

# Donor support to private sector development in sub-Saharan Africa

## Understanding the Japanese OVOP programme

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Kiyoto Kurokawa, Fletcher Tembo  
and Dirk Willem te Velde

**Working Paper 290**

Results of ODI research presented  
in preliminary form for discussion  
and critical comment

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## Executive Summary

Private sector development is crucial for growth, development and employment creation in Africa. This is being recognised by donors in their support programmes for the private sector. This study examines how one type of Japanese development and trade support, the One Village One Product (OVOP) approach, fits in with other donor approaches and how it relates to development of small and medium enterprises (SMEs). It also provides some preliminary insights from the experience of OVOP in Malawi.

While SMEs play an important role in Africa's economies (GDP and employment), cross-country and micro-level research is not conclusive on the causal link between SMEs and economic development – in other words, growth depends on all type of firms equally, small and big. Nonetheless, smaller firms may face larger and different growth constraints, which might explain the lack of SMEs' contribution to growth and which would call for a targeted or at least different approach.

We find that major constraints on the performance of SMEs include costs and access to finance, access to electricity, corruption, tax administration, level of skills and transportation. Within these categories, it appears that access to finance is the major (resource) constraint for SMEs. But there are also certain skill and knowledge constraints on the operations of SMEs (such as lack of market knowledge and contacts).

Many of the binding constraints are due to the presence of market and government failures. Public support for private sector development (PSD) is justified when markets fail to allocate resources efficiently. There are several examples of market failures in PSD, in the area of capital, skills, technological development and the co-ordination amongst them. However, public support can also fail, and it can be market distorting or favouring individual firms more than others.

On the one hand, firm specific intervention is justified by theory, but on the other hand this raises question about the ability of governments to fine-tune the market. Within much of the donor community, there is a change away from specific donor interventions in individual firms towards upstream support for the 'enabling environment' for the private sector, defined by policies, laws and regulations affecting PSD.

Together with partner governments, donors supporting the private sector need to assess the benefits and weaknesses of each approach and weigh up their respective risks. Donors can provide support at least at three levels:

- *The macro level:* which refers to the overall investment climate and is shaped, amongst other things, by the government policies and regulatory frameworks
- *The meso level:* which refers to labour and capital markets at the national, regional or sectoral level. Donor initiatives at this level aim to improve the functioning of markets are often come under the rubric 'making markets work'
- *The micro level:* This refers to a single business unit or a collection thereof. Private sector support at this level may be in the form of a business development service or firm specific assistance (e.g. in value chains).

Table A1 summarises how OVOP is expected to alleviate constraints on the development of SMEs. The first column lists the market failures and constraints which confront SMEs, and the second column indicates whether OVOP addresses these constraints. The other columns identify examples of OVOP support and complementary actions by local governments. The last column suggests additional / alternative sources of donor assistance.

**Table A1: How OVOP is expected to alleviate constraints on SME development**

Constraint on SMEs	Japanese assistance for OVOP	Examples of OVOP related involvement	Examples of complementary actions by host Government	Examples of other donor assistance
Low Skills	Directly, by providing ex-pat skills and training courses in Japan	Packaging, Labelling, Accounting, Marketing etc.	Training	Limited, GTZ
Lack of technology, standards and knowledge	Directly, by providing advice and training courses	Quality Control, Kaizen, 5S, TQM JIT etc.	No	Limited, standards support by the EC, UNIDO on standards
Lack of external links such as in value chains	Directly, by linking SMEs to Japanese markets	Trade fair in Japan, Web site	Trade Fair	e.g. IDRC.
Lack of access to credit	Indirectly, via government policy	No	Yes, sometimes. Cooperatives, OVOP secretariats	World Bank, DFID etc.
Weak BDS markets	No, OVOP provides BDS itself and does not promote the BDS market	No	No	Donor Committee on small enterprises. DFID etc.
Infrastructure	No, only small equipment will be provided.	Cooling tanks for milk plant.	No	World Bank, EC,
Regulatory framework and governance framework more widely	No, only limited guidance for the OVOP framework will be provided	No	Limited	World Bank UNDP UNIDO DFID etc

The OVOP approach is clearly located at the micro end of the spectrum of donor activities since it aims to provide specific support for individual firms, groups of firms and / or households. Such an approach stands in stark contrast to the ‘enabling environment’ support, which tends to be non-discriminatory and aimed at improving overarching rules and regulations rather than helping a handful of firms. The OVOP approach has attracted a good deal of interest in Africa with Malawi providing one of the first test cases. The OVOP approach differs from mainstream donor approaches in so far as it aims to achieve regional economic development by developing products and services using locally available resources and adding value through processing and marketing. It encourages villages to develop specific products and promote them in such a way as to make them instantly recognisable and identifiable with their community.

The approach, which originated in Oita, Japan, takes several different forms. The Japanese OVOP therefore differs from those pursued elsewhere in Asia. One illustrative example of an Asian OVOP is OTOP (One Tambon One Product) in Thailand. Inspired by OVOP, the Thai government began promoting local industry by supporting the manufacture of attractive products drawing on local resources, culture and tradition. Government provided the initial stimulus in the Thai OVOP approach whereas the original Japanese OVOP was a popular reaction to local development policy led by an independent people's movement and therefore less dependent on government from the outset.

We have begun to examine aspects of an assessment of OVOP in Malawi: firm-specific effects, the contribution to knowledge public goods and the effects on the wider institutional framework governance for private sector development in Malawi. It is clear that such an assessment will be a data-intensive exercise. The assessment offered in this paper is therefore preliminary and limited in scope and we have indicated some ways in which a fuller analysis can be undertaken. Having said this, it is already possible to highlight some issues. The OVOP programme is still small (\$500,000 with four dozen projects supported). Nonetheless, there is evidence that OVOP has supported companies to become more productive, helping them with leadership, entrepreneurship and forming effective groups. This is a promising finding, especially if this applies to the range of projects supported (which we have not yet examined). It is a visible way of support at the firm or farm level, more so than support that tries to remove regulatory constraints. It is a different way of promoting growth which deserves further attention and evaluation along-side other approaches. For instance, what conditions are necessary for OVOP to work best and are these present in Malawi.

However, there are also challenges for the OVOP approach. While the specific interventions associated with OVOP relate well to theoretical considerations such as spatial economy and market failures, in practice there might be unintended consequences. While some suggest the programme has been unusually shielded from political abuse, there are challenges related to the selective nature of the support. This links in to the wider point that selective BDS interventions stand in contrast with approaches that promote public goods such as those that promote the market for BDS and each approach may have its positive and negative approaches. It is fruitful that the various donors learn from each other's approach. This assessment is part of that process.

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## Selected Acronyms and Abbreviations

5S	5S is a system to reduce waste and optimize productivity through maintaining an orderly workplace and using visual cues to achieve more consistent operational results. Just-in-time delivery and 5S are all included within the Kaizen system. Seiri: Separating. Seiton: Sorting. Seiso: Cleaning. Seiketsu: Standardizing. Shitsuke: Sustaining.
ACP	African, Caribbean and Pacific
BDS	Business Development Services
CDE	Center for Development of Enterprises
DFID	UK Department for International Development
EC	European Commission
EIB INFAC	European Investment Bank Investment Facility
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HRD	Human Resource Development
IDRC	International Development Research Centre
IFIC	Institute for International Cooperation, JICA
JETRO	Japan External Trade Organization
JICA	Japan International Cooperation Agency
Kaizen	Japanese production management system; "continuous improvement" or "continual improvement"
MITI	Ministry Of International Trade and Industry, Government of Japan
MOFA	Ministry of Foreign Affairs, Government of Japan
MPRSP	Malawi Poverty Reduction Strategy Paper
OTOP	One Tambon One Product (A tambon is a Thai administrative unit smaller than a district)
OVOP	One Village One Product
SME	Small and Medium Enterprise
TI	Trade and Investment
TIC	Tokyo International Centre, JICA
TICAD	Tokyo International Conference on African Development
TQM	Total Quality Management
UNDP	United National Development Programme
UNIDO	United National Industrial Development Organization

# 1. Introduction

Private sector development is crucial for growth, development and employment creation in Africa. This is being recognised by donors in their support programmes for the private sector. The Japan International Cooperation Agency is also supporting private sector development in Africa and has taken this to a higher level more recently. However, there is little agreement amongst donors about how best to support the private sector. Some donors suggest it is best to remove regulatory constraints to private sector development, whereas others think it is better to engage from the bottom-up at the micro-firm level. This paper will examine what donors do to support the private sector and why, and in particular aims to understand how one type of Japanese development and trade support, the one village one product (OVOP) approach, fits in with other donor approaches.

While a consensus towards a less-interventionists approach to private sector development has emerged among donors, there is in fact very little evidence about what works best and why. More donor committees are examining private sector development programmes and lessons are being learned; however, there is still disagreement among donors on whether approaches may be complementary, and hence should focus on comparative advantages, or whether approaches should ultimately converge. This paper will discuss the Japanese approach in greater detail in order to gain a better understanding of how it aims to help Africa's private sector.

There are a number of compelling reasons for gaining a better understanding of Japanese support for private sector development, both in Japan and abroad. This is because support to Japan has, historically, been different from support enjoyed in other countries. The type of support offered in Japan has, moreover, been very successful in promoting domestic industrial development. For example, Japan is well known for its high quality trade goods such as motor vehicles and electrical devices. Japan has developed its original skills in mass production and combined it with good quality control and high productivity. How this has come about, however, is not always well understood outside Japan. That said, we must be mindful of the fact that what works in Japan may not work elsewhere (i.e. Japan's approach may only work in a specific policy and institutional environment).

Japan began to formulate its development policy for Africa nearly 20 years ago. Japan's commitment was demonstrated in launching the TICAD (Tokyo International Conference on African Development) process and shifting the international community's attention back to Africa. TICAD was launched in 1993 to promote high-level policy dialogue between African leaders and development partners, mainly in Asia. As part of its development and trade policy, the Government of Japan supports the 'One Village One Product' (OVOP)" approach in developing countries as part of the 'Development Initiative for Trade' advocated by Former Prime Minister Koizumi. This approach is now set to expand to a number of developing countries. Through this approach, which started in 2006, culturally specific products such as craftwork items, textiles, and processed foods from nations in Asia, Africa, Oceania, and Central America are now being launched in Japan and across the world.

While there have been a number of recent methodological advances in evaluating private sector development programmes, such evaluations are not straightforward. Given that we are still learning about what works best in different country contexts, this paper suggests it is important to evaluate approaches such as OVOP on a continual basis and draw on lessons learned. We suggest there are three dimensions to any evaluation:

1. the economic effects at the firm level;
2. the knowledge gained from the supported SMEs in terms of gaining a better understanding of their constraints; and
3. the effects on governance at local and regional level.

The structure of this paper is as follows. Section 2 begins with an analysis of how SMEs contribute to growth and development, and how the operations of SMEs are constrained by various factors; Section 3 reviews the various donor approaches towards private sector support and locates the Japanese OVOP at one end of the spectrum in terms of donors interventions; Section 4 discusses the origin and academic context of OVOP; Section 5 reviews a number of key issues in an evaluation of the OVOP approach and provides a brief assessment of OVOP in Malawi; Section 6 concludes.

## 2. SME, growth and constraints in Africa

The private sector is the key driver of economic growth and in this chapter we examine whether SMEs contribute to growth in a different way to other firms.

### 2.1 The role of SMEs in Africa's economies

The private sector in Africa is diverse. It consists of various types of firms, old and new, small and large, formal and informal, domestic and foreign-owned. This section focuses on one key dimension of this: the size distribution and in particular Small and Medium Enterprises (SMEs).

There is no commonly agreed definition or success criteria for SMEs. There is instead a wide range of definitions and measures for SMEs, varying from country to country. Standard criteria for categorising firms by size include the number of employees, total net assets, sales and investment level. However, different countries and sources will use a different upper and lower size limit for SMEs. Despite this variance, Ayyagari *et al* (2005) argue that a large number of sources define an SME to have 0–250 employees; in African countries this is often 200 or less; what constitutes an SME in Japan therefore may be classified as a large firm in Africa. Ayyagari *et al* (2005) focus on formal manufacturing firms. Table 1 shows that a sizeable share of formal employment is in SMEs.

**Table 1: Employment share of SMEs in Africa**

Country	Size Class (upper limit for SMEs)	Employment
Burundi	100	20.51
Cameroon	<200	20.27
Cote D' Ivoire	200	18.70
Kenya	<200	33.31
Malawi	50	38.00
South Africa	100	39.00
Tanzania	<200	32.10
Zambia	<200	36.63
Zimbabwe	<200	15.20

Source: Ayyagari *et al* (2005)

Ayyagari *et al* (2005) also show that the importance of informal enterprises decreases with economic development, while the importance of formal SMEs increases when estimating the relationship based on a larger sample of developing and developed countries. The SME sector's contribution to both employment and GDP shows a strong positive correlation with GDP per capita. Thus, as countries grow richer, there is an increase in the labour force employed in SMEs and overall, they make a larger contribution to GDP.

There are different views about the dynamic contribution of SMEs to growth. On the one hand, SMEs may contribute to competition and entrepreneurship. Some argue they are more productive as long as key constraints are removed, and some argue SMEs are better at generating employment, and hence at reducing poverty. Others argue large firms may exploit economies of scale in R&D, with some having doubts about the often considered high labour intensity of SME.

However, the evidence does not support the view that SMEs are generally better for growth than other firms – all types of firms could contribute equally to growth. At the micro-level, smaller firms tend to pay their employees less (Te Velde and Morrissey, 2003). Smaller firms are also less productive than

larger firms in the case of Benin, Ethiopia, Mauritius and South Africa. See Table 2, taken from Qureshi and Te Velde (2007) – of course this could be because they are currently more constrained.

