and private participation in infrastructure (PPI) development, and stakeholder discussions in nine DMCs. The assessment of ADB institutional performance is based on a review of private sector assessments for the case study countries and institutional arrangements and staff skills for dealing with enabling environment issues.

Relevance of ADB Support

ADB's 2006 Revised Strategic Framework for PSD focuses on policy areas that are relevant for addressing PSD constraints in DMCs. Like ADB's 2000 Private Sector Development Strategy (PSDS), the revised framework includes support to developing member country (DMC) governments in creating enabling conditions for business as one of ADB's three operational PSD thrusts (the other two being the promotion of public sector goods and services and direct investments in private sector projects and companies). It defines enabling environment support as support for pertinent policy reforms and institutional development related to public sector management, good governance, financial sector development, trade and investment, and private sector involvement in productive areas and in the delivery of public goods and services. Corruption, bureaucratic inefficiency and unnecessary red tape, lack of competition, and access to finance have been identified as important business constraints by private entrepreneurs in a large number of DMCs. For these areas there are significant gaps between the frameworks, standards and practices used by developed countries and those used in many DMCs. As countries develop, the quality of the regulatory and governance environment becomes increasingly important for enterprise performance

and national competitiveness. In addition, macroeconomic instability is a key business concern during periods of economic crisis. Emphasis on promoting conditions for the private provision of public services is also relevant given substantial infrastructure bottlenecks in most DMCs that can only be alleviated with significant levels of private investment and expertise.

However, no specific operational guidance or targets were provided. While Strategy 2020 envisages that by 2020, 50% of ADB's assistance in terms of value and numbers will support PSD and private sector operations (PSO) (up from 38% in terms of numbers and 35% in terms of value during 2008-2012), it set no specific targets for support to improve the enabling environment for PSD. The 2000 Private Sector Development Strategy and the 2006 revised strategic framework did not provide substantial guidance on conceptual or operational approaches to strengthening the enabling environment. Partly due to this lack of direction ADB policy and institutional support for strengthening the enabling environment for private enterprises has been smaller (and has grown less) than investment support. PSD enabling environment support did not increase significantly after approval of Strategy 2020 and accounted for 8% of total ADB approvals and financing during 2008-2012.

Elements of the investment climate that are critical to fostering PSD have not received adequate attention. Although ADB support for physical infrastructure has generally been substantial compared to other operations, more could be done to address gaps in electricity supply, which together with governance-related issues are key concerns of private entrepreneurs in DMCs. Some ADB-financed transport infrastructure projects did not optimize their potential for PSD contributions, as rural income generation, construction industry or logistics issues and constraints to private sector participation were not sufficiently addressed. Support for education to prepare a qualified workforce has been limited at less than 3% of total lending.

While ADB has provided significant support for promoting financial sector development and PPI, and improving fiscal and economic management, particularly during the 2008-2009 global economic crisis, its support for reforms seeking to reduce unnecessary regulatory transaction costs, enhance competition, improve the rule of law and property rights, and reduce corruption—though growing—remains low. Policy dialogue on pertinent issues requires substantial advocacy work in coordination with other development partners. Consultation with a broad range of relevant private sector representatives is crucial in the identification and design of specific regulatory reform measures. ADB has played a minor role in national donor-private sector forums seeking to promote business environment reforms.

A sound financial system is important for PSD and economic development in general. Given its role in inclusive and private sector-led growth, Strategy 2020 identified financial sector development as one of ADB's five core areas of operations, but did not set any specific quantitative targets for sector operations. Support for the development and reform of financial systems substantially declined since 2008 compared to earlier years despite it being one of ADB's core operational areas under Strategy 2020.

Business constraints vary according to firm size and ownership, but ADB strategies, analysis, and support lacked adequate differentiation to ensure greater inclusiveness. Small enterprises suffer from the same enabling environment constraints as larger enterprises, although enterprise surveys tend to report more problems with access to finance, business regulatory costs, and competition issues than large ones.

Meanwhile, rural entrepreneurs are particularly concerned about lack of rural connectivity and access to land, while female entrepreneurs have problems with access to finance and land, particularly in South Asia. There was little differentiation between various groups of entrepreneurs in ADB's analysis and approach to address group-specific constraints to business entry and operations. In general, there have been few synergies between ADB operations involving these groups and investment climate support.

Results

Success with business-relevant governance reforms has been mixed so far. Reforms related to business registration, tax administration, procurement systems, customs administration and other trade facilitation measures are showing promise as envisaged outputs in the form of good practice laws, regulations, processes or systems were largely achieved. Enterprise registration, customs clearance and tax filing times have been reduced and procurement has been made more transparent. Initiatives incorporating e-governance systems have been particularly useful in reducing delays and the scope for corruption by enhancing transparency, limiting direct interactions with the government bureaucracy, reducing opportunities for discretionary decision making, and increasing process efficiencies.

However, the achievement of meaningful development outcomes is not automatic and the impact of outputs on de facto business transaction costs and new enterprise formation, and ultimately on private sector activity, productivity and employment, will depend on adequate implementation, which in many cases is too early to assess. Moreover, improved performance indicators (such as the reduction of de jure rather than de facto costs) are required to assess reform effectiveness. For example, as business registration requirements were simplified and related costs declined, the number of business registrations and level of business density generally increased in supported DMCs. However, in some countries this growth leveled off after the first year or two. Due to a lack of relevant, differentiated data and the short period of operation of a number of new business registries, it could not be conclusively determined whether additional business registrations were the result of re-registrations mandated by new laws, formalization of previously informal businesses or actual new business entries, and to what extent they were triggered by changes in overall business conditions rather than changes in registration requirements.

Other supported reform areas included property rights and contract enforcement. Adopted land titling and administration reforms have yet to be fully implemented and translate into improved access to land and security of ownership. Issues encountered included cultural sensitivities (about the commercial use of communal land); lack of access by intended beneficiaries to information on document and process requirements; inadequate cadastral systems; and governance problems. Promoted alternative disputes resolution mechanisms have generally shortened the time taken for judicial decisions and improved pertinent private sector perceptions, although, in a few countries, issues related to institutional capacity and incentives continue to affect the quality and speed of judgments. The mixed success of efforts to establish good practice competition frameworks highlights the importance of stakeholder commitment to the underlying economic principles of market mechanisms.

ADB support for financial sector reforms had uneven results in improving private sector access to and costs of finance. ADB-supported banking sector reforms facilitated increases in private sector credit. However, in some of the supported DMCs,

interest rate margins, and thus financing costs for entrepreneurs, are still high due to continued macroeconomic uncertainty, continued lack of competition, lack of reliable credit and financial information on borrowers, inadequate risk management by banks, and, to a lesser extent, continuing interest rate distortions. Although lenders generally consider improved credit information to be more important for expanding outreach—including to previously excluded groups—, ADB focused on increasing the use of collateral through support for the development of secured transactions systems. While most related support achieved expected outputs, this might not necessarily be sufficient to significantly increase access to finance, unless other critical constraints are addressed as well. Evaluation evidence for other ADB efforts to increase financial inclusion through assistance for microfinance development indicates that ADB support helped ease regulatory and policy constraints, but was less focused on developing the capacity of the poor to access and use financial services and the development of pro-poor financial products and delivery models. Despite improvements in the legal and regulatory frameworks for securities markets, ADB support for capital market reforms did not significantly improve enterprise access to external equity or debt financing in a sustainable manner in part due to insufficiently addressed weaknesses in corporate and financial governance practices, regulatory enforcement, and debt recovery frameworks.

ADB support for public private partnerships has not yet resulted in significant increases in private participation in infrastructure investment and service provision due to lack of progress made with underlying sector reforms and investment climate concerns. Some success has been seen with the adoption of public private partnership (PPP) policies and laws and with the strengthening of PPP units in DMC governments and agencies. However, this has not translated into expected levels of actual PPP transactions mainly due to a lack of progress made with underlying sector reforms, regulatory capacity constraints, financial sector issues, and overall investment climate concerns of private investors and financiers. IED findings indicate that private participation is unlikely to materialize on a large scale without recourse to comprehensive government guarantees unless sector risks are adequately mitigated, i.e., sectors are sufficiently restructured, adequate incentives for government procurement agencies are in place, tariffs for network infrastructure services reflect costs, regulatory structures are robust and decision making is transparent and predictable, and laws and policies are in place to control risks associated with land acquisition.

ADB had comparatively little effective policy dialogue on sector restructuring and regulatory reform outside the power sector, where ADB's engagement has also been declining, due to sector agencies' lack of reform incentives and resistance to tariff reforms, particularly in the water sector. ADB had limited policy dialogue on the separation of regulatory, operating, and procurement functions of government sector agencies deciding on private sector investments because required reform measures lacked the necessary support from key stakeholders. This has particularly affected the scope for private participation in the transport sector. Institutional incentives of sector agencies encouraged public procurement options. Value for money analysis, which can help establish the benefits of public procurement versus procurement options involving private infrastructure, has only been receiving more attention from DMC governments and ADB during the last few years. While ADB support helped establish or strengthen sector regulators in a number of DMCs, their effectiveness has been reduced by a lack of political and/or fiscal autonomy, which was not sufficiently discussed during ADB's policy dialogue. Tariff reforms as well as sector restructuring including private participation require strong regulatory oversight. Regulatory lag slowed the progress of sector reforms and likely increased economic costs. Reforms of legal and policy

frameworks governing land acquisition by governments or the private sector in conjunction with infrastructure projects, received little attention from ADB despite their importance for more private infrastructure investments.

The effectiveness of PSD enabling environment reforms varied depending on a range of factors, primarily the levels of government and stakeholder commitment and the quality of the overall governance environment. Reforms worked best when introduced in conjunction with general governance, public administration, and civil service reforms, which can reinforce reform momentum and sustainability, as they determine underlying institutional incentives for implementation and enforcement. Nevertheless, there appears to be some merit in piloting public administration-related reforms in one ministry or government agency where institutional resistance is less pronounced and to use the results to catalyze wider reform efforts.

Existing government capacity was helpful, but not a necessary condition for project success, as demonstrated by ADB's experience in the Pacific. The design of institutional reforms needs to consider a country's institutional capacity, incentives for change, and vested interests. There is likely to be need for complementary advocacy and capacity development support. The development of any business-related reforms has to seek inputs from private sector stakeholders. As with any reform effort, continued stakeholder involvement and systematic monitoring are necessary to ensure relevance and implementation. Regulatory impact assessments, which are being introduced by a number of DMCs with ADB support, should help prevent the adoption of unnecessarily costly regulation and facilitate buy-in.

Apart from high levels of government reform commitment and institutional incentives for change, a number of other generic factors influenced the success of ADB's enabling environment reform support. These factors included: (i) best practice designs (e.g., credit information systems that are mandatory and full file, secured transactions systems that permit out-of-court enforcement of collateral, and business registries that minimize contact with administrators); (ii) recognition of the links between different areas of the investment climate and the need for complementary reforms; (iii) the selection of sustainable systems that are adopted to local conditions, in particular financial and human resource levels (as was the case for many company and secured transactions registries in the Pacific region); (iv) the provision of long-term support throughout the reform process, including implementation; and (v) the selection of effective consultants advising on reforms.

Institutional Performance

Internal coordination and support mechanisms for PSD have been weak. Linkages between sector and PSD objectives and activities were not explicitly and systematically recognized in the 2006 revised strategic framework, sector and country partnership strategies (CPSs), project designs, and related results frameworks. This negatively affected the mainstreaming of PSD objectives in ADB's operations and ADB support was not always properly sequenced or coordinated within and or across sectors, or systematically screened for PSD relevance and impact. Furthermore, the usefulness of private sector assessments as a basis for policy dialogue and for selecting and prioritizing country-level PSD support has varied. The current staff skills base would appear to be insufficient to cope with the inherent challenges of meeting the corporate target for PSD-related support and more staff training is required to facilitate the incorporation of PSD concerns throughout ADB's operations. Recent capacity additions were largely limited to private sector transactions. ADB does not have any institutional

focal point to provide consistent guidance on investment climate and business-related regulatory or governance issues and promote internal coordination with other relevant communities of practice and between the various operational and knowledge departments working on PSD topics.

Synergies between enabling environment support and PSO have been weak.

Although the PSDS and the revised PSD framework emphasize the need for ADB enabling environment support and PSO to be mutually reinforcing, there have been few linkages so far outside the energy sector, where sector reforms have stimulated PSO. The share of PSO related to any ADB enabling environment support has not increased since approval of Strategy 2020 despite the improved incorporation of PSO in country strategies.

Operational Implications

The study suggests a range of measures to further improve the relevance and effectiveness of ADB support for improving the private sector enabling environment. The key ones are summarized below. While a number of recommendations will likely require additional technical assistance (TA) resources, most measures can be achieved through a reallocation of existing human and financial resources.

- (i) **Create an ADB-wide focal point** to provide operational support on investment climate and business regulatory issues, promote information exchange, coordinate work of existing sector and thematic communities of practice on private sector issues, and organize staff training.
- (ii) **Strengthen the quality and use of private sector assessments** by (a) using standardized templates; (b) prioritizing PSA recommendations according to a transparent methodology; (c) supporting key recommendations with economic cost-benefit analysis to enhance buy-in and development effectiveness; and (d) identifying areas for PSD-related ADB support considering country priorities and needs, the activities of other development partners and complementarities with other ADB operations.
- (iii) **Increase the inclusiveness of PSD enabling environment support** through (a) consideration of specific constraints to entrepreneurship and business operations for informal, small, rural, or female entrepreneurs in PSA analysis and recommendations; (b) an operational focus on alleviating business constraints for such groups; and (c) the inclusion of relevant benchmarks for projects seeking to strengthen the enabling business environment for these groups in design and monitoring frameworks.
- (iv) **Strengthen ADB support for business regulatory and governance reforms** by (a) increasing ADB contributions to advocacy efforts; (b) increasing levels of advisory and investment support for reforms that lower unnecessary regulatory and transaction costs for private businesses, reduce the scope for corruption, improve competition, and strengthen property rights; (c) following good practice approaches attuned to local conditions, using appropriate institutional incentives; (d) focusing project design and monitoring on the achievement of meaningful reform outcomes rather than merely policy actions and outputs, and ensuring the collection of relevant data; (e) providing adequate support to facilitate reform implementation; (f) promoting

- the use of e-governance systems and regulatory impact assessments; and (g) providing implementation support for PSD-relevant mitigation measures identified in governance risk assessments.
- (v) **Address underlying issues that affect private sector financing access and costs** through (a) continued policy dialogue on financial sector reform including rectifying causes of interest rate distortions, strengthening financial market competition and regulation, strengthening financial market supervision and regulatory enforcement, improving frameworks for financial and corporate governance, and developing functioning secured transaction and bankruptcy regimes; and (b) more support for improving credit information and credit risk management systems, and financial literacy programs.
 - (vi) **Mainstream PSD in ADB's core operations** through (a) systematic consideration in CPSs and sector road maps of actual and potential private business contributions to sector development, sector-specific PSD issues including those related to the enabling environment, and sector contributions to PSD; (b) an increase in the share of infrastructure, finance, and education support that seeks to enhance private sector contributions and impact; (c) systematic identification of any private sector impacts in project approval documents; and (d) inclusion of meaningful PSD-related outcome and impact indicators in the design and monitoring frameworks for all projects with PSD classification, together with the identification of complementary efforts required by ADB or others to achieve the stated private sector impacts.
 - (vii) **Help improve the enabling environment for ADB's private infrastructure and PPP programs** through (a) adequate support for underlying sector reforms and other relevant investment climate reforms; (b) appropriate sequencing of such interventions and PPI support in sector strategies and road maps; (c) the provision of long-term support to build regulatory capacity and facilitate enforcement and the promotion of value for money analysis to help improve economic returns of PPI.
 - (viii) **Improve synergies between enabling environment support and private sector operations** through the provision of adequate enabling environment support for key areas of PSO.

CHAPTER 1

Introduction

A. Private Sector Development and Inclusive Growth

1. The private sector plays a key role in the development process of most developing member countries (DMCs).¹ Profit seeking and competition among private firms drive innovation and economic growth. The private sector is expected to help address infrastructure investment gaps in the region and improve the efficiency of public service delivery.

2. Inclusive growth entails broadening access to economic opportunities by the poor and other disadvantaged groups, including women, through (self) employment. Private sector enterprises, both formal and informal, provide the vast majority of jobs in most DMCs and are critical to any poverty reduction efforts. Particularly in low-income countries, the largest group of entrepreneurs more closely resembles wage workers than employers. These subsistence entrepreneurs operate in the informal sector with little potential to grow their businesses.² The challenge for policy makers is to create conditions that allow all types and sizes of enterprises and entrepreneurs to develop to the best of their potential and with the greatest benefits to the economy and society feasible.

B. The Importance of the Enabling Environment for Private Sector Development

3. The contributions that private firms can make to the economy are significantly determined by the underlying investment climate, which shapes the opportunities and incentives for firms to invest productively, expand, and create jobs. Key enabling factors for private businesses to function include (i) predictability (in particular political, policy and macroeconomic stability, security, and the rule of law); (ii) clear property rights and their registration and enforcement; (iii) efficient government regulation and taxation; (iv) a level playing field for state-owned enterprises (SOEs) and private companies, domestic and foreign companies, and among private companies; (v) functioning financial markets; (vi) accessible, affordable, and efficient infrastructure services; and (vii) a productive labor force. The relative importance of the various factors will differ from country to country and from enterprise to enterprise. Linked document 1 summarizes research findings on the impact of institutional quality (in particular adequate governance and regulatory systems and the rule of law), access to finance and infrastructure provision on private sector development.

4. Governments have a crucial role in providing a conducive enabling environment for private sector activities by ensuring the predictability and functioning of the policy and legal environment, adequate market competition, the availability of public goods and services required by businesses, a functioning finance system, the efficient and transparent

¹ For the purpose of this study, private sector is defined as the part of the national economy that is not owned or operated by the state. The term encompasses privately owned for-profit enterprises engaged in the production of goods and services.

² McKenzie, David and Christopher Woodruff. 2008. Experimental Evidence on Returns to Capital and Access to Finance in Mexico. *World Bank Economic Review*. 22 (3). pp. 457–482.

regulation and taxation of private enterprises, and the development of a healthy workforce through investments in education and health.

C. Relevant ADB Corporate Strategies

5. ADB's Private Sector Development Strategy (PSDS), which was approved in 2000, sought to utilize the capabilities of its public and private sector operations to deliver synergistic solutions to problems that impede private sector growth in DMCs and to leverage private sector contributions to poverty reduction. While ADB's private sector operations (PSO) were to primarily catalyze private investments, for public sector operations, the strategy had two thrusts: (i) to support DMC governments in creating enabling conditions for business; and (ii) to generate business opportunities in ADB-financed public sector projects through support for PPPs and privatization programs. Under PSDS, support for strengthening the enabling environment covered a wide range of interventions without prioritization, including efforts to improve macroeconomic policies; financial markets; competition frameworks; trade, judicial, and tax regimes; labor and land markets; and physical and social infrastructure. Enabling environment support was to be implemented mainly through policy dialogue in the above areas, with particular emphasis on strengthening public sector governance, financial intermediation, and public and private partnerships. PSDS was to be operationalized through the preparation of country-specific private sector development (PSD) strategies as part of country operational strategies, a core staff of PSD specialists, and systematic screening of projects to ensure that public sector projects incorporated elements that promote a better business environment.

6. Despite approval of PSDS, public sector lending for PSD, including for the promotion of an enabling business environment, stagnated from 2001 to 2005. An internal ADB review of PSDS found a number of issues with regard to its design, such as (i) the absence of an implementation plan and effective monitoring mechanisms, including performance indicators and targets; (ii) an insufficient emphasis on the role of public sector goods and services in facilitating private investment. There were also issues with the implementation of PSDS, such as (i) weak leadership (i.e., the continuous downgrading of the key oversight function for PSD, which indicated to staff that PSD was not a high priority at ADB); (ii) inadequate attention paid to the quality of country partnership strategy (CPS) documents; and (iii) a limited skills base and limited teamwork between regional departments and the Private Sector Operations Department (PSOD).

7. A revised strategic framework for PSD was approved in 2006 to enhance ADB's efforts to meet the growing and diversifying needs for PSD in DMCs. The revised framework contained a number of actions to address identified issues, including (i) the establishment and prioritization of PSD as a core theme in ADB's corporate strategy, (ii) improvements in the quality and depth of diagnostic work on themes during CPS preparation, (iii) the incorporation of themes in sector road maps, (iv) the systematic screening of ADB operations for PSD content, (v) a clear reporting framework, and (vi) improved coordination between PSOD and regional departments during CPS preparation and skills development in the areas of institutional analysis and policy reforms related to PSD. In addition, the second PSDS thrust—to generate business opportunities—was replaced with a new thrust—to promote public sector goods and services to increase PPP support and public non-sovereign operations—although the PSD relevance of the latter is unclear. The revised strategic framework also seeks to improve and expand ADB's support for policy reforms and institutional development for private sector development and emphasizes an integrated approach for actions in the three thrust areas. The scope of ADB support areas under the first thrust, i.e., establishment of an enabling environment for PSD, was more tightly defined, covering relevant policy and institutional reforms in public sector management,

finance, and investment and trade, as well as efforts to ensure greater involvement of the private sector in productive services and the provision of public services.

8. ADB's long-term corporate strategy (Strategy 2020), which was prepared in 2008, confirmed the strategic importance of ADB support for PSD by committing to a substantial increase in related operations. It identifies PSD as one of the drivers of change and states that ADB, among other measures, will invest in infrastructure and advise governments on the basics of a business-friendly environment, including reliable rules, regulations, and policies that do not disadvantage private enterprises. Strategy 2020 assumes that by 2020, 50% of ADB's assistance will support PSD and PSO. Support for strengthening the enabling environment for PSD is an integral part of this effort, although no specific sub-target has been set for such support.

D. Evaluation Rationale and Approach

9. The thematic evaluation study seeks to understand how ADB has been contributing towards PSD by improving the enabling environment for private sector businesses to identify ways of enhancing such efforts in line with Strategy 2020 objectives. The study specifically assesses

- (i) the responsiveness of post 2000 corporate and country-level strategies and assistance allocations with regard to addressing investment climate issues—based on a review of corporate and selected country strategies as well as portfolio analysis (chapter 1: “strategic relevance”);³
- (ii) the relevance and preliminary results of ADB projects approved from 2001-2102 in the operational areas defined as enabling environment support under the 2006 revised strategic framework for PSD⁴—based on available evaluation reports as well as desk and selective in-country reviews of projects (chapter 2: “results”); and
- (iii) related ADB institutional capacity and performance—based on a review of strategic and operational guidance provided to staff, staff skills, internal coordination mechanisms, project identification mechanisms and results monitoring (chapter 3: “institutional performance”).

10. All chapters of this study identify a range of lessons and implications for ADB's future operations in PSD. An evaluation framework is included in Linked document 2 (Table A2.1).

11. Assessments were based on (i) desk reviews of ADB project and strategic documents, (ii) an analysis of (self)-evaluation reports, (iii) a review of ADB project and skills databases, (iv) a review of literature and databases on PSD in DMCs,⁵ (v) a survey of and interviews with selected ADB staff, (vi) feedback obtained from government and private sector representatives in selected countries that have received substantial assistance

³ The study reviewed PSD-relevant country strategies and assistance programs for Bangladesh, Cambodia, India, the Kyrgyz Republic, the Philippines, and Solomon Islands. This coverage of countries considered: (i) DMCs that account for a large share of ADB assistance for strengthening the enabling environment for PSD or where such assistance figures prominently in the overall country portfolio; (ii) DMCs at different stages of PSD, including transitional economies; (iii) different conceptual approaches to PSD; and (iv) adequate geographic spread and representation of Asian Development Fund and ordinary capital resources countries.

⁴ Enabling environment support areas include public sector management and governance, trade and investment, financial market development, and private participation in infrastructure development (PPI).

⁵ The evaluation study also made use of existing indicators, including from the Doing Business database, Enterprise Surveys, Investment Climate Assessments, Global Competitiveness Reports, and Worldwide Governance Indicators databases, to measure results.

from ADB for PSD to confirm the relevance and effectiveness of ADB assistance strategies and programs, and (vii) in-country reviews of selected projects in various DMCs.⁶

12. The evaluation study has several limitations with regard to analyzing the results of ADB support due to: (i) attribution problems given the multitude of external factors affecting impact and, in some cases, outcomes; (ii) the paucity of available data to reliably assess project outcomes; and (iii) the ongoing nature of a number of assistance programs, which only allows the assessment of interim results in some cases. ADB's likely contributions to PSD were determined on the basis of actual output and outcome attainments along results chains that link project inputs to development impacts. The basic results chain underlying the evaluation framework for this study is outlined in Linked document 2 (Figure A2.1)

⁶ In addition to projects in Bangladesh, Cambodia, India, the Kyrgyz Republic, the Philippines, and Solomon Islands, the evaluation team reviewed PPI-relevant projects in Indonesia as well as ADB-financed projects supporting access to finance and land, business legislation and registration, and business development schemes in Tonga and Vanuatu.

CHAPTER 2

Strategic Relevance of ADB Support

13. This chapter assesses the responsiveness of ADB's corporate- and country-level strategies and assistance programs for enabling environment support to private sector constraints and government PSD priorities. It identifies enabling environment constraints in DMCs on the basis of enterprise surveys, literature review, and other stakeholder feedback and ascertains to what extent these are being addressed by ADB support on the basis of portfolio analysis and a review of ADB strategies and actual programs in selected case study countries.

A. Enabling Environment Concerns in Developing Member Countries

14. Entrepreneurs are in the best position to assess issues that affect their performance. Tables A3.1 and A3.2 in Linked document 3 show how entrepreneurs in DMCs perceive various constraints to their business operations. The data are derived from the latest enterprise surveys conducted by the World Economic Forum⁷ and the World Bank in these countries.⁸ World Bank and World Economic Forum survey findings for the same topic vary in a number of instances given differences in the survey populations, options, and timing.⁹ However, some of the survey results should not be over-interpreted. There are a number of enabling environment factors that do not register as significant concerns because they do not affect all of the businesses surveyed (e.g., customs and trade regulations) or are not captured explicitly by the surveys, but are very important to those businesses and possibly to the economy as a whole (e.g., macroeconomic stability, internet access). In addition, enterprise surveys only target incumbent enterprises rather than informal enterprises or enterprises that have gone out of business, so issues constraining

⁷ The World Economic Forum has conducted its annual Executive Opinion Survey for over 40 years, modifying it over time to capture new data points essential to the Global Competitive Index and other Forum indexes. It has also expanded the scope of its sample to over 15,000 surveys in almost 150 economies between January and June 2012. The Survey is a tool that aims to capture crucial information that is not otherwise available on a global scale. Response options for perceived business constraints include: access to financing, corruption, crime and theft, foreign currency regulations, government instability and coups, inadequate supply of infrastructure, inadequately educated work force, inefficient government bureaucracy, inflation, policy instability, poor public health, poor work ethic in the national labor force, restrictive labor regulations, tax administration, and tax rates.