**Table 2: Estimation results for explaining TFP across countries**

	Benin	Ethiopia	Madagascar	Malawi	Mauritius	South Africa	Zambia
Age	0.003	0.004	-0.005	0.023***	-0.001	0.013***	-0.001
<b>Size</b>	<b>0.005***</b>	<b>0.000***</b>	<b>0.000</b>	<b>0.000</b>	<b>0.001**</b>	<b>0.001***</b>	<b>0.000</b>
Foreign	0.005	0.006	0.004	0.006*	0.006	0.007***	0.005*
State	-0.015***	0.020***	0.010	-0.011	0.056***	0.011**	0.001
Export	0.004	0.011	-0.002	0.010*	0.000	0.011***	-0.003
Member	-0.189	0.731***	-0.040	0.354*	0.637**	0.336***	0.385*
Lobby	-0.262				0.743**	0.192	-0.057
Uncertainty	-0.167*	0.058	-0.019	-0.101	-0.014	-0.016	0.018
Regtime	-0.003	0.012	0.014	0.021	0.006	-0.014***	-0.005
Constant	2.357***	1.940***	3.279***	3.702***	7.159***	7.074***	5.724***
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	100	141	99	120	64	399	146
F-statistic	2.12**	27.02***	0.56	4.85***	6.02***	27.14***	2.07**
R-squared	0.25	0.38	0.23	0.30	0.40	0.45	0.15

Notes: Dependent variable is log of TFP obtained from the Levinsohn-Petrin technique; \*, \*\*, \*\*\* indicate significance at 10%, 5% and 1% levels respectively; the estimated standard errors are robust; variable lobby not included in the equations for Ethiopia, Madagascar and Malawi because of lack of data. Size is proxied by number of employees.

At the macro-level, Beck *et al* (2005) examine the relationship between the relative size of the SME sector, economic growth, and poverty alleviation using a sample of 45 developed and developing countries. They find a strong, positive association between the importance of SMEs and GDP per capita growth, but SMEs do not exert a causal impact on growth. Furthermore, they suggest that SMEs do little more than other firms to alleviate poverty or decrease income inequality. As the authors suggest, such cross-country results should be interpreted with caution. For example, certain types of SMEs might be more conducive to growth and all SMEs may be more conducive to growth when certain complementary factors are in place.

Others, however, suggest that is entirely possible for SMEs to fulfil a social role. Hallberg (2001) suggests that scale-based enterprise promotion is driven by social and political considerations rather than economic concerns.

In conclusion, while SMEs play an important role in Africa's economies there is no conclusive evidence to suggest that they are different from other firms in their contribution to growth.

## 2.2 Constraints on SME performance in Africa

While cross-country and micro-level research is not conclusive on the causal link between SMEs and economic development, smaller firms may face growth constraints of a different nature and magnitude (e.g. they may have less access to formal sources of external finance, which might explain their poor performance lack of contribution to growth). Such a finding would clearly be relevant to donors aiming to support private sector development and growth through SMEs.

Broadly speaking, firm performance is the result of the interaction between:

- individual characteristics of the firm (internal to the firm); and
- the macro economic environment (including sector effects), policies, institutions and networks (external to the firm)

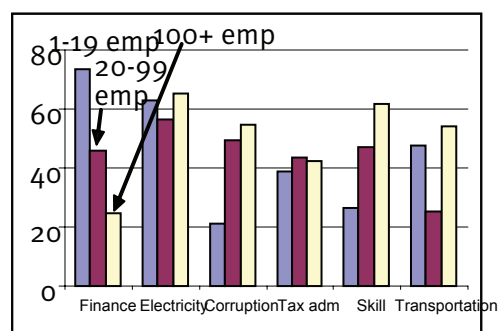
It is important to focus on whether SMEs are affected differently by these two types of constraints.

### 2.2.1 Individual characteristics of SMEs

Individual characteristics consist of resource capabilities (skills and education of workers, capital), technological capabilities (R&D, capital investment, engineering skills) and other factors (size and ownership of firm, sector of operation generally, type of activity). A major question is which constraints affect SMEs more than they do other firms. One way to answer that is to quiz firms on possible constraints and then categorise the answer by firm size. This is done in Figure 1 for Malawi and Figure 2 for the average of seven sub-Saharan African countries. The raw data are presented in Table 3.

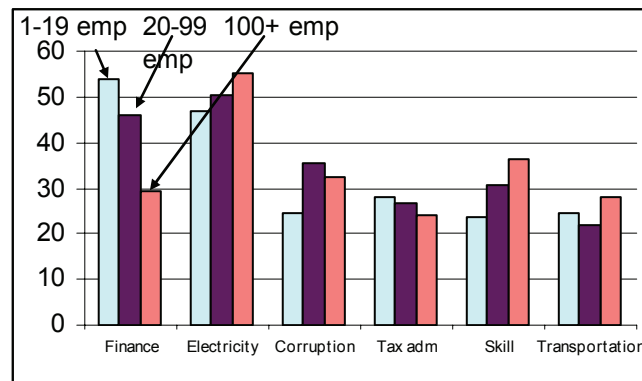
Major constraints on the performance of SMEs include (in descending order for Africa) access to and costs of finance, access to electricity, corrupt practices, tax administration, low skills levels and poor transportation / infrastructure. Within these categories, the importance of three constraints varies considerably by firm size: access to finance, skills and electricity. It appears that *access to finance* is the major resource constraint particularly for SMEs while this is much less important for larger firms. In Malawi, access to capital is three times more important as a constraint for smaller firms than for larger ones. On the other hand, skills and electricity, which are important constraints for all firms, are more often reported by larger firms, although clearly availability of skills is still a problem for small firms. Unfortunately, it is not possible to examine whether SMEs lack different types of skills. Nonetheless, there are certain skills and knowledge that are really helpful for SMEs. For instance, Te Velde *et al* (2005) provides evidence that lack of market knowledge and contacts are important barriers for selling and exporting products such as non-timber forest products.

**Figure 1: Percentage (%) firms reporting constraints (Malawi) by firm size**



Source: World Bank enterprise surveys

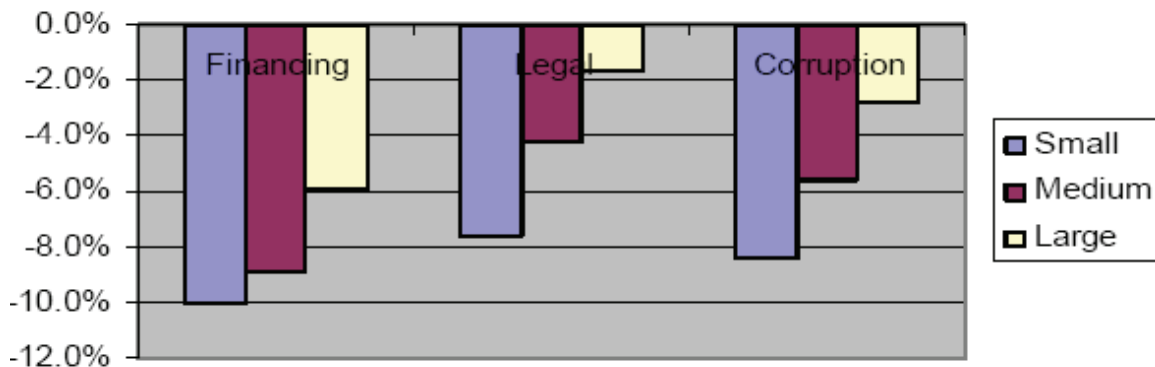
**Figure 2: Percentage (%) firms reporting constraints (sub Saharan Africa) by firm size**



Source: World Bank enterprise surveys

Perceptions on constraints may not necessarily be the same as actual effects. Nevertheless there is also some evidence to suggest that the effects of growth constraints vary by firm size. Figure 3 shows the effect of financing, legal and corruption constraints to firm performance (percent growth change) and is based on a regression of firm growth on growth constraint, interacted with dummy variables for small, medium-size and large firms, and controlling for other firm and country characteristics. Clearly access to finance affects smaller firms more than other firms. In conclusion, capital seems a major constraint for all firms but the effects are felt disproportionately more for SMEs. Conversely, while access to skills is a major constraint for all type of firms, it is reported as a more important constraint for larger firms.

**Figure 3: Growth constraints across firms of different sizes**



Source: based on Beck, Demirguc-Kunt and Maksimovic (2005).

Another factor that can affect firm performance is *ownership*. Nationality of owner, gender of owner, and public vs. private ownership can all affect firm performance. Legal status – formal or informal – is also an important factor. These factors might be accentuated for SMEs.

The *location* of SMEs in space and business networks also matters. African SMEs that are clustered and located in urban areas have better growth performance than those operating in isolation and in remote areas (McCormick, 1999). This is true for all firms, but locational barriers will be even greater for smaller firms. The location of SMEs in the value chain also matters because SMEs are more likely to move up along the value chain from labour-intensive and low value-added operations to more sophisticated and higher-value added activities when there is a process of learning and building up internal capabilities (Humphrey and Schmitz, 2000).

*Strategies* of SMEs are also important. Firms are able to compete internationally and meet certain quality standards when they are more exposed to new technologies, know-how and international best practices (Albaladejo, 2002). It is more likely for larger firms to have an outward-oriented strategy. An exporting strategy requires sunk costs and it is usually larger, more productive firms that can take the risk and absorb such costs.

### **2.2.2 External to the firm**

The development of SMEs depends on various external factors, among them the macro-economic and regulatory environment, SME-specific support services and business linkages. SME support services include quality control services, provision of training and financial loans (as discussed above).

The regulatory framework is important as certain regulations are relatively more costly for smaller firms. Figure 3 shows that legal constraints are more binding on growth performance for smaller firms than for larger firms.

Physical and ICT infrastructure are also important. Of these, access to electricity is a major constraint, although this is reported more frequently by larger firms (Figures 1 and 2).

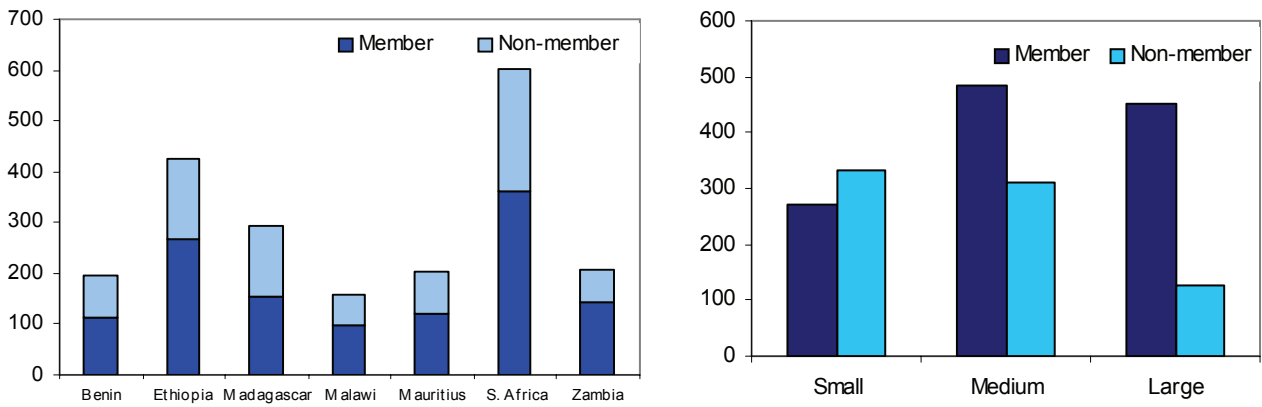
SMEs can learn through business linkages (learn-by-linking): through other firms, they can improve their practices in areas such as technical requirements, health, safety and environmental practices. Large firms set the standards according to which smaller firms supply them. Larger firms are frequently required or stimulated to adopt better quality standards from their home base. Research has shown that some types of linkages are more beneficial than others, and that some firms are more likely to gain than others, e.g. firms that have an initial absorptive capacity (UNCTAD, 2001; Te Velde, 2002). Different firms follow different 'cumulative learning' processes.

Ayyagari *et al* (2005) showed that cross-country variation in the effectiveness of information sharing and the ease of entry can explain variation in the relative importance of SMEs in manufacturing. Reducing costs of entry and property rights protection and allowing for more efficient credit information sharing allows for in a larger employment share of SMEs in manufacturing.

African SMEs are less likely to be a member of a business association. Figure 4 presents the distribution of firms that are members of business associations across countries in Africa. Zambia has the highest percentage of firms that are members of business associations, at around 70 percent of the firms covered in the survey, whereas Madagascar has the lowest percentage of member firms with only 53 percent. Figure 4 shows that a majority of small firms in the sample are non-members whereas a majority of large firms are members of business associations. This observation contradicts the argument that there is no business case for large firms to join business associations as they could lobby the government directly. On the other hand, business associations may not lobby on behalf of a significant part of the SME sector.



**Figure 4: Private sector organisations SSA**



Notes: Small = employees less than 19; Medium = employees in the range of 20-100; Large = employees greater than 100. Figure on right hand examines the sum of all countries.

**Table 3: Constraints by firm size: seven African countries (% of firms reporting key areas as a constraint on their operations)**

Firm Size	Botswana(2006)			Ghana(2007)			Malawi(2006)			Mauritius(2005)		
	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>
<b>Access/Cost of Finance</b>	50	29	8	69	68	42	74	46	25	35	37	21
<b>Electricity</b>	6	7	7	83	92	97	63	57	65	3	16	10
<b>Corruption</b>	25	23	5	8	16	12	21	49	55	36	41	18
<b>Tax administration</b>	10	12	6	14	17	6	39	43	42	20	23	18
<b>Labour Skill Level</b>	14	29	34	6	3	1	26	47	62	22	47	43
<b>Transportation as a Major Constraint</b>	13	15	9	17	16	22	47	25	54	11	19	2
<b>Business licensing and permits</b>	19	19	15	5	6	3	0	8	6	46	49	41
<b>Customs &amp; Trade Regulations</b>	12	10	8	6	12	34	18	28	19	14	26	20
<b>Identifying Labour Regulations</b>	7	10	19	2	2	0	11	12	13	30	27	22

Firm Size	South Africa(2003)			Uganda(2006)			Zambia(2002)			Simple average of 7 countries		
	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>	Small <sup>a</sup>	Medium <sup>b</sup>	Large <sup>c</sup>
<b>Access/Cost of Finance</b>	14	17	8	48	49	42	65	61	41	51	44	27
<b>Electricity</b>	7	6	12	82	88	90	26	36	47	39	43	47
<b>Corruption</b>	12	16	16	23	24	32	52	52	37	25	32	25
<b>Tax administration</b>	19	9	10	25	21	22	39	28	26	24	22	19
<b>Labour Skill Level</b>	30	31	42	11	7	13	43	35	34	22	28	33
<b>Transportation as a Major Constraint</b>	11	8	13	21	24	23	17	34	28	20	20	22
<b>Business licensing and permits</b>	2	3	4	17	10	5	13	9	8	15	15	12
<b>Customs &amp; Trade Regulations</b>	16	10	23	9	9	19	26	34	33	14	18	22
<b>Identifying Labour Regulations</b>	33	33	33	1	2	2	13	16	18	14	15	15

<sup>a</sup> = employees less than 19; <sup>b</sup> = employees in the range of 20-100; <sup>c</sup> = employees greater than 100

Source: Investment Climate Surveys, World Bank

### 3. Donor approaches to private sector development in Africa

Private sector development is crucial for growth in Africa. This section focuses on the importance donors attach to support the African private sector (3.1), with an emphasis on support for SMEs, and reviews the rationale (3.2) for public support. An important characteristic of donor support is the level of intervention (3.3). Section 3.4 provides some selected examples.