⁸ The World Bank enterprise surveys are composed of representative random samples of firms. The sampling universe is composed of the manufacturing and service sectors, including retail wholesale hospitality and IT. The sectors of construction, transport, and communication are also included. Samples have broad in-country coverage typically centralized in the major centers of economic activity of a country. Data are collected across the world using the same core questionnaire and the same sampling methodology. Response options for perceived business constraints include access to finance; business licensing and permits; corruption; crime, theft, and disorder; court system; customs and trade regulations; electricity; inadequately educated work force; labor regulations; practices of competitors in the informal sector; tax administration; tax rates; and transportation. Data is typically collected on a 3 to 4 year rotation.

⁹ Although they seek to cover a range of different types of enterprises, the World Economic Forum surveys tend to be more indicative of obstacles faced by larger domestic companies engaged in trade, as well as international companies operating in the country than the World Bank enterprise surveys.

business entry and exit might not be adequately captured. Moreover, respondents are likely to give answers that reflect constraints on their bottom line rather than broader welfare implications. Tax rates and labor regulations are survey areas that are likely to be affected by this bias.¹⁰

15. Despite these limitations, the surveys give a fairly accurate and consistent overview of pressing concerns of the private sector in the region, which match issues raised by private sector representatives in case study countries during discussions with the study team. Moreover, they tend to reflect relative costs of business impediments. For example, investment climate surveys in Cambodia indicate that production lost due to power outages accounts for about 3.8% of total sales, bribes for about 4.7%, and payment for security and production lost to crime a combined 1.8% in 2007. In India, production lost to power outages accounted for 7.8% of total sales, bribes for 2.1% and payment for security and production lost to crime a combined 1.5% in 2006.¹¹ In both cases, this corresponds to enterprise survey findings on the relative severity of these business constraints. Studies on critical constraints to growth in the case study countries come to similar conclusions with regard to issues associated with inadequate infrastructure, corruption, human resource constraints (Bangladesh), governance (Philippines), regulatory uncertainty (India), and the rule of law (Cambodia).¹²

16. **Corruption and bureaucratic inefficiency are leading business concerns.** The order of top constraints experienced by businesses in Asia varies according to the source, but impediments include corruption, red tape and inefficient government bureaucracy, lack of a level playing field and competition, inadequate access to finance, inadequate supply of infrastructure, and lack of an adequately educated workforce. However, according to both surveys, corruption is perceived to be a major constraint to doing business in more DMCs than any other constraint (Tables A3.1 and A3.2). The World Economic Forum also seeks private sector views on other governance-related business constraints, including inefficient government bureaucracy and policy instability, which were seen to be among the three most problematic business environment factors. By comparison, the World Bank enterprise surveys seek more differentiated feedback on the quality of the business regulatory environment by a range of topic areas, including business licensing and permits, customs and trade regulations, and labor regulations, which might explain the lower individual rankings. Another question asked only by the World Bank surveys relates to unfair business practices (“practices of competitors in the informal sector”), which were identified as a major concern, particularly by SMEs, in more than a third of DMCs. The types of business constraints considered as severe in most DMCs by World Economic Forum survey respondents were: (i) inefficient government bureaucracy, (ii) corruption, and (iii) access to financing. According to World Bank enterprise survey results, the top constraints relate to: (i) corruption, (ii) electricity, and (iii) tax rates. When asked to identify the “biggest obstacle” to doing business (as opposed to a range of “major constraints”), lack of electricity is perceived to be the most severe business constraint in seven of 27 surveyed DMCs, ahead of access to finance (six DMCs). More detailed survey findings indicate that access to finance is a bigger concern for most enterprises than the cost of finance.

¹⁰ Vinod Thomas and Xubei Luo. 2012. *Multilateral Banks and the Development Process: Vital Links in the Results Chain*. New Brunswick.

¹¹ Cambodia 2007 Investment Climate Survey and www.enterprisesurvey.org

¹² World Bank. 2009. *Sustaining Rapid Growth in a Challenging Environment – draft Cambodia Country Economic Memorandum*; Rahman, J. and A. Yusuf. *Economic growth in Bangladesh: Experience and policy priorities*; Wei Li, Taye Mengistae, Lixin Colin Xu. 2011. *Diagnosing Development Bottlenecks: China and India*. Policy Research Working Paper 5641. The World Bank; ADB. 2007. *Philippines: Critical Development Constraints*. Manila; and Alessandro Magnoli Bocchi. 2008. *Rising Growth, Declining Investment: The Puzzle of the Philippines*. World Bank Policy Research Working Paper 4472, with the latter pointing out the economic problems associated with a rent-seeking conglomerate economy.

17. **Lack of electricity is seen as a more severe constraint than inadequate transport infrastructure.** Survey findings that differentiate between electricity and transport infrastructure constraints imply that inadequate electricity supplies have been more problematic for entrepreneurs than lack of transport infrastructure in all DMCs except Armenia, Bhutan, Mongolia, Tonga, and Viet Nam. This finding can be partly explained by the fact that until recently, surveys mainly covered entrepreneurs located in urban areas. Newer surveys that cover the views of rural entrepreneurs show lack of transport connectivity as more of a concern. However, lack of access to reliable power supplies is still perceived to be the more serious issue for enterprise performance by comparison. Insufficient and unreliable power supplies significantly impact small and rural enterprises, which are less able to pay for the purchase of a generator and related running costs.

18. **Perceived business constraints vary according to firm size and ownership.** Small, new, and domestic enterprises report to be significantly affected by investment climate issues, in particular lack of access to finance and land,¹³ inadequate and unreliable electricity supplies, and lack of competition. While larger firms spend significantly more time dealing with officials and red tape, micro and small firms have less access to formal finance, pay disproportionately more in bribes, and face greater interruptions in infrastructure services.¹⁴ The 2009 enterprise survey for the Philippines found that more bribery was reported by smaller companies that accessed informal sources of credit and by firms in cities with high poverty incidence. The same is likely to be true for informal enterprises, which are not covered by the above survey or any other standardized enterprise surveys. Although these types of enterprises are not formally recognized, they likely interact with government institutions in the course of their business. Business environments also affect male and female entrepreneurs differently. Female-run companies, particularly in South Asia, report greater problems with regard to access to finance and land. Financial access problems are substantial for micro, small, and medium enterprises (MSMEs), in particular those enterprises that operate in the informal sector. The International Finance Corporation (IFC) and McKinsey & Company estimated the value of the gap in formal SME credit at \$250 billion–\$310 billion in East Asia, the equivalent of 11%–14% of the total formal SME credit outstanding in that region, while the financing gap in South Asia was estimated at \$30 billion–\$40 billion, or the equivalent of 29%–35% of outstanding SME credit there.¹⁵ By comparison, the financing gap for non-formalized SMEs and microenterprises is significantly higher in these two regions, and is estimated to be about one trillion dollars for all DMCs, including Central Asian countries.

19. **The implications of enterprise survey results for decision makers are not always clear-cut** as private sector concerns are one of many considerations for public policy and investment decisions, which have to balance private sector, economic, environmental, and social development needs to maximize overall benefits to society. Tax rates are a case in point. While private entrepreneurs generally prefer these to be low, tax rates, like labor regulations, will ultimately need to be determined by each country based on its social preferences. Also, tax rates have implications for the level of fiscal revenues and the provision of public services, including infrastructure and education, which will affect conditions for doing business. Reducing regulation is not always better for society, and

¹³ Using enterprise survey data, research by the World Bank confirms that SMEs are more likely to be credit constrained than large firms. They are also more likely to use trade credit and informal sources of finance as funds for investment and working capital. Although size is a significant predictor of the probability of being credit constrained, firm age is not. High performing firms measured by labor productivity are less likely to be credit constrained, as are firms in countries with high private credit to GDP ratios. Source: V. Kuntchev, R. Ramalho, J. Rodríguez-Meza, and J. Yang. 2005. *What have we learned from the Enterprise Surveys regarding access to finance by SMEs?* Washington DC: The World Bank.

¹⁴ R. Aterido, M. Hallward-Driemeier and C. Pages. 2007. *Investment Climate and Employment Growth: The Impact of Access to Finance, Corruption and Regulations Across Firms*. IDB Working Paper No. 527.

¹⁵ Source: IFC and McKinsey & Company. 2010. *Two trillion and counting*. Washington, DC: IFC.

there are optimal degrees of regulation (footnote 10). Enterprise survey results will thus have to be considered together with the priorities of other stakeholders and other analysis in determining interventions to support PSD.

20. **Higher levels of economic development are associated with generally improved investment climate conditions.** While growth enables larger investments in physical and social infrastructure and government capacity, it is likely that growth in turn is facilitated by improved quality of institutions, infrastructure, and human resources. Table 1 shows a high correlation between DMC country groupings as per ADB's classification system, which is largely based on countries' per capita income and creditworthiness levels, and scores obtained in a wide range of different global competitiveness categories that approximate the quality of investment climate conditions. Moreover, while infrastructure and human resources constraints are key impediments to Asian Development Fund (ADF) countries' global competitiveness as reflected by the low scores in these areas, the relative importance of improvements in institutional quality increases for ordinary capital resource (OCR)-only countries that have reached the efficiency-driven stage of development.¹⁶ The largest gaps in scores between OCR countries and countries that have graduated from ADB assistance are in this area, infrastructure and higher education and training.

Table 1: Average Scores for Selected Global Competitiveness Components by DMC Status

Global Competitiveness Category /DMC Status	ADF only Countries (Group A)	Blend Countries (Group B)	OCR-only Countries (Group C)	Countries Graduated from ADB Assistance
Institutions	3.50	3.64	4.03	5.15
Infrastructure	2.54	3.20	4.09	6.22
Macroeconomic Environment	4.12	4.28	5.57	5.97
Health and Primary Education	5.14	5.31	5.87	6.48
Higher Education and Training	3.42	3.55	4.28	5.60
Goods Market Efficiency	4.01	4.16	4.41	5.26
Financial Market Development	3.67	3.73	4.33	5.20

ADB = Asian Development Bank; ADF = Asian Development Fund; DMC = developing member country; OCR = ordinary capital resource.

Note: Scores measured on a 1 to 7 scale with 7 being the best rating.

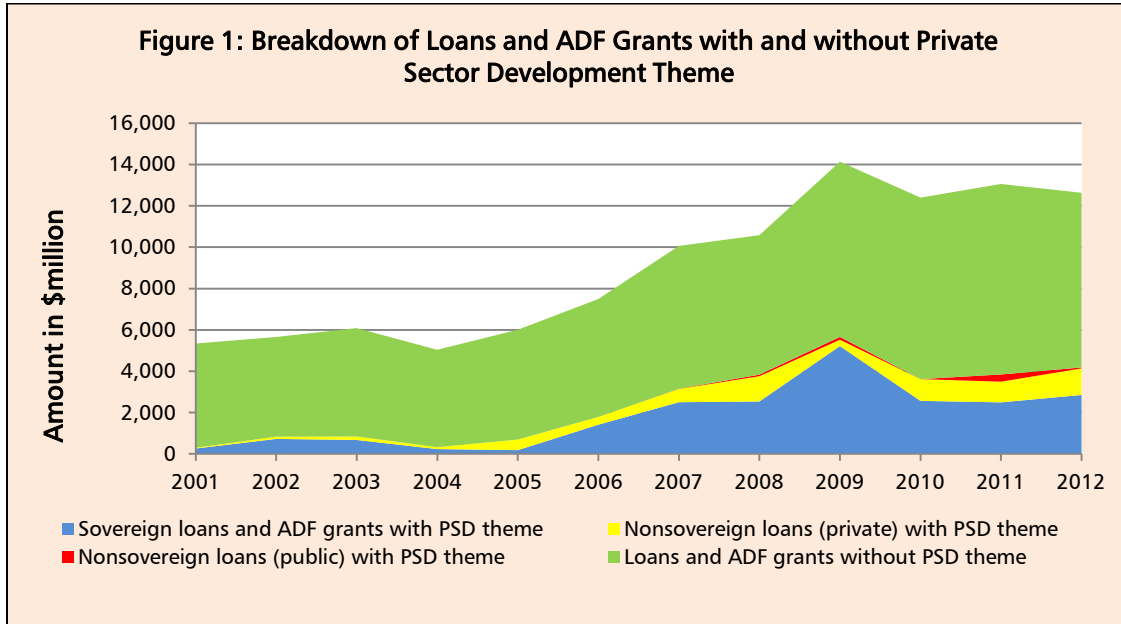
Source: Independent Evaluation Department calculations using competitiveness scores from World Economic Forum. 2012. *The Global Competitiveness Report 2012–2013*.

B. Findings from Portfolio Analysis

21. **The level of PSD-related ADB operations increased after 2006.** From 2001 to 2012, ADB approved 357 loans and ADF grants with PSD objectives according to their thematic classification, including 243 public sector transactions, 8 non-sovereign (public) transactions, and 106 PSOD transactions in the total amount of \$29.1 billion accounting for about 27% of all loans and grants approved by ADB during this period in terms of numbers and value. The share of PSD-related operations in ADB's overall lending grew

¹⁶ Low-income countries are mainly *factor-driven economies*, competing based on their factor endowments—primarily low-skilled labor and natural resources—with their low productivity reflected in low wages. Maintaining competitiveness at this stage of development hinges primarily on institutions that ensure the functioning of basic factor markets, adequate infrastructure provision, a stable macroeconomic environment, and a healthy workforce with at least a basic education. As countries move into the *efficiency-driven* stage of development, they must begin to develop more efficient production processes and increase product quality because wages have risen and countries cannot increase prices in line without losing their market position. Competitiveness is increasingly driven by the presence of higher education and training, efficient goods markets, well-functioning labor markets, developed financial markets, the ability to harness the benefits of existing technologies, and a large domestic or foreign market. Development stages can vary significantly within large countries and among different industries and sectors. Adapted from: World Economic Forum. 2002 and 2012. *The Global Competitiveness Reports 2001–2002 and 2012–2013*.

substantially upon approval of the revised strategic framework for PSD in 2006. After increasing to 40% during 2009 (mainly as a result of ADB's economic crisis-related support), the share of loans and grants with a PSD theme came down to 29% of total financing volumes during 2010 and 2011 before increasing again in 2012 to 33% (Figure 1).



Source: ADB Project Database.

22. **The level of ADB policy and institutional support for strengthening PSD enabling environments has grown more slowly.** Based on the 2006 revised strategic framework, assistance for PSD-relevant policy reforms and institutional development would count as enabling environment support. If this definition is applied, ADB interventions to improve the enabling environment for PSD comprised 89 program and TA loans and grants with a PSD thematic classification in the total amount of \$8.2 billion, accounting for 8.1% of total ADB financial support from 2001 to 2012 and 28% of financial assistance with PSD objectives during that period (Table 2).¹⁷ A list of these projects is attached in Linked document 4, Table A4.1. The share of ADB operations involving such support increased from 3% during 2001–2005 to 10% of total ADB financial assistance during 2006–2012 after the revised strategic framework was approved, which was due to large increases in program lending with a PSD classification in the aftermath of the 2008 global economic crisis. Nevertheless, PSD-relevant investment support has been substantially larger and has grown faster than policy and institutional support.

23. **The exact level of PSD enabling environment support is unclear due to project classification issues.** It is difficult to gauge the exact extent of ADB support for strengthening the enabling environment for PSD as ADB neither used a consistent and precise definition for such support nor used any pertinent project classification category throughout the review period. Moreover, in most cases, measures and components directly relevant to PSD accounted for only a minor part of the overall policy agenda under crisis support programs. This is particularly true in the case of public sector management

¹⁷ This number is comparable to the number that would result if the PSD sub-classification policy support was used instead to identify enabling environment support. Since this sub-theme was only introduced in 2004, portfolio analysis in this study is based on the volumes of non-investment loans and grants with a PSD classification.

programs, which also address other issues that do not directly affect private entrepreneurs. However, a number of relevant public sector management, financial, and power sector reform programs did not have a PSD classification.¹⁸ The actual level of support for improving policy and institutional aspects of an enabling environment conducive to PSD might therefore be somewhat different than the above estimates, but likely not by a large margin as a more detailed analysis of case study country portfolios indicates.¹⁹ If assistance for indirect PSD enablers such as relevant energy, transport, and education investments is counted as well, levels of relevant support would increase substantially.²⁰

24. **ADB's policy and institutional support for PSD has focused on fiscal and economic management, financial sector reforms, and PPP development.** Policy and institutional support for strengthening the enabling environment for PSD was limited to a few sectors: public sector management and multi-sector (mainly support for cross-sector infrastructure PPP and general economic reform and stabilization programs in conjunction with crisis support), finance, energy, and industry and trade (Table 2). Support for governance and business regulatory reforms accounted for a small share of ADB's public sector management assistance, which mainly focused on public expenditure and fiscal management reforms, public administration reforms including public procurement, and SOE restructuring. Support for business regulatory reforms, which has emerged since 2006, included policy dialogue and investments aimed at (i) reducing business transaction costs related to business registration, tax, customs, and land administration and (ii) strengthening business laws and property rights. Only 11 of several hundred ADB loan projects approved during the review period were classified as supporting anti-corruption objectives. Only two of the five judicial reform projects included measures related to commercial issues. While ADB support for public sector management reform increased in absolute and relative terms the wake of the 2008 global economic crisis, support for financial sector development overall, and sector policy reforms in particular declined since 2008, despite finance being one of the designated core operational areas under Strategy 2020. ADB's assistance during the review period was largely focused on support for general financial sector reforms, mainly pertaining to capital markets, as well as measures to increase financial inclusion through improvements in the policy and regulatory environment for microfinance and the development of secured transactions regimes. With regard to infrastructure-related assistance, there has been comparatively little support for the development of sector-based regulatory, policy, and institutional frameworks for private infrastructure investments and PPPs. Also, ADB has only recently engaged in more

¹⁸ The majority of financial sector reform and microfinance and rural finance policy programs did not have a PSD classification. In the case of microfinance programs, most of them aim to improve the basic policy and regulatory framework for microfinance operations while expanding the scope of microfinance institutions' products and services. Supported financial sector reforms usually involved the development of regulatory and supervisory frameworks, in particular for capital markets operations and bank restructuring. There does not appear to be much difference in PSD relevance between financial sector operations that were classified as supporting PSD and those that were not. The share of reform support within the energy sector is underestimated by about 3% as several program loans did not have PSD classifications despite supporting sector unbundling and private sector participation. By comparison, few of the non-PSD classified public sector management programs are directly relevant to improving conditions for private business operations. For the case study countries, the levels of financial assistance for PSD-relevant policy and institutional support with and without PSD classification were similar.

¹⁹ Analysis undertaken for the case study countries found that ADB assistance components seeking to support business regulatory reforms accounted for less than 2% and components for other investment climate reforms for about 3% of total ADB lending in these countries, while assistance components supporting reforms to facilitate private participation in infrastructure development accounted for another 4%. This compares to a share of 7% of program and technical assistance loans and grants with PSD classification in total ADB financial assistance for the case study countries.

²⁰ A review of ADB project portfolios in the case study countries found that about 40% contributed to varying degrees toward improving the investment climate for private enterprises. About 70% of these projects involved support for PSD-relevant infrastructure and education investments. A list of relevant projects in the study countries is attached in Linked document 4, Table A4.3.

policy dialogue on the need to reduce the burden of electricity connection fees, which in some DMCs amount to double digit multiples of per capita incomes, a substantial amount for small entrepreneurs.

Table 2: PSD Enabling Environment Support as Share of Total Public Sector Financial Assistance by Sector, 2001–2012

	ANR	EDU	ENE	FIN	HSP	I&T	PSM	T&ICT	WS	MS	TOTAL
Total ADB financial assistance	7,439	2,932	21,503	7,682	1,373	1,221	15,012	32,514	8,463	10,894	109,034
Total nonsovereign financial assistance	49	8	4,878	1,524	30	125	0	838	517	0	7,968
Total public sector financial assistance (A)	7,390	2,924	16,625	6,159	1,343	1,096	15,012	31,676	7,947	10,894	101,066
Without PSD classification	6,675	2,796	11,459	4,251	1,278	660	10,382	26,925	7,035	7,931	79,391
With PSD classification	716	128	5,166	1,908	65	436	4,630	4,751	912	2,963	21,675
Investment support Policy/institutional	716	128	4,656	395	65	200	183	4,441	909	1,794	13,487
support (B)	0	0	510	1,513	0	236	4,447	310	3	1,169	8,188
PSD Enabling Environment Support as share of total public sector financial assistance (B/A)	0.0%	0.0%	3.1%	24.6%	0.0%	21.5%	29.6%	1.0%	0.0%	10.7%	8.1%

ANR = Agriculture and Natural Resources; EDU = Education ; ENE = Energy; FIN = Finance; HSP = Health and Social Protection; I&T = Industry and Trade; PSD = private sector development; PSM = Public Sector Management; T&ICT = Transport and ICT; WS = Water Supply and Other Municipal Infrastructure and Services; MS = Multisector

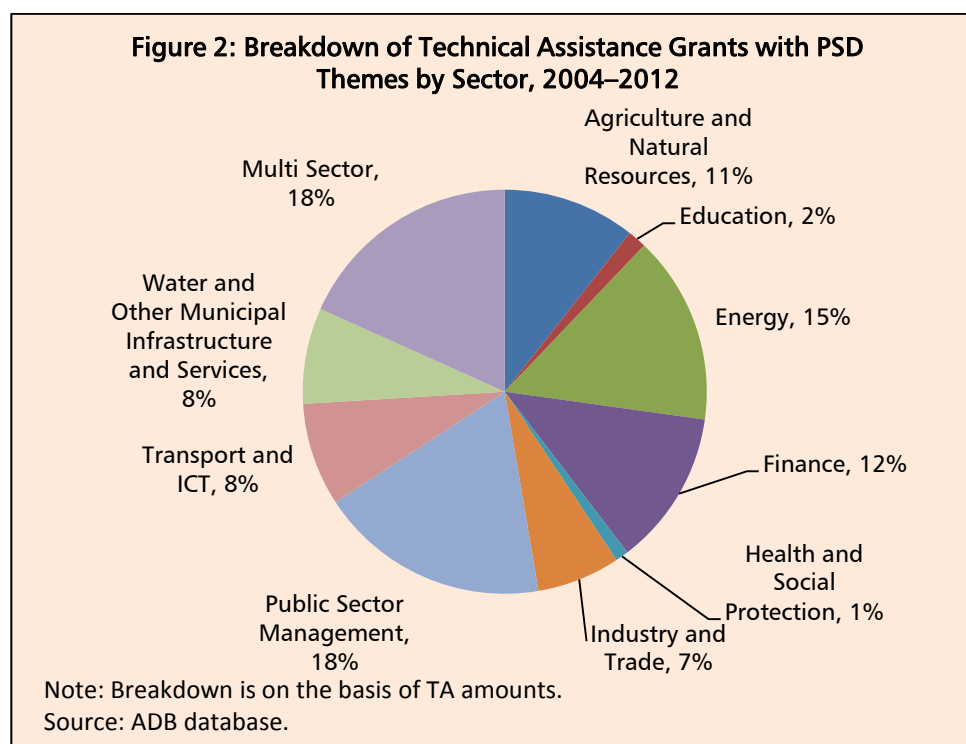
Source: ADB database.

25. **Little or no financial assistance for strengthening the policy and institutional environment for PSD was provided in the agriculture, education, health, transport, and urban sectors** despite the potential for private sector participation and impact.

26. **ADB's investment support did not adequately address critical elements of the investment climate.** ADB support for power sector investments was significantly smaller than support for transport sector investments despite its higher relevance from a private sector viewpoint. Despite Strategy 2020 intentions of increasing attention to education in general and the quality of technical education and vocational training and selected fields in tertiary education, the actual level of (sub)sector operations has stayed below these expectations. Education sector support accounted for less than 3% of ADB's total financial assistance during the review period, of which a total of 27% was provided for non-formal education, technical education and vocational training, and tertiary and higher education. Although some of these loans sought to better align education and training with private sector needs, none of them had stated PSD objectives and most supported public training or education institutions.

27. With regard to allocation by region, support for strengthening the enabling environment for PSD played a relatively larger role in ADB operations in Southeast and Central and West Asia than in the other three regions, in part because of the initially larger reform needs of the formerly transitional economies in Central Asia and Cambodia, the Lao People's Democratic Republic (PDR), and Viet Nam. Support related to business regulation, registration, property rights, and other regulatory reforms has been concentrated in the Pacific region, the formerly transitional economies in the Mekong Region, the Kyrgyz Republic, and the Philippines, while support for improving access to finance has been provided in other regions as well. ADB assistance for private infrastructure development has been focused on DMCs in South Asia and Southeast Asia, as well as Pakistan.

28. TA is indispensable for effective policy dialogue and institutional support. More than 313 TA projects approved from 2004–2012 in the total amount of \$375 million (accounting for 19% of total TA approvals and 21% of approved financing) had PSD objectives (Figure 2).²¹ Most of this TA involved efforts to (i) facilitate private participation in the development, construction, investment, or operations and maintenance of specific infrastructure projects in the power, gas, water, and transport sectors; (ii) design underlying sector regulatory reforms; (iii) create PPP frameworks; (iv) develop SME and agribusiness, including measures to improve the enabling business environment and provide assistance for targeted support schemes; and (v) improve access to finance (Linked document 4, Table A4.2). The TA for supporting PSD was spread more broadly across various sectors than financial assistance, as ADB has been exploring the use of PPP modalities outside transport and energy and has started to promote agribusiness development.



29. ADB's private sector operations (PSO) have contributed to improvements in the overall investment climate through financial support for private financial institutions and infrastructure providers and through the associated demonstration effects of private sector projects. PSO also included investment commitments for a credit information bureau in the Philippines and a credit guarantee company in the PRC.

30. Although six of the nine approved public sector non-sovereign transactions had private sector development objectives, the impact of these particular transactions on improving enabling conditions for private sector activity is likely to be small. Most of these transactions involved support for state financial institutions providing financing to private enterprises, as well as two infrastructure transactions.

²¹ Technical assistance did not have thematic classifications prior to 2004.

C. Findings from Country Case Studies

31. Government interest in investment climate reforms has been increasing.

Government strategies in the case study countries during the review period varied with regard to the emphasis given to PSD issues and measures to strengthen the enabling environment. Although national development plans in all of the study countries were based on the premise of private sector-led growth, employment, and expansion of economic opportunities for the poor, not all of them included specific strategies or measures to improve the conditions for PSO. While the 2004 Medium-Term Philippine Development Plan supported initiatives for SME development and PPI, it did not explicitly address enabling private sector environment concerns, which were only included in the 2011 Plan. The government nevertheless supported infrastructure development and technical/vocational training provision, and initiated governance, competition, tax, and business licensing reforms. The 10th and 11th development plans in India recognized the importance of an investor-friendly business environment, particularly for infrastructure development, and advocated a reduction in (rather than removal of) unnecessary restrictions on entrepreneurial initiative related to business entry, licensing, foreign direct investment, and trade. While the government prioritized infrastructure development and vocational and technical training ahead of financial sector development and regulatory reforms, governance and competition reforms were given only moderate attention until recently. Going forward, the Government of India, among other things, plans to adopt national competition and business regulation policies, introduce regulatory benchmarking and impact assessments, and promote single window systems.

32. In Bangladesh, the government has pursued a similar strategy of creating an open and competitive environment conducive to private investment, with particular emphasis on facilitating exports and the development of rural areas. It has sought to promote infrastructure development and the development of human resources while initiating a number of regulatory and governance reforms. In Cambodia, the government prioritized support for infrastructure and financial sector development ahead of governance, competition, and regulatory reforms, although the latter also received government attention, albeit at lower levels. Government strategies in Cambodia and the Kyrgyz Republic included measures seeking to improve the investment climate by removing major obstacles to doing business, including eliminating delays in approvals and high transaction costs, addressing trade issues affecting private sector activity, and enhancing the overall governance and judicial environment. In the Solomon Islands, the government prioritized infrastructure and financial sector development and undertook governance and SOE reforms. By comparison, property rights, business entry, and tax administration reforms were given less priority. For most of the study countries, governments perceived a higher need to transport sector investments than the private sector, whereas the private sector accorded more importance to governance reforms.

33. A range of external factors drove and guided government reforms, and ADB seized related openings for policy dialogue. For example, economic crisis facilitated buy-in for the implementation of fiscal and financial sector reforms in the Kyrgyz Republic. In Cambodia, commitments associated with World Trade Organization (WTO) membership led to the preparation and approval of new legal and regulatory frameworks and policy regimes related to trade, competition, foreign investment, and financial markets. Doing business, governance, and global competitiveness rankings influence foreign investors and public debate and prompted a number of case study country governments to initiate related reforms.

34. Governments' prioritization of reform measures was influenced as much by considerations of political expediency as by potential for PSD impact, particularly if the

latter was not clearly demonstrated and quantified. For example, there was more interest in undertaking reforms related to business entry, secured transactions, and property registration than reforms related to business exit, contract enforcement, and credit information, which are associated with greater potential to conflict with vested interests.

35. **ADB country strategies to address PSD issues were largely in line with government priorities.** According to feedback received from CPS team leaders, government priorities for ADB support were major considerations in selecting areas for ADB intervention related to PSD enabling environment support in all studied countries with the exception of Cambodia. In Bangladesh and India, government priorities were considered a more important basis for prioritization than the relative significance of enabling environment constraints.²² For most of the study countries, ADB staff saw a greater need for governance, competition, and tax and customs administration reforms than the respective governments, whereas governments perceived a higher need for power sector investments than ADB. ADB and government views on the importance of human resource development also differed from country to country.

36. ADB country strategies for PSD in Bangladesh and Cambodia focused on easing infrastructure bottlenecks (especially transport and power), building the foundations for a productive labor force, fostering PPPs, and improving the overall policy, legal, and governance environment. In Bangladesh, ADB also sought to nurture SMEs through assistance for business development and financial support schemes and to facilitate the restructuring of SOEs. In Cambodia, more emphasis was given to support for the creation of an enabling environment for all enterprises, including SMEs. The India country strategies prioritized support for PSD with a focus on mobilizing financial resources for private investments, removing infrastructure impediments, and creating an enabling environment for private participation in infrastructure (PPI) through reforms. There has been little support for other PSD-related reforms. The Kyrgyz country strategies for PSD focused on financial sector development, the development of trade and transport infrastructure, and improvements in the regulatory business environment. ADB's Philippines country strategies had a stronger emphasis on investment climate and governance reforms than government strategies at the time. In the Solomon Islands, ADB's strategic focus was on state enterprise reforms, the revision of commercial laws, and improvements in the frameworks for enterprise finance, business registration, tax, and customs administration.

37. **In all of the study countries ADB strategies sought to address some of the key constraints to doing business as perceived by private entrepreneurs.** The range of areas covered and level and depth of related ADB support varied between the study countries. While ADB support focused on few of the top business constraints in India, ADB aimed to address most of the perceived major business obstacles in Bangladesh, Cambodia, the Kyrgyz Republic, and the Philippines (Linked document 5, Tables A5a.–A5e.; Solomon Islands is not covered by the enterprise surveys). However, related assistance levels differed with substantially more resources and attention given to infrastructure concerns than to other issues. Less significant has been the level of support given to ameliorate business constraints related to governance, especially corruption, which figured among the top three private sector concerns for all study countries for which enterprise surveys were available. Also, the extent of governance-related reform support was somewhat lower than that of other development partners (e.g., regulatory reforms in Bangladesh).

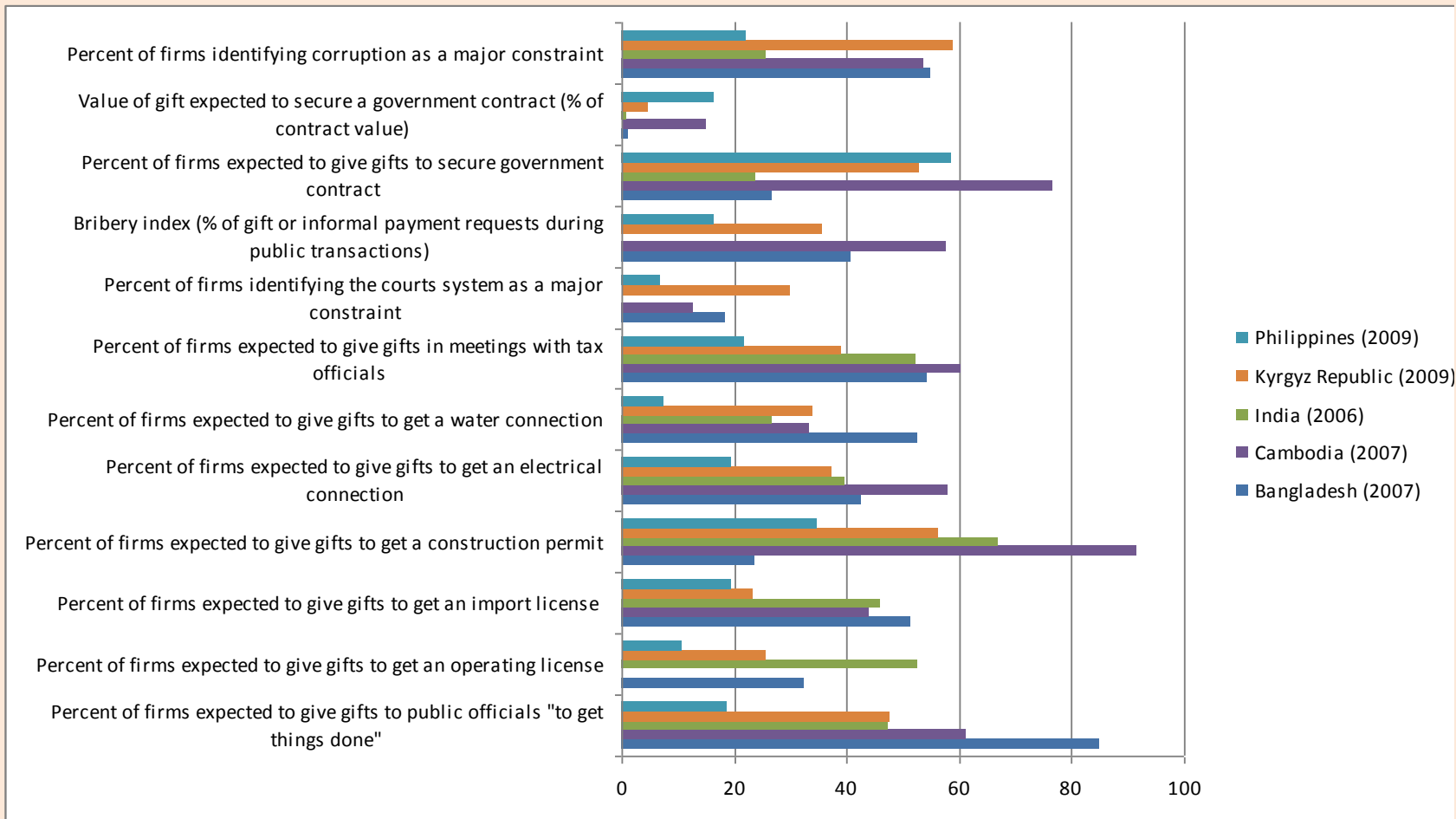
²² In India, the government generally has not sought external support to address governance and competition issues, which are key business environment concerns. In Bangladesh, the government prefers to receive financial intermediation loans from its development partners to help improve access to finance in lieu of support for sector reforms that would likely be more effective in addressing private sector concerns.

38. **Some key regulatory and governance-related business constraints remained unaddressed.** In Bangladesh, ADB policy dialogue and TA have been supporting the creation of an independent anti-corruption commission, and in a number of study countries, ADB has been providing support for streamlining government processes and institutions dealing with procurement (Cambodia and the Philippines), customs (the Kyrgyz Republic and, to a lesser extent, Cambodia and Solomon Islands), business licensing and registration (Cambodia, the Kyrgyz Republic, the Philippines, and Solomon Islands), tax administration (Bangladesh and the Kyrgyz Republic), or land registration (Cambodia and the Philippines), with the underlying objective of reducing scope for corruption and related transaction costs. ADB also promoted judicial reform with the aim of enhancing the speed and transparency of judicial decision processes (Cambodia, the Kyrgyz Republic, and the Philippines). The focus of ADB's support has been appropriate given enterprise perceptions of corruption related to government procurement in the Philippines and to tax administration and court systems in the Kyrgyz Republic (Figure 3). However, in a number of countries, major concerns related to corruption and red tape remained largely unaddressed. Examples are tax administration in Cambodia and India, which was not included in ADB's policy dialogue on public sector management in either of these two countries, and government procurement and permits in the Kyrgyz Republic.

39. **There has been emerging policy dialogue on domestic competition issues.** Competition and the creation of a level playing field are important private sector concerns in Cambodia, the Philippines, and the Kyrgyz Republic, as reflected in the high scores for "anticompetitive or informal practices." Large politically well-connected business groups have been allowed to dominate a number of industries as entry by foreign or smaller local companies has been effectively curtailed qua regulation or anti-competitive business practices. Associated ADB support for competition frameworks has been emerging in Cambodia and the Philippines. In the Kyrgyz Republic, ADB focused on leveling the playing field between state and private enterprises in terms of access to markets and finance. ADB conducted little policy dialogue on restrictions to foreign direct investment, which have significantly affected the competitive environment in India and the Philippines.

40. **Most PSD-relevant support was provided for wider investment climate issues related to infrastructure and finance.** In all study countries, ADB programs addressed issues related to lack of infrastructure provision and lack of access to finance, which also reflect the strategic importance of infrastructure and financial sector development as core operational areas under Strategy 2020. Inadequate power supplies have been a key concern for entrepreneurs in Bangladesh, Cambodia, India, the Kyrgyz Republic, and, to a lesser extent, the Philippines. Only in Bangladesh and the Philippines did ADB focus its infrastructure operations on power sector development, whereas most of ADB's infrastructure support in Cambodia, India, and the Kyrgyz Republic was for transport sector investments. This support was directed toward the improvement and rehabilitation of existing roads, although transportation was perceived to be less of a problem by entrepreneurs in all the countries than electricity (Linked document 3, Table A3.2). In Cambodia, the availability of cheaper funds from the PRC for power generation projects reduced government demand for sector-related ADB support, which accounted for less than 10% of total ADB lending in the country during the review period. In general, investment support by far exceeded policy and institutional support for infrastructure development. While ADB also provided substantial support for public-private partnerships in infrastructure by financing related financial institutions and project development facilities in Bangladesh, India, and the Philippines, policy and institutional support for underlying infrastructure reforms has significantly decreased in the power sector and remained low in other sectors.

Figure 3: Selected Corruption Challenges for Private Enterprises in Study Countries



Source: World Bank Enterprise Survey database.

41. ADB support for financial sector development in general and access issues in particular was less significant in terms of financial assistance volumes. ADB supported relevant policy reforms in Bangladesh (capital market development), Cambodia (microfinance regulation, credit information, secured transactions, and leasing), the Kyrgyz Republic (banking sector reforms, secured transactions, and capital market development), the Philippines (capital markets development and microfinance), and Solomon Islands (secured transactions). ADB also provided SME credit lines in Bangladesh, India, and the Philippines, which only in the case of the Philippines were associated with policy dialogue to address SME access constraints.

42. Lack of an educated labor force has been identified as a key business constraint in Cambodia and, to a lesser degree, in Bangladesh. Education sector support, including for vocational and technical training and skills development, accounted for more than 10% of ADB's financial assistance to these countries.

43. **Although ADB support for physical infrastructure investments has been substantial, its contributions to PSD have not been optimized.** PSD, as a theme, has not been mainstreamed in sector road maps. Although the importance of infrastructure development, public sector management reforms, and education for PSD was generally acknowledged in CPS documents, respective road maps and results frameworks usually contained very little reference to sector-specific issues that affect private sector activity in general and within the respective sector, or analysis on the impact of the overall investment climate on sector performance. Nor do they promote any concrete measures to strengthen the enabling environment for PSD. They also do not systematically consider actual and potential contributions of private businesses to sector development. Moreover, infrastructure projects, like projects in other sectors, are not systematically screened for PSD relevance and impact other than for PPP potential. While ADB support for the provision of physical infrastructure and related services led to improvements in related indicators and likely facilitated private sector-led economic growth in the case study countries, it is probable that such impact could have been even larger if it had been adequately recognized and realized through complementary measures by ADB or other development partners.²³

D. Operational Implications

44. **Strengthen definition of PSD enabling environment support and related project classifications.** Considering the existence of quantitative corporate targets for supporting

²³ Only seven of the 35 road projects approved in the case study countries during the review period had their potential impact on PSD identified in their approval documents. Four of these seven projects included complementary measures and/or linkages required to realize or enhance such envisaged private sector impact through the construction of cross-border customs facilities, tourism facilities, and service stations. No special consideration was given to other logistics aspects in these or the other road projects, including the quality of logistics services and informal road taxes or the potential for the development of the local construction industry. The Rural Infrastructure Project in Bangladesh included support for market infrastructure and linkages to income generation programs in its design. Also, a recent Japan Fund for Poverty Reduction-funded project in Cambodia (Grant No. 9156-CAM: Improving Market Access for the Poor in Central Cambodia) that involves the provision of business advisory, skills training, marketing support, and microfinance to micro and small enterprises, seeks to demonstrate how these micro and small enterprise development activities can be integrated into an ADB-financed rural road improvement program that had been approved earlier. Four of the seven available project completion reports for completed road projects, including the Bangladesh Rural Infrastructure Development Project, the India Rural Road Investment Program, the Madhya Pradesh State Roads Sector Development Program, and the Greater Mekong Subregion: Cambodia Road Improvement Project, identified and quantified (positive) PSD impacts, although only the Bangladesh and the Great Mekong Subregion projects included complementary measures in their design. The India projects, nevertheless, benefited from parallel government efforts to improve agricultural extension services and social infrastructure services.

PSD, a definition of PSD support and associated project classifications has to adequately capture relevant ADB contributions to facilitate monitoring of progress made vis-à-vis these targets and focus the attention of decision makers on appropriate issues to address. The 2009 PSD classification system comprised four PSD sub-themes: (i) policy reforms, (ii) private sector investments, (iii) PPP, and (iv) privatization. Most enabling environment support as defined under the revised 2006 strategic framework has been classified under the first PSD sub-theme, and a number of enabling environment projects were classified under other (sub)themes (mainly PPPs).

45. In June 2012, an internal PSD working group tasked to ensure a more accurate and consistent PSD classification,²⁴ recommended a realignment of the PSD sub-themes as follows: (i) establish a conducive policy and institutional environment; (ii) develop public sector goods and services essential for PSD over time; and (iii) promote private investment. This implies that ADB public sector power supply, transmission, or road projects that unlock a country's trade potential can now be classified as supporting PSD under the second sub-theme. To avoid an overstatement of PSD relevance, the working group qualified that the project's design and monitoring framework needed to explicitly demonstrate that the project's PSD contribution is an important component of total project impact and that the project will address constraints to PSD as identified in the CPS, the background binding constraints analysis study, and the private sector assessment (PSA). The accompanying staff instructions on the modification of the project classification system, which were issued in December 2012, specify that assignment of any PSD classification also requires that the design and monitoring framework (i) explicitly demonstrate linkages with PSD objectives and (ii) include related outcome or impact targets (for projects with PSD as a primary theme). However, it can be argued that this might not be enough. Most reviewed CPS documents considered infrastructure bottlenecks as a business constraint without much supporting analysis in sector road maps or PSAs. To ensure relevant consideration of PSD aspects within country strategies, the underlying binding constraints and PSA analysis have to be strengthened along the lines suggested in this report. Furthermore, supported PSD-classified programs and projects need to quantify anticipated benefits for private entrepreneurs to the extent feasible to arrive at more meaningful PSD outcome and impact targets.

46. **Increase enabling environment support to meet corporate lending target for PSD.** Given current headroom constraints and a strategic limit of a 25% share of aggregate operations exposure for non-sovereign operations, significant increases in PSD-relevant lending will have to come from ADB's public sector window. Under the 2012 redefinition of PSD support (para. 48), the existing 50% target under Strategy 2020 would appear to be achievable, although care needs to be taken to ensure the relevance and effectiveness of PSD-classified public sector investment projects. More efforts for improving the enabling environment for PSD, including by ADB, will be necessary to facilitate increases in ADB's non-sovereign operations and public investment support for PPPs.²⁵

47. **Further improve the relevance of ADB support for strengthening the enabling environment at the country level taking into account the relative severity of business constraints as perceived by entrepreneurs as well as economic costs and benefits associated with addressing them.** The relative significance of business constraints varies from country to country and according to enterprise size, age, location, and industry. An assessment of relative costs, together with structured feedback from entrepreneurs, can help identify and prioritize measures to strengthen the enabling environment for PSD. Cost-benefit analysis

²⁴ ADB. 2012. *Achieving Strategy 2020 Private Sector Development Objectives: Ensuring Accurate and Consistent Classification of Private Sector Development*. Internal PSD Working Group Report.

²⁵ Current volumes of ADB operations are significantly below the 50% target of Strategy 2020 for 2020. In 2011, 32% of total ADB operations funded from ordinary capital resources and special funds had a PSD classification.

can also help inform decisions about the most efficient operational approach to achieving the same development objective. For example, upgrading a national highway that runs from an economic center to a port or border might save between a few hours to a few days of transit time and related costs depending on the distance and the state of the road prior to improvement. By comparison, customs reforms can reduce the transit time for traded goods by several weeks at much lower expense.

48. Recognize and address governance issues. Perception surveys suggest that corruption in many DMCs is pervasive and impedes investment. In three of the study countries (i.e., Bangladesh, Cambodia, and the Kyrgyz Republic) more than half of firms surveyed in 2007 and 2009 considered corruption to be a major constraint for the operation and growth of their business. A large percentage of them reported having to make informal payments to “get things done.” A reduction in unnecessary regulatory and administrative requirements reduces the scope for rent-seeking by officials. ADB has provided comparatively little support for related reforms and measures to address competition and general governance issues, which are critical constraints to economic growth in a number of countries. Governance risk assessments identify risk mitigation measures that need to be followed up on with adequate TA, relevant investment support, and continued policy dialogue. Such measures will also facilitate financial sector development and PPI. Besides investments in new administrative systems, ADB should support improvements in the governance environment for PSD through policy dialogue and advisory work in coordination with other development partners.

49. Mainstream enabling environment support for PSD. Regardless of whether they have a PSD classification or not, the potential impact on the private sector of ADB projects supporting public investments needs to be adequately considered. Otherwise, economic benefits of such investments arising from increases in private sector activities might fall short of their potential. For example, in the case of physical infrastructure investments that seek to facilitate trade (e.g., regional transport corridors and roads to ports), it has to be ensured that key logistics issues are also addressed by governments and necessary support is provided by either ADB or other development partners.²⁶ Also, there is need for supporting the development of the local construction industry capacity for building infrastructure and participating in international competitive bids for public and private infrastructure projects. Another example is projects involving the modernization of land or tax administration with the objective of increasing fiscal revenues, which need to also explicitly recognize their potential positive impact on private businesses. Potential synergies and complementarities should be identified and realized. This needs to be done through (i) systematic consideration of actual and potential contributions of private businesses to sector development and sector-specific PSD issues, including those related to the enabling environment and potential sector contributions to PSD in country partnership strategies and sector road maps; (ii) identification of any PSD-related impacts in all reports and recommendations to the President; (iii) inclusion of private sector-related outcome and impact indicators in the design and monitoring frameworks for all projects with PSD classification; and (iv) arrangements that ensure the implementation of required complementary measures by ADB, the government, or other development partners to realize envisaged private sector impacts.

50. Promote ADB’s inclusive growth agenda within PSD enabling environment support. So far, most of ADB’s support has not explicitly considered the special needs of small, rural, and female-run businesses and it has not involved differentiated approaches to address group-specific constraints to business entry and operations. In general, there have been

²⁶ For example, in Cambodia logistics costs per kilometer are reported to be twice as high as in Viet Nam in part due to informal payments, including for road checks.

few synergies between ADB operations involving these groups and investment climate support. For example, only four projects with PSD classification sought to also promote gender equality. In addition, ADB support that sought to promote SME development did not necessarily identify or address relevant enabling environment concerns, but instead focused on targeted assistance schemes involving the provision of credit or business development services. Going forward, more differentiated approaches will have to be developed to ensure that enabling environment constraints of smaller, rural, and female-run businesses are adequately addressed. Moreover, there is a case for prior, or at least parallel, support for critical enabling environment reforms to enhance the effectiveness of any targeted schemes and policies (Linked document 6).

CHAPTER 3

Results

51. This chapter assesses the relevance and preliminary results of ADB projects in the operational areas defined as enabling environment support under the 2006 revised strategic framework for PSD, including governance and public sector management, trade and investment, financial sector development, and the incorporation of the private sector in key productive areas and public goods and services. The latter area comprises ADB support for privatization and private participation in infrastructure development.

A. Improving Governance and Public Sector Management

52. Analysis in the following section draws on available (self)-evaluation studies, project progress reports, project reviews in case study countries, and literature review. The focus is on those ADB governance and public sector management operations that have direct relevance for private sector investment and business activities in recipient DMCs.

1. Improving overall governance frameworks

53. ADB provided comparatively little direct support for Governments to address governance and corruption issues in a systematic and cross-cutting manner. Even fewer of these projects have been evaluated. For example, ADB capacity building support for the newly established anti-corruption commission in Indonesia helped strengthen its internal processes, which helped the commission to successfully pursue several hundred corruption cases contributing to improvements in corruption perceptions. Apart from project-based support, ADB has also sought to advance policy dialogue on governance issues through governance risk assessments.²⁷ As of December 2012, 30 country and 74 sector-level governance risks assessments have been completed. IED is undertaking its first in-depth evaluation of ADB's governance support for completion in 2014, which, among other things, will review the effectiveness of these assessments and other project support.

54. The limited experience gained with relevant ADB support in the TES case study countries highlights the challenges involved. Reform measures initiated to deal with corruption in Bangladesh showed initial promise, but have yet to be fully implemented. To tackle the issue of corruption and rent-seeking behavior by public officials, the government set up the Anti-Corruption Commission under the Anti-Corruption Commission Act passed in February 2004. The World Bank and ADB provided support for the establishment of the Anti-Corruption Commission. ADB policy support contributed to the formulation of a national integrity framework, including the approval of whistleblower legislation, stronger focus on administrative justice, and a number of actions to strengthen the justice system. This has helped improve the country's rankings in World Bank governance indicators related to control of corruption and the rule of law since 2006. The country's Transparency International Corruption Perceptions Index score also increased from 2.0 in 2007 to 2.7 in 2011. This, in turn, improved private (including foreign) investors' perception of the country, which contributed to increases in capital investments. However, reforms in this

²⁷ Following the approval of the Governance and Anti-corruption Action Plan in 2006, governance risk assessments have been conducted at country, sector, and project levels by the regional departments and have focused on three themes: public financial management, procurement, and anti-corruption measures.

area appear to have stalled, as reflected in a reduced CPI score of 2.6 for 2012. Draft amendments of the Anti-Corruption Commission Act proposed to reverse the commission's independence from government. Also, approval of the National Integrity Strategy, which seeks to provide a system of governance that creates trust among citizens, has been pending.²⁸ Given slow reform progress, release of the third tranche under ADB's Good Governance Program has been substantially delayed (by more than 52 months as of October 2013).

55. ADB has mainly sought to reduce the scope for corruption and improve bureaucratic efficiencies in the areas of business licensing and tax, customs, and land administration through support for policy reforms and the introduction of new processes and systems. These are assessed in the following sections.

2. Improving public procurement

56. **ADB support for procurement reforms generally delivered envisaged outputs, but achievement of meaningful outcomes will depend on improvements in overall governance environment and institutional capacity.** Public procurement accounts for about half of global GDP, reflecting its importance to private sector activity. Enterprise survey results indicate that bribes are expected in most DMCs to obtain government contracts, with values often exceeding 10% of contract value. Reducing the scope for corruption in public procurement would not only help save fiscal resources and improve compliance with regulations, including those related to environmental, health, and safety concerns, but would also reduce transaction costs for private enterprises and enhance the predictability of procurement processes. ADB has supported public procurement reforms mainly through policy dialogue in conjunction with program loans, advisory TA, and participation in country government procurement assessments.

57. A review of the ADB's assistance for procurement reforms reveals some of the difficulties of implementing new legal and institutional frameworks. In Indonesia, ADB support helped bring national procurement procedures in line with international practice, establish the Indonesian National Public Procurement Agency, and prepare a full set of standard bidding documents. Progress made with the implementation of an e-procurement system has been very promising. However, institutions charged with overseeing procurement practices remain weak with low staffing levels, overlapping responsibilities, and endemic corruption in the auditing bodies, which, taken together with contradictory regulations and turf battles within the Indonesian bureaucracy, creates an environment that potentially undermines procurement reform.²⁹ In Nepal, ADB supported the Public Procurement Monitoring Office in the development of standard bidding documents, the procurement website, policy documents for a strategic procurement framework, guidelines, manuals, training modules, and an e-government procurement system, although actual implementation remains uncertain given the office's lack of capacity and resources. In Mongolia, ADB helped implement procurement legislation through comprehensive capacity development for the central procurement policy and coordination department, a working division in the Ministry of Finance. Previously, the department did not have the necessary

²⁸ The National Integrity Strategy includes several elements: (i) strengthening the relevant institutions of accountability such as the Electoral Commission, Parliament, and Judiciary; (ii) making effective use of civil society, media, and the private sector as partners in formulating and implementing governance reforms, including, in particular, measures to improve the allocation and use of government expenditure; (iii) strengthening current internal control measures across selected public sector agencies; (iv) developing an ethics-and values-based foundation for the public service to complement the existing rules-based systems; and (v) determining selectively strategic measures against forms of corruption that will be identified through a broad-based consultation.