#### 3.1 Donor statements on the importance of private sector development in Africa

Private sector development (PSD), the performance of private sector activities, is now seen as crucial to economic growth and poverty reduction in developing countries (OECD, 2004). It is therefore important to understand how donors think they can promote a vibrant private sector.

There have been various discussions in policy circles, including amongst donors, whether and how to support PSD in developing countries (see Te Velde, 2006).

The UK's report on the Contribution to MDGs (2005, p. 43) discusses the role of governments to create an enabling environment for foreign and domestic investment, through capacity building, appropriate regulatory frameworks and the implementation of competition law.

The G8-communiqué in Gleneagles (2005) states:

‘ Private enterprise is a prime engine of growth and development. Enhancing governance and the rule of law will attract more and broader private investment, including FDI, which is the basic condition for inclusive growth. African countries need to build a much stronger investment climate: we will continue to help them do so, including through the promotion of a stable, efficient and harmonised legal business framework ... and increased access to finance including strong support for the development of micro-finance.’

The Commission for Africa (2005) suggested promoting the private sector by creating a good investment climate; supporting the provision of infrastructure (not just the enabling framework); and supporting SME development, e.g. by extending challenge funds for the private sector.

The Sachs Report (2005) suggested that many developing countries are stuck in a poverty trap that requires substantial and coordinated support, a big bang approach. The underlying assumption is that outsiders / public sectors can create a vibrant private sector through general and specific interventions, including interventions beyond investment climate support.

There are further reports suggesting that more can be done to support the private sector than supporting the investment climate. The World Bank's (2006) study *‘Pro-poor growth in the 1990s, lessons and insights from 14 countries’*, highlights a number of options for poor households to take advantage of non-agricultural and urban employment opportunities. Beyond improving the investment climate, this included expanding access to secondary education; enhancing access of girls to education; designing labour market regulations to create more formal employment for poor workers; and improving access to infrastructure, particularly roads and electricity. The latter is to improve urban–rural linkages, and support agricultural incomes by lowering transactions costs to access markets, while encouraging contract farming and producers' organisations. It would also strengthen property rights to improve land access and investment incentives for smaller farmers. Currently, the Growth Commission hosted by the World Bank is examining what is known about growth.

Japanese attention towards Africa has dramatically increased since the inception of the TICAD (Tokyo International Conference on African Development). In the early 1990s, when 'aid fatigue' set in after the Cold War, Japan launched TICAD in order to refocus international attention on the importance and urgency of Africa's economic development issues. Japan has stressed the importance of 'Africa's ownership' of its development as well as of the 'partnership' between Africa and the international community. A central feature of TICAD is the cooperation between Asia and Africa. African countries also took initiative in the 'Revitalisation of Africa' and established a New Partnership for Africa's Development (NEPAD). This has become a turning point for African engagement and donors have begun to align their strategies with those of African governments

### **3.2 The rationale of public support for private sector development**

There are three components of the rationale for public support for private sector development. First, there is the premise that private sector development is good for growth (some 9 out of 10 jobs in the developing world are in the private sector). Secondly, the private sector is constrained by factors as discussed in section 2.2 (where we discuss the most binding constraints on SME development). Finally, the constraints are due to market failures – and we discuss these below – so that, in principle, there is a role for government to address these (of course the leaves aside the question how this can be done, and the notion that government intervention can fail too, see further below).

Public support for PSD is justified when markets fail to allocate resources efficiently, i.e. in cases of market failure (see Gravelle and Rees, 1992; Stiglitz, 1994; Arrow, 2002). Markets fail to allocate resources efficiently when property rights, which define the control over assets and rights, are incomplete. Firms will not appropriate all the benefits and costs of their decisions because markets for certain rights are missing. It is difficult for one firm to exclude other firms from the future knowledge gained by adopting a new technology successfully.

There are several examples of market failures in PSD, in the area of capital, skills, technological development and the coordination amongst them (see Te Velde and Morrissey, 2005 and a summary below). Most of these will have a major effect on African development.

#### **3.2.1 Capital market imperfections**

Perfect capital markets will lend surpluses of savings to those with skills, talents and ideas who want to invest in profitable projects, including new SMEs. However, the market is associated with credit constraints, caused by imperfect information surrounding the (future) profitability of projects, on which basis lenders determine the probability of repayments of their funds. High transactions costs arising from screening, monitoring and enforcement in the credit market create obstacles to lenders. The use of collateral might reduce such need for screening, monitoring and enforcement, and therefore reduce transactions costs. However, poor people, informal firms, small firms and start-ups need capital but are unable to pledge collateral and often lack formal title rights to land and houses. This prevents them from financing profitable projects including projects to enhance trade and which may hold back development of SMEs.

#### **3.2.2 Skills development**

On-the-job training and schooling tends to be sub-optimally low because firms do not have sufficient incentives to invest in worker skills because trained workers can decide to work for other firms that can use these skills. This is particularly true for firm-specific training. Lall (2001) finds the following instances of market failures in the components that make up the education and training system: The *trainee* may 1) not recoup all benefits of educational investments; 2) not be aware of future values and future need for certain educational investments; 3) be excessively risk averse; 4) lack access to certified training and 5) not access capital markets. *Firms* may 1) lack knowledge of best-practices in

training and 2) lack full appropriability of benefits. The *education and training system itself* can 1) lack information on educational needs in industry; and 2) lack access to capital markets to fund the development of better standards. African SMEs may face all of these constraints.

### 3.2.3 Institutional framework and governance

PSD depends on an appropriate institutional and governance framework that the private sector is unlikely to provide by themselves at an appropriate level. This reflects the development and set-up of institutions such as technology institutes, accreditation, or it could simply reflect institutes to engage in good state–business relations. There are insufficient incentives for individual firms to begin to operate such institutions, although joint action amongst firms is also a clear option (Schmitz, 1997).

## 3.3 Types of donor intervention for PSD

There is therefore a clear rationale for public support for PSD. In principle, the existence of market and co-ordination failures justifies public involvement in PSD. Again, in theory, the scope for public intervention large in theory. For example, there could be support for the adoption of technology in individual firms; for providing general technical training, for improving the market for credit, or for co-ordinating the direction of firms, clusters and whole sectors.

Despite a strong theoretical case, it is important to underline that public support may fail to improve PSD. This could be for several reasons.

First, it seems questionable to assume that governments can have perfect information and perfect foresight, or better information than private firms. Investment climate reform might address market failures by establishing rules and regulations when they are lacking, though the literature often suggests that existing rules and regulations are inadequate so that investment climate reform addresses government failures (WDR, 2005; ICEET, White and Fortune, 2004).

Secondly, government intervention can also suffer from moral hazard problems (Stiglitz and Uy, 1996; Hausman and Rodrik, 2002). The development of new technology and adoption of existing technology is characterised by externalities which cannot be fully appropriated. Thirdly, there can be private non-market means that can solve market failures. Joint action may raise collective efficiency, by internalising externalities (Schmitz, 1997). McCormick (1999) discusses six examples of African clusters, which include accounts of associations that have been helpful in sharing ideas and information about repair procedures (Ziwani, Kenya) or where associations are disseminating garment industry information and developing special programmes to assist small garment firms (Western Cape, South Africa). Fourthly, addressing national coordination failures based on scale economies is probably the most far-reaching, but also the riskiest, because intervention could be quite substantially wrong. Finally, government intervention carries the risk of misallocation and rent-seeking behaviour. How does the government know what firms to select – and selection may have negative aspects.

Together with partner governments, donors supporting the private sector need to assess the benefits and weaknesses of each approach and weigh up their respective risks. Donors can provide support at least at three levels:

- *The macro level:* which refers to the overall investment climate and is shaped, amongst other things, by the government policies and regulatory frameworks
- *The meso level:* which refers to labour and capital markets at the national, regional or sectoral level. Donor initiatives at this level aim to improve the functioning of markets are often come under the rubric ‘making markets work’

- *The micro level:* which refers to a single business unit or a collection thereof. Private sector support at this level may be in the form of a business development service or firm specific assistance (e.g. in value chains).

On the one hand, firm-specific intervention is justified by theory, but on the other hand this raises questions about the ability of governments to fine-tune the market. Within much of the donor community, there is a change away from specific donor interventions in individual firms towards upstream support for the ‘enabling environment’ for the private sector, defined by policies, laws and regulations affecting PSD. One important document that described this move is the Guiding Principles of the Committee of Donor Agencies (2001). This argues for the ‘fundamental belief in the principles of a market economy, where the State has a role in providing an enabling environment, in correcting or compensating for market failures, and in the provision of public goods, but not in the direct provision of private goods that can be more efficiently provided by the market’.

The World Bank’s World Development Report (WDR) 2005 on Investment Climate emphasises the need for creating an enabling environment for private sector development, and argues that there needs to be a right balance between market and government failures, and that investment climate (i.e. enabling environment) reform essentially addresses both market and government failures.

Several donors agree that effective private sector development is good for (pro-poor) growth and that further support for the investment climate is required to achieve this. An implicit assumption is that further selective intervention in PSD is counterproductive by distorting the rules of the game, and that governments fail to identify adequately candidates that merit special attention, fail to resist rent-seeking and fail to ensure that interventions are cost-effective (WDR, 2005). Such reports ignore industrial policy (one footnote in WDR 2005) or national innovation systems (mentioned once in WDR 2005) and therefore assume there is little place for industrial policy. Yet in Japan, industrial policy worked, so a major question remains whether its approach would work in different settings and under what circumstances.

### **3.4 Donor intervention, selected examples**

We will briefly describe private sector programmes of bilateral and multilateral donors. Most of them provide support to the enabling environment, but others will also go beyond this. This section aims to illustrate the range of support services. OTF (2007) also provided an interesting comparison of bilateral agencies and concluded that there is a move towards tools that catalyse and encourage activity, rather than direct intervention. Concurrently, there is a move towards broader interventions (programmes vs. projects) that simultaneously involve multiple tools and approaches.

#### **3.4.1 The World Bank Group**

The World Bank Group has a substantial portfolio of small and SME-related activities. More than \$10 billion in SME support programmes were approved in the past years, \$1.3 billion alone in 2003. It has several programmes together with the IFC. The IFC provides loans, equity and guarantees to firms or equity funds. In addition, it provides technical assistance in two forms. First it builds financial markets and contributes to governance reform. Secondly, based on cost-recovery, it provides technical assistance to (mostly large) firms.

#### **3.4.2 European Commission**

The European Commission is an example of a donor with many different programmes in place, with a comparatively large share of support tending to be at the micro level through the Centre for Development of Enterprises and access to credit. It also provides TA and finance through the EIB. Table 4 below provide a selected summary of the type of interventions by each instrument showing the broad range of interventions by the European Commission under ACP framework.

**Table 4: Interventions of EU-ACP wide instruments**

Fields of intervention	EIB INFAC	CDI/E	Pro Invest
	1962 -	1977 -	2002 -
<b>Macro level</b>			
Assisting the proposal of reforms to macro-economic policies and for the legal-regulatory environment			
Facilitating the State/private sector dialogue to stimulate implementation of these reforms			
Supporting the design of national or regional strategies for developing the private sector/proposing adequate reforms			
<b>Meso level</b>			
Assisting the proposal of strategies for modernising the institutional environment			
Diagnosing the specific needs of intermediary organisations concerned			
Indirect financing for the private sector through local financial intermediaries	✓		
Strengthening capacities and expertise of local financial institutions	✓		
Aid for privatisation and for financing private sector infrastructure	✓		
Cost-sharing assistance for institutional strengthening of intermediary organisations and their service capacity		✓	
Institutional strengthening of agencies promoting investment and organisations representing the private sector			✓
<b>Micro level</b>			
Direct financial services	✓		
Cost-sharing assistance for enterprises, training and aid for consultancy partnerships and ACP advisory offices		✓	
Stimulation of the Business Development Services (BDS) market by cost-sharing provision of services to enterprises and BDS suppliers			
Sectoral investment promotion and partnership between EU and ACP enterprises			✓

Source: Binns *et al.* (2002)

### 3.4.3 United Kingdom

DFID published a private sector development strategy in December 2005 (a new one is currently being prepared). DFID aims to

- Act as a catalysts and facilitator, rather than intervening in markets;
- Work in partnerships with a range of other actors, including the private sector;
- Strengthen the business environment for all firms; and
- Make markets work for the poor.

DFID is involved in

- Improving the business and investment environment (encouraging public-private dialogue, regulatory reform, infrastructure, trade, competition policy and land reform);
- Improving business capacity, e.g. by increasing private sector access to finance, and by improving business access to quality services, including information and skills; and



- Improving corporate social responsibility.

The emphasis is on making markets work, rather than on intervening in the market and in firms specifically. However, one example of more direct involvement included the business linkage (about £20 million in total) and financial deepening challenge funds. As mentioned in DFID (2005), the Financial Deepening Challenge Fund (FDCF) supported 60% of the costs for a Leasing Company to develop a leasing product for SMEs. SMEs make up around 90% of Ugandan businesses, but only 5% qualified for a lease before this initiative. By February 2004, DFCU Leasing had offered over 330 leases. The DFCU Leasing experiment appears to have rejuvenated the leasing market.

#### 3.4.4 Netherlands

Similar to DFID, the Dutch government also supports general private sector development support. But the Dutch Programme for Cooperation with Emerging Markets (PSOM) also makes funds available ‘to cost-share the initial financial risks that [Dutch or LDC] companies face when investing in the emerging markets of developing countries. PSOM aims to finance pilot investment projects that lead to follow-up commercial investments and / or a lasting trade relation between the Dutch and local companies.’ The budget was increased to €51 million in 2004, with the average size per project being €825,000. These are large projects compared to SME interventions (and especially OVOP as we will see later).

#### 3.4.5 UNIDO

Table 5 provides a classification of the activities of UNIDO. Support is provided at different levels.

**Table 5: Classification of UNIDO's technical assistance activities**

	<b>Competitive economy (making industry more efficient)</b>	<b>Environment (environmentally-friendly industry)</b>	<b>Productive employment (promoting employment in industry)</b>
Policy	Industrial governance and statistics	Industrial energy and Kyoto Protocol	Private sector development
Institutional	Quality and productivity; investment and technology promotion	Environmental management	Agro-industries
Enterprise		Montreal Protocol	

Source: [www.unido.org/doc/3353](http://www.unido.org/doc/3353). Updated by UNIDO staff

A cluster of activities relates to building capacity in the area of standards, metrology, testing and accreditation to overcome constraints related to market access. It includes UNIDO (2004):

- Strengthening the regulatory framework for conformity;
- Strengthening the operational components of the conformity infrastructure;
- Competitiveness enhancement through quality and productivity improvements; and
- Accessing global subcontracting and supply chain networks.

As Morrissey and Te Velde (2005) suggest, activities are also undertaken at enterprise levels when pilot schemes are needed. The pilot cases then inform policies and institutional strengthening at a higher level, thus contributing to governance public goods. A good example is the case of Pakistan where one of the projects revolved around ensuring that the national accreditation body has the necessary capacity and know-how to provide accreditation services to the laboratories in the country. In doing so, the project assisted several private laboratories as part of a pilot scheme, in developing their quality manual and prepare them for an accreditation audit. The national accreditation body's objective was then to perform an assessment of these laboratories while being observed and evaluated by an internationally recognised accreditation body. This process led to increased governance capacities.

### 3.5 Concluding remarks

This brief review aims to illustrate that donor agencies have an interest in supporting the business environment: including macroeconomic strategies, governance issues, and policy, legal and regulatory frameworks (White, 2004). A donor such as DFID places great importance on the enabling environment and, for example, supports much work on competition policy, though it also has had a few micro-level programmes in place, such as the challenge funds.

There are differing views on how support is set in the set of social attitudes and value systems (important to GTZ), whether and how entrepreneurship is embedded in support for the enabling environment (ILO), how innovation and industrial and technological development is included (UNIDO), and how the enabling framework is consistent with social norms and attitudes and economic, social and political institutions (SIDA). It seems that donors such as DFID are more closely aligned with the view that support for the enabling environment is most that can be done to support PSD, while donors such as GTZ and UNIDO believe that more selective policies (e.g. industrial policy) may also be appropriate. There may well be complementarities and different comparative advantages, so that some donors specialise in some operations other donors in others. The OTF group (2007) provides another way of looking at private sector development, see table 6.

**Table 6: Comparing donors, by intervention and activity**

	Priority Focus	Active	Inactive
<b>Enabling Environment</b>			
Support for Public-Private Partnerships	● ● ●	● ● ● D	
Regulatory Reform	● ● D	● ● ●	
Infrastructure	●	● ● D	● ●
Competition Policy	△	● ● ● D	● ● ●
Privatization	△	● ●	● ● ● ● D
Governance	● D	● ● ●	
Land			● ● ● ● D
Labour	● ● ●	● ●	● D
<b>Trade &amp; Market Linkage Support</b>			
International Trade Policy Reform	● ● ● D	●	●
Fair Trade	△	● ●	● ● ● ● D
Value Chain Initiatives	● ● ● ●	●	D

<b>Financial Sector</b>			
Banking Sector Support	● ●	● ● ● ● ● D	
Investment Capital	●	● ● ● ● ● ●	D
Microfinance	● ● ●	● D	● ●
Remittances	△	● ● ● D	● ● ● ●
“Challenge Funds”	D	●	● ● ●
<b>Engaging the Private Sector</b>			
Business Services	● ●	● ● ● ● ● D	
Sector-Level Initiatives	●	● ● ● ●	D
Corporate Social Responsibility	△	● ● ● ● ● ● D	

Source: OTF (2007)

**Key**

- GTZ
- SDC
- USAID
- DANIDA
- SIDA
- DUTCH
- “D” DFID
- △ Gap in Leadership

Apart from the variety in approaches, this table shows that DFID is more active in the enabling environment part, while donors such as GTZ and DANIDA are more engaged at the business services and engagement level. JICA was not included, and we discuss JICA in the next section – especially the private sector development programmes at the business engagement level. Variety in approaches probably still exists because there appears to be no one best model.

## 4. Japanese approaches to development of SMEs and OVOP

### 4.1 Japan and SME development around the world

#### 4.1.6 Japan's approach to SMEs in Japan

It is generally accepted that Japan's development involved heavy government intervention with the state playing a substantial role in promoting successful industrialisation (Fukao *et al*, 2006). This was quite effective particularly given the country's limited human and capital resources. Between 1880 and 1970 Japan achieved sustained economic growth through industrialisation. The driving force behind that growth was domestic investment in industry and infrastructure. Both public and private sectors invested in infrastructure with the help of national and local government which guided the process.

Japanese growth was originally investment- rather than export- led. While Japan's exports grew rapidly – particularly between 1956 and 1973 when they grew at almost double the rate of world trade, imports continued to outstrip exports (Shinjo 2003). Although investment in manufacturing capacity was left largely to the private sector, rising domestic savings made capital accumulation possible. At the same time, the cost of securing foreign technology was reduced by the government's proactive industrial policy. There was also a significant role for government in the industrialisation of heavy industries including steel manufacturing and oil refinery. Special quasi-government banks provided long-term credit to kick start the modernisation of the heavy industry. An important element of modernisation included human resource development and directed credit to SMEs.

#### 4.1.7 Japan's international cooperation policy on SMEs

Japan has been seeking synergies between its aid policy on the one hand and trade and investment policies on the other for some twenty years. As such it has contributed to the development of Asia's infrastructure by providing yen denominated credit to a number of airport, rail road and expressway projects as well as HRD projects including management training and technical skills (Government of Japan 2005).

The Japanese approach was comprehensive providing long term assistance to SME development programmes. This included setting up a specific body for the promotion of SMEs, putting in place basic legal protections for SMEs and providing a credit guarantee facility to address any shortfalls in financing. Specialist financial institutions were also introduced as was a certified SME management consultant system.

The focus of Japanese SME cooperation varies across regions (JICA 2004):

- In Asia the focus is on industrial competitiveness
- In Africa the focus is on creating employment opportunities
- In East Europe the focus is on developing private sector economies.

**Table 7: Japan's cooperation policy on SMEs**

Development Goal	Approach	Project Example
<b>Trade and Investment Development</b>	<ul style="list-style-type: none"> <li>i) Trade, Investment &amp; Industrial Policy</li> <li>ii) Trade &amp; Investment Promotion Strategy</li> <li>iii) Market Analysis &amp; Development</li> <li>iv) Industrial Sector Development</li> <li>v) Human Resource Development</li> <li>vi) Infrastructure Development</li> </ul>	<ul style="list-style-type: none"> <li>• Design Promotion Plan (INO)</li> <li>• <b><i>Export Promotion Strategy (INO)</i></b></li> <li>• Supporting Industry Development (ASEAN 4)</li> <li>• Trade Business Training Centre (INO)</li> <li>• Capacity Building for Implementation of WTO Agreements (ASEAN 4)</li> <li>• Power Plant / Road / Port Development (ASEAN 4)</li> <li>• Industrial Estate / EPZ Development (ASEAN 4)</li> </ul>
<b>Enabling Business Environment</b>	<ul style="list-style-type: none"> <li>i) Improving Economic / Business Regulation and Implementation</li> <li>ii) Improving Custom Administration</li> <li>iii) Supporting Decentralisation</li> </ul>	<ul style="list-style-type: none"> <li>• <b><i>SME Promotion Programme (THI)</i></b></li> <li>• Supporting Market Economy (VTN)</li> <li>• Industrial Standardisation (ASEAN 4)</li> <li>• Intellectual Property (ASEAN 4)</li> <li>• Electronic Data Information System (INO)</li> <li>• Improving Local Government Capacities (INO)</li> </ul>
<b>SME Development</b>	<ul style="list-style-type: none"> <li>i) SME Development Policy</li> <li>ii) Financial Support</li> <li>iii) Business Development</li> <li>iv) Human Resource Development</li> <li>v) Technology Development</li> </ul>	<ul style="list-style-type: none"> <li>• <b><i>SME Promotion Programme (THI)</i></b></li> <li>• SME Development Programme (INO)</li> <li>• Cluster Development (INO, THI)</li> <li>• <b><i>Improving Access to SME Financing (VTN)</i></b></li> <li>• Vocational Training (ASEAN 4)</li> <li>• Supporting Industry Development (ASEAN 4)</li> </ul>

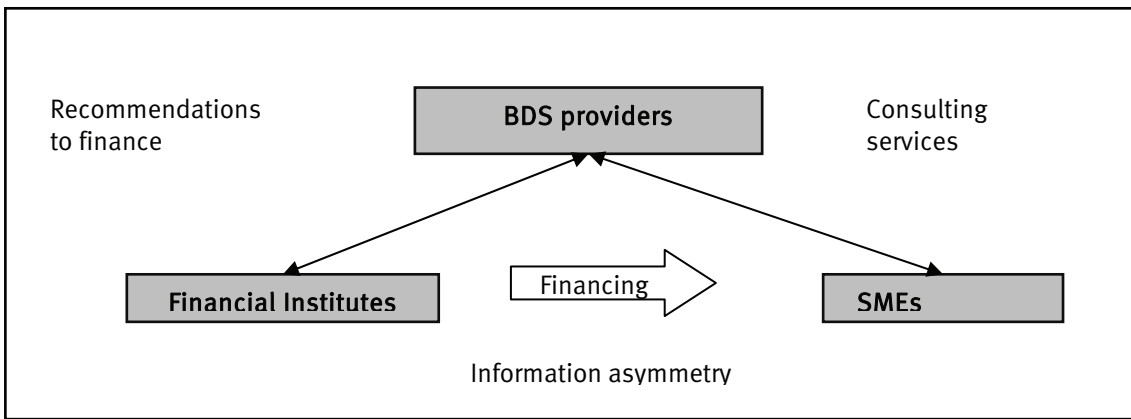
Source: UFJ Institutes, 2003

#### **4.1.8 Japanese SME cooperation and the role of BDS Providers**

Japan's policy for the promoting SMEs focused predominantly on identifying the right type of public interventions to address SMEs problems. In Japan government assistance was required because it was generally accepted that the market mechanism could not solve the failures of SMEs. JICA has therefore been working with BDS providers in a bid to overcome these problems. (JICA 2002)

In Japan, chambers of commerce usually assist SMEs to obtain access to finance on the condition that the borrower attends training courses or seminars including quality control. Nationwide, there are over 6,000 management instructors, assistant instructors, and bookkeeping instructors at local chambers of commerce who advise SMEs on improving management, financial issues, and tax matters (The Japan Chamber of Commerce & Industry 2004).

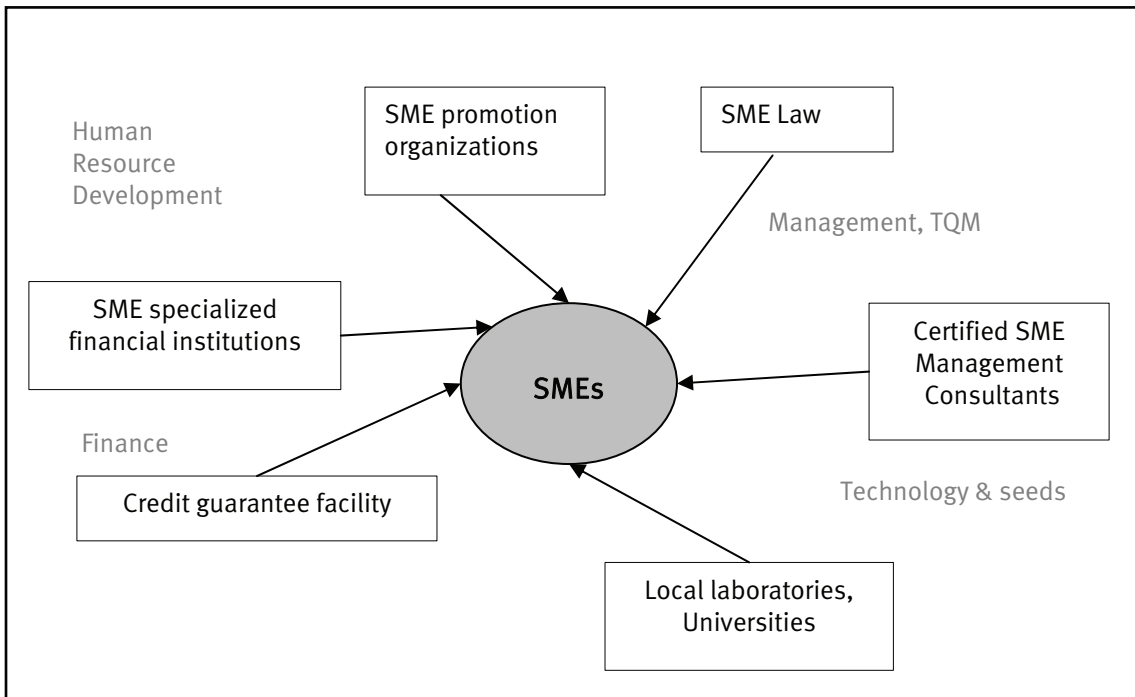
**Figure 5: BDS Providers and Financial institutions**



An important role for BDS providers is to reduce information gaps between big enterprises and SMEs. In addition to this, the Japanese government usually provides financial, legal and human resource development assistance to SMEs.

There is an SME support centre in each of the 47 prefectures of Japan. This nationwide network mobilises around 15 000 consultants, most of them from the private sector, including some recently retired senior executives. Consultants and trainers are recruited from this network by Japanese SME ODA institutions when required (Régnier, 2006) and it tends to work well. The provision of Japanese SME assistance is one part of a comprehensive approach which is illustrated in Figure 6 (below).