²⁹ E. Aspinall and G. van Klinken, ed. 2011. *The State and Illegality in Indonesia*. Honolulu, HI: University of Hawaii Press. pp. 141–166.

autonomy and credibility to effectively fulfill its strategic role and its involvement throughout the entire procurement cycle created inefficiencies, delays, and overlaps with line agencies. A 2010 review of the procurement system undertaken in cooperation with ADB and the World Bank identified the need for improved institutional and human capacity in public procurement as well as for improved transparency and public awareness. More than a third of tenders received were rejected, which indicates the need for private sector training. An earlier evaluation of ADB support for procurement reforms in the PRC found that it had helped establish a sound and unified legal framework for government procurement consistent with international practice. Ensuing implementation was not assessed. With regard to ADB support in the case study countries, ADB policy dialogue contributed to the increased posting of bid notices and awards on the Philippines Government Electronic Procurement System and the development of basic procedures for public procurement in Cambodia. The 2012 country procurement assessment report for the Philippines showed significant improvements in procurement operations, market practices, and the transparency of the procurement system. The 2012 governance risk assessment for Cambodia highlights the continued lack of a unified set of procurement rules and procedures, skilled human resources, and adequate enforcement.

3. Improving payment of taxes

58. Complexity, instability, and enforcement are the three ways in which taxation affects the transaction costs of businesses. The number of taxes, the timing of tax reporting and payment, the basis for calculation, and exemptions determine the amount of complexity. The more complex the tax system, the more resources businesses must expend on calculation and compliance. If the rules of taxation are continually changing, then enterprises incur transaction costs in learning and complying with new systems. If the rules are fixed but their application is discretionary, enterprises incur extra costs on long-term planning, making both coordination and information collection more costly. If enforcement is strong, the transaction costs imposed by the tax system's complexity and instability will be unavoidable. If enforcement is weak, then these costs may be avoided. However, tax avoidance has its own set of transaction costs. Firms often maintain two or more sets of books, pay off tax inspectors, and hold more cash. About half of surveyed enterprises in DMCs reported that they were expected to give gifts in their meetings with tax officials. Very high rates, complex rules, and weak enforcement all lead to significant tax avoidance and encourage informality.

59. There are many possible approaches and avenues to successfully reduce administrative burdens associated with taxes, including regulatory reform, organizational and process re-design, and the effective use of information and communication technologies. Efforts to make tax collection more efficient and reduce administrative costs for taxpayers usually include one or more of these measures: (i) standard business reporting (and similarly focused initiatives) that eliminate duplicated reporting obligations to government and automate its transmission; (ii) single "one stop shop" government registration and numbering for businesses and citizens, and the associated ability to update registration data; and (iii) mechanisms for more effective sharing of information across government, thereby eliminating the need for unnecessary requests to businesses and citizens.³⁰ Automation will also help reduce contact between taxpayers and tax authorities and minimize opportunities for corruption.

³⁰ Organisation for Economic Co-operation and Development Forum on Tax Administration: Taxpayer Services Sub-group. March 2010. *Information Note: Programmes to Reduce the Administrative Burden of Tax Regulations – Follow-up Report by OECD Center for Tax Policy and Administration*. <http://www.oecd.org/tax/administration/44972185.pdf>

60. **Most ADB support for tax administration reforms is likely to reduce enterprise transaction costs related to tax payments.** ADB support primarily focused on tax enforcement rather than issues related to complexity and instability. ADB helped seven DMCs strengthen their tax administration. In India, ADB support for process reengineering and capacity development led to an improved risk-based selection of tax cases for further scrutiny and to an increase in the transparency and efficiency of excise tax audits and compliance verification, which reduced arbitrariness and enhanced efficiency of indirect and direct tax administration. In Indonesia, electronic filing of returns, improved taxpayer rights, and monitoring of tax administration halved the time spent preparing, filing, and paying taxes, which resulted in improved enterprise perceptions of tax administration with regard to doing business. In the Kyrgyz Republic, the rollout of the new integrated tax administration system and related software development is still underway, but initial measures, including the introduction of an e-filing system, have helped reduce tax filing times. In Viet Nam, a new online tax filing system is being rolled out to more provinces, but tax payment times have not been significantly reduced in the pilot locations. Also, tax reforms have yet to significantly improve efficiency in tax collections. The automation of tax administration functions in Tajikistan was unsuccessful as basic foundations for an effective tax administration, including staff skills and a functional operational structure, are not in place. Furthermore, the new system was introduced in one go without a pilot—despite limited absorptive capacity. In Bangladesh and the Maldives, where ADB has been supporting e-filing systems, implementation is still underway.

4. Improving property rights

61. **Support for land administration reforms has been relevant but highly politicized, with uncertain results so far.** ADB has supported land legislation and registration reforms in Afghanistan, Bangladesh, Cambodia, the Federated States of Micronesia, Kiribati, the Philippines, Samoa, and Viet Nam. In Afghanistan, ADB support contributed to the preparation of a new land policy, which was approved in 2007. ADB also helped successfully pilot a community-based pasture land administration approach, but no funds could be found to finance a nationwide rollout. Support in Cambodia for land titling did not significantly increase access of the rural population to land in part due to a number of insufficiently addressed issues including (i) governance problems affecting land redistribution, which led to the granting of economic land concessions for the development of agro-industrial plantations; (ii) a lack of harmonized cadastral procedures; and (iii) poor access by the rural population to relevant information on document and process requirements. The effectiveness of support for reforming land registries, surveys, and mapping systems in the Federal States of Micronesia has varied in line with local government commitment to the process. Its impact on private sector access to credit is not yet clear. Program preparatory technical assistance for similar reforms in Kiribati and Samoa has not yet resulted in any concrete reform measures due to lack of broad-based political support. In Viet Nam, ADB policy dialogue supported 2003 government land legislation that promulgated a uniform system of land certificate issuance, simplified land registration, improved use of idle land, and property market development. Although the new law granted greater land tenure security, implementation issues have constrained enterprise access to land.³¹ Support for land registration reforms in Bangladesh and the Philippines is too recent to assess results. With regard to facilitating land ownership by women, several ADB-supported disaster rehabilitation and resettlement programs ensured that female heads of households received the land title deed to the new house regardless of whether

³¹ As the uniform land registration system has not yet been rolled out nationwide, the implementation of simplified procedures for issuing land use rights certificates has been uneven with the process taking longer than targeted. Many obstacles remain, especially with regard to obtaining land for new projects or changing land use. Also, the mandatory release of the master land use plan to the public within 30 days of its publication has not been adequately complied with.

they previously held the land title. Outreach measures included special legal aid centers to help women generate and file required documentation and information campaigns.

Box 1: Lesson – Land Reform

Land reforms are difficult to implement, but potentially high-reward. Land reform is one of the most difficult policy reform areas, a fact demonstrated repeatedly by the stop-and-go experiences of ADB TA projects on land regulation in Samoa, Kiribati, and beyond. The simultaneous difficulty and importance of land management forces a program design trilemma: (i) leave it alone, (ii) tinker around the edges (e.g., design financial instruments but don't engage in reform), or (iii) make the big investment of time and money to support reform. The first and last are approaches with a historical track record, and show the level of risk and reward. The middle option is not as well tested, and may be unrealistic as a way to escape the all-or-nothing nature of the main options. But it would be worth further study, given the progress (admittedly, not always happy) in real estate-related financial innovation around the world. Eventually, it all comes down to whether non-freehold land can really be alienated or not. But until that fraught issue is finally resolved, there are likely to be intermediate steps that improve on existing experiments with leasehold mortgages and the like.

5. Improving contract enforcement and dispute resolution

62. **Limited ADB support focused on capacity development for court systems and the development of alternative dispute resolution mechanisms, with uneven results so far.** An essential element of a market system is a legal framework and judiciary that provide market participants with confidence that decisions concerning ownership and contracts will be made impartially and objectively according to clearly established rules. However, contract enforcement and dispute resolution usually take several years or are associated with high costs in about half of ADB's DMCs. ADB has sought to address this important issue in six DMCs so far, including Cambodia, Indonesia, the Kyrgyz Republic, the Lao PDR, Pakistan, and the Philippines. In all of these assisted countries, private sector perceptions of the efficiency of the legal framework for settling disputes improved according to the executive surveys of the World Economic Forum, with the largest improvements registered in Cambodia, Pakistan, and the Philippines.

63. Common features of judicial reforms relating to commercial dispute resolution have included updating claim thresholds, introducing case management systems and automation, creating specialized commercial courts, making judgments publicly available, allocating more resources to the judiciary, as well as training judges, although comparatively little was done to change underlying incentives for judges, which reduced the effectiveness of related support in a number of cases. ADB support also focused on the development and implementation of alternative dispute resolution mechanisms, particularly arbitration. Supported reform measures usually resulted in a reduction of the age of the case (in the most extreme case from 15 years to as low as 3 years for some district courts in Pakistan, which was helped by the introduction of small causes courts). While promoted out-of court settlement mechanisms will likely be mostly successful in the assisted DMCs, there have been issues related to the capacity of arbitrators, and delays caused by the requirement that arbitration decisions be formally recognized by courts.

64. For example, in Cambodia, where ADB promoted the creation of an appropriate legal basis for commercial arbitration and the establishment of a national arbitration center, some observers find the center's staffing (mainly college graduates with little legal training or experience) unsuitable for dealing with complex cases and consider it an unlikely alternative to the court system for resolving commercial disputes. Moreover, the Commercial Contract Law has yet to be passed, and draft legislation for the establishment

of commercial courts has been pending due to perceived inconsistencies with the country's constitution.

65. In the Kyrgyz Republic, ADB supported a comprehensive diagnostic assessment of judicial problems, a streamlining of court appellate procedures, increased transparency through the publication of court proceedings, and the introduction of out-of-court arbitration. There have been substantial achievements in this area, and the 2010 European Bank for Reconstruction and Development (EBRD) Judicial Decisions Assessment found that Kyrgyz courts' decisions were above the regional Commonwealth of Independent States average in terms of quality of decision, predictability, speed, cost, enforcement, and impartiality. However, the Judicial Decisions Assessment also identified remaining challenges, including variable standards of judicial decisions, allegations of corruption, occasional slow proceedings due to heavy caseloads, and lack of effective enforcement mechanisms. Out-of-court settlements still need to be confirmed by a court, which takes time. According to the World Bank worldwide governance indicators, international perception of the rule of law in the country has been low since 2006.

66. Judicial reform support in the Philippines helped reduce the average duration of cases in lower courts from 3 to 2 years. It also helped reduce the large backlog of court cases through continuous trial implementation, capacity building for court staff, and increased reliance on court annexed mediation, including arbitration nationwide. ADB also successfully promoted the use of alternative dispute resolution through the establishment of an alternative dispute office at the Department of Justice.

67. ADB policy dialogue on international arbitration legislation to help attract foreign investment and financing for private infrastructure projects was limited to Pakistan, and results are uncertain so far.³²

6. Strengthening the macro-economic environment

68. **Sizable countercyclical crisis support during the recent global economic crisis together with general budget support under ADB program loans helped mitigate short-term macroeconomic instability** and supplemented country resources for implementing reforms. Macroeconomic stability increases the predictability of the business investment and operational environment. An IED study assessing ADB's crisis support facilities concluded that ADB's financial support for governments' fiscal stimulus packages helped lessen the short-term macroeconomic impacts of the recent global economic crisis.³³ With regard to the case study countries under this TES, ADB crisis support helped Bangladesh, the Philippines, and Solomon Islands cope with the immediate impact of the recent global economic crisis, although it can be argued that in the case of Bangladesh, there was no compelling need to use high-cost external funds for budget support given fiscal and macroeconomic developments during the second half of 2009. It is likely that support for the government's fiscal stimulus program in the Philippines did not crowd out private

³² The International Investment Disputes Act was enacted in 2011 to implement the International Convention on the Settlement of Investment Disputes between states and nationals of other states, with an aim to bringing transparency in the settlement of investment disputes. In addition to this Act, Pakistan is also preparing the enactment of two statutes relating to international arbitration. The first—a law to enforce the New York Convention—was enacted in 2011. The second—a new arbitration act based on the United Nations Commission on International Trade Law Model Law—has been pending before the National Assembly since 2009.

³³ Independent Evaluation Department. 2011. *Real Time Evaluation: of ADB's Response to the Global Economic Crisis 2008–2009*. Manila: ADB.

investment.³⁴ Similar research is not available for the Solomon Islands. While the Kyrgyz Republic and Cambodia did not draw on ADB's crisis facility, they nevertheless received budget support under program loans during that time, which helped Cambodia rebuild fiscal space in the aftermath of the crisis. The Kyrgyz Republic experienced significant political disturbance during 2010, exacerbating the effects of the earlier global economic crisis and leading to significant reconstruction needs and a worsening fiscal position.

69. **By comparison, regular ADB support that focused on strengthening the policy and institutional frameworks for public expenditure and fiscal management was less effective** due to lack of government buy-in, capacity issues, and changes in the political environment (Table 3). Public sector management projects aiming to improve overall economic management were more successful, in particular multi-donor development policy support programs that were based on a wider range of government economic reform priorities.

Table 3: Evaluation Ratings for Economic and Fiscal Management approved from 2001–2012 by Subsector

	Success rate (%)	Available (self)-evaluations (#)	Approved projects (#)
Countercyclical support	80%	5	5
Public expenditure and fiscal management	13%	8	28
Economic and public affairs management	73%	11	23

Source: IED database.

70. ADB support for fiscal reforms in the case study countries was largely limited to India and the Philippines, with the exception of a few TA projects and policy dialogue that contributed to improvements in public debt and financial management in Cambodia and strengthened revenue administration in the Kyrgyz Republic. In the Philippines, ADB contributed toward improvements in the country's fiscal sustainability through support for reductions in public sector deficits, more efficient and transparent tax revenue administration, increases in value-added tax, a strengthened institutional reporting framework for public financial management, and anticorruption measures in revenue agencies. In India, support was limited to a few selected states where it helped consolidate finances in Assam and Mizoram, but failed to do so in Kerala.

B. Facilitating Investment and Trade

71. Analysis in the following section draws on available (self)-evaluation studies, project progress reports, and project reviews in case study countries Tonga and Vanuatu.

1. Improving business registration

72. Early empirical evidence found that the new entry of formal businesses grows two to four times faster when regulation is relaxed and the administrative process simplified. As a result, business registration reforms have been an integral part of institutional reform agendas related to strengthening the enabling business environment. Doing Business indicators for business start-up costs and time have been used as level 1 indicators in ADB's development effectiveness results framework and for the purpose of determining performance-based allocations for ADF recipients.

³⁴ Analysis by the Economic Relations Division indicates that government spending had a positive long-term impact on private investment in the People's Republic of China, Indonesia, and the Philippines, but a negative impact in India and Thailand. ADB. 2010. Seok-Kyun Hur, Sushanta Mallick, and Donghyun Park. *Fiscal Policy and Crowding Out in Developing Asia*. ADB Economics Working Paper Series No. 222. Manila:ADB.

73. Good practices for business registration include a number of features, such as low or no minimum capital requirements; a single interface; a unique company identification number; a computerized registry; and easy access to forms and fee schedules. Minimum capital requirements for limited companies should be commensurate with national economic conditions and should not unnecessarily restrict business entry. Single interfaces for business start-ups not only save time and money, but they can also make procedural requirements more transparent and easier to access. While some one-stop shops are solely for business registration, others carry out many integrated functions, including post-registration formalities with tax authorities or municipalities. Some one-stop shops are virtual; others are physical, with one or more windows. Some one-stop shops automatically forward information from the company registry to the licensing authority, some include separate desks with representatives from different agencies, and others provide a single electronic interface for entrepreneurs.³⁵

74. **ADB support was effective in increasing the number of business registrations. Its impact on business formation, formalization, and performance, however, could not be assessed.** During the review period, ADB promoted business registration reforms in nine DMCs, with a focus on a simplification of registration procedures, single interface registration, online registration, and improvements in access to company information. The results have been mainly positive so far (Table 4 and Linked document 7, Table A7.1). New electronic registries in Armenia and the Philippines have not been fully implemented yet. Interventions reduced de jure start-up times and cost and improved access to company information in the other 7 assisted DMCs, although subsequent new requirements in Cambodia increased registration time from 35 days in 2011 to 104 days in 2012 and costs from 110.5% to 150.6% of income per capita.³⁶ In Cambodia, Indonesia, and the Lao PDR, registration times or costs are still far higher than worldwide average levels, resulting in comparatively low Doing Business rankings. Nevertheless, the level of company registrations increased in all these countries,³⁷ although the relative contribution of various other factors, such as economic growth, is unclear. It remains to be seen whether business entry rates continue to increase, as they have done in the Kyrgyz Republic. International experience with the introduction of improved company registries suggests a slowdown in new enterprise registrations once the initial backlog has been cleared. Cases in point are Cambodia and Tonga, where registrations peaked shortly upon the introduction of new registries before coming down again. In addition, financial sustainability has been an issue for company registries in the Pacific as company registration fees as high as one third of annual per capita GDP have not been sufficient to fully finance the operating costs of the registries. The impact of increased business registrations on new businesses start-ups, the formalization of informal enterprises, and enterprise performance and growth could not be assessed due to a lack of relevant data. Available data do not distinguish between registrations due to re-registrations mandated by new laws, formalizations of previously informal businesses, and actual new business entries. Also, whether improved business registration practices translate into better enterprise performance needs to be further assessed through systematic enterprise surveys considering, for example, that formalization is a necessary but not sufficient condition for access to formal credit and government services. In a number of assisted DMCs, complementary reforms measures are ongoing.

³⁵ The World Bank Group. *Starting a Business: Good Practices*. <http://www.doingbusiness.org/data/exploretopics/starting-a-business/good%20practices>

³⁶ Cambodia made starting a business more difficult by introducing a requirement for a company name check at the Department of Intellectual Property and by increasing the costs both for getting registration documents approved and stamped by the Phnom Penh Tax Department and for completing incorporation with the commercial registrar.

³⁷ Although no business density rates are available for Viet Nam, firm registrations steadily increased by 20% to 30% from 2006 to 2009 following approval of new business registration procedures.

Table 4: Cost and Time Associated with Registering a Business in DMCs with ADB Support for Business Entry Reform

	Time (days)		Cost (% of income per capita)		Paid-in minimum capital (% of income per capita)		Business density*	
	2003	2012	2003	2012	2003	2012	2004	2011
Armenia	18	4	8.4	1.1	5.4	0.0	1.26	1.12
Cambodia	94	104	480.1	150.6	394.0	27.5	0.13	0.22
Indonesia	168	48	136.7	20.5	69.1	38.5	0.14	0.27
Kyrgyz Republic	21	8	12.5	2.7	0.7	0.0	0.7	0.95
Lao PDR	153	92	23.9	6.7	32.1	0.0	0.13	0.22
Philippines	49	35	28.6	18.7	2.3	4.6	0.26	0.19
Solomon Islands	56	9	145.5	47.5	0.0	0.0	NA	0.1
Tonga	32	16	16.1	7.7	0.0	0.0	2.05	1.96
Viet Nam	59	34	31.9	7.7	0.0	0.0	NA	9.57

■ = improvements ■ = little or no change ■ = deterioration.

* Number of newly registered limited liability companies per 1000 working age population

ADB = Asian Development Bank; DMC = developing member country; Lao PDR = Lao People's Democratic Republic.

Source: The Doing Business Project of the World Bank Group. <http://www.doingbusiness.org> as of 31 October 2013

Box 2: Lessons - Business Entry Reforms

Business registration reforms need to be accompanied by other reforms to sustainably increase business entry rates. The development community, including ADB, has focused regulatory reform efforts on reducing the transactions costs associated with business entry. However, business registration is one of many bureaucratic processes that entrepreneurs have to deal with. Other regulatory requirements might pose a greater burden and regulatory costs on entrepreneurs, but are not subject to such scrutiny. Many types of business licenses have to be renewed on a regular basis, which might not be justified in all cases. Unless related requirements can be streamlined and simplified as well, regulatory burdens associated with business registration might shift to other licenses and discourage particularly small businesses to register. It is noteworthy that Armenia, the Kyrgyz Republic, and Tonga, which have the highest overall Doing Business rankings among the assisted countries, also have the highest new business density (i.e., new registrations per 1,000 voting age population) of these DMCs.

One window business registries can reduce entry costs. One-stop business licensing services, which were implemented in Armenia and in a local government pilot in Indonesia, have been successful in lowering business formal entry transaction costs. Key to improvements in Sragen, Indonesia, the most successful of the pilots, has been strong ownership, comprehensive capacity development efforts, and emphasis on accountability and transparency (e.g., through the use of tracking timesheets).

Online registration systems reduce the scope for corruption. In institutional environments that are characterized by significant governance problems, the involvement of institutions and people with a vested interest in undermining the process can sabotage the new registration system. For example, in Cambodia, where business registration had to be done through a government registration office, a significant share of surveyed enterprises hired facilitators who were employees of a local government agency to handle business registration activities on their behalf, paying a fee that significantly exceeded the official registration charge. Online systems can help cut out potential rent-seeking behavior.

The inclusion of non-limited companies in registries needs to be considered. For limited liability partnerships and companies, company registries need to ensure the validity, transparency, and

accessibility of corporate ownership information. Incorporation implies creating a distinct corporate persona that is legally independent of its owners. As there are limited information needs of the public with regard to non-limited companies, it is not necessary to register them in a public business register, although some countries do. However, experience in Viet Nam shows that it might make sense to have a centralized business name registry to reduce scope for confusion and fraudulent behavior. In any case, non-limited companies should be included in one-stop systems to facilitate the processing of other licensing requirements.

75. ADB also supported underlying enterprise or company legislation in a number of DMCs, particularly in the Pacific region, which helped people conduct business in these countries. With regard to related results in the case study countries, in Cambodia the Law on Commercial Enterprises (promulgated in June 2005) provides a clear legal framework for the operations of sole proprietorships, branches, companies, and partnerships, and facilitates enterprise formation. In Solomon Islands, the Companies Act 2009 replaced outdated laws, simplified the structures, eliminated unnecessarily burdensome requirements, and eased the way for smaller enterprises and nonprofit organizations to formalize.

2. Facilitating business exit

76. **ADB support improved legal frameworks, which need to be adequately implemented to facilitate business exits and resolutions.** Effective bankruptcy laws that allow viable firms to reorganize and unviable ones to liquidate or be sold are important for economic growth.³⁸ ADB provided support for insolvency reforms in seven DMCs. Despite improvements in the underlying legal basis in six of the assisted DMCs with regard to increasing transparency and protecting secured creditors, only one of these countries (the Maldives) has also achieved resolution of insolvencies with reasonable speed and costs so far. Lack of progress in the other five countries was in part due to the lack of specialized courts and effective reorganization procedures. In yet another country (Vanuatu), insolvency legislation drafted with ADB support has been pending due to lack of broad-based support.

77. In Cambodia, although the Bankruptcy Law was promulgated in 2008, its implementation has been constrained by a lack of relevant skills. Sub-decrees are still under preparation. In the Kyrgyz Republic, ADB-supported bankruptcy or insolvency legislation was generally found to be sound and in line with international practice, although an EBRD assessment also identified a number of material shortcomings, in particular the stay on enforcement action on the opening of bankruptcy proceedings, which does not cover secured creditors, as well as other provisions that are likely to hinder the work of insolvency administrators.³⁹ The 2012 Doing Business report estimates that resolution of insolvency takes about 4 years and costs 15% of the estate value with a recovery rate of only 12 cents on the dollar, which is very similar to the 2004 Doing Business assessment. In Solomon Islands, TA helped produce the Companies (Insolvency and Receiverships) Act 2009, along with accompanying regulations, which provides a route to restructuring—and modernizing liquidation processes—for insolvent companies. However, recovery rates for creditors are estimated to be low.

3. Improving customs administration

78. Costs associated with trading across borders can impose a heavy burden on private companies that need to import or export. Features such as a single window, computer-

³⁸ E. Cimzi, L. Klapper and M. Uttamchandani. 2010. *The Challenges of Bankruptcy Reform*. Policy Research Working Paper Series. Washington, DC: The World Bank.

³⁹ European Bank for Reconstruction and Development (Office of the General Counsel). 2011. *Commercial Laws of the Kyrgyz Republic. An Assessment by the EBRD*. London.

controlled risk management, post release audit and post-clearance reviews, and compliance of the legal and regulatory framework with international standards of the World Customs Organization can help reduce such costs. Automation can facilitate a reduction of discretionary interface between customs officials and private sector operators.

79. **ADB support was mostly effective in reducing customs clearance times, but not costs.** During the review period, ADB supported customs reforms in 11 DMCs. ADB support resulted in (i) the adoption of international standard customs laws in Cambodia, the Kyrgyz Republic, and Tajikistan, (ii) partially automated customs data and systems in Indonesia and Mongolia, (iii) the introduction of the Automated System for Customs Data (ASYCUDA) in Bangladesh and Cambodia, (iv) the introduction of single windows in Indonesia and the Philippines, and (v) the introduction of e-customs programs in the Philippines and Viet Nam. A unified automated customs information system was implemented in Tajikistan during 2011, and is nearing completion in the Kyrgyz Republic after substantial delays due in part to customs service capacity problems. Support in Afghanistan and Pakistan was ineffective.⁴⁰ ADB project outputs contributed to a reduction in de jure customs clearance times ranging from a few to 39 days (for imports) and to 29 days (for exports) in Bangladesh, Cambodia, Indonesia, Lao PDR, the Philippines and Viet Nam. During 2008 to 2012, private sector perceptions of burdens posed by customs procedures significantly improved in six of eight supported DMCs for which World Economic Forum executive survey results are available.⁴¹ However, de jure business costs for trading across borders went up for imports and exports in the Kyrgyz Republic, the Lao PDR, Mongolia, Tajikistan, and Viet Nam. Only in the Philippines did import costs markedly go down (Table 5). Also, earlier enterprise surveys reported significantly higher de facto than de jure costs in the Kyrgyz Republic, Mongolia, the Philippines, and Tajikistan. The next round of enterprise surveys will shed more light on actual changes in overall cross-border trading costs and in their components (i.e., customs-related costs associated with documentation and clearances and logistics costs related to terminal fees and inland transport and handling) after the implementation of customs reform measures. In particular, landlocked DMCs tend to have high trading costs, with logistics-related costs substantially exceeding customs-related costs.

80. Higher level impacts of customs reforms on private economic activity, productivity and, employment are less clear. Customs reform outcomes include the reduction of trade-related transaction costs associated with delays and uncertainty. Such cost savings should help reduce production costs and increase the competitiveness of local exporters, which should translate into more exports. Export volume and value indices increased in eight of the nine DMCs where ADB support achieved trade facilitation outputs, the exception being Tajikistan. Customs reforms reduced trade-related transactions costs in four of these countries (Bangladesh, Cambodia, the Lao PDR, and Viet Nam, all of whose export industries, with the exception of the Lao PDR, operate in highly competitive markets). On the other hand, trade also significantly increased in the Kyrgyz Republic and Mongolia despite the slow progress made with the implementation of customs reforms so far. One possible explanation is the nature of their exports: minerals in the case of Mongolia and re-exports from the PRC in the case of the Kyrgyz Republic. In Indonesia and the Philippines, further reductions in relevant transaction costs that were already comparatively low were associated with much lower growth in export volumes. More analysis is needed to differentiate the impact of customs reforms on private economic activity from those of numerous other factors influencing trade activities.

⁴⁰ Support for facilitating cross-border trade between Afghanistan and Pakistan through the upgrading of customs infrastructure did not materialize because Afghanistan did not have sufficient capacity to implement proposed improvements in cargo customs clearance stations.