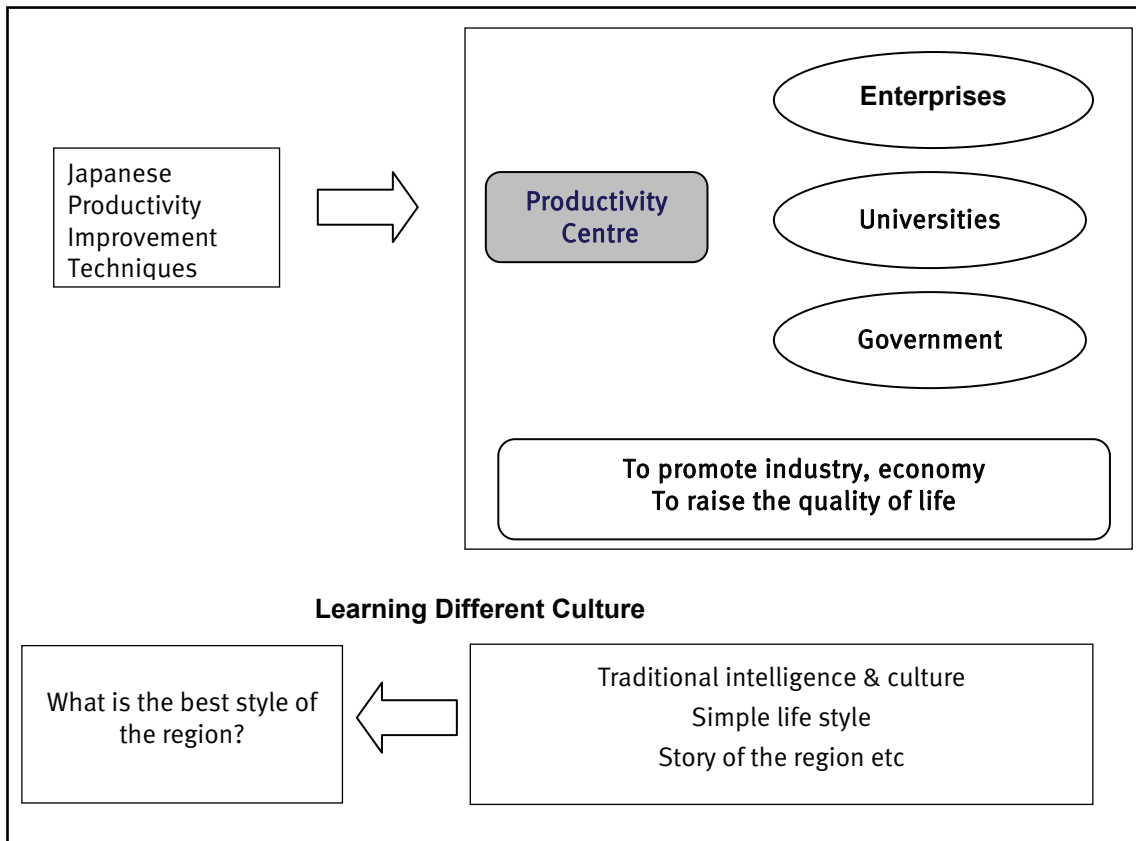
**Figure 6: BDS and SME performance**



Technical cooperation and “Kaizen” or continuous improvement are embedded features of Japanese production management systems. Quality lies at the heart of Japanese manufacturing and technical cooperation aimed at promoting Kaizen and the 5 S’s (Seiri: Separating. Seiton: Sorting. Seiso: Cleaning. Seiketsu: Standardizing. Shitsuke: Sustaining) (Imai 2006) would no doubt contribute to the growth and development of SMEs

To a large extent, Japanese SME development cooperation overseas is linked to its own experience of SMEs (Régnier 2006). The establishment of a productivity centre to facilitate collaboration among enterprises, universities and government for example is not unusual (see Figure 7).

**Figure 7: Transfer of techniques to SMEs using a productivity centre**



#### 4.1.9 Japanese uniqueness and western standards

Japan’s industry developed through new management techniques which combined American mass production techniques with traditional quality control. Workers embraced many of the key ideas of “just-in-time” inventory control in assembly industries, learning how to do rapid machine setups as part and parcel of an effort to produce components "just-in-time" and without failure. There are essential differences between the production and operations management philosophies of the West and those of Japan. (Imai, 2006)

The basic principles of Japanese industrial development coincide with Robert Chambers’ thinking. He calls for a fundamentally new approach to development which emphasises people over things, and is guided by principles which include: self-critical awareness and admitting and learning from mistakes, making reversals in existing behaviours, professionalism, bureaucracy, careers and modes of learning (Chambers 1997). Self-critical awareness is a key feature of Japanese Kaizen and, by extension, the OVOP movement.

#### **4.1.10 Japanese cooperation is covered by several organisations**

Several Japanese institutions now provide assistance for SMEs. The Japan Bank for International Cooperation (JBIC) is a financial institution that provides assistance through import/export and investment credit to the private sector, untied-loans and two-step loans to small firms. The Japan External Trade Organization (JETRO) promotes the development of supporting industries and assists Japanese enterprises in developing countries by dispatching experts, organizing trade fairs and industrial exchange fora etc. Furthermore, the Association for Overseas Technical Scholarships (AOTS), and the Japan Overseas Development Corporation (JODC) accept trainees and dispatch experts to conduct training (JICA *et al* 2000).

In this paper, we discuss selected cooperation offered by several Japanese organisations including JICA, JBIC, JETRO and Oita OVOP International Exchange Promotion Committee. For OVOP, JICA mainly provides OVOP Theory, training in Japan, small scale equipment and organises the dispatch Japanese volunteers. Oita OVOP International Exchange Promotion Committee support training in Oita, Japan and host the Overseas Seminar.

### **4.2 What is OVOP?**

Japanese co-operation defines OVOP (One Village One Product) as a “strategic movement” which relates closely to regional development policies. As part of the Aid for Trade initiative at the WTO Hong Kong Ministerial Conference, Japan initiated the OVOP Campaign. Regardless of the suspension of DDA (Doha Development Agenda) negotiations, Japan will continue with the campaign (MITI 2006) JICA also supports the OVOP movement in Africa as an effective tool to change the awareness of community members in Africa, promote empowerment, and reduce poverty through the improvement of income and economic growth in rural areas (JICA, 2007). The OVOP approach encourages farmers or firms to develop a product or industry unique to their region and develop it into a nationally recognisable and, where appropriate, a globally recognisable product.

To date, OVOP has been introduced in a number of countries including Thailand, China, Indonesia, the Philippines and Malawi. The precise content of the OVOP approach varies from country to country. For example, in Japan there was little role for (central) government and the onus was with the private sector. In Thailand, the government played a very important complementary role. The success of the OTOP (“One Tambon, One Product”) model in Thailand has demonstrated the value and potential of grassroots innovation when combined with effective political and institutional support. (Supachai and Ellis 2005)

#### **4.2.1 Historical background of OVOP**

The “One Village One Product” or OVOP movement has its origins in Oita, one of the 47 prefectures of Japan. It began in the 1970s as a community-based business activity aimed at rediscovering and revitalising economically backward rural areas. The movement was introduced in 1979 by former governor of the Oita Prefecture in Japan, Dr. Morihiko Hiramatsu. Under the OVOP movement each village is encouraged to produce at least one product or service which can be showcased across the country and the world.

The impetus for the OVOP movement in Oita was threefold (JETRO, 2007):

- i) The population shift from rural areas to major cities and the loss of vitality in various regions of the prefecture;
- ii) The need to create new industries in the regional areas;
- iii) The need to reduce over-dependence of business on local government.



To overcome the above problems, the governor established three basic principles of the OVOP movement. These are as follows:

- 1) **Local yet Global:** being local and global simultaneously called “Glocal”. The idea is to make products that represent local areas/regions but which could also be competitive in global markets;
- 2) **Self-reliance / Creativity** or independence and new ideas. Villagers themselves were encouraged to decide which product(s) should be chosen as OVOP products; local governments were intended only to provide technical assistance;
- 3) **Human resource development:** OVOP would promote innovation and creativity and also encourage people to improve or harness their skills (Hiramatsu and JETRO, 2007).

All OVOP products in the Oita prefecture are determined according to these principles. This specialisation has been referred to as the Japanese product specialisation method. However, there is no intention to limit village products. In Thailand, competitions for authorised OVOP products are organised regularly. In this case, only one product will be approved and championed but in Japan there is no such limit in place.

Figure 8: OVOP product in Oita prefecture in Japan



Source: Oita OVOP International Exchange Promotion Committee, 2008

Prior to the OVOP movement, local communities sought to stimulate their economies by appealing to government for assistance in the form of grants and subsidies. They relied heavily on government handouts. While government, together with quasi-government agencies and local authorities launched several assistance programmes for the SMEs and farmers, these assistance programs were not universally embraced. One of the main reasons for the limited uptake was the difficulty in accessing funds due to a host of complicated government procedures. In addition, local culture (religious beliefs and practices, customs and traditions) stifled the growth of SMEs. In particular, women were forced to work in the home even they had skills and capabilities sufficient to start new businesses.

The OVOP movement encouraged local people, including women, to work closely with government agencies in order to overcome constraints by themselves. The widely respected former governor of Oita Prefecture, Dr. Morihiko Hiramatsu, became the movement's first official leader in 1979. He encouraged local people to do business using their own initiative bypassing complicated government procedures. The message was clear: local people could and should pursue economic activities in their villages and communities. Training courses and seminars on topics such as business ethics were designed to mobilise and empower the people. Individuals and communities were encouraged to use their own skills and experience to start new businesses while limiting their reliance on government to productive assistance only.

#### **4.3 Japanese OVOP and government-led OVOP approach**

The OVOP approach can be implemented in a number of ways. As we have already discussed, the Japanese approach differed from that pursued in Thailand and the rest of Asia. One illustrative example of an Asian OVOP is OTOP (One Tambon One Product) in Thailand. Inspired by OVOP, the Thai government began promoting local industry by supporting the manufacture of attractive products based on local resources, culture and tradition.

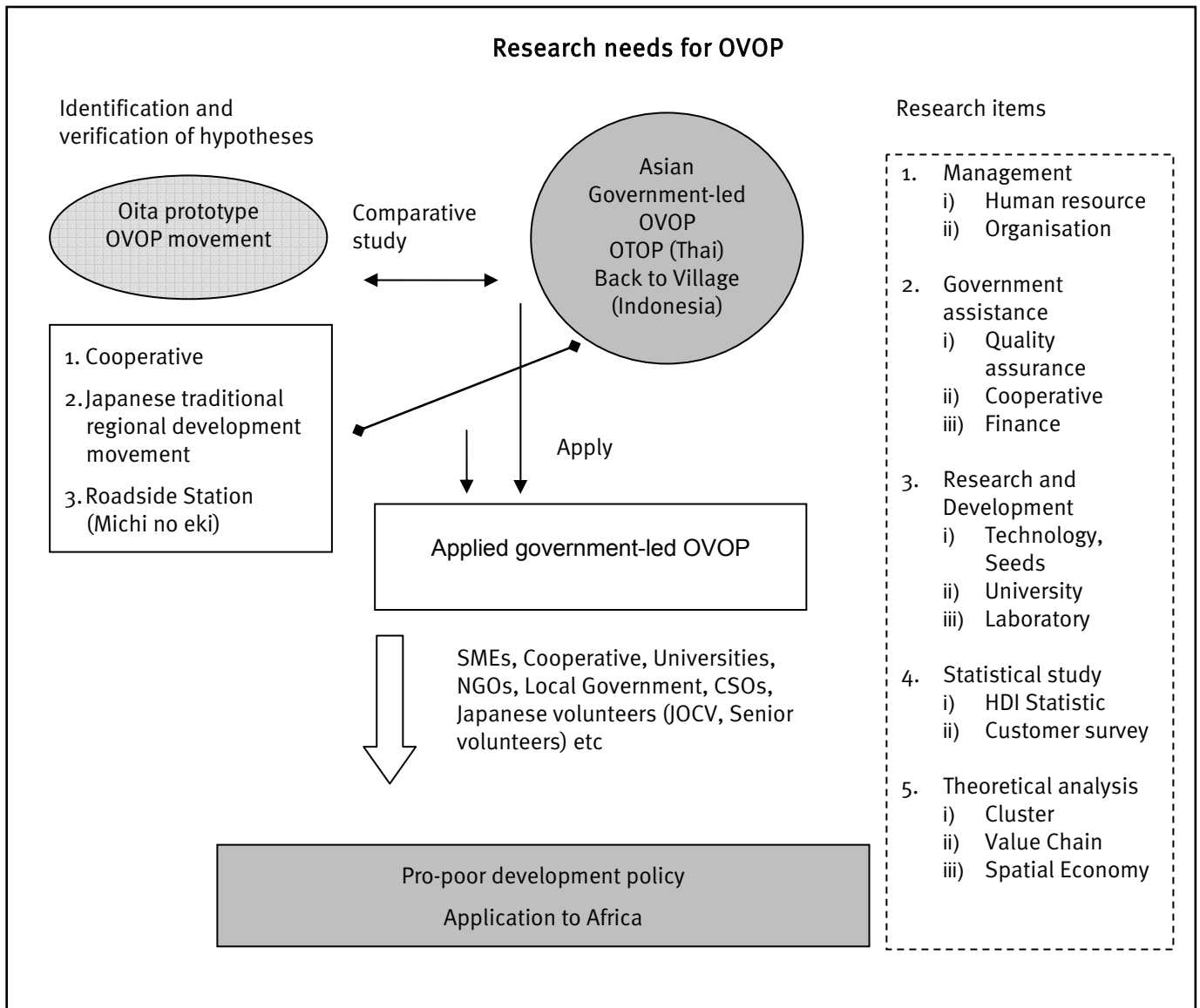
One of the main objectives of the OVOP approach is to promote and export locally produced goods globally with government assistance. In Thailand the Department of Export Promotion (DEP), Ministry of Commerce, staged the "OTOP to the World 2007" campaign which presented a selection of quality OTOP products from across the country, including gifts and decorative items, fashion and jewellery (Thai OTOP <http://www.thaitambon.com>) Meanwhile, in the Philippines, local chief executives take the lead in identifying, developing and promoting a specific product or service, which has a competitive advantage (<http://www.otopphilippines.gov.ph>) Governments are the driving force in the Asian OVOP approach. This is in stark contrast to Japanese OVOP which emerged as a popular reaction to local development policy led by an independent people's movement and therefore less dependent on government from the start.