⁴¹ These DMCs include Bangladesh, Cambodia, Indonesia, Mongolia, the Philippines, and Tajikistan. Marginal improvements were seen in the Kyrgyz Republic and Viet Nam.

81. With regard to related ADB support in the case study countries, ADB approved support for upgrading the existing ASYCUDA in Chittagong Port, the biggest and busiest port in Bangladesh, with a view toward establishment of Single Window.⁴² This effort was subsequently suspended to avoid duplication with other ongoing automation efforts. Nevertheless, ADB support for improved terminal management and access roads contributed to efficiency improvement in terms of handling of ships and loading and unloading of cargo at Chittagong Port.

82. In Cambodia, the ADB-supported 2007 Customs Law facilitated the adoption of several regulations to fulfill commitments to the Association of Southeast Asian Nations (ASEAN) to move to the Common Effective Preferential Tariff scheme, adhere to the 1999 Revised Kyoto Convention, and implement the WTO Agreement on Customs Valuation. According to the customs authorities, all imports now comply with WTO valuation methods. ASYCUDA is being implemented with support from the World Bank in Sihanoukville, which is the country's largest sea port, Phnom Penh International airport, and three dry ports. Simultaneously, a risk-management framework to manage and control the clearance of imported and exported goods was introduced in these five customs points,⁴³ reducing the inspection rate for both outbound and inbound containers from 100% to below 25% by end 2010. The General Department of Customs and Excise indicates that wherever ASYCUDA has been introduced, 90% of import declarations are cleared and goods released within 24 hours of the filing of the declaration. As a result, the time it takes to export was reduced from an average of 37 days in 2007 to 22 days in 2010, and the time to import was reduced from an average of 45 days to 27 days during that period.⁴⁴ Further improvements can be expected once the electronic single administrative document is fully implemented. However, costs per container for imports and exports have not declined. Moreover, although the Doing Business report calculates the official costs associated with exporting and importing to be lower than in any of its ASEAN neighbors, other estimates based on feedback from business representatives, which also consider informal payments, indicate that actual costs are higher. For example, logistics costs are estimated to be about twice as high than in neighboring Viet Nam, in part due to unofficial road charges.

83. In the Kyrgyz Republic, ADB-supported reforms helped (i) strengthen the legal and regulatory framework in line with international standards and conventions, (ii) improve operational efficiency through the simplification of clearance and control procedures, (iii) develop properly supervised customs service intermediaries, and (iv) improve the cooperation between customs and tax authorities. However, the introduction of a unified automated information system and associated activities, namely the installation of communication infrastructure and human resource development, was delayed by several years. Although a pre-customs single window has been adopted, automation of pre-customs clearing and the required harmonization of pre-customs clearance documents have yet to be fully implemented. Businesses have thus continued to face inconsistent regulations and a lack of standardized documents and coordination among ministries and other certification bodies. Exporters and importers have to submit almost a dozen documents to various agencies at the pre-customs stage, and high formal and informal transit and transport costs have further affected their business.

⁴² A Single Window is a facility enabling the provision of standardized information with a single body to fulfill all import, export and transit related regulatory requirements. If information is electronic then individual data elements should only be submitted once.

⁴³ Sub-Decree 21 on the Facilitation of Trade through Risk Management was implemented by Ministerial Order 607 on the Establishment and Functioning of the Risk Management and Audit Office. It identifies the respective roles and duties of all trade facilitation-related agencies and eliminates overlap of responsibilities or duplication of activities.

⁴⁴ See *Cambodia's Aid for Trade Story, #2: Reform of Trade Facilitation in Cambodia*.

84. In the Philippines, the fees and charges on export documentation requirements were eliminated. In Solomon Islands, a request from the government resulted in a team being engaged to review and draft a new Customs and Excise Act. The new legislation is aimed at substantially improving enforcement, removing cumbersome processes, generating greater revenue collection, and enhancing overall border integrity. This is a collaborative effort between the Pacific Private Sector Development Initiative and the Australian Customs Service, working together with the Regional Assistance Mission to Solomon Islands.

Table 5: Cost and Time Associated with Importing Goods in DMCs with ADB Support for Customs Reform

	Time to import (days)		Cost to import (US\$ per container)	
	2005	2012	2005	2012
Bangladesh	60	35	1,287	1,470
Cambodia	54	24	816	930
Indonesia	27	23	675	660
Kyrgyz Republic	75	75	2,450	5,150
Lao PDR	65	26	1,690	1,910
Mongolia	33	50	2,274	2,950
Philippines	18	14	806	560
Tajikistan	65	72	4,500	10,250
Viet Nam	23	21	586	600

■ = improvements ■ = little or no change ■ = deterioration.

ADB = Asian Development Bank; DMC = developing member country; Lao PDR = Lao People's Democratic Republic.

Source: The Doing Business Project of the World Bank Group. <http://www.doingbusiness.org> as of 31 October 2013.

4. Trade Reforms

85. **ADB support for other trade-related reforms has been limited outside support for regional trade initiatives.** At the country-level, ADB support for general trade reforms has focused on helping a small number of countries make their trade regimes WTO compliant, which facilitated increases in trade and investment. For example, in the Lao PDR, ADB-supported measures clarified trading rights and led to the preparation of a strategy for reforming the import-export management systems in line with WTO requirements. Furthermore, ADB support helped to make import licensing requirements and procedures consistent with WTO requirements. In the PRC, ADB provided experts to advise on trade laws related to WTO agreements on anti-dumping, subsidies, countervailing duties, safeguard measures, and transnational mergers and acquisitions. In Viet Nam, ADB helped assess options to improve the institutional process for tariff policy consultations and organized an international symposium in preparation of the Doha Round Negotiations on a range of topics, including dispute resolution, technical barriers to trade, rule of origin, and intellectual property rights. ADB has also been promoting the development of industrial, technical, or sanitary and phytosanitary standards in Bangladesh, Bhutan, Cambodia, and Viet Nam through support for standards legislation, accreditation frameworks, and testing facilities. The introduction of these standards will help private producers sell in domestic and foreign markets while improving product quality and safety. In the Lao PDR, ADB also promoted the introduction of a geographical indication for Laotian products.

86. In Cambodia, ADB supported the implementation of WTO commitments including trade remedies legislation. Draft trade remedies legislation, in the form of a single law encompassing antidumping and countervailing measures and safeguards, has been under review. According to the trade policy review completed in November 2011 with inputs from an ADB-financed consultant, trade-related sanitary and phytosanitary standards are one area where progress in implementing the WTO agenda has lagged. More progress will be needed for Cambodia to be able to introduce a National Single Window, as committed to

under ASEAN, and a WTO-compatible flat fee.⁴⁵ The 2007 Law on Standards of Cambodia is the legal basis for all measures related to standards and technical regulations, but does not cover sanitary and phytosanitary standards. A major government *prakas* (proclamation) was adopted recently by the Council of Ministers to clarify the legal and enforcement responsibilities of various ministries (Ministry of Commerce; Ministry of Industry, Mines and Energy; Ministry of Health; and Ministry of Agriculture, Forestry and Fisheries) and agencies with regard to sanitary and phytosanitary standards.⁴⁶ In addition, ADB and the World Bank are supporting a sanitary and phytosanitary standards risk management system that can be incorporated into customs clearing procedures.⁴⁷ With ADB support, the Ministry of Industry, Mines and Energy developed and started implementing an action plan to commercialize the Industrial Laboratory Center of Cambodia to help it become an internationally recognized testing service provider for the private sector, particularly for agro-processing industries.⁴⁸

87. In the Kyrgyz Republic, ADB supported the harmonization and simplification of the tariff structure in accordance with the WTO agreement, as well as a reduction in the number of tariff bands from six to four. ADB also promoted cross-border agreements between the Kyrgyz Republic and Kazakhstan and the Kyrgyz Republic and Tajikistan to ease the movement of goods, vehicles, and people across the designated borders through streamlined customs inspections. However, the border crossing between Kazakhstan and the Kyrgyz Republic has become more difficult due to bureaucratic procedures in Kazakhstan, which is a member of the customs union with Russia and Belarus. There has been a substantial increase in trade volumes between Kazakhstan and the Kyrgyz Republic, resulting from tariff differentials that encouraged the import and re-export of Chinese goods by the Kyrgyz Republic to the Russian-led customs union, of which Kazakhstan is a member.

5. Investment Reforms

88. **ADB support for reforms facilitating foreign direct investment was very limited with uncertain outcomes.** In the Lao PDR, ADB-supported measures helped streamline the investment approval processes in special economic zones and create one-stop service centers. In Papua New Guinea, ADB supported the adoption of provincial investment policy legislation and the establishment of a one-stop service office for promoting trade and investment. ADB also recognized earlier efforts by Cambodia to facilitate direct foreign investments through the establishment of bilateral investment promotion and protection frameworks and agreements. As of end 2010, agreements were in force with 24 countries or territories (up from 20 in 2007), and an investment framework was initiated with the United States. However, Cambodia does not have any double taxation treaties yet, and this deters investment. Support in Cambodia, Lao PDR, and Papua New Guinea has yet to translate into markedly higher levels of foreign direct investment.

⁴⁵ ASEAN Member States agreed to establish their National Single Windows by 2012 and to connect them through a regional Single Window, a cornerstone of establishing the ASEAN Economic Community by 2015.

⁴⁶ The recent trade policy review identifies the continued need for relevant ministries and agencies to minimize duplication, reduce unnecessary inspections, and improve reporting mechanisms for food safety, as agency duplication of functions and inspections through the proliferation of subordinate legislation has had detrimental effects on Cambodia's sanitary and phytosanitary standards policy, reporting, and enforcement systems.

⁴⁷ WTO. 2011. *Trade Policy Review: Cambodia*. (Report by the WTO Secretariat). Geneva.

⁴⁸ The plan covers corporate governance, strengthening of the technical capacity of staff, and measures for International Organization for Standardization accreditation for major food safety tests. Progress has also been made in developing the Institute of Standards of Cambodia Conformity and Assessment Board for management and process standards.

6. Increasing competition

89. **There has been little support for competition reform, with mixed success.** Dedicated ADB support in this area was largely limited to four DMCs: the PRC, Azerbaijan, Uzbekistan, and the Philippines. In the PRC, ADB TA advisory services and capacity building have contributed toward the development and operationalization of a legal framework on competition, centered in the Anti-Monopoly Law and the Law against Unfair Competition. In addition, an institutional framework was set up with the establishment of the State Council's Anti-Monopoly Committee. Private sector perceptions of the effectiveness of the competition framework improved as a result. Similar support in Azerbaijan and Uzbekistan was less successful. In Azerbaijan, the government did not take up ADB TA as planned, but instead relied on other development partners to help with the drafting of competition legislation and the design of related institutional implementation arrangements. In Uzbekistan, ADB support mainly resulted in greater awareness of competition issues among decision makers as TA implementation coincided with a slowdown in the government's reform drive at the time. The economy continues to be characterized by a high degree of protectionism and lack of market orientation, which reflects a low underlying commitment to more competition. Ongoing policy dialogue in the Philippines is promoting changes in the competition framework, including the establishment of an effective competition office. Lessons so far imply that continued broad-based stakeholder commitment to the underlying economic principles of market-based competition has to be in place to facilitate the effectiveness of external support for competition reforms and the establishment of related legal and regulatory frameworks.

7. Other reforms to reduce regulatory costs

90. **The introduction of frameworks for regulatory impact assessments (RIAs) has been promising, although their effectiveness will have to be assessed further.** To help avoid unnecessary regulatory costs, ADB has been promoting the introduction of RIAs in Bhutan, Cambodia, the Kyrgyz Republic, the Lao PDR, and Viet Nam by supporting the development of related policy, legal, and institutional frameworks. These frameworks are at various stages of implementation and have not been fully implemented in any supported country so their effectiveness cannot be assessed at this moment. Most of the RIA work has been led by ministries of industry and commerce, which comprise the direct counterpart agency under pertinent ADB program loans. Although rollouts to other line ministries are planned for most assisted countries, it remains to be seen whether other government agencies will also support the implementation of RIAs in their areas of responsibility. In a number of countries, pilot RIAs are either ongoing or have just been completed. It is unclear whether the pilot RIAs will lead to any changes in proposed legislation and regulations. In the case of Bhutan, one of the two RIA pilots selected pertained to proposed legislation on SME support schemes, which would appear to be an unlikely candidate for such an assessment.

91. In Cambodia, ADB has been promoting the introduction of RIAs prior to the approval of new regulations, and the establishment of an Office of Regulatory Impact Assessments under the Economic, Social and Cultural Council to institutionalize such assessments nationally. However, there are some doubts whether an Office of Regulatory Impact Assessments will be effective under the Economic, Social and Cultural Council as the Council functions more like a coordinating than an implementing body. RIAs are being piloted by the Department of Industry and the Ministry of Environment. All completed assessments show that benefits arising from proposed regulatory changes are likely to exceed related costs, although RIAs are unlikely to fully capture informal compliance costs associated with new regulations. The introduction of RIAs is perceived to be useful by most development partners, but was initially met with resistance from a number of government departments, including the Department of Energy. Effective implementation will take time,

significant institutional involvement and commitment, and close interaction with the private sector.

92. In the Kyrgyz Republic, regulatory impact assessments of business-related license requirements have been made mandatory. The 2011 amendments to the Inspections Law introduced risk-based inspections, which are expected to reduce the compliance burden for many firms since the share of inspected businesses and average number of inspections per year had been higher than in many other countries in the region. In an enterprise survey conducted by the IFC in 2008, about one-third of SMEs indicated involvement of unofficial practices to facilitate compliance with administrative procedures. One of the problems has been the short validity of many licenses and permits, which will also need to be addressed to reduce the regulatory burden. In the Kyrgyz Republic and Cambodia, 2012 surveys of company executives indicate that their perceptions of regulatory burdens have improved since 2005, which is a likely result of government efforts in these countries to reduce unnecessary bureaucratic hurdles.

93. **ADB support for recourse and complaint mechanisms related to regulatory actions has not been effective.** In Cambodia, the promoted pilot recourse mechanism involving a hotline at the subcommittee for small and medium-sized enterprises secretariat for complaints relating to licensing decisions and inspections has not been utilized. The majority of users had been seeking advice on their business plans, rather than clarification on or resolution of licensing or other regulatory issues. It has since been reconfigured as a Ministry of Industry, Mines and Energy-based website, which also provides business advice to SMEs. Regulatory complaints reportedly usually pertained to ministries other than the Ministry of Industry, Mines and Energy. The Ministry plans to transfer the website to the Cambodian SME Organization with private sector funding.

C. Improving Access to Finance

94. Analysis in the following section draws on available (self)-evaluation studies, project progress reports, and project reviews in case study countries, as well as Tonga and Vanuatu.

95. Sound and efficient financial institutions and markets facilitate PSD and economic growth by channeling funds to their most productive uses and allocating risks to those who can best bear them. Firms are less financially constrained in economies with more developed financial markets.⁴⁹ The same is true for small firms.⁵⁰ Recent empirical panel data analysis of banking and capital market characteristics that can improve the ability of banks to provide increased credit flows to the private sector while simultaneously improving financial inclusion for the poor concludes that financial policy should seek to foster interbank competition, develop appropriate macro-prudential safeguards, and promote capital market development.⁵¹ Most of the 30 sovereign loan projects approved from 2001 to 2012 that supported the development of money, bond and equity markets, the establishment of financial market infrastructure, banking sector reforms and restructuring, and financial sector regulation and supervision should thus in principle have been relevant for increasing and broadening private sector access to finance. ADB also financed 15 projects supporting policy and institutional reforms related to rural and microfinance to improve financial sector outreach and financial inclusion.

⁴⁹ G.R. Rajan and Zingales, L. 1998. Financial Dependence and Growth. *American Economic Review*. 88. pp. 559–586.

⁵⁰ Aghion, P., T. Fally and S. Scarpetta. 2007. Credit constraints as a barrier to the entry and post-entry growth of firms. *Economic Policy*. 22. pp. 731–779.

⁵¹ C. Gimet and T. Lagoarde-Segot. 2012. Financial sector development and access to finance. Does size say it all? *Emerging Markets Review* 13, 3 (2012) pp. 316–337.

96. The following section provides an overview of findings from existing evaluations and country case studies with regard to the likely impact of ADB support for financial sector development on PSD, as well as an in-depth assessment of ADB support for improving credit information and secured transaction systems. The latter topics have been selected because financial market imperfections, such as information asymmetries and transactions costs, have been especially binding on micro- and small entrepreneurs, who lack the required collateral and credit histories, which in turn limits their access to credit and economic opportunities.

1. Developing commercial banking and capital markets

97. **ADB support helped improve financial market conditions albeit not in all countries or assistance areas.** Eight of the 13 (self)-evaluated post-2001 programs for banking and non-bank financial sector reforms were rated as successful by available (self)-evaluations. ADB support for banking sector reforms focusing on the development of appropriate regulatory and supervisory frameworks and bank restructuring was mostly effective, particularly with regard to improving the soundness of financial systems, which helped banking systems withstand the impact of the recent economic crisis. Greater PSP and competition in the financial sector have contributed to efficiency improvements in financial intermediation in a number of assisted countries that formerly had predominantly state-owned banking systems, including Bhutan and Cambodia. By comparison, ADB-supported state bank restructuring efforts in the Lao PDR failed to achieve meaningful results. Support for capital market development was mostly effective, particularly with regard to the development—but not necessarily the full enforcement—of legal and regulatory frameworks and the establishment of trading, clearing, and settlement infrastructure. Equity market capitalization, liquidity levels, the number of listed companies, and volumes of new capital raised through initial public offers and rights issues increased in most markets, although these increases were often below expectations, particularly in the smaller markets, where the small size of the economy limits the potential for market liquidity and growth. Support was less than successful with regard to corporate bond market development given slow progress made with the establishment of credible yield curves, and good practice debt recovery frameworks, adequate financial reporting and disclosure, the reduction of issue costs, the development of an institutional investor base, and the introduction of functioning liquidity mechanisms.⁵²

98. **Supported financial sector reforms in case study countries had mixed success in improving private sector access to finance and reducing financing costs.** ADB support for banking sector reforms in Cambodia and the Kyrgyz Republic helped restructure banks and improve banking regulation and supervision, which facilitated increases in private sector credit. While interest rate margins have come down significantly in line with greater macroeconomic stability, they remain high compared to countries with more advanced financial systems due to a lack of adequate credit information and risk management skills. In the Philippines, ADB support for general financial market development has helped improve the soundness of financial institutions, but has done little to improve enterprise access to financial markets, which remains constrained by lack of adequate credit information—a centralized information systems is scheduled to become fully operational within 2014—, unaddressed deficiencies in the secured transactions regime, and limited prospects for debt recovery. Domestic credit to private sector as share of GDP has actually slightly worsened over the last decade.

⁵² Independent Evaluation Department. 2008. *Special Evaluation Study: ADB Assistance for Domestic Capital Market Development*. Manila: ADB. With the exception of support for Bangladesh, Bhutan, the Kyrgyz Republic, and Nepal, case studies undertaken in conjunction with the evaluation covered most of ADB's financial support for capital markets development during the review period.

99. ABD support for capital market reforms in the Philippines facilitated increased enterprise access to external equity, but has yet to significantly improve conditions for debt financing. After remaining at levels ranging from close to 0% to 1.3% of GDP per annum during the last decade, which is low compared to many developed markets, capital raised through the securities market increased to 2.1% of GDP in 2012. Although the legal and regulatory framework for capital market transactions was improved with successful ADB assistance, the 2009 Financial Sector Assessment Program, a joint International Monetary Fund and World Bank effort, points out the need for further strengthening capital market supervision, in particular on-site examinations, enforcement, and the use of self-regulatory organizations, some of which are being addressed under ongoing policy dialogue by ADB. Moreover, capital market efficiency could be improved through the removal of tax distortions between different financial products and services, reductions in the costs of debt and mutual fund offerings, and the removal of unnecessary restrictions on the sale of mutual funds. New rules approved in 2011 make it easier for non-bank financial institutions to set up standalone trust units. ABD support for capital market reforms in Bangladesh and the Kyrgyz Republic did not significantly improve enterprise access to external equity or debt financing. Capital markets in Bangladesh and the Kyrgyz Republic remain underdeveloped with capital raised remaining below 0.2% of GDP every year except 2008. ADB support in Bangladesh during the last decade was limited to the establishment of a central depository, which is working well, but problems related to market regulation, surveillance, and enforcement remained unaddressed. ADB support for capital market reforms approved in 2012 includes relevant policy actions. In the case of the Kyrgyz Republic, ADB support helped establish a basic legal and regulatory framework for securities market operations. However, the small size of the economy limits the potential for market liquidity and growth. Also, a number of the few listed companies are still majority state-owned with a very small public float.

100. To further develop capital markets in a sustainable manner, Bangladesh, the Kyrgyz Republic, and the Philippines need to also improve frameworks for corporate governance, financial disclosure, or debt recovery. In the Philippines, where ADB support helped strengthen financial reporting and corporate governance requirements for listed companies, there are continued implementation problems disadvantaging outside shareholders. In the Kyrgyz Republic, the ADB-supported legal framework for promoting corporate governance was assessed as “medium compliant” with international standards by an EBRD assessment⁵³ because of issues concerning the rights of shareholders, the responsibilities of the Board, and the role of stakeholders in corporate governance.⁵⁴ A 2010 IFC survey of corporate governance practices in the Kyrgyz Republic found that while good progress had been made with the introduction of the principles, there is scope for further improvement in this area.⁵⁵ ADB also contributed to an upgrading of the country’s legal and statutory framework for corporate financial reporting through policy dialogue on the introduction of international accounting and audit standards under 2002 revisions of

⁵³ EBRD. 2007. *Corporate Governance Sector Assessment: Kyrgyz Republic*. London.

⁵⁴ Among the shortcomings identified with its implementation that affected minority shareholders pertained to the publication of financial reports for large and listed joint stock companies in the media; the timing, notice, and holding of general shareholder meetings; the scope for exercising of preemptive rights; and payment practices for shares (often in kind).

⁵⁵ Corporate governance principles were not properly formalized; little attention was given to improving organizational management structures and procedures for interaction between the management; the vast majority of companies did not have independent directors on their boards; there was minimal dissemination of the corporate governance principles applied by the company; there was a lack of understanding on the nature of internal audits; and there was poor understanding of the legislation related to corporate governance.

the accounting and audit laws and other relevant decrees. Further reforms are needed, though, particularly with regard to the implementation of the standards.⁵⁶

2. Developing microfinance and rural finance

101. **Support for microfinance and rural finance has been less than effective in promoting market development and expanding outreach.** Five of the nine (self)-evaluated public sector loan projects involving policy or institutional development support for microfinance and rural finance were rated less than successful. A recent IED evaluation of ADB's microfinance activities⁵⁷ found that ADB support focused on performed reasonably well at the macro level in easing regulatory and policy constraints. The results have been less than effective in market and institutional development, and outreach to the poor, in part because little attention was paid to demand side issues such as developing the capacity of the poor to access and use financial services and promoting pro-poor financial products and delivery channels.⁵⁸ By comparison, microfinance operations in the case study countries not only improved policy, legal, regulatory, and supervisory frameworks, but also strengthened the outreach and sustainability of microfinance institutions (MFIs). In Cambodia, support for microfinance regulatory reforms helped increase industry soundness and access to funds from depositors and commercial banks. This translated into comparatively high outreach, with 8% of the total population having outstanding microfinance loans, although microfinance operations remain constrained because of continuing market distortions, MFI restrictions on the use of leasing products, and potential borrowers' lack of financial literacy. In the Philippines, ADB support to reform MFI regulations⁵⁹ as well as capacity enhancement contributed to increased soundness, efficiency, and outreach of MFIs, as reflected in an increase in the number of microfinance borrowers to about 3% of the total population. The establishment of the Philippine Microfinance Literacy Program helped develop the financial knowledge of both microfinance providers and users. Evaluation findings from Bangladesh, where 30% of IED-surveyed borrowers under an ADB-financed SME credit line did not understand their loan terms, also highlights the need for improving financial literacy.

102. The provision of ADB credit lines in Bangladesh and the Kyrgyz Republic did little to develop rural finance markets. Although the ADB project in Bangladesh provided tens of thousands of small loans, it did not fundamentally address the conditions for and impediments to rural finance in the country, including the market-distorting behavior of the state agricultural banks, high provisioning requirements for such lending, inadequate credit information systems, and weak secured transactions regime. In the Kyrgyz Republic, many supported rural credit unions folded. Most of the other assisted credit unions failed

⁵⁶ According to a 2008 Report on Standards and Codes on accounting and audit, the standards had not been updated and were not in full compliance with International Financial Reporting Standards and International Standards on Accounting at the time of the review. More importantly, despite strengthened accounting and audit requirements, the report concluded that greater efforts had to be made with their application and enforcement. There is a lack of compliance with existing public disclosure requirements, and financial statements are not readily available. This is in part due to a lack of related capacity, but also corporate governance issues.

⁵⁷ Independent Evaluation Department. 2013. *Special Evaluation Study: Microfinance Development Strategy 2000-Sector Performance and Client Welfare*. Manila

⁵⁸ The average penetration among the countries with ADB support remained low at nearly 20% of the population as of end 2011. Six case study countries showed that fewer than 9% of microfinance clients lived below \$1.25 per day and fewer than 22% lived below \$2 per day.

⁵⁹ Reforms included strengthened rules and regulations for the credit and multipurpose cooperatives that helped them expand their range of financial services, including microfinance; enhanced transparency and disclosure requirements for MFI nongovernment organizations; reorganization of the Cooperative Development Authority into a financial regulatory agency; adoption of performance standards that helped to strengthen MFI institutional and operational capacity; the introduction of risk-based supervision of MFIs; and incentives for microfinance-oriented banks to set up branches anywhere in the country.

to become financially sustainable and continue to rely on external credit lines for funding. The overall success rate for ADB's completed and evaluated rural and microfinance credit lines approved during the review period was 50%.

3. Improving Credit Information

103. The existence of a credit bureau increases the probability that a small firm receives a bank loan.⁶⁰ Credit bureaus help banks extend credit to small firms by reducing default rates.⁶¹ The impact is largest in credit bureaus that capture positive and negative information (a "full file"), rather than only negative information (a "black list") (Linked document 7, Table A7.2 and Figure A7.1). Moreover, credit bureaus can improve the efficiency of the bank lending process, with most banks reporting a reduction of processing time and costs by more than 25% as a result of implementing a credit bureau.

104. **ADB support for improving credit information has been moderately effective.** A large number of DMCs have yet to develop functioning credit information systems. Given emerging research confirming the positive impact of credit information bureaus on access to finance, increasing attention has been paid to their importance by central banks and supervised financial institutions. As a result, the demand for related advisory services has been increasing in recent years. Among development partners, IFC has emerged as the prime advisor for credit information systems in Asia and elsewhere. During the review period ADB supported the development of credit information systems in eight DMCs, including (i) three full file bureaus that were set up in Bhutan (2009), Cambodia (2011), and the Maldives (2011) with the help of international credit information providers; (ii) one full file bureau in Bank Indonesia; (iii) two computerized negative credit information only databases in the central banks of Cambodia (in 2006) and the Lao PDR; and (iv) two micro-credit information systems in Nepal and Pakistan (Linked document 7, Table A7.3). ADB also approved an equity investment in a newly set up full file bureau in the Philippines, but due to changes in legislation, ADB became ineligible as an investor.