In Malawi, OVOP is regarded as a microfinance initiative. The Ministry of Gender and Community Services has implemented a number of donor funded microfinance initiatives in recent years. These have mostly targeted rural women, although evidence from recent studies suggests men are also now benefiting. OVOP is the latest microfinance initiative to be launched by the Government (Government of Malawi 2004)

OVOP and OTOP are becoming increasingly popular models in Asia in terms community development and local industrial promotion. Globalising trends notwithstanding, the approach has been pursued as an alternative to conventional economic development models particularly in Thailand, the Philippines and China (Igusa, 2006). The main objective of the approach is to achieve economic development, primarily through export promotion. As illustrated in Figure 9, it is important to recognise the difference in approach between Japan and other Asian countries. Even in Japan, there are several local development models including Michino-Eki, "Road side station". The Japanese Government is keen to champion this approach above others in LDCs because of its success in other parts of Asia. The key to

sustainable regional development is the voluntary and independent involvement of communities with effective support from the authorities. (Yoshimura 2004)

**Figure 9: OVOP movement and Development Policy**



**4.4 How is OVOP expected to alleviate constraints on SMEs?**

As discussed in a previous section, SMEs in Africa face growth constraints of a different nature and magnitude to those in Asia. The table overleaf summarises how the OVOP approach is expected to alleviate those constraints. The OVOP approach is not a panacea and complementary action will be needed to overcome all the constraints confronting African SMEs. That said, strong government leadership in Thailand has successfully tackled a number of similar constraints proving it is possible for recipient countries to remove some constraints themselves without having to rely on Japanese aid and cooperation. It is also possible that other donors will seek to tackle some of Africa’s more enduring growth constraints.

Table 8 summarises how OVOP is expected to alleviate constraints on the development of SMEs.

**Table 8: How is OVOP expected to alleviate constraints on SME development?**

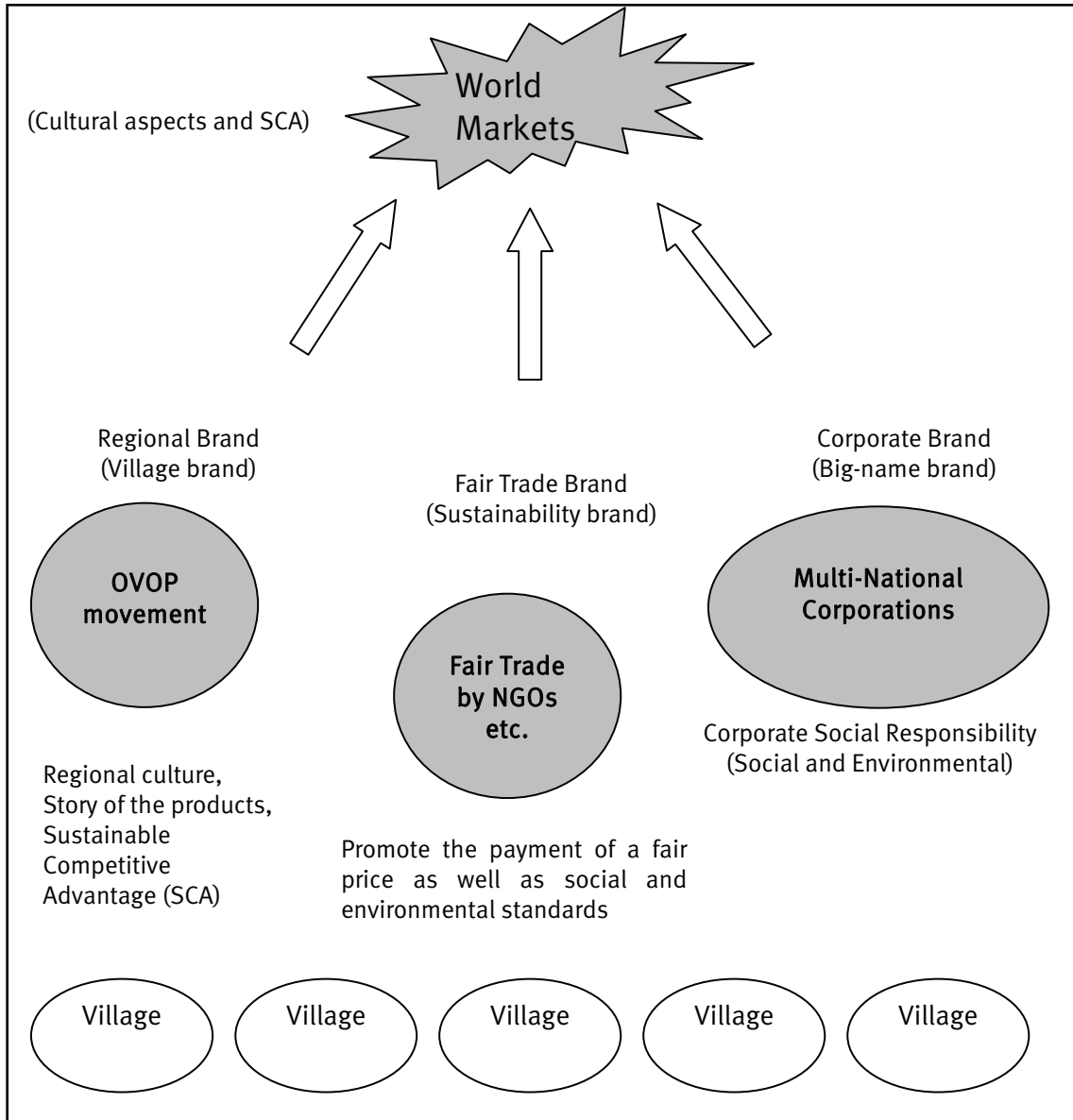
<b>Constraint on SMEs</b>	<b>Japanese assistance for OVOP</b>	<b>Examples of OVOP related involvement</b>	<b>Examples of complementary actions by host Government</b>	<b>Examples of other donor assistance</b>
Low Skills	Directly, by providing ex-pat skills and training courses in Japan	Packaging, Labelling, Accounting, Marketing etc.	Training	Limited, GTZ
Lack of technology, standards and knowledge	Directly, by providing advice and training courses	Quality Control, Kaizen, 5S, TQM JIT etc.	No	Limited, standards support by the EC, UNIDO on standards
Lack of external links such as in value chains	Directly, by linking SMEs to Japanese markets	Trade fair in Japan, Web site	Trade Fair	e.g. IDRC
Lack of access to credit	Indirectly, via government policy	No	Yes, sometimes. Cooperatives, OVOP secretariats	World Bank, DFID etc.
Weak BDS markets	No, OVOP provides BDS itself and does not promote the BDS market	No	No	Donor Committee on small enterprises; DFID etc.
Infrastructure	No, only small equipment will be provided.	Cooling tanks for milk plant.	No	World Bank, EC
Regulatory framework and governance framework more widely	No, only limited guidance for the OVOP framework will be provided	No	Limited	World Bank UNDP UNIDO DFID etc

Note: Constraints are taken from section 2, donor examples from section 3, and Japanese support including OVOP from section 4.

### 4.5 Comparing OVOP to other approaches

The OVOP model is linked to other approaches. The remainder of this section will provide a brief outline of each and identify the linkages between them. Figure 10 locates OVOP in a group of similar initiatives designed to establish brands at the local, regional, national and global level.

Figure 10: OVOP and similar approaches



#### 4.5.1 Fair trade, CSR and OVOP

The fair trade initiative favours small producers over large enterprises and aims to achieve a fair price for goods and services while at the same time guaranteeing minimum environmental standards and social rights for small producers in developing countries. Large multi-national companies (e.g. Nestle or Unilever) are trying to improve their corporate image by pursuing 'Corporate Social Responsibility' (CSR) initiatives. OVOP meanwhile promotes a local brand and seeks to improve standards. It aims to forge a new relationship between local people and world markets by capitalising on unique local cultures and traditions.

#### 4.5.2 Sustainable Competitive Advantage (SCA)

The OVOP also relates to terms such as Sustainable Competitive Advantage (SCA). Competitive advantage (CA) occurs when a firm occupies a certain space in the competitive landscape. Michael Porter suggests that a competitive advantage exists when a company makes economic rents, that is, their earnings exceed their costs (including cost of capital). In a similar vein, the OVOP approach aims to create a Sustainable Competitive Advantage (SCA) at a village level. SCA is different from a competitive advantage (CA) in that it provides a long-term advantage that is not easily replicated.

#### 4.5.3 Fair Trade, CSR, and product standards

Good quality is key for sustainable long-term business. There is an increased pressure to produce quality products by making traceability an integral feature of CSR. A UK initiative, the so called ETI, promotes quality standards. The Base Code and Principles of Implementation have two related functions:

- They provide a basic philosophy or platform from which ETI identifies and develops good practice; and
- They provide a generic standard for company performance.

The labour standards incorporated in the Base Code constitute a minimum requirement for any corporate code of labour practice. ETI is funded by Membership fees (60%) and DFID (Department for International Development) (40%). This might be an example for other donors such as Japan as it may fill a gap in the OVOP movement.

### 4.6 OVOP in relation to other development concepts

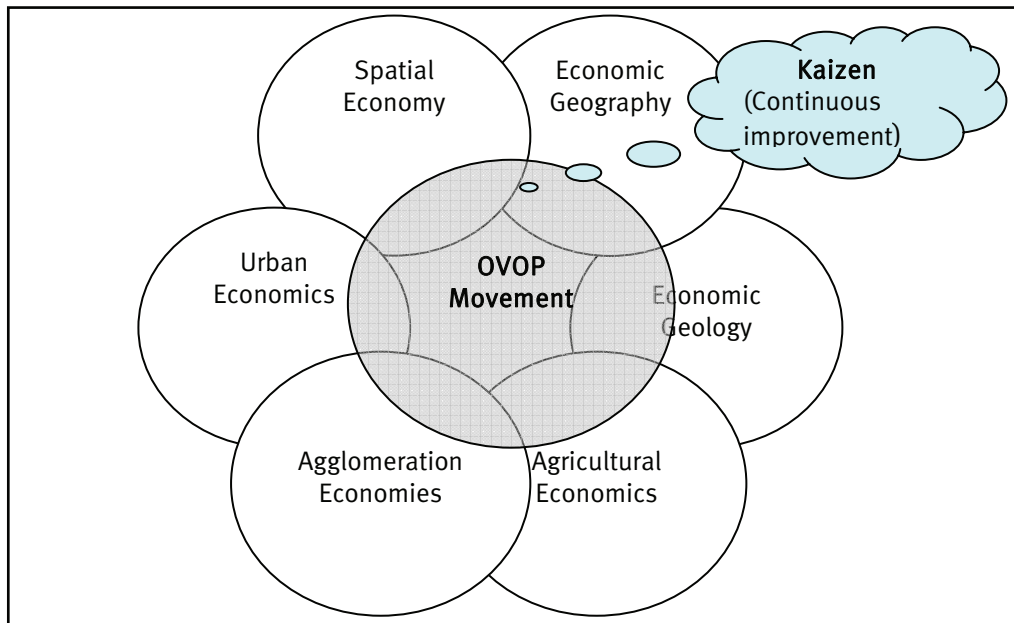
The OVOP movement also relates to the following concepts. (See Figure 11)

Space is an important element in the OVOP movement. With improved transportation technologies which reduce cost, industrial activities gradually move out of urban centres and are replaced by business and personal services. This allows cities to specialise in different industries – a basic tenet of the OVOP approach. Fujita *et al* (1998) define the field of new economic geography and the economics of agglomeration, which combines new economic geography and urban economics. A spatial perspective has become increasingly relevant to our understanding of economic phenomena.

Urban Economics is the economic study of urban areas. It involves using the tools of economics to analyse urban issues such as crime, education, public transport, housing, and local government finance. More narrowly, it is a branch of microeconomics that studies urban spatial structure and the location of households and firms. Agglomeration economies can explain the advantages of the "clustering effect" of many activities ranging from retailing to transport terminals.

Agricultural economics originally applied the principles of economics to the production of crops and livestock - a discipline known as agronomics. Agronomics was a branch of economics that specifically dealt with land usage. It focused on maximizing the yield of crops while maintaining a good soil ecosystem.

**Figure 11: OVOP and relevant background theories**



Economic Geology is concerned with natural resources such as minerals that can be utilized for economic and/or industrial purposes. Economic Geography analyses the endogenous determination of the location of economic activity in a general equilibrium framework. It is usually regarded as a subfield of the discipline of geography, although recently economists such as Paul Krugman and Jeffrey Sachs have pursued interests that can be considered part of economic geography.

OVOP relates to these concepts mainly because it has geographical features and clustering effects. Geographical features would include spatial perspectives, transportation and communication technologies. The clustering effects include scale economy, technological spill over and vertical clustering, value chains.

However, for practitioners, the OVOP movement can be explained by “Kaizen”, (continuous improvement). The “Manufacturing Culture” is one of the two pillars of Japan’s culture. The other is the “Local Revitalization”. “Local Revitalization” schemes have absorbed hundreds of thousands kaizen processes and technologies (Kimura 2005)

#### **4.7 Value chain analysis and the OVOP movement**

Value chain analysis provides an additional dimension to our understanding of the OVOP movement. There are a number of parallels between the theory of value chains and the reality of OVOP. The OVOP approach builds value chains by integrating primary activities (e.g. production, marketing) with support activities (communications, logistics etc) at the local / regional level. The value chain approach suggests that all firms can participate in a chain providing the relevant standards and conditions are met. SMEs that do not possess the appropriate skills and technology need training in areas such as accounting and ICT. The important thing to note here is that all participants in the chain benefit from

this training because it adds value to the finished product. OVOP includes a training and skill component. Leadership, however, is the key to nurturing the chain and the suppliers within it.