105. The new full file bureaus in Bhutan, Cambodia, and the Maldives have been making good progress in building their databases, extending coverage, and handling credit inquiries. However, given the bureaus' short operational history, it is too early to assess their impact on credit. The other full file registry in Indonesia has been functioning well, and likely contributed to the increases in SME credit in Indonesia. The computerization of black lists was not effective due to technical issues with the new systems, which made them unreliable, as well as the limitations posed by the provision of only negative information and the inadequate coverage of financial institutions. A pilot microfinance information service was launched in 2010 in Pakistan and will be rolled out nationwide after positive experience gained with the pilot, while one in Nepal is behind schedule. In the latter case, the planned expansion of the existing credit information bureau to cover micro-credit would be premature given the shortcomings of the current system.

Box 3: Lessons – Credit Information Systems

To ensure sustained buy-in for the implementation of a new credit information system, all stakeholders need to agree up front on its basic features and objectives. Limited experience gained with ADB projects appears to confirm experience from other countries, which shows that credit bureaus give the greatest value if they share two characteristics: (i) being "full file," and (ii) having

⁶⁰ A World Bank survey of 5,000 firms across 51 countries found that the probability that a small firm has a bank loan increases from 28% for countries without a credit bureau to 40% for countries with a credit bureau.

⁶¹ The same survey found that borrower default rates of small banks in countries without a credit bureau was 2.42%, as opposed to 0.52% for such banks in countries with a credit bureau. Even for large banks there were notable differences, with a 2.22% default rate in countries without a credit bureau as opposed to 1.31% where better credit information was available.

mandatory participation. Credit bureaus tend to increase competition by giving advantage to smaller lenders and new entrants as they are effectively built on information provided by the larger banks for whom access to other banks' information is less important. Larger established lenders are thus motivated to resist the implementation of credit bureaus. Also, banks might be concerned about confidentiality and about other banks getting access to credit information on prime borrowers. For a credit information bureau to work, it is crucial to get agreement from all stakeholders on (among others): data supplied by participants, safeguards used by the credit bureau to protect commercially sensitive data, format of reporting, and ownership of the bureau (most of these were issues in the Philippines). Moreover, the introduction of credit information often requires changes in laws and regulations to permit the required data sharing.

Involvement of experienced credit information firms in building bureaus improves effectiveness.

International credit information firms have the experience to deal with the complexity of building a functioning credit bureau, and they can offer additional services that enhance commercial and financial viability. For example, in more developed countries, many successful bureaus offer credit scoring, and the credit information bureau in Bhutan has stated publicly that it wishes to introduce credit scoring in the future. To do this, it needs to start building a history of relevant demographic and other information, which is far broader than the information required just to give a credit performance record. Also, it often makes sense to import a ready-built system rather than starting one from scratch. Based on its long-term experience, a specialist credit information firm will also be better equipped to design processes that can deal with exceptional situations.

Reliable personal identity systems are a prior requirement for functioning credit information systems.

Experience in a number of DMCs, including Cambodia and in the Pacific, shows the need to have a comprehensive and functioning system of personal identity in place so that credit histories can be accurately attributed to individuals as well as companies.

4. Improving Secured Transactions Systems

106. **ADB actively promoted secured transactions legislation and the establishment of collateral registries.** Insufficient collateral is seen by MSMEs as being among the top reasons for their difficulty in accessing finance.⁶² Collateral can facilitate access to finance and lower financing costs. Secured, as opposed to unsecured status, grants priority to a creditor against some property belonging to the debtor if the debt is not paid as agreed. Secured lending thus allows a business to borrow funds at lower costs while reducing risk to the lender. The use of movable assets as collateral can facilitate financing for small enterprises.⁶³ The Office of the General Counsel spearheaded ADB's advocacy work starting in the late 1990s through a couple of regional TA projects, which conducted comparative assessments of existing secured transactions regimes and their use and enforcement in selected DMCs and developed a broad strategy for implementing secured transactions law reforms in discussions with key policy makers, government officials, and lenders. The studies, discussions, and ensuing publications, together with the adoption of international conventions, helped build interest among DMCs and within ADB's operational departments in secured transactions law reform, triggering demand for related TA. With its emphasis on property rights, the PSD approach pursued by ADB in Pacific countries also promoted secured transactions reforms. This often also included support for the establishment of secured transactions registries to help implement the new laws.

107. **The adoption of best practice frameworks offered no guarantee for improving access to finance.** ADB supported the development of secured transactions systems in 17 DMCs during 2000-2012. There are few DMCs that did not receive ADB support. Most of them are located in Central Asia and obtained assistance from the EBRD for this purpose.

⁶² According to World Bank enterprise survey results, more than 70% of rejected credit applications by survey respondents in Asia were turned down due to insufficient collateral.

⁶³ In the United States, movable property makes up 60% of enterprises' capital assets, whereas in developing countries the share is close to 80%. Movables account for 70% of small business funding in the United States.

ADB generally supported the adoption of good practice standards for legislation and registries. Good practice standards promote the inclusion of the nine minimum principles in related legislation (Linked document 7, Box A7.1). Best practices for a collateral registry for movable collateral promote registries that are unified geographically and by asset type, with an electronic database indexed by debtors' names. Ideally, a registry ensures accuracy, speed and timeliness, accessibility, unity, cost-effectiveness, simplicity, restriction to purposes of filing, rule-based decision making, flexibility, accountability, transparency, and consistency.

108. Eight of the 16 DMCs, who had received support for the development of related legal frameworks, adopted laws that are largely in line with international best practices (Appendix 7, Table A7.4). These included Cambodia, India, the Kyrgyz Republic, the Marshall Islands, Solomon Islands, Tonga, Vanuatu, and Viet Nam. TA recommendations were not adopted in Bangladesh, Indonesia, the Lao PDR, Pakistan, and Sri Lanka, mainly due to lack of sufficient buy-in from stakeholders. In a number of cases, governments, at the time, were not prepared to promote required amendments of related laws, particularly the civil code and contract and insolvency laws. Although suitable secured transactions legislation was approved by Parliament in Mongolia, the supreme court overturned proposed out-of-court enforcement provisions, complicating implementation. Problems also emerged in Cambodia and the Kyrgyz Republic, where the civil code requires a court decision or confirmation for the seizure of collateral which significantly increases enforcement times and costs for creditors. Moreover, in the Kyrgyz Republic, the introduction of legal amendments to allow accelerated enforcement of pledged or leased assets, where this is agreed to in the pledge or lease agreement, has been delayed. Common shortcomings in adopted secured transactions legislation in most assisted DMCs were related to the priority of secured creditors in the case of insolvency and liquidation.

109. With regard to secured transactions registries, ADB supported the design and development of 13 registries, which contributed to the actual establishment of eight registries. These included five in Pacific DMCs, which largely followed good practice standards.⁶⁴ Functioning registries have yet to be set up in Bangladesh, the Lao PDR, Pakistan, and the Philippines. In the Lao PDR and the Philippines, this would require political commitment toward the establishment of an adequate underlying legal framework.

110. In terms of assistance outcomes, in Viet Nam, banks have reportedly started to provide credit on the basis of movable collateral. The impact of the registry in Tonga on lending is too early to assess, although there are cost and capacity issues. For recent support in some of the Pacific countries, including Solomon Islands and Tonga, it is too early to assess impact on credit extension with certainty.⁶⁵ Also, the level of registrations has varied and appears to be mainly a function of overall credit market conditions and constraints. The Solomon Island registry has begun successfully, as reflected by the large number of registrations and searches, which will likely have a positive impact on credit provision. However, registries in the Marshall Islands, the Federated States of Micronesia, and, to a lesser degree, Vanuatu have had lower uptake as a result of unresolved constraints affecting credit markets. The Kyrgyz registry is being utilized as expected, and required collateral values decreased.⁶⁶ However, this has not yet been fully reflected in a

⁶⁴ The DMCs included Cambodia, the Federated States of Micronesia, the Kyrgyz Republic, the Marshall Islands, Solomon Islands, Tonga, Vanuatu, and Viet Nam.

⁶⁵ In the PRC it took about 2 years after the adoption of the legal framework and the establishment of the registry before significant increases in secured lending backed by movable collateral started to occur.

⁶⁶ The number of registered pledges increased from 2,082 during 2008, when the Investment Climate Improvement Project was established, to 26,018 in 2010. The number of contracts with arbitration clauses increased significantly.

sustainable increase in credit levels, which have been affected by the global economic and 2010 political crises. Due to enforcement problems, the use of movable collateral has not increased in Cambodia, and collateral requirements mainly in the form of immovables remain high for SMEs at more than 180% of loan value. In India, Mongolia, and Nepal, adopted secured transactions legislation has not been fully operationalized and translated into changes in credit decisions due to the absence of functioning registries for movable collateral. Based on progress achieved so far, banks in less than half of the 17 DMCs where ADB provided support for secured transactions are likely to accept movable assets as collateral and expand their lending to SMEs in the next few years.

111. **Reliable credit information is more important for lending than collateral registration.** It is important not to lose sight of the fact that the overall objective of secured transactions systems is to improve access to finance and ensuing follow-on effects on growth and investment. Economic impact will not only be dependent on a modern legal and regulatory framework and a functioning registry, but also on interest and incentives for financial institutions to accept (and manage) movable collateral and use the system. In countries visited by the independent evaluation mission, lenders have made it clear that the ability to access reliable credit history through such a facility is more important than the secured transactions system, as credit assessment is fundamental to any kind of lending, whether secured or unsecured.

112. Despite emphasis by ADB and others on improving the conditions for the use of movable collateral, it must be remembered that with respect to asset-based lending, even to SMEs, the preferred security generally is land and buildings. Yet in a number of DMCs, including throughout the Pacific region, there are serious questions about owners' or users' ability to convey or mortgage interests in real estate. This issue, together with land titling, warrants more attention going forward.

Box 4: Lessons – Secured Transactions Systems

Capacity development needs for secured transactions regimes need to be assessed and addressed.

The preparation and implementation of secured transactions laws is inherently complex. Depending on the capacity of the legal profession and other stakeholders, substantial awareness building and training efforts might be required. This involves developing some complicated underlying “code” that is necessary to make this straightforward exchange feasible—i.e., the contractual mechanism; notice and perfection; the creation of property rights in the collateral; priority rules; self-help enforcement; and other aspects of default, bankruptcy, purchase money, good-faith purchasers, and all the potential lienholders. This requires a special effort of publicity, outreach, training, explanation, repetition, reinforcement, and eventually widespread habitual use. Otherwise, the system is underutilized, or, as happened in Solomon Islands, farmers show up at the registry with their chickens or pig tusks expecting a loan. Experiences across the Pacific region suggest that these systems are not yet living up to their potential, and that one of the keys to unlocking that potential is to make the systems relevant to everyone in the value chain, including financial institutions, dealers and suppliers, service providers who are potential lienholders, and microfinance institutions seeking to refinance their loan books. There are probably many ways of making the systems relevant, but a start can be made with wider and more frequent dissemination of knowledge in ways already familiar. It may also be advisable to support centers of expertise, where a cadre of legal and other specialists can be built up to supply the necessary technical advice.

The financial sustainability of secured transactions registries needs to be ensured. A number of the Pacific registries have had problems financing their operations on the basis of fees alone. The cost and benefits of online secured transactions registries have to be carefully considered and options chosen accordingly. In small markets dominated by SME borrowers, subsidies might be needed to make a collateral registry commercially viable. An interesting approach was adopted for the Solomon Islands online registry system, which is being hosted in the United States.

Approaches for insolvency and secured transactions regimes need to be coordinated. There are inherent tensions between secured transactions and insolvency frameworks, particularly with regard to the application of the priority payment rules (which usually cover taxes and employee salary payments) to the proceeds of a secured asset sale that need to be sorted out through provisions clarifying consequences of the opening of an insolvency case, the possession and use of secured assets during stay against enforcement action, and limitations of priority claims.

Insurance cover is required for secured assets. Lenders in ADB-supported Pacific countries repeatedly expressed concern about the value of collateral. This was especially true in rural and agricultural lending, where the risks to potential securities such as cash crops, trees, and livestock discourage their use as collateral. This is not a simple matter to sort out, and would require some combination of public and private sector intervention. For those most in need, the beginnings of a solution might be found in experiments that have been conducted elsewhere in the provision of micro-insurance products. A related need is for the development of warehouse financing. The secured transactions reform is a major step toward making this possible, but some additional work is likely to be needed in terms of legislation, documentation, and infrastructure. Warehousing would provide additional support for the financing of agricultural commodities. Also related is the obvious need for overall transport infrastructure improvements—including roads and shipping.

D. Reducing the Role of the State in the Provision of Goods and Services

113. **ADB support for SOE restructuring and privatization has been relevant, but actual divestments remain below expectations.** Economic reforms undertaken during the 1990s substantially increased the role of the private sector in most transitional economies and India. The private sector now dominates economic activity and investment in most DMCs. However, in a number of countries there has been continued need for (i) restructuring remaining state enterprises to make them more efficient and reduce their need for fiscal transfers; (ii) leveling the playing field between state-owned and private enterprises that are competing with each other since SOEs often have the benefit of subsidized financing and other privileges; and (iii) further divestment, including of public utilities, to improve service provision. ADB has been supporting related initiatives in 14 DMCs. While assistance in Nauru, the PRC, Uzbekistan, and Viet Nam was limited to enhancing the performance of SOEs, efforts in the other 10 DMCs also included support for privatization.⁶⁷ In most of these countries, the number of actual privatizations stayed below levels envisaged in approval documents due to lack of broad-based political commitment for divestments or failure to attract private buyers for offered enterprises at prices acceptable to the government, particularly during times of economic and political crisis.

114. ADB support strengthened the legal and institutional basis for state enterprise restructuring and liquidation in the Kyrgyz Republic, although the level of actual corporate restructuring has fallen below expectations. There was public discussion of privatization policies and a privatization program was initially approved by the outgoing government before being suspended by the interim government due to allegations of irregularities and corruption, which contributed to political discontent.⁶⁸ Privatizations of Severelectro (an electricity distribution company in the Bishkek region) and Kyrgyz Telecom occurred through international tenders, but the process fell short of full transparency and their privatizations were reversed. ADB also supported divestments of state enterprises, including through the stock exchange, but these did not materialize. ADB programs in Solomon

⁶⁷ Supported DMCs included Bangladesh, Indonesia, the Kyrgyz Republic, the Maldives, Mongolia, Nepal, Samoa, Solomon Islands, Tonga, and Vanuatu.

⁶⁸ As part of the energy sector reform program initiated by the previous government in 2009, six large energy companies were to be privatized, with two of them completed in 2010. The interim government annulled the privatizations and suspended the privatization program altogether.

Islands helped usher in the State Owned Enterprises Act 2007, which strengthens governance and monitoring of state enterprises and assists with privatizations.⁶⁹ In Bangladesh, ADB provided capacity development support for the Privatization Commission. However, political support for privatization has fluctuated over the last decade and not many privatizations have been subsequently implemented.

115. In Cambodia, ADB sought to promote a more level playing field between state and private enterprises, as many private enterprises in Cambodia see anti-competitive practices as a major constraint to doing business. State enterprises and politically well-connected businesses are reportedly given unfair advantages. Competition legislation has been drafted and is under review. Its effectiveness remains to be seen, as enforcement will also depend on improvements in the overall governance environment.

E. Encouraging Private Participation in Infrastructure Development

116. **ADB has been promoting private participation in infrastructure (PPI) as a means of mobilizing private investments to fill considerable infrastructure funding gaps and to increase the efficiency of public service provision.** This should also help private enterprises in other sectors. During the review period, ADB provided related advisory support or had policy dialogue on the development of PPI in 20 DMCs with particular emphasis on the development of policy, legal and institutional frameworks for cross-sector PPPs, and the preparation of PPP transactions in the energy sector. IED conducted a special evaluation study in 2009 focusing on PPI policy and legal frameworks, institutions, project development, and ADB-financed transactions.⁷⁰ By comparison, this study focuses on investment climate and underlying sector reforms that are needed to make PPI work, while updating findings of the earlier study in other relevant areas. It is based on assessments of ADB support for strengthening the enabling environment for PPI in five selected countries: Bangladesh, India, Indonesia, Pakistan, and the Philippines. These countries accounted for a large share of such assistance during the last decade. Detailed assessments of the rationale, relevance, and results of such support are presented in Linked document 8. The following section summarizes key findings and lessons.

117. **Private investment in infrastructure in the selected DMCs has stayed below projected levels.** During the review period, ADB provided substantial support for (i) the development of policy, institutional, and financing frameworks for PPPs in India, Indonesia, and Pakistan, and more recently in Bangladesh and the Philippines; (ii) reforms promoting private participation in the energy sector in all the study countries; and, to a lesser degree, (iii) pertinent reforms in other infrastructure sectors. However, such support has yet to translate into significant increases in actual private infrastructure investment in most of the study countries, with average annual investment volumes in Indonesia and the Philippines during 2001–2012 falling below levels achieved during 1991–2000, and growth in Bangladesh and Pakistan largely limited to the energy sector (Linked document 8, Tables A8.1 and A8.2). Only India has had remarkable success in mobilizing private investment in recent years, mainly for the energy and transport sectors. In terms of (sub)sectors, electricity generation received the largest share (57%) of private investment in all reviewed countries during 2001–2012. As a result of ADB-supported sector unbundling efforts, there

⁶⁹ An example was the privatization of Sasape Marina Ltd. in the Solomon Islands, which one observer called the “most professionally run process.” The outcome was considered better than expected, though it ended as an asset sale rather than the sale of a going concern. The full privatization of Home Finance Ltd. was also completed. The biggest problem of privatization in the Solomon Islands has been politicization and political interference. This affected the marina privatization when an investigation was called (widely seen as unjustified and politically motivated), causing delay.

⁷⁰ Independent Evaluation Department. 2009. *Special Evaluation Study: ADB Assistance for Public-Private Partnerships in Infrastructure Development—Potential for More Success*. Manila: ADB.

also were increases during the last decade in private investments or participation in (i) power transmission in Bangladesh, India, Pakistan, and the Philippines; (ii) power distribution in Bangladesh, India, and Pakistan; and (iii) gas transmission and distribution in Indonesia. However, private participation in network infrastructure or distribution in other countries or sectors, namely water, has been very low, particularly compared to Latin America.⁷¹ Levels of new investment in water increased from nonexistent to small volumes in India, but little new investment occurred in Indonesia and the Philippines after the earlier Manila and Jakarta concessions in part due to difficulties experienced in implementing required tariff increases.

118. **A range of enabling environment issues has constrained PPI.** ADB support helped establish general PPP policy, legal, and regulatory frameworks that contain many best practice elements. While this has been helpful, it has not been sufficient in encouraging PPI. Continuing weaknesses in the overall investment climate of some of the study countries, while key concerns, have not necessarily been perceived as binding constraints to PPI by investors and bankers, including foreign ones. An exception is Pakistan, not only because of investor concerns about political and macroeconomic instability, but because of the previous government's default on guarantees provided for Central Power Purchasing Agency's payments obligations to independent power producers (IPPs) in 2012, which was resolved in 2013 by the new government through payment of outstanding dues. However, there are numerous other reasons for insufficient private sector interest in infrastructure investments. The following enabling environment issues continue to be relevant, to varying degrees, in all of the study countries and in most infrastructure sectors:

- (i) slow progress with sector reforms, including the commercialization, restructuring, or unbundling of public utilities;
- (ii) slow progress in adopting tariff reforms to facilitate full cost recovery for services;
- (iii) lack of long-term financial viability of government contracting agencies and lack of government performance guarantees;
- (iv) absence of truly independent regulators with clearly defined responsibilities and discretion for making decisions, and judicial power to enforce decisions;
- (v) inadequate laws and policies governing the acquisition and financing of land for projects, either right-of-way acquisition or land acquisition;
- (vi) poor coordination among various government agencies and offices and lack of institutional incentives and capacity, leading to poor PPP project selection and inadequate project preparation; and
- (vii) underdeveloped domestic banking and capital markets.

119. ADB sought to address most of these issues to varying degrees and with different levels of success.

120. **Uneven progress was made in the reviewed countries with power sector reforms that are required for more private investment.** ADB has had longstanding policy dialogue on power sector reforms in all of the study countries. ADB-supported power sector unbundling in Bangladesh, India (Assam and Gujarat), Pakistan, and the Philippines facilitated PSP not only in power generation, but also transmission and distribution. Power sector reforms in the Philippines have been most advanced, with much of the sector now under private sector ownership. Private investment levels were largely maintained at the high levels achieved during the previous decade. However, cross-ownership between

⁷¹ In Latin America in 2003, private utilities were managing 86% of telecoms subscriptions, 60% of electricity connections, and 11% of water connections. Source: M. Fay and M. Morrison. 2005. *Infrastructure in Latin America & the Caribbean: Recent Developments and Key Challenges*. Report No. 32640-LCR, The World Bank Finance, Private Sector and Infrastructure Unit, Latin America & the Caribbean Region. Washington, DC.

generation and distribution and supply companies, limited use of the wholesale electricity spot market, delays in implementing open access and retail competition, and capacity constraints on the part of the regulator contributed to comparatively high electricity tariffs while also possibly deterring new industry entrants. Some progress was made with reforming Bangladesh's power sector, including improvements in the operational and financial performance of the national power grid and the Dhaka Electricity Supply companies culminating in their stock exchange listing. However, further restructuring of the Bangladesh Power Development Board, in particular the corporatization of generation and distribution operations outside Dhaka, have been negatively affected by delays in moving toward fully cost-reflective tariffs. Power sector reforms in Pakistan have stalled after some initial success with attracting independent power producers (about half of the country's power is generated by the private sector), privatizing the Karachi Electric Supply Company, and unbundling the Water and Power Development Authority. The sector's financial viability is severely affected by unresolved triangular debt stemming from inadequate power tariffs, which recently led the off-taker to withhold contracted payments under power purchase agreements.

121. The extent and success of power sector reforms in India varied depending on the level of political commitment, with good progress made in Gujarat and limited progress in Madhya Pradesh; these varying degrees of progress have been reflected in different levels of private investment in the power sector. Particularly in Assam and Gujarat, restructuring led to a more commercial and competitive sector environment, which facilitated change management initiatives and efficiency gains, contributed to a reduction of transmission and distribution losses, and enhanced the financial viability of the sector. In Indonesia, where ADB had promoted sector unbundling, the Constitutional Court annulled the 2002 Electricity Law, arguing that provisions for unbundling and competition violated the country's constitution. The 2009 Electricity Act allows private entities to participate in the electricity supply business, although related implementing regulations still have not been issued. Public resistance has thwarted government plans to increase power tariffs in Indonesia and the state utility company, Perusahaan Listrik Negara, continues to rely on yearly government budget transfers to honor its payment obligations under power purchase agreements. This has significantly reduced investor interest in the absence of pertinent long-term government guarantees.

122. Sector restructuring and tariff reforms require strong regulatory oversight. ADB support helped establish or strengthen energy sector regulators in Bangladesh, India (in Assam and Gujarat), Indonesia (for gas), Pakistan, and the Philippines. However, in many cases, their effectiveness has been reduced by a lack of political and/or fiscal autonomy. The newly established upstream gas regulator in Indonesia was dissolved, after the Supreme Court deemed it unconstitutional.

123. **ADB policy dialogue on improving incentives for PPP in the transport sector yielded few successes.** Compared to the energy sector, ADB efforts to create better conditions for more private investment in the transport sectors have been modest. In the road sector, restructuring support by ADB resulted in the establishment of credible government contracting agencies (GCAs) in Madhya Pradesh. In Pakistan, ADB successfully supported the introduction of private rail services. ADB policy dialogue on the restructuring of state monopolies in transport infrastructure sectors in Indonesia (many of whom are the designated government contract agencies for PPPs) has been less effective so far, as these institutions continue to actively limit entry by private competitors. The restructuring of state entities often runs against vested institutional interests. Unless there are incentives and/or external pressures for powerful line ministries and agencies to reform, there is unlikely going to be much demand for related ADB support. It can be argued that the ready

availability of ADB financial support for public transport sector investments has reduced incentives for institutional reform, including for PPI.

124. ADB support for water sector reforms that are required for PPP in the reviewed countries was less than effective. ADB sought to address water sector policy issues in all of the study countries, albeit with modest success. Policy dialogue in Indonesia supported an end of water district monopolies in the provision of water. However, outside Jakarta, private participation in the sector remains constrained by an uncertain regulatory framework, growing public opposition to more private sector involvement based on the fraught Jakarta experience, and the low creditworthiness of many water districts, which have little incentive to increase water tariffs in light of political resistance. ADB efforts to strengthen Manila Water, a regulator, were less than successful, as the regulator lacks the resources and operational independence to effectively supervise the water concessionaires. Also, the adopted hybrid approach of regulation by contract and the (less than) independent regulator contributed to regulatory confusion. Policy dialogue on restructuring the water sector outside Manila, including the establishment of a more efficient administrative structure, a policy and legal framework for PSP, and an independent regulator, contributed to the internal debate on sector reforms, but has yet to yield tangible results. Support for water sector reforms in Bangladesh and Pakistan led to some restructuring, although dialogue on tariff reforms had limited success due to public resistance. In India, ADB focused on improving the financial viability of municipalities in charge of water provision through taxes, but water tariffs have remained below costs. ADB recently approved regional TA for India, Nepal, and Sri Lanka to advise on tariff formulas that cover operation and maintenance costs, approval processes, lifeline tariffs for the poor, and consultation processes to introduce tariff increases to the public. In the case of India, the TA will produce national guidelines for tariffs that enable full cost recovery and conduct a pilot program involving five regions.

125. The effectiveness of ADB support for the development of PPP institutional capacity has been mixed. ADB supported the development of PPP capacity at the central and subnational levels in India, Indonesia, and Pakistan. Similar support was approved after 2010 for the development of national PPP centers in Bangladesh and the Philippines. To facilitate PPI on a larger scale given limited DMC capacity, ADB's operational focus has been on central cross-sector PPP units rather than sector-based institutions. In a number of case study countries, however, responsibility for energy sector PPPs remained with the respective sector agencies, which tended to have more relevant experience and expertise than other government entities. The monopoly position of state-owned utilities and sector agencies thwarted the participation of the private sector in their respective infrastructure sectors, often with the tacit support of the line ministries and departments. ADB initially did not provide much support for value-for-money analysis,⁷² which could have helped with the selection of projects for private participation based on a transparent and objective methodology. An issue encountered in conjunction with ADB support in Indonesia has been the location of the PPP function in the National Development Planning Agency (BAPPENAS) rather than the government's treasury. BAPPENAS has viewed PPP as an alternative funding rather than a procurement option, which contributed to its suboptimal selection and preparation of PPP projects. In Indonesia and Pakistan, support for building institutional capacity for project development and contracting was somewhat premature given the state of infrastructure sector reforms at the time, which hampered the emergence of a realistic pipeline of PPP projects affecting the credibility of the newly created PPP institutions. While mostly effective, the success of ADB's support for strengthening PPP capacity of state governments in India varied in line with the level of

⁷² The rationale for value-for-money analysis is to determine the benefits of private procurement versus a public comparator.

government commitment, TA consultant performance, and internal coordination among relevant government entities. While capacity development efforts in India benefitted from hands-on work with live projects throughout, it is also noteworthy that the vast majority of PPP projects were prepared for implementation and financing by domestic project developers and financiers, unlike in the other assisted DMCs.

126. ADB support for the development of local financing mechanisms for private infrastructure projects had mixed relevance and effectiveness. Earlier dollar-denominated credit lines to domestic public and private financial institutions for financing private infrastructure projects in Bangladesh, India, and Indonesia experienced demand problems.⁷³ Other than these, ADB, together with the World Bank, also supported the establishment of specialized commercial infrastructure financing institutions in India and Indonesia, including the India Infrastructure Finance Company Limited (IIFCL), Indonesia Infrastructure Financing Facility (IIFF), and PT Sarana Multi Infrastruktur Indonesia. The IIFCL was set up in 2010 as a special purpose vehicle to directly provide—or facilitate through take-out financing—long-term financial assistance to infrastructure projects. Take-out financing by the IIFCL was to help domestic banks free up headroom for more infrastructure lending.⁷⁴ The IIFF was established in January 2010 to offer long-term, mainly local currency, financing for infrastructure at market conditions. It is to play a catalyst role in terms of co-financing with commercial lenders to provide long-term debt and to provide advisory services for project preparation.

127. The IIFCL is a well-established and well-managed institution, and its role will evolve in coming years as financing constraints become a major issue for PPI in India. As of September 2013, the IIFCL had onlent ADB loan proceeds of \$1.15 billion to 49 private infrastructure projects in India. However, although the IIFCL has achieved the outputs envisaged at the time of loan approvals, it is not leading deals, structuring innovative products and instruments, and/or catalyzing new sources of long-term financing for PPP projects. The IIFCL is a syndicate member without the capability (or mandate) to lead syndications and/or influence loan terms and conditions, particularly relating to environmental and social safeguards, as it has a maximum exposure limit of 20% to any one project. Many of the project loans in which the IIFCL has participated probably would have been fully subscribed even without its involvement. However, the IIFCL could play a critical role in developing credit enhancement and take-out financing products, subject to these products having competitive pricing.⁷⁵ Major state banks along with some private sector banks are reaching statutory borrower and sector exposure limits and need to be refinanced in order to continue lending for project financings. A new initiative spearheaded by the South Asia Department and the Private Sector Operations Department (PSOD) seeks to help the IIFCL develop institutional capacity for the provision of partial credit guarantees to project bonds issued by infrastructure special purpose vehicles. A partial credit

⁷³ All credit lines had problems disbursing funds for stipulated purposes due to the availability of cheaper domestic sources of funds, project companies' apprehension with respect to the procedural requirements of ADB subloans (especially social safeguard procedures in India), and, more importantly, the lack of bankable PPP projects at the time.

⁷⁴ Domestic banks had become heavily exposed to infrastructure projects due to a range of measures by the Reserve Bank of India, such as: (i) allowing banks to enter into take-out financing arrangements; (ii) freedom to issue long-term bonds by banks for financing infrastructure; (iii) adjustment of single and group borrower limits to allow for additional credit exposure in the infrastructure sector; (iv) flexibility to invest in unrated bonds of companies engaged in infrastructure activities within the overall ceiling of 10%; (v) excluding the promoters' shares in the special purpose vehicle of an infrastructure project to be pledged to the lending bank from the banks' capital market exposure; and (vi) permitting banks to extend finance for funding promoter's equity where the proposal involves acquisition of shares in an existing company engaged in implementing or operating an infrastructure project in India.

⁷⁵ So far, there has been little demand for IIFCL refinancing given the IIFCL's pricing, which reflects its high funding costs since it continues to source most of its funds from domestic banks.

guarantee facility in the amount of \$128 million to the IIFCL was approved by ADB's Board on 20 September 2012.

128. While demand for financing from private infrastructure projects in India has rapidly increased to the point that domestic banks are reaching exposure limits, a substantial PPP project pipeline has yet to materialize in Indonesia. In March 2009 ADB approved the provision of subordinated debt through a Government holding company to the IIFF. It only made its first disbursement in June 2013 supporting 3 infrastructure projects. Apart from the fact that there have been only a few sizable PPP projects that have closed in Indonesia during the last 5 years because of continuing enabling environment constraints discouraging private investment in infrastructure, the IIFF's slow start has also been due to the ready availability of competitively priced (shorter term) debt financing in the highly liquid domestic market, which limits demand for such kind of funding from the ADB-supported institution. The Indonesia Infrastructure Guarantee Fund was established in December 2009 to provide government guarantees or credit enhancements to economically viable PPP projects. The fund, which is fully state-owned but operates independently and has its assets ring-fenced, is intended to act as a credible guarantee provider protecting the interests of infrastructure investors. The government expects that the fund will attract other parties to provide capital support and expand guarantee coverage. The Indonesia Infrastructure Guarantee Fund guarantees are to be issued in lieu of direct government guarantees ("Letters of Comfort") such as those provided to IPPs in the past. It is probable that there will be major issues to overcome in terms of the pricing of the guarantees, the claim process, as well as the quality of the guarantee considering IIGF's thin capitalization (Rp4.5 trillion or \$0.5 billion as of December 2012), which means that large projects will still need a co-guarantee from the Government of Indonesia.

129. Given the capitalization levels of these institutions, any significant upscaling of private infrastructure financing will require substantial amounts of local currency debt financing from capital markets. The provision of infrastructure financing suffers from underdeveloped corporate debt markets. ADB has supported corporate bond market development in all study countries with limited success so far given the lack of credible yield curves, inadequate debt recovery frameworks, inadequate financial reporting and disclosure, high issue costs, lack of an institutional investor base, and lack of liquidity mechanisms.⁷⁶ For example, in India, ADB provided TA for secondary debt market development, as well as TA for complementary reforms of the mutual fund industry, regulation and supervision of derivatives markets, and pension reform. TA recommendations for secondary debt market development were generally perceived to be useful by the Ministry of Finance, the executing agency, for furthering the government's understanding of relevant policy issues and options. However, a number of relevant consultant recommendations under ADB capital markets-related TA have not been implemented. For example, the level of government ownership in financial institutions, its role in determining interest rates, large fiscal deficits, lack of transparency about macroeconomic and monetary targets by the Reserve Bank of India, and the underdeveloped institutional investor base continue to impede the development of bond markets. Mutual fund development is constrained through the lack of tax incentives and shortcomings in the regulatory framework, including the lack of an effective self-regulatory structure.

130. **Reforms facilitating land acquisition for the provision of public services have received little attention from ADB.** ADB has provided comparatively little support in this area outside Indonesia, where support contributed to the adoption of the Land Acquisition

⁷⁶ Independent Evaluation Department. 2008. Special Evaluation Study: *ADB Assistance for Domestic Capital Market Development*. Manila: ADB.

Procedures for Public Interest Development Law in December 2012 allowing the government to appropriate land for public interest, which is deemed crucial for mitigating infrastructure bottlenecks and attracting foreign investment. Yet land acquisition has proved to be one of the major constraints to private toll road projects and site-specific projects in all study countries. The existence of land acquisition laws that provide a process, definitive timelines for land acquisition and financing, and a formula for compensating landowners are crucial for reducing associated completion and regulatory risks in infrastructure PPP projects. Central and local governments, although willing to assist private sector sponsors, are mindful of the political and social repercussions of dispossessing local people. Schemes for resettlement and/or employment are important factors in securing cooperation of the local people. Project sponsors have to engage with local people at the early stages of land acquisition and employ the local people in the project.

Box 5: Lessons – Facilitating Private Participation in Infrastructure Development

ADB assistance for sector reforms needs to continue over a long period. Sector reform is a complex and long-term process involving consistent and continued support commencing with campaigns to educate politicians, bureaucrats, and the general public, and financing to support the costs of reform. Frequent interventions through policy-based loans may be required to ensure implementation of reforms stays on track and on time. Successful sector restructuring in the power sector was usually the result of a series of interventions and consistent and continual support for capacity and policy development over more than a decade. The pace and cost of sector reforms are impacted by the sequencing of assistance, and “regulatory lag” can slow and increase the costs of sector reforms. It is crucial to establish a robust and transparent regulatory framework, along with an independent and capable regulator, prior to undertaking asset divestitures and other forms of PPI. The establishment and strengthening of regulators is an ongoing process and cannot be achieved with one-off support for capacity building. Regulators’ roles evolve as industry restructuring or unbundling progresses and the number of competitors increases in the sector. Regulatory reforms involve a dynamic process where unexpected obstacles can impede progress and undermine the intent of the reforms. As such, they need to be proactively supported by ADB.

Special efforts are needed to achieve broad-based buy-in for tariff reforms. ADB has had few consistent and concerted efforts to support tariff reforms in infrastructure sectors outside power. Although loan covenants under two-thirds of ADB-financed public investment projects included actions related to tariff reforms and cost recovery, compliance was achieved in only half of the cases without follow-up or consequences from ADB.⁷⁷ The viability of many power and most water sector entities is undermined by non-cost reflective tariffs for power and water, and as a result there are concerns as to the creditworthiness of the government contracting entities under PPPs. The general public remains to be convinced that the private sector can deliver reliable, good quality infrastructure services, and therefore, there is often resistance to tariff reforms for the sake of PPI. Any increase in prices of services needs to be justified by efficiency gains and service improvements. Further, the absence of capable and independent regulators willing and able to approve tariff increases further undermines attempts to implement tariff reforms.

An earlier IED study concluded that related reforms are difficult but not impossible (footnote 70). The few successful projects shared some of the following elements: (i) effective stakeholder communication and consultations, (ii) early identification of winners and losers, (iii) tariff structures that are perceived to be fair and affordable, (iv) reforms that are accompanied by service improvements, (v) metered rates so that customers can manage their service bills by controlling consumption, (vi) gradual tariff adjustments, (vii) crisis conditions that legitimize infrastructure investments and related tariff reforms, and (viii) credible and legitimate service providers. ADB and other development partners need to support governments in undertaking the substantial analytical and advocacy work (involving, among others, willingness-to-pay surveys and comprehensive public consultations and public communication strategies) needed to help determine tariff structures and

⁷⁷ Independent Evaluation Department. 2010. *Special Evaluation Study: Water Policy and Related Operations*. Manila: ADB.

levels that accommodate private and public sector interests. Furthermore they need to design any required lifeline and block tariffs (or alternatively, targeted cash subsidy schemes) to protect the poor. However, regulators need to ensure that water utilities do not bypass poor areas due to the poor financial viability of new connections in such areas and that subsidies actually benefit the most needy.

Equally important for enhancing the long-term financial viability of sector institutions is political commitment to reducing nonrevenue water and electricity theft.

Regulatory issues need to be proactively addressed to maximize economic benefits. There are several reasons for lack of regulatory enforcement:

(i) Often there is only superficial and inconsistent political support for commitment to regulatory change.

(ii) Where the independent regulatory model is adopted, it is often not clear whether the regulator has extensive or limited regulatory responsibilities, and it is also unclear how much discretion the regulator has in taking decisions. All successful regulators operate with defined and accountable discretion within a rules-based framework

(iii) In most Asian countries, a hybrid regulatory model exists with regulation by contract (concession) alongside an independent regulator. The regulator's role in supervising concessions causes confusion and tension among all parties, as seen in the case of Manila Water, and care needs to be exercised in allowing regulation by contract to override an underdeveloped, but evolving, independent industry regulatory model.

(iv) Sector regulatory reform is a complex and long-term process, requiring consistent and continual support; campaigns to educate politicians, bureaucrats, and the general public; and financing to support the costs of industry restructuring and reform.

(v) Newly established regulators often not lack the expertise and resources to perform effectively. Moreover, they also lack financial and institutional independence, particularly if they are staffed and located within line agencies with sector responsibilities.

Government financial support for PPPs needs to be credible and justified. The Indian PPP experience shows the potential that viability gap funding (VGF) can have in kick-starting PPP development. It also demonstrates that private sector competition that relies on bid selection on the basis of lowest required subsidy can reduce levels of required VGF over time and over the course of many transactions. The level and mechanism for such payments needs to be determined on the basis of a transparent methodology.

Given the low financial viability of many public sector contracting agencies, private sector investors and banks usually require performance guarantees for GCAs. Governments have also been providing guarantees to protect project sponsors from government-related project risks in PPPs, in particular against regulatory risk. While these guarantees are particularly helpful in getting sub-sovereign projects off the ground, their overall usefulness depends on the perceived government ability to make good on them. Private sector investors and banks often remain skeptical of governments' commitment and capacity in this regard, with recent experience in Pakistan reinforcing these concerns. The establishment of thinly capitalized guarantee agencies to act as guarantors on behalf of the government (as supported by ADB in Indonesia) confuses and complicates the risk-sharing process. Under these conditions, it is likely that a two-tier guarantee structure will emerge with the guarantee agencies providing minimal cover, and the Ministry of Finance back-stopping most of the cover. A more sustainable way forward is to support improvements in the financial viability of contracting entities.

For all forms of government support, the level of government financial support required can be reduced by good feasibility studies, transparent and fair bidding processes, the rule of law and existence of satisfactory dispute resolution mechanisms, and regulatory and policy predictability.

India's experience with PPPs is not necessarily applicable to other countries. India's PPP model is an extension of its development finance model. The PPP program has generated a lot of private investment because of government financial support for projects and state bank lending on a massive scale. Although this has facilitated large volumes of private infrastructure investments and seems to have also improved the quality and speed of infrastructure provision, there have been issues as well. Firstly, although the level of government-required financial support appears to have gone down for

recent transactions, with increasing competition among contractors and improved institutional capacity for contracting PPPs, initial levels of annuity payments and VGF have been perceived as high in the absence of value for money analysis.⁷⁸ Also, there is need to monitor contingent liabilities inherent in annuity schemes to ensure long-term fiscal sustainability. Secondly, the existence of several large state sector banks willing to take risks and lend on terms inconsistent with international established practice raises serious concerns about the sustainability of PPP financing and PPI in India. The massive growth in “project finance” lending from 2005 to 2010 is likely to result in substantial loan provisions as large projects encounter implementation and other problems. It is also unlikely international banks will become active lenders to projects in India unless and until projects sponsors are willing to structure deals on different terms than in the past. Caution is also advised in attempting to emulate the Indian experience with PPPs at local government levels. Some of the Indian state economies are as large as national economies, and some state governments have highly capable institutions to implement PPPs. Local government entities in most other Asian countries do not have such economies of scale and capabilities.

F. Lessons

131. **This evaluation study identified a number of drivers of success.** Success factors for enabling environment reform support included (i) high levels of government reform commitment and institutional incentives for change; (ii) best practice designs (e.g., credit information systems that are mandatory and full file, secured transactions systems that permit out-of-court enforcement of collateral, and business registries that minimize contact with administrators); (iii) the selection of sustainable systems that are adopted to local conditions, in particular financial and human resource levels (e.g., many company and secured transactions registries in the Pacific region); (iv) the provision of long-term support throughout the reform process, including implementation (e.g., power sector reforms in Bangladesh and the Philippines); and (v) the selection of effective consultants advising on reforms (e.g., PPP advisors in India or PSD advisors in the Pacific region). Existing government capacity was helpful, but not a necessary condition for project success, as demonstrated by ADB’s experience in the Pacific.

132. **The effectiveness of PSD enabling environment reforms varied depending on the levels of government and stakeholder commitment and the quality of the overall governance environment,** which combined to determine underlying institutional incentives for implementation and enforcement. Institutional capacity was less of a predictor of reform success than political support, as positive experience with Solomon Islands demonstrates. Reforms worked best when introduced in conjunction with general governance, public administration, and civil service reforms, including remuneration levels, which can reinforce reform momentum and sustainability. Institutional incentives for implementing reforms should be carefully assessed as part of the PSA and addressed during the CPS process. Also, support for institutional reforms was usually more successful when pursued over a longer time frame and backed up by sufficient advisory services and investment assistance.

133. Although there are some variations in private sector concerns, there is a general consensus on what constitutes a conducive investment climate for private businesses. Moreover, while approaches to strengthening the enabling environment for PSD must consider local conditions, particularly with regard to political economy and institutional factors as well as the country’s development stage, there are nevertheless basic generic principles that apply to the design of reform agendas in most assistance areas. One repeated lesson is to focus policy dialogue on binding constraints and measures to address the underlying issues, be they changes governance conditions to ensure the effectiveness of regulatory reform or critical infrastructure sector reforms to ensure the effectiveness of PPP

⁷⁸ Infrastructure Development Finance Company. 2011. *India Infrastructure Report 2011*. New Delhi. p. 385.

concepts. It is advisable to commence with enabling environment support in areas where such reforms are feasible. Moreover, more analysis needs to be undertaken on the economic costs of postponing essential policy reforms.

G. Operational Implications

134. **Engage in advocacy work and long-term policy dialogue.** It is important to build and support constituencies that have an interest in improving the investment climate. Support for the analysis of economic costs and benefits of potential reform measures, advocacy work, as well as pilot projects with committed government entities can help strengthen the hand of reformers who want to address pertinent issues. Buy-in can be improved by initially focusing on reforms that have immediate positive impacts for a large number of entrepreneurs such as those related to business licensing. Given the importance of an appropriate PSD enabling environment for private investment and economic growth, sustained ADB engagement, even in politically difficult areas and times, is warranted. Coordination with other development partners can ensure a consistent approach in addressing the binding constraints to private sector-led economic growth.

135. **Focus support on reform implementation.** The focus of ADB support and related policy dialogue needs to be on reform outcomes, not only policy actions. For example, changes in laws and regulations alone do not achieve much impact if they are not also enforced. There are a number of measures that can be taken that ADB should support, including: (i) increasing the likelihood of implementation and enforcement of enabling environment reforms, including related capacity development and skills training; (ii) using standardized processes and automated systems, including e-governance approaches, that enhance transparency and minimize the scope for subjective and arbitrary decisions; and (iii) introducing relevant performance measurements, enhanced disclosure, and other processes that strengthen the accountability of implementing agencies. Performance indicators in ADB design and monitoring frameworks that reflect the implementation rather than merely the adoption of reforms need to be used.

136. **Focus analysis and monitoring of business transaction costs on actual rather than de jure costs.** ADB projects that seek to reduce unnecessary private sector transactions costs arising from regulatory requirements often rely on Doing Business indicators, which measure de jure regulatory costs, to monitor reform progress. However, formal compliance costs can be misleading. While de facto and de jure costs are nearly identical in countries with good governance, in an environment that is prone to corruptive practices, there can be substantial differences between the two. De facto costs are often lower than de jure costs as bribes are paid to avoid paying the full costs. In those cases, the impact of a reduction in de jure costs will likely be smaller than anticipated. Sometimes actual compliance costs even increase post-reform, as reported in the Lao PDR for customs clearances despite de jure time reductions. This is usually due to the presence of intermediaries that specialize in handling bureaucratic formalities on behalf of their enterprise clients. Obtaining reliable data to monitor reform progress would imply spending resources to obtain feedback from stakeholders on actual transaction costs.

137. **Focus financial sector support on addressing underlying issues that affect costs and access to finance.** This entails continued and enhanced ADB policy dialogue for relevant financial sector reforms, including (i) rectifying causes of interest rate distortions, (ii) strengthening financial market competition and regulation, (iii) strengthening financial market supervision and regulatory enforcement, (iv) improving frameworks for corporate and financial governance, and (v) reducing risks for lenders through the development of functioning secured transaction, debt recovery and bankruptcy regimes. In addition, more support needs to be provided for improving credit information and skills, and for financial

literacy programs to expand outreach. Financial sector road maps need to systematically consider efficiency and outreach aspects of financial intermediation; determine associated challenges; and identify meaningful strategies for addressing these issues and related outcome targets. Government support mechanisms can expand the SME finance space, but their potential for market distortion needs to be recognized and addressed, and the mechanisms' actual outreach, additionality, and leverage confirmed. Also, given the magnitude of estimated financing gaps, improving enabling conditions for the commercial provision of SME credit will be the most feasible strategy of facilitating access to finance. More support is needed to help determine actual funding gaps for smaller private enterprises based on effective demand for credit by collecting more data on SMEs and their operations.

138. **Ensure a realistic time frame for and adequate sequencing of PPI-relevant interventions, and provide adequate support for related sector reforms.** ADB defines its approach to PPP support under four pillars: (i) advocacy and capacity development, (ii) enabling environment, (iii) project development, and (iv) project finance.⁷⁹ While there should be overlap between and among the pillars, ADB appears to underestimate the need to achieve a certain level of progress with each pillar before moving to the next stage. For example, in some instances, support for the development of and decisions on risk-sharing mechanisms between public and private parties and government financial support schemes lagged support for PPP project development, in the case of Indonesia by several years. While well-structured PPP pilot transactions can reinforce the need for sector reforms, such projects will unlikely develop in (sub)sectors where tariff and other policy issues pose binding constraints to PPI, e.g., in water distribution. There can be some overlap between reform support and support for the development of individual PPP transactions as long as a credible reform road map that has broad-based political support is in place. Nevertheless, large-scale support for project development and financing should preferably follow, rather than precede, the implementation of critical sector reforms. Sustainable PPP projects will emerge from an infrastructure sector if sufficient progress is achieved with the commercialization, restructuring and unbundling of sector entities, tariff reforms, and development of the regulatory framework and oversight. ADB should engage in policy dialogue on critical sector reforms and ensure adequate levels of reform support.

139. Support for project development or PPP financing in an attempt to kick-start a pipeline of PPP projects in the absence of required sector reforms might lead to disappointment and frustration with the PPP process and possibly distract governments from focusing on the need to progress fundamental reforms. PPPs are not a panacea for poorly regulated and inefficient infrastructure sectors, even if bulk supply projects with regulation by contract and government guarantees can avoid and/or postpone the need to tackle fundamental structural and regulatory reforms. ADB needs to remain engaged in policy dialogue in key reform areas. It needs to find a way to operationalize such dialogue not only under policy-based loans, but also under other lending modalities, including multi-tranche finance facilities.

140. If there is substantial need for sector restructuring and reform, it will likely take 5–10 years before there is any significant impact on PPI. For example, India commenced major reforms in power and transport during the 1990s and at the same time promoted private participation. Initial PPP approaches were developed and piloted in the late 1990s, but did not take off in earnest before 2006. Once required sector reforms have been implemented and a policy, legal, and regulatory framework for PPP is in place, projects can be developed on a larger scale. PPPs are inherently complex and take on average 3–4 years to prepare

⁷⁹ ADB. 2012. *ADB's Approach to PPP Support: Four Pillars. Advocacy. Enabling Environment. Project Development. Project Finance.* Manila.

from concept to financial close. It is thus important to manage expectations of government counterparts and within ADB regarding the extent and length of this process to avoid frustrations and pipelines of nonbankable projects. For example, in Indonesia, ADB and the government anticipated that PPPs would materialize within 5 years of the start of sector reforms, but this turned out to be too optimistic.

141. **Provide long-term support to build regulatory capacity and facilitate enforcement to increase economic benefits of PPI.** ADB support for infrastructure regulators has been largely limited to their establishment. However, little support has been provided to help with the implementation and enforcement of regulations. Regulatory reform analysis and recommendations must be followed up with detailed implementation plans and appropriate institutional arrangements along with financial, capacity building, and consulting support. Political commitment and leadership are probably the most important factors in establishing a capable and independent regulator.

142. Sustained TA to “operational” regulators, such as the Energy Regulatory Commission, Metropolitan Waterworks and Sewerage System – Regulatory Office (MWSS-RO), and Bangladesh Energy Regulatory Commission, would improve the efficiency of those entities and indirectly improve service reliability, coverage, and quality. Sustained TA will also ensure the regulators can evolve from the current emphasis on tariff reviews and performance-based rates to identifying and enforcing penalties for abuse of market power if there is a concentration of ownership in an infrastructure sector. An example are the emerging challenges facing the Bangladesh Energy Regulatory Commission during the next stage of the power sector reform process, which will require additional capacity support to ensure an adequate level of price competition in generation and retail markets.

CHAPTER 4

ADB's Institutional Performance

143. This chapter assesses to what extent ADB institutional issues identified during the preparation of the revised PSD strategic framework paper have been adjusted to improve PSD-related support, including support for strengthening the enabling environment for private business activities. In particular, this chapter focuses on issues related to strategic guidance, identification of PSD support, results management, internal coordination, and staff skills

A. Strategic and Operational Guidance

144. **Existing strategic guidance is insufficient.** The internal review of the Private Sector Development Strategy (PSDS) identified a number of important issues that have affected PSD-related support by ADB. The revised strategic framework for PSD contained a number of actions that were a priori relevant, but generally lacked sufficient definition for successful implementation. Neither PSDS, the revised framework, nor Strategy 2020 include any targets with regard to PSD enabling environment support. The second and third thrusts under the revised framework have been given more attention than enabling policy and institutional environment support. With regard to enabling environment support, it is difficult to discern any difference in related ADB operations as a result of the revised strategic framework. The revised framework was followed up with more detailed strategic guidance to implement the second and third thrusts, which helped increase ADB's PSO and revived its engagement in private infrastructure. However, comparatively little internal discussion focused on efforts to improve the business regulatory environment and policy and institutional issues shaping the overall investment climate. This is in part because support for related reforms would have to be operationalized through programs in sectors that are not core operational areas for ADB under Strategy 2020 (e.g., public sector management and industry and trade).

145. Most available ADB corporate sector policies and strategies refer to the potential that private sector involvement can bring to increasing sector investment and efficiencies. However, with the exception of the energy policy and the water operational plan 2011-2020, these sector policies or operational action plans do not contain explicit strategies for addressing related enabling environment issues to facilitate such participation. Nor do they consider the impact of investment climate issues on sector performance. Another area that requires more attention is potential sector contributions to PSD. Only the education sector operations plan contains substantial links between sector operations and PSD, as it seeks to improve the relevance of ADB support for education sector policies and investment to labor market needs, among others, by promoting an expansion of post-secondary education and a reform of technical education and vocational training systems, including a shift of actual training provision to the private sector and industry. The 2009 energy policy focuses on improving access to energy, which should help small enterprises in rural areas; energy

efficiency and renewable energy, which should also help reduce costs and enhance energy security; and promoting energy sector reforms and governance, which should improve efficiency and encourage PPI. However, its results framework does not contain any targets related to capacity expansion and PPI. The financial operational plan limits more direct sector links to PSD to financial inclusion, and the transport operational plan limits them to cross-border or logistics-related operations.