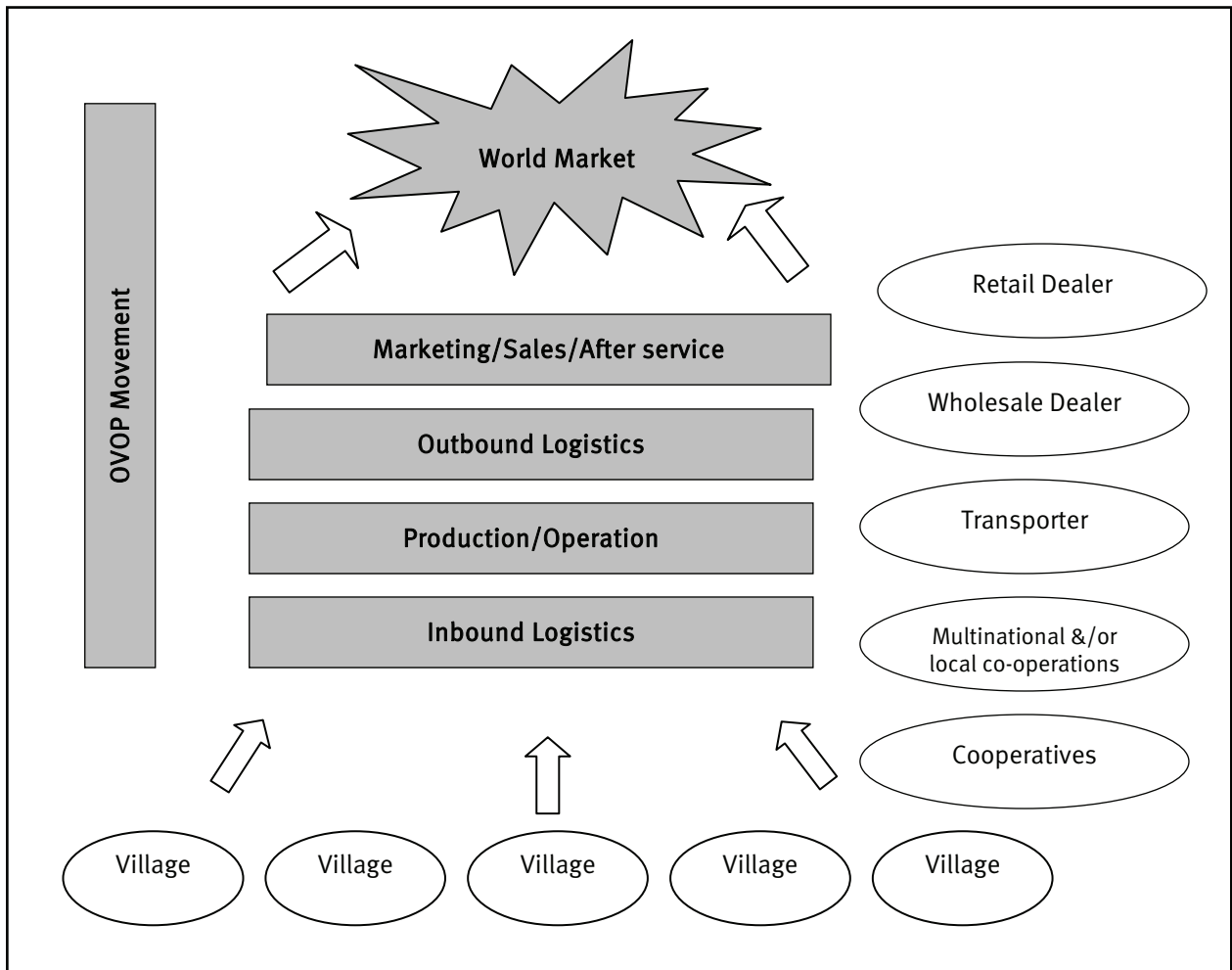
In Thailand, the OTOP project organises the distribution of products to large retail centres, department stores, local shops and convenience stores. The distribution of products is handled by the government in combination with the private sector firm (Régnier 2006).

The future landscape of value chains will be more varied. In Africa, we can already identify some emerging trends. Supermarkets for example have sprung up across Africa and no longer target affluent consumers alone but also attend to the needs of middle- and low income consumers. (Humphrey 2007).

There are substantial advantages to value chain analysis. The OVOP approach lacks a clear understanding of sequencing and service flow. (See Figure 12 OVOP and value chain analysis). The OVOP approach would therefore benefit from value chain analysis.



Figure 12: OVOP and value chain analysis



## 5. Assessing OVOP: initial considerations

This section discusses some initial considerations when assessing OVOP. Section 5.1 discusses recent developments of OVOP in Africa. Section 5.2 discusses methodological issues how a programme such as OVOP might be assessed. Section 5.3 summarises a number of initial observations on the basis of initial discussions and available information.

### 5.1 OVOP in Africa: recent developments

Now that the OVOP movement has spread to Asia, the Japanese government is currently considering whether and how to advance the OVOP movement to support access for low-income developing countries to a wider market for their products. JICA views the OVOP movement as a vehicle for empowering African rural communities, including women, and generating rural income opportunities.

JICA has had four separate missions in 2007 to 10 African countries: Ethiopia, Kenya, Madagascar, Mozambique, Nigeria, Tanzania, Senegal, South Africa, Zambia and Uganda to disseminate the concept of OVOP in the African context and to assess the capacity and the political will of the implementing government ministries as well as the potential needs at the village level. These missions also discussed with other donors, who shared the view that it was important to support the African informal sector and small scale farmers to generate income and employment opportunities through market based approaches.

JICA is currently contemplating whether and how to support the rapidly growing OVOP movement in the aforementioned countries through its technical cooperation programme including expert assignments, dispatch of volunteers and training in Japan and other countries as well as marketing support by JETRO and fair trade organisations. JICA has cooperated with Malawi and Ghana on OVOP.

In Ghana, JICA has been assisting rural women's groups to increase production and improve quality of soap made from the fruits of the indigenous tree, Shea. Japan External Trade Organisation (JETRO) has been supporting its marketing to overseas including Japan.

In Ethiopia, JAICAF (Japan Association for International Cooperation of Agriculture and Forestry) has reviewed the policy documents and strategy papers in order to elicit information on the productions, processing and marketing of agricultural products related to the application of the OVOP movement.

In Malawi, the Malawi Government institutionalised the OVOP movement as a part of its national development plan in 2003. This was the first example of the OVOP movement in Africa. The Japan International Cooperation Agency (JICA) sent a study team to Malawi in 1997 which introduced Malawian officials to Oita's project of the OVOP Movement as a scheme for regional development. In December, former Minister Aleke K. Banda of Agriculture and Irrigation visited Oita to understand the facts of Oyama Town in Oita and other OVOP projects, and finally requested the Oita Prefecture and JICA to extend cooperation to Malawi in adopting the OVOP.

JICA has been assisting the capacity development of the OVOP implementing agency of the Malawi Government and has provided technical and business support to the OVOP farmers on the ground. Local people prepare business plans and send it to the OVOP secretariat.

## **5.2 Assessing OVOP: methodological issues**

There are quite a number of different donor programmes supporting the private sector in Africa, as we suggested in chapter 3. Few programmes are properly evaluated using good data, probably because it requires data-intensive research. Indeed it is not straightforward to assess cooperation development programmes such as OVOP.

There will be three key components of an assessment of OVOP

1. What impact areas are relevant?
2. What is the support measure that will be assessed?
3. How can the effects be assessed?

### **5.2.1 Impact areas**

It is important to understand the way OVOP and associated development support might affect firms, regions and countries. We suggest there are three levels of objectives or impact areas where the effects of OVOP could be important.

OVOP supports local industries and SMEs in particular, to become more productive and export more, much as other business support programme. This should lead to better economic and social development in the region. One important aspect therefore will be to assess whether OVOP has led to better firm performance, such as sales, productivity and employment. Because much support is at the level of household, it also requires an assessment of whether households have gained in terms of employment, incomes and consumption patterns.

Secondly, OVOP could lead to a better understanding of what constraints are faced by SMEs which can inform support at higher level. So it will be important to understand whether OVOP generates knowledge of public goods beyond the firm-specific effects identified before (see the discussion of UNIDO's activities). This could be about the use of a technology because this the implementation generates positive externalities (see section 2). This is a qualitative assessment.

Thirdly, we also need to understand the sustainability of the effects, in particular for institutions at the institutional and governments at the local, regional and national levels. Does the support build up a better local institutional capacity to promote private sector development, for example, in the market of BDS?

### **5.2.2 Understanding the types and levels of support**

As a first step in any impact assessment or evaluation, it is crucial to be clear about what support is being provided. Is it credit, training or skilled personnel? A good description of what type of support firms have received is necessary.

### **5.2.3 How can the effects be assessed?**

There are quantitative and qualitative aspects to assessing the effects. The literature on the quantitative evaluation of private sector development programmes suggests that various evaluation techniques (see e.g. Oldsman and Hallberg, 2002) can be used during programmes. Evaluation depends on the formulation of a strategic counterfactual (what would have happened without the support), and evaluation techniques differ in the way they select controls used to separate project effects ('treatment' effects) from other factors. There can be experimental design with random assignment of controls and treatment groups, quasi-experiments with constructed controls (partly based on regression analysis), and ex-post evaluation using regression analysis and expert judgement. The strength of causal inferences that can be drawn from the analysis depends on how well the

particular approach deals with the validity of controls: are controls exactly the same except for the fact that they have not received treatment?

Evaluation of firm specific effects will depend on availability of good data of firms that have been supported in terms of

- Sales
- Exports
- Labour
- Investment

At the household level, sample information needs to be gathered on

- Employment
- Cash income and
- Consumption

When data of supported firms or households exist over time (e.g. doing a questionnaire for a number of firms), it would be possible to conduct a before / after comparison, rather than compare supported firms with non-supported firms. If performance has improved over time, this might be attributed to the introduction of certain types of OVOP support, after controlling for other factors. If data exist for firms (households) that have not been supported but which are similar to those that have been supported, it might be possible to compare the firms (households) and attribute the difference in performance to support received. Not all firm- (household-) specific effects can be easily quantified – for example, we also need to allow for improvements in entrepreneurship. It is not difficult to imagine that extensive firm and household surveys would be needed, and this is time consuming.

The assessment of other effects needs to be more qualitative and centre around the following questions

- Does OVOP promote knowledge public goods, e.g. through the demonstration effects of the successful implementation of OVOP support?
- Does OVOP lead to better capacity at local, regional or national level to support private sector development and provide an enabling investment climate?
- Is OVOP linked in with national development strategies?
- How does OVOP link in with other government and donor support strategies?

Such an assessment requires a number of qualitative discussions and review of documents.

UNIDO also conducted a case study for the Thai One Tambon, One Product (OTOP)<sup>1</sup> project in 2005 and covered issues related to evaluation and monitoring. It suggested that, ‘unfortunately, no information has been obtained from any agency concerning the direct benefits perceived by the communities and the rural target population or on the socio-economic impact of OTOP movement’. A system is required to obtain data on indicators such as (UNIDO, 2005):

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<sup>1</sup> A 'tambon is a Thai administrative unit smaller than a district.

- i) Net effect of the project on the target populations in terms of employment, income creation and poverty alleviation, particularly for the farmers and fishermen;
- ii) The ratio between new enterprises and existing enterprises participating in OTOP;
- iii) Survival rate of enterprises;
- iv) Sales earning ratio between communities and SMEs;
- v) Cost/benefit analyses based on investments and returns of the OTOP craft system.

### 5.3 OVOP in Malawi: an initial assessment

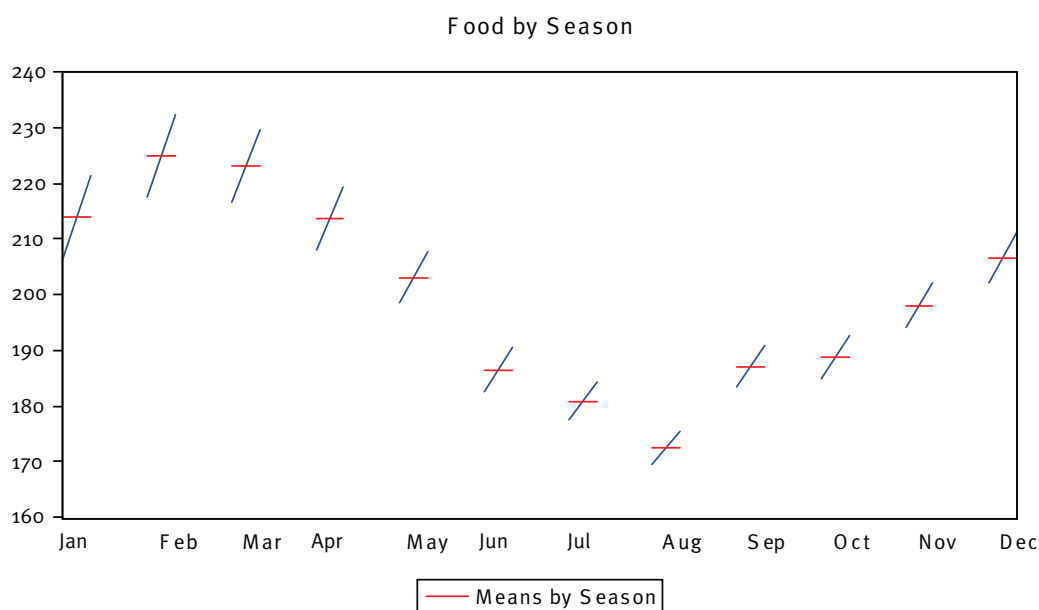
We have not yet conducted an extensive analysis nor have we done extensive field survey work. However, there are various pieces of information available for an initial assessment of OVOP in Malawi. A full assessment would need good quantitative data as well as further qualitative discussions.

#### 5.3.1 External factors

There need to be a number of qualifying remarks at the start about Malawi. Malawi is a very poor country and any support programme faces multiple challenges. Failures (or successes) of companies and households supported by OVOP may not necessarily be attributed to the level or type of support, or it might be difficult to identify the effects of support because other more variable factors dominate.

Since OVOP support often goes to agriculture it is important to point out the risks to agriculture activities. In particular, there are often food shortage and associated risks, e.g. due to droughts. Indeed, Malawi's output is extremely volatile by international standards. Further, food prices are highly variable. Figure 13 shows the consumer price index for rural food in Malawi from 2006 to 2007. This means that there are a number of external factors that are likely to affect success or failure of agriculture activities in Malawi.

**Figure 13: Variability in food prices**



Source: The National Statistical Office of Malawi (CPI Rural (Food) 2006 and 2007 as 2000=100) <http://www.nso.malawi.net/>

### 5.3.2 Type and level of support

The OVOP programme in Malawi aims to develop products and services through value adding by communities using locally available resources in a designated area (Kaluma-Sulumba, 2008; Gwaza and Kumbatira, 2008). It aims to:

- Promote the OVOP concept approach of economic development at the level of villages;
- Promote value adding technologies, such as agro-processing, quality control and packaging, at the village level;
- Facilitate small-scale business skill development at the village level;
- Promote market linkages between products & services from villages and domestic / international markets.

The Malawi OVOP Programme has so far supported 46 projects for 12,943 beneficiaries. The actual project activities include: dairy processing; fish processing; vegetable production and processing; rice milling; honey production and mushroom production. One group, for example, received technical support from the programme and built a multi-purpose model factory where members successfully managed to produce commodities like confectionaries, cooking oil, and milk from soy beans and other products among others. Some of the OVOP products have been exported to South Africa and Japan. Locally, some of the products are on sale in some supermarkets in Lilongwe and Blantyre.

OVOP is co-financed by both the governments of Malawi and Japan. Groups of firms are funded to purchase machinery to enhance their productivity and training is provided to use the machines. The groups pay back the loans and the money is revolved to support other groups. As of December 2007, OVOP has disbursed a total of US\$418,721 (Kaluma-Sulumba, 2008)

### 5.3.3 Quantitative effects

At this stage we do not have good quantitative data; however, Gwaza and Kumbatita (2008) provide one illustrative example which clarifies the potential of OVOP (see below) in terms of supporting performance as well as governance. However, they also caution that only a limited amount of supported projects are still continuing, so that would need further investigation.

#### **Box 1: Bvumbwe Milk Cooperative**

Bvumbwe Milk Cooperative, formed in 2003, was one of the first projects to be funded by OVOP. Bvumbwe received a loan of around US\$12,000. JICA helped dairy farmers in Bvumbwe who had a bulking group to form a cooperative. JICA also procured a cooling tank which the cooperative uses to store its milk before it is sold to the Dairy Board, the largest consumer of raw milk in Malawi.

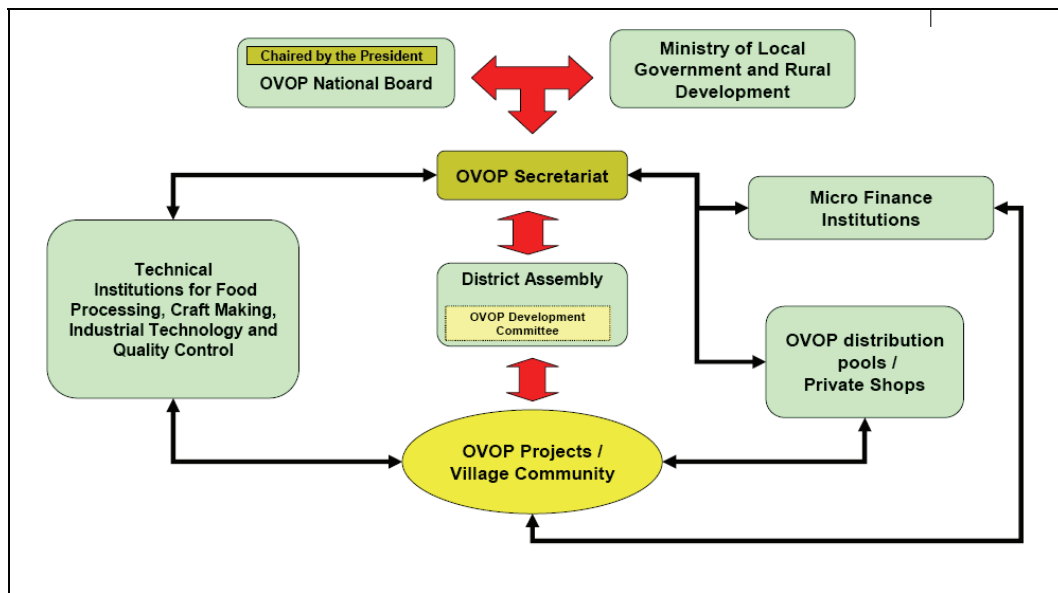
JICA's technical assistance to the cooperative has improved productivity and reduction in losses of milk collected from its members. Milk production has increased from 13 litres to 27 litres per animal per day. The establishment of the cooperative has made it possible for them to negotiate with Dairy Board better prices as quality of milk produced is of high standard. This has also led to an increase in the number of farmers and animals in the cooperative, increasing from 12 to 117. The Cooperative is currently planning to install a pasteurizing plant so that they can package and sell directly to consumers.

Source: Gwaza and Kumbatita (2008)

### 5.3.4 Institutional Context and Governance

The Malawian OVOP is technically managed by a National Secretariat under the Ministry of Local Government & Rural Development. The Head of State, His Excellency Dr. Bingu wa Mutharika, chairs the National OVOP Board (see Figure 14 below) as part of his initiative of Malawi Growth and Development Strategy (MGDS)<sup>2</sup>. This suggests political will of the government, as is often the practice in launching OVOP in new countries (unlike in Japan, but more like Thailand). However, it is not clear whether resource flows and government commitment to OVOP remains if the political climate changes. This is a risk with respect to sustainability of the OVOP programme.

Figure 14: Institutional context of OVOP



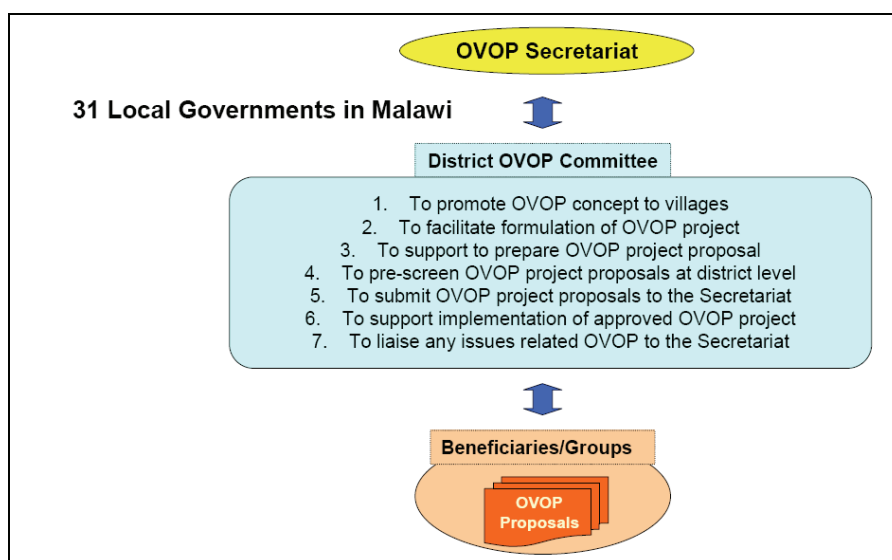
Source: Kaluma-Sulumba, 2008

The link to local government, via district assemblies, is also an important distinctive for Malawi, which is not the case for Thailand and the other countries in Africa. It resembles the original Oita idea in that planning is taking place at the lowest administrative units of government. At this level, institutionally, there is the strongest interface with the traditional structures and processes, and a greater potential for cultural identities of products and resources.

Box 1 shows the potential of OVOP in empowering local communities economically as well as improving leadership skills. OVOP focuses on ensuring that all the members in the group develop management and leadership skills. This has also assisted in ensuring that groups pay back loans.

<sup>2</sup> Six key priority areas of agriculture and food security; irrigation and water development; transport infrastructure development; energy generation and supply; integrated rural development; and prevention and management of nutrition disorders, and HIV/AIDS.

Figure 15: OVOP secretariat



Source: Kaluma-Sulumba, 2008

The link to the district assemblies, however, needs to be explored in the context of the quality of decentralisation and hence the decision-making processes that follow from these assemblies. The challenges cited by the OVOP Secretariat include issues such as ‘distorted beneficiary identification’. These kinds of issues that arise in the use of district assemblies to identify beneficiaries do not lend themselves to technical solutions as other kinds of challenges such as ‘lack of community awareness’. On the backdrop of political interference with decentralisation processes since independence in Malawi, it should not be just assumed that the presence of district assemblies translates into greater citizen participation in the choices of resources and products for OVOP. In the current political environment, the influence of political parties on local constituency dynamics and decisions is very significant in Malawian societies. Gwaza and Kumbatita (2008), however, suggest that the OVOP programme is unusual as it has not been the subject of politically abuse. This is an issue that requires further exploration

Scaling-up challenges, as evident in the small number of OVOP projects since inception, are indicative of both the capacity development strategies (outside the main OVOP business development packages) and the incentive structures for civil service in the various ministries that are meant to support the development of the programme. The civil service salaries in real terms were less than half the 1980 levels in 2001/2002 (Booth et al, 2006). Although salaries have increased, most civil servants are underpaid. It is therefore important to ascertain how incentives within the various support ministries influence the implementation of the OVOP programme in Malawi

Budget commitments and alignment with OVOP programming is important, given that the government is a major source of OVOP resources. The Malawian government’s main development documents, such as the MGDS, do not clearly prioritise OVOP, which implies that the allocations are often at the discretion of the President rather than clear budget lines that can be identified in line ministries and district assemblies.



A final systematic issue that needs to be mentioned is the extent to which OVOP stimulates the market for BDS. Presently, it appears that OVOP works alongside other BDS, rather than stimulating them. Other providers include the Small Enterprise Development Organisation of Malawi (SEDOM) and the Development of Malawian Enterprises Trust (DEMAT) which are semi-governmental organisations meant to support SMEs in Malawi, as well as independent firms. This issues needs to be further examined in the light of the increasing move by donors away from intervening in BDS markets themselves but rather supporting the development of this.

The OVOP Secretariat identifies a number of strengths and weaknesses of the OVOP in Malawi in a SWOT analysis, as shown in Table 9 below. It also provides an overview of the kinds of products that are currently traded under the OVOP initiative, as shown in Box 2 below.

**Table 9: Strengths and weaknesses of OVOP**

<b>Positives</b>	<b>Negatives</b>
<p><b><u>Strengths</u></b></p> <ol style="list-style-type: none"> <li>1. Committed political leadership</li> <li>2. Piloted OVOP projects</li> <li>3. A strong drive from beneficiaries</li> <li>4. Existing institutional structures (village, area, district and national levels)</li> <li>5. Initial publicity of programme (media)</li> <li>6. A secretariat in place</li> <li>7. Donor interest (JICA)</li> <li>8. Existing local raw materials</li> <li>9. Strong agriculture base</li> <li>10. Thirteen Malawians trained in OVOP programmes in Oita, Japan</li> <li>11. OVOP consistent with MPRSP</li> </ol>	<p><b><u>Weaknesses (selected)</u></b></p> <ol style="list-style-type: none"> <li>1. Shortage of local OVOP experts</li> <li>2. OVOP concepts not well understood</li> <li>3. Weak research and extension base</li> <li>4. History of default elements</li> <li>5. Limited business culture</li> <li>6. Weak financial resource base</li> <li>7. Low literacy levels in communities</li> <li>8. Poor infrastructure e.g. communication, transport, roads and markets</li> <li>9. Shortage of skills at community level</li> </ol>
<p><b><u>Opportunities</u></b></p> <ol style="list-style-type: none"> <li>1. Some existing projects based on OVOP concepts</li> <li>2. Donor confidence</li> <li>3. Demand driven extension and research services</li> <li>4. National training institutions are available</li> <li>5. Pointers of success story (Oita, Japan)</li> <li>6. Committed communities</li> <li>7. Presence of promotional institutions e.g. MIPA, MEPC</li> <li>8. International marketing opportunities e.g. AGOA</li> <li>9. Expanding markets in cities and towns</li> </ol>	<p><b><u>Threats</u></b></p> <ol style="list-style-type: none"> <li>1. Break-up of bilateral ties with the donors and trading partners;</li> <li>2. HIV/AIDS pandemic</li> <li>3. Change of government policy (priority rating of OVOP on government projects)</li> <li>4. Political interference and instability</li> <li>5. Staff attrition</li> <li>6. Misuse of resources (corruption, thefts)</li> <li>7. Weak economic environment</li> <li>8. Poverty and ignorance</li> <li>9. Natural calamities and environmental degradation</li> </ol>

Source: Government of Malawi, 2004

## Box 2: Overview of Products traded under OVOP in Malawi

- 1) Major Projects and Products
  - i) Bvumbwe Dairy Group (Bvumbuwe/Thyolo): Pasteurized & Packed Milk
  - ii) Khumbo Oil Group (Michiru/Brantyre): Cooking Oil, Soap, Bio-diesel & Herbs
  - iii) BCA Carpentry Group (BCA/Blantyre): Carpentry Products
  - iv) Mitundu Agro-Business Group (Mitundu/Lilongwe): Jam, Bread, Soy Milk & Cooking Oil
  - v) Bwanje Valley Rice Group (Mtakataka/Dedza): Milled & Packed Rice
  - vi) Chalera Mushroom Group (Bunda/Lilongwe): Oyster Mushroom
  - vii) Hara Rice Group (Hara/Karonga): Milled & Packed Rice
  - viii) Kapolo Palm Oil Group (Kapolo/Karonga): Palm Oil & Soap
  - ix) Mitundu Village Factory (Mitundu/Lilongwe): Jam, Bread, Soy Milk & Cooking Oil
  - x) ADEA Cassava Flour Group (Rumphi, Lilongwe): Packaging
- 2) Self-Financing / Pipeline Projects & Product
  - i) 18 on-going projects around the country are recognized as Self-Financing OVOP. They use the principles of OVOP although not funded by OVOP programme

Source: Government of Malawi, 2006

### 5.3.5 Other issues

Given the emphasis on local resource use in OVOP, it is important to evaluate the relationship between OVOP programming and the major factors of production in Malawi, which, apart from capital, are land and labour. Malawi experiences pressures on land that are the result of a combination of population growth and elite capture (in the form of large estates, which characterised much of economic growth strategies of the 1970s and 80s). The principal victims of the situation are smallholders on customary land. Malawi is the most densely populated sub-Saharan African country with a single, short annual rainy season (Booth et al, 2006).

Environmental considerations for OVOP are important, given that soil erosion is a serious problem in Malawi (it is estimated that for every inch of top-soil lost, grain yields are reduced by 6%). While most of the 60-plus forest reserves in the country were created to protect fragile catchments and watershed areas, land scarcity and fuel requirements have led to these areas, as well as mountainous land and stream beds, being encroached upon by farmers, wood sellers and charcoal makers. Overall, it is estimated that between 1972 and 1990 Malawi's forest cover declined by 41% and that it is now being reduced at a rate of not less than 2.8% per annum. At the same time, wild animals have been hunted to extinction, fishing beds have been over-exploited, and contaminants have been released into the lake (ibid, 2006).

### 5.3.6 Summary

The OVOP approach has gained importance in Africa over time, with early experience from Malawi. In this section we have begun to examine aspects of an assessment of OVOP: firm-specific effects, the contribution to knowledge public goods and the effects on the wider institutional framework governance for private sector development in Malawi. It is clear that a proper assessment of the OVOP programme will be data intensive.

The assessment is preliminary and limited in scope, and we have indicated some ways in which a fuller analysis can be undertaken. Having said this, it is already possible to highlight some issues. The OVOP programme is still small (\$500,000 with four dozen projects supported), and given the large variability of economic performance in Malawi, it will be hard to find an aggregate effect attributable to OVOP. Nonetheless, there is at least some evidence that OVOP has supported a company become more productive