146. **ADB's support for PSD did not promote any particular conceptual approach to investment climate issues.** ADB's enabling environment support in Cambodia, the Kyrgyz Republic, and the Philippines has largely followed the World Bank's Doing Business agenda, which has gained traction over the last decade among governments and their development partners. The Doing Business agenda is based on the premise that economic activity requires rules that establish and clarify property rights and reduce the costs of resolving disputes, rules that increase the predictability of economic interactions, and rules that provide contractual partners with core protections against abuse.⁸⁰ In recent years some criticism has emerged regarding the agenda's underlying assumption that less regulation (and lower tax rates) is better. It is argued that less regulation (particularly labor market and environmental regulation) and low tax rates could be inadequate from a socioeconomic viewpoint.⁸¹ Nevertheless, there is general acceptance among development practitioners that unnecessary business regulations and bureaucratic burdens need to be removed, and the required regulatory framework should be efficient and transparent. Success with related reforms aimed at reducing the complexity and costs of regulatory processes and strengthening legal institutions in the case study countries has been mixed. So far, most progress has been made in the Kyrgyz Republic, where ADB supported a broad reform program based on the Doing Business agenda, although de jure improvements have not always translated into de facto gains. In Cambodia, good progress has been made in some areas, including the adoption of a commercial legal framework, microfinance development, and the introduction of regulatory impact assessments. However, other reforms have either not been fully implemented yet (customs reform), did not effectively deal with underlying governance issues (business registration), or involved the introduction of laws or systems that were not fully in line with best practices (the insolvency law and the first credit information system). In the Philippines, relevant ADB support has not yielded any results yet, as it is either ongoing or was cancelled.

147. The approach adopted by ADB in the Pacific region has been strongly shaped by assumptions drawn from a particular strand of institutional analysis associated with the economist Hernando de Soto, which has been highly influential throughout the international development community. There is much to recommend about this approach, in particular its compelling and action-oriented diagnoses of failures in the institutional frameworks for property rights and contract enforcement. Its weaknesses are its one-sided focus on the costs imposed by formal institutions and its relative neglect of empirical social science inquiry into actual microeconomic behaviors, including informal norms and networks, resource sharing, coping mechanisms, and social enforcement, which have complicated land administration reforms. Also, despite achieved outputs in the form of functional company registration and secured transactions systems, outcome attainment will also be dependent on the implementation of other measures that expand the scope for entrepreneurial activity and address other critical financial sector constraints.

148. In Bangladesh and India, ADB support has been largely driven by governments' priorities and philosophical approaches to PSD, which are characterized by a greater level

⁸⁰ World Bank. 2010. *Doing Business 2011*. Washington, DC.

⁸¹ Independent Evaluation Group, World Bank. 2009. *Doing Business: An Independent Evaluation-Taking Measure of the World Bank-IFC Doing Business Indicators*. Washington, DC.

of interventionism to address perceived market failure in the development of SMEs through targeted (and often subsidized) government credit and other support schemes rather than improvements in the overall business environment. For example, although ADB promoted a more demand- and commercially-oriented provision of SME financial and business advisory and development services in Bangladesh, there has been little broad-based support for the new SME Foundation embodying these principles, while the institutional culture and capacity of the existing public service providers remained largely unchanged. ADB credit facilities did not address the underlying constraints to SME lending, including lack of reliable financial or credit information on borrowers, insufficient collateral, and interest rate distortions driving up funding costs of financial intermediaries. Nevertheless, the government also implemented a range of PSD-relevant policy and regulatory measures with the help of various other development partners.⁸² Related ADB support for online filing of tax returns, digitization of the land records management system in selected districts, and improved access to tax and land information in specialized information and service centers is ongoing.

149. **PSD conceptual approaches must be adapted to suit country conditions.** Conditions for private sector activity and constraints to doing business vary from country to country. An approach that works well in one country or countries with common characteristics does not necessarily work elsewhere, as ADB experience shows. This is particularly true for institutional reforms that need to take into consideration a country's institutional capacity, incentives for change, and vested interests. Whatever conceptual framework is used, it must address these underlying currents successfully to be effective. More operational guidance based on a review of wider international experience—experience gained with ADB projects is rather limited in some areas—on what approaches work under what conditions would be helpful.

150. **Areas of PSD-related support at the country level have been largely determined on the basis of country-specific strategies and approaches,** as envisaged under the PSDS and the revised framework. There have been many variations in terms of topics covered, mainly reflecting a country's investment climate conditions, government development priorities, but also the preferences of ADB team leaders. Given limited resources and institutional capacity on the part of ADB, more focus on a few topics would likely allow ADB to build up specific expertise and help deliver related assistance with greater effectiveness and efficiency.

151. **A common approach adopted for the Pacific region focusing on a few support areas enhanced the efficiency and effectiveness of ADB support for PSD.** Only in the Pacific region did ADB apply a consistent approach to addressing the binding constraints to private sector-led economic growth involving support for: (i) increasing access to finance by expanding the availability of microfinance and mobile payments, and reforming the collateral framework for lending; (ii) business law reform and simplified business registration; and (iii) state-owned enterprise (SOE) reform. One of the objectives for adopting a homogeneous approach was to increase the efficiency and responsiveness of ADB support considering the small size of individual economies and comparatively low institutional capacity of government agencies. Activities are implemented using a mix of country-specific and regional initiatives that cover analytical work, TA, capacity development, and advocacy. The regional Private Sector Development Initiative leverages existing ADB country programs by providing a rapid-response capability for PSD reform that

⁸² These included streamlined tax and customs administration, improvements in business licensing, an expanded role for private banks, and streamlined processes related to foreign direct investment. These measures had a positive impact on private business performance, while a number of issues related to contract enforcement and resolving insolvencies remained unaddressed.

supports the ability of Pacific DMC governments to quickly respond to arising reform opportunities.

152. The flexibility and holism of ADB's approach in Pacific countries has paid dividends around the region, ensuring responsiveness to local conditions and providing comfort and motivation to reform partners. On the other hand, the analyses and broad program outlines reflect a central intellectual and policy template embraced by ADB more than they do the dynamics of national and local economies in the region. This is not to suggest that the programs have been "imposed," but rather that ADB is offering a suite of products that it has conceived and that it is willing to customize as far as possible to local conditions. There are some scale efficiencies here, which is appropriate given the highly inefficient scale of most Pacific island nations and certain institutional and legal commonalities. But there are also costs and risks involved, including the possibility that "overselling" based on a uniform template could lead to disenchantment and a falloff in demand and use of the product. This may partly explain some of the unevenness in results across the region, although complete explanations must be sought in local political and economic contexts.⁸³

B. Identification of ADB Support

153. ADB identified areas of support for strengthening the enabling environment for PSD in the study countries through private sector assessments (PSAs), consultations with government and private sector representatives, and its own operational experience. Other sources of information, including enterprise and investment climate surveys and doing business and global competitiveness reports and rankings, played a smaller role in Bangladesh, India, and Solomon Islands, although the methodology, coverage, and quality of analysis of these information sources was generally perceived to have been adequate by the respective CPS team leaders. In Cambodia, the Kyrgyz Republic, and the Philippines, more use was made of global rankings and related analysis, in part because of the comparatively high level of attention given by the governments of these countries to attracting foreign investment.

154. **The usefulness of PSAs in selecting and prioritizing country-level support has varied.** PSAs were introduced in 2002 to strengthen the analytical foundations of ADB's private sector-related support. The 2011 CPS template made the preparation of a 4-page PSA appendix mandatory. From 2003 to 2011, standalone PSAs were completed for 16 of ADB's 39 borrowing DMCs, including for eight Pacific countries. Ten of these 16 PSAs were undertaken prior to 2006. A review undertaken under this study of PSAs that were prepared for the case study countries in conjunction with the CPS process reveals a number of issues with regard to assessing and addressing constraints to PSD.

155. There has been a lack of institutional guidance on the objectives, content, and structure of PSAs, which has resulted in a lack of consistency in PSA approaches and

⁸³ IED reviewed support for commercial laws and property rights in the Federated States of Micronesia, the Marshall Islands, Solomon Islands, Tonga, and Vanuatu. Secured transactions reforms have been fully implemented in all countries with likely moderately positive outcomes, although there are sustainability issues in Vanuatu. The company reforms were likewise formulated, adopted, and successfully implemented in the Federated States of Micronesia, Tonga, and Solomon Islands. Company registries operate effectively in Solomon Islands and Tonga and are likely having the expected benefits for company formation, although there have been financial sustainability issues in the Federated States of Micronesia and Tonga. The main gap in achievement was the failure of the Parliament in Vanuatu to act on a series of company reform and insolvency bills developed with ADB assistance due to changes in government and the level of reform commitment on the part of political decision makers. Also, the government in Tonga seems to take an increasingly antagonistic view of the private sector and, at times, its champions, including ADB.

quality. Earlier guidelines lacked operational relevance, enforcement, and dissemination. Six of the eight PSAs reviewed by IED (Bangladesh, Cambodia, the Kyrgyz Republic, the Philippines in 2005 and 2011, and Solomon Islands) focus almost exclusively on the first thrust of PSDS (creating enabling conditions) and touch only lightly (if at all) on the other two thrusts. Some give a rationale for this. For example the 2005 PSA for the Philippines states that creating the enabling conditions for business is the fundamental component for sustainability and that where enabling conditions exist, there is no need for donor interventions, as market forces suffice to create business opportunities and attract private investment. By comparison, the 2007 India PSA (written by an infrastructure advisory firm) focused exclusively on potential ADB support for private infrastructure projects and PPPs, and did not discuss other investment climate issues.

156. With exception of the India PSA, assessments touched upon most enabling environment factors when mapped against potential business constraints.⁸⁴ Areas that have not been adequately covered included macroeconomic stability, competition, public procurement, government permits or licenses, sector-specific policy and regulatory conditions for PPI, and trade-related issues such as product standards and logistics costs. Moreover, the analysis in most covered areas was not supported by adequate data, and issues were not systematically prioritized in terms of relative severity (Linked document 9, Table A9.1). There was little or no analysis pertaining to the needs of MSMEs or female entrepreneurs, and consequently no recommendations were made to address any issues these groups face (Linked document 9, Table A9.2). Also, ADB did not usually analyze the potential impact of proposed investment climate reforms measures on these groups.

157. PSAs are supposed to inform operations so their findings and recommendations are important. PSA recommendations differed with regard to their relevance for addressing key business environment concerns of the private sector as captured in various enterprise surveys or with regard to issues identified by the PSAs themselves. Problem areas not adequately covered by recommendations included issues related to governance, competition, property rights, availability of skilled workforce, and trade tariffs. Also, while a number of PSAs made general recommendations to governments on how to support the enabling environment for PSD, other assessments, notably the one for India produced in 2003, listed only those recommendations that would lead to “lending activity in the near future. Recommendations range from the general (e.g., “government to support SME sector”) to the specific (e.g., “Limit, to 3 days, the time that customs may hold up a shipment for inspection; if customs officer fails to file a complaint against shipper within 3 days, then shipment is released. Maintain a computerized database identifying for each customs officer how many shipments are held and released without complaint”). Some recommendations are given as suggestions or posed indirectly. All PSAs have gaps in terms of strength of support for their recommendations, such as discussions with stakeholders, openness to scrutiny through web publication, and justification given to support the recommendations in terms of prioritization and costs and benefits) (Linked document 9, Table A9.3). Nevertheless, most PSA recommendations were incorporated in ADB operations in the respective case study countries. However, in many recent instances in other DMCs, PSAs were undertaken at the same time that the sector road maps were being developed. In several instances, the PSAs were completed after the sector road maps had been laid out, which reduced their operational relevance.

158. **ADB sought private sector feedback during CPS formulation, but did not play a proactive role in private sector forums.** The extent of ADB consultations with the private

⁸⁴ There were some gaps between concerns raised by private entrepreneurs and problems identified by the PSAs, including competition issues in Cambodia, labor force issues in Cambodia and the Kyrgyz Republic, electricity supplies in the Kyrgyz Republic, and non-infrastructure issues in India.

sector in selecting support areas was generally adequate, although concerns were not necessarily fully reflected in ADB's strategies and programs. All CPS team leaders for the study countries report that they have had consultations with a range of private sector institutions during the CPS process, including chambers of commerce, industry groups, foreign companies, SMEs, female entrepreneurs, and private financial institutions. In each of these groups more than five institutions were consulted in Cambodia, India, and Solomon Islands, whereas in Bangladesh and the Philippines, one to four institutions were consulted in most groups. Feedback was usually sought through seminars and workshops with private sector representatives and one-on-one meetings, as well as through requests for comments on the draft CPS documents. Structured surveys were not used. During CPS implementation, ADB kept in touch with private sector concerns through its representation in public-private consultative forums, including the Private Sector Forum in Cambodia, which is held twice a year and attended regularly by resident mission staff and sporadically by ADB headquarters staff; the Philippines Development Forum Working Group on Growth and Investment Climate, which is sporadically attended by ADB headquarters and resident mission staff; and the Economic Consultative Working Group in the Solomon Islands, for which ADB acts as secretariat. However, although ADB participates in meetings of these forums in Cambodia and the Philippines, it has not played a more proactive role by contributing to their running or leading any of the topic groups. In the absence of such forums in Bangladesh and in India, ADB interactions with private sector representatives on strategic private sector issues are limited to one-off meetings on specific projects, as well as regular resident mission consultations with the Chamber of Commerce and Industry in India.

C. Coordination of Private Sector Operations with Private Sector Development Enabling Environment Support

159. **Complementarities between enabling environment support and private sector operations (PSO) have not increased.** In infrastructure, any linkages have been largely limited to the energy sector, where ADB support for sector reforms in Bangladesh, India, Pakistan, and the Philippines facilitated private sector investments in IPPs including by the PSOD, as well as the privatization of the Karachi Electric Supply Corporation. Earlier ADB TA contributed to the development of a regulatory framework for the gas industry in Indonesia, which enabled private sector investment in the sector, including for the Tanguh Liquefied Natural Gas Project. An ADB investment in the China Environment Fund was preceded by TA for drafting the Clean Production Law and developing the underlying policy framework, which also effectively prepared the stage for subsequent PSOD investments in renewables. Only a few PSO occurred in DMCs without any ADB support for energy sector restructuring. In the telecommunications subsector, TA support for the establishment of an independent competition regulator in Papua New Guinea facilitated rapid privatization of the industry and helped maximize economic returns from private licensees, including one supported by ADB. PPP-related policy dialogue in Indonesia preceded the creation of the Indonesian Infrastructure Financing Facility, but was less than effective. Opportunities for private infrastructure investment in some of the other DMCs and sectors have been constrained by the status of sector reform efforts. Related support from ADB went down over the last decade mainly due to lack of political commitment for such reforms in client DMCs.

160. There were not many complementarities between PSO in the financial sector (including those seeking to facilitate SME development) and enabling environment support

by regional departments.⁸⁵ A number of PSO, including support for asset-based securitization in the Philippines as well as for a mortgage credit guarantee company in India, would have benefited from ADB policy dialogue in these areas. Despite greater involvement of the PSOD in the CPS process in recent years, the share of PSO that is related to any ADB enabling environment support has not increased, in part because investments have been concentrated in countries where ADB does not have much policy dialogue or provide significant levels of TA (in Armenia, Azerbaijan, the PRC, Georgia, and Thailand).

161. The relevance of PSD enabling environment support for potential PSOD investments was a minor consideration for prioritizing enabling environment support during the CPS process in most study countries. The latter is surprising given the emphasis of ADB's revised 2006 strategic framework for PSD on a coordinated operational approach for all of the three PSD thrusts. Nevertheless, in three of the four case study countries with PSOD investments, experience with these investments informed the identification of enabling environment issues.

D. Results Monitoring

162. **PSD-related results are not adequately monitored.** ADB has increased the monitoring of PSD results through the introduction of related level 1 indicators (business start-up costs and time) in ADB's corporate results framework. However, these indicators are not really impact indicators,⁸⁶ and do not have any corresponding level 2 core output or outcome indicators,⁸⁷ nor have they been translated into results frameworks at the country level. In fact, a number of CPS results frameworks for the case study countries did not have any PSD- targets or indicators.

163. There have been issues at the project level as well with regard to monitoring PSD outcomes and impacts. For example, only three out of 10 projects involving business registration reforms included impact on business formation or formalization within their design and monitoring frameworks. A number of projects involving access to finance did not explicitly measure systemic increases in MSME financing. Secured transactions projects did not systematically capture increases in registered assets or changes in lending backed by movable collateral. Monitoring of project impacts has also been constrained by a paucity of accessible data, particularly with regard to enterprise productivity and profitability as well as entrepreneurial activity.

E. Staff Skills

164. **PSD-related staff skills need further strengthening.** One of the issues identified by the revised strategic framework for PSD was a lack of relevant staff skills. It is unclear to what extent skill levels related to PSD have changed as relevant baseline data are not

⁸⁵ Exceptions include policy dialogue on financial sector reforms in Mongolia and Sri Lanka, which facilitated PSOD investments in Mongolian banks and Sri Lankan leasing companies, as well as ADB policy dialogue on SME reforms in Cambodia, the Lao PDR and Viet Nam and TA support for the IFC-managed Mekong Project Development Facility, which helped improve the enabling environment for both ADB-invested Mekong Enterprise Funds.

⁸⁶ In fact, the existing level 1 indicators would have been more appropriate as a level 2 outcomes, as they potentially could be project outputs or outcomes. Net changes in the number of private enterprises as well as in private sector outputs and employment would be more suitable level 1 indicators. There are a number of other current level 1 indicators that are relevant for PSD (e.g., banking assets to GDP and the average score of governance and public sector management assessments from country performance assessments), but could be complemented by indicators with greater PSD relevance (e.g., private credit to GDP).

⁸⁷ Current PSD-relevant level 2 indicators are limited to the number of microfinance and SME accounts and borrowers, as well as various infrastructure indicators, none of which are directly related to enabling environment support.

available. The current skills base would appear to be insufficient to deal with the inherent challenges posed by the corporate target of half of ADB's operations supporting PSD. As of August 2012, based on self-assessments, only 12% of international staff in relevant operational departments who had completed the Budget, Personnel and Management Systems Department's technical skill registry had at least a proficient level of knowledge of PSD issues (15% of staff in the Central and West Asia Department, 5% in the East Asia Department, 3% in the Pacific Department, 22% in the PSOD, 11% in the South Asia Department, and 15% in the Southeast Asia Department). The skills inventory lumps together skills related to PSD-relevant policy reforms, private sector investment, PPPs, and privatization. There is need for a more differentiated analysis that matches specific available PSD skills with demand arising from the nature and level of ADB's PSD-related operations going forward. Given the improved availability of PPP-relevant skills among operational staff qua professional background and training provided within ADB, it is likely that the biggest gaps are with regard to non-PPP related PSD skills, particularly with regard to business regulatory issues. Existing departmental PSD specialist staff positions were converted into PPP specialist positions. As of December 2012, there were a total of four PSD specialists in ADB (two in the Pacific Liaison and Coordination Office and one each in Central and West Asia Public Management, Financial Sector and Trade Division and Southeast Asia Public Management, Financial Sector and Trade Division, which corresponds to a higher prevalence of enabling environment support in these regional departments), compared with 11 PPP specialists and advisors. There has been comparatively little PSD-related knowledge generation and dissemination outside PPP-relevant topics. In part this has been due to the dissolution of the PSD community of practice after 2006, which had previously spearheaded internal discussions of PSD-relevant assistance approaches and provided guidance on PSAs and project concepts. In the absence of a dedicated community of practice, PSD project classifications are validated by the PPP community of practice instead. Unlike for PPP issues, there currently is no internal ADB-wide focal point to promote PSD enabling environment issues and liaise with other development partners.

F. Operational Implications

165. **Strengthen results orientation.** While this study does not recommend the preparation of a new strategy for PSD, it nevertheless suggests the need for operational guidance on concepts as well as ADB targets for enabling environment support, not only in terms of inputs, but also outcomes that are translated into regional department performance targets. These include identifying appropriate level 1 and 2 indicators for ADB's corporate results framework and improving incorporation of PSD enabling environment support outcomes and related indicators in country and sector results frameworks.

166. **Develop holistic approaches for investment climate support.** Often, interventions in other sectors are required to strengthen the enabling environment for enterprises operating in a particular economic sector. Examples include transport sector investment and trade facilitation measures and the introduction of e-governance and company registration reforms. Holistic approaches at the country and CPS levels involving relevant institutions in all relevant sectors are required to ensure coordinated action. Country strategies, relevant sector road maps, and related ADB support need to reflect this, including the long time frames required to get tangible results on "soft" infrastructure issues. For example, the implementation of trade facilitation agreements has lagged behind the construction of substantial physical infrastructure for Greater Mekong Subregion

regional transport corridors.⁸⁸ There have been improvements in the coordination of regional transport and trade facilitation activities, partly as a result of the connection made between these two areas in ADB's Regional Cooperation and Integration Strategy and the transport sector action plan. Also, the use of road maps for the resolution of pertinent specific issues such as SME access to finance or increasing private investment in roads could help create a common vision of what needs to be achieved, define targets, and ensure proper sequencing and coordination with other reform initiatives and support.

167. **Improve the quality and use of PSAs.** PSAs potentially have an important role to play in identifying pertinent issues and in helping prioritize areas for intervention at the country level. Consensus needs to be developed on the objectives, content, and structure of PSAs. Once such parameters have been decided on, sufficient resources should also be allocated for the exercise of preparing the PSA. Table 6 contains a number of proposals on how to improve the relevance and quality of PSAs. Apart from greater standardization through use of a template, a key suggestion would be to quantify costs, benefits, time, and risks associated with any PSA recommendations to enhance decision makers' understanding and buy-in. Such analysis could be introduced on a pilot basis to firm up the methodology. There should be sufficient time lag between PSA preparation and the CPS process to allow for ADB to influence government strategies and priorities rather than have government priorities determine ADB support for PSD. Moreover, PSAs need to precede the preparation of sector road maps to facilitate operational relevance.

Table 6: Recommendations for Improving PSAs

Recommendation	Rationale	Degree of Change from Existing Practice
Consider mandating that all private sector assessments cover enabling conditions at a minimum	<ul style="list-style-type: none"> • Supports the notion that this is "the fundamental component for stability," since where enabling conditions exist, donor interventions are no longer required 	<ul style="list-style-type: none"> • Minor change – Standardizes report focus (on enabling conditions, rather than on specific projects)
Develop a standard template, specifying all items that need to be reviewed in a private sector study. Generic governance and anti-corruption, judicial, competition, and business regulatory issues that are critical for creating enabling conditions for PSD should be explicitly featured in the PSA template.	<ul style="list-style-type: none"> • Helps consolidate ADB's thinking on what needs to be in place for the private sector to grow • Reduces differences in coverage between reports • Reduces skills requirements for the initial data gathering 	<ul style="list-style-type: none"> • Minor change – Standardizes report structures and contents
Split private sector assessments into two phases 1. Desk based "benchmarking": pull all the publicly available data on country in question, together with peer group comparisons, and generate a set of hypotheses of what recommendations should be	<ul style="list-style-type: none"> • Ensures team starts with a full set of available data • Avoids using expensive consultants in the field to collect data that could be done by an analyst at headquarters 	<ul style="list-style-type: none"> • Limited change – Most reports appear to follow this approach already
2. In-country fieldwork : fill in any gaps in data, and test hypotheses	<ul style="list-style-type: none"> • Reduces time to get to a set of recommendations agreed with the stakeholders 	

⁸⁸ IED. 2008. Sector Assistance Program Evaluation: *Transport and Trade Facilitation Sector in the Greater Mekong Subregion – Time to shift Gears*. Manila; and Summary of Proceedings for Fourteenth Meeting of the GMS Subregional Transport Forum, 2–3 December 2010, Nanning, the PRC.

Recommendation	Rationale	Degree of Change from Existing Practice
Require that all reports list recommendations clearly in a separate section	<ul style="list-style-type: none"> Increases clarity: Some reports call the same thing a “suggestion” in one part, and a “recommendation” elsewhere 	<ul style="list-style-type: none"> Limited change – Most reports appear to follow this approach already
Introduce a requirement that recommendations are prioritized using a transparent methodology, based on at a minimum: <ul style="list-style-type: none"> Benefits (quantified wherever possible) Cost to implement Time to implement Risk of failure (e.g., due to political opposition) 	<ul style="list-style-type: none"> Provides a tool to include all stakeholders in the prioritization process Helps make informed trade-offs between each recommendation Ensures that resources are focused to be most productive 	<ul style="list-style-type: none"> Major change – none of the PSAs quantify benefits of any recommendation; where recommendations are prioritized, prioritization methodology seems subjective

ADB = Asian Development Bank; PSA = private sector assessment; PSD = private sector development.
Source: Independent Evaluation Department.

168. Strengthen coordination between regional department support for enabling environment issues and PSO. The vast majority of PSO had very little connection to ADB support for strengthening the enabling environment for PSD. There would appear to be both substantial need and potential for more synergistic approaches to PSD, particularly in frontier countries. Moreover, there would appear to be some benefit in systematically assessing and addressing the policy, legal, regulatory, and institutional requirements for key areas of PSOD operations, such as renewable energy and SME development.

169. Improve ADB resources for strengthening the enabling environment for PSD. There is no central unit or community of practice that can backstop ADB support for business regulatory reforms through guidance on operational approaches, an exchange of experiences on effective approaches, the generation and dissemination of related knowledge products, staff training, and coordination with external development partners. This study proposes to designate at least one qualified staff member, possibly within the Regional and Sustainable Development Department, to work full-time as the internal focal point for investment climate issues that are not covered by other ADB focal points. In addition, a standalone community of practice could further stimulate internal discussion and coordination. To facilitate the mainstreaming of PSD enabling environment issues in sector operations, it is further proposed that the Regional and Sustainable Development Department sector focal points and the relevant communities of practice (for the various sectors as well as for PPP and governance) identify (i) how ADB sector activities can be strengthened to improve benefits to private entrepreneurs and the overall investment climate, (ii) incorporate related support in sector operational plans and project designs, (iii) identify skills gaps, and (iv) build required internal capacity.

**ADB Support for Strengthening the Enabling Environment for Private Sector Development
LIST OF LINKED DOCUMENTS**

1. **Literature Review**
<http://www.adb.org/sites/default/files/Literature-Review.pdf>
2. **Evaluation Approach**
<http://www.adb.org/sites/default/files/Evaluation-Approach.pdf>
3. **Constraints to Doing Business Identified by Enterprise Surveys**
<http://www.adb.org/sites/default/files/Constraints-to-Doing-Business.pdf>
4. **Financial Assistance and Technical Assistance Grants for Strengthening the Enabling Environment for Private Sector Development**
<http://www.adb.org/sites/default/files/Financial-Technical-Assistance-Grants.pdf>
5. **Country Case Study Findings**
<http://www.adb.org/sites/default/files/Country-Case-Study.pdf>
6. **Assessment of ADB Support for Small and Medium Enterprise Development**
<http://www.adb.org/sites/default/files/ADB-Support-for-SME-Dev.pdf>
7. **Assessment of ADB Support for Improving Business Registration, Credit Information, and Secured Transactions**
<http://www.adb.org/sites/default/files/Assesment-ADB-Support-Business.pdf>
8. **Assessment of ADB Support for Strengthening the Enabling Environment for Private Participation in Infrastructure Development**
<http://www.adb.org/sites/default/files/Assessment-ADB-Support-Infra.pdf>
9. **Background Analysis of Private Sector Assessments**
<http://www.adb.org/sites/default/files/Background-Analysis-Private-Sector-Assessments.pdf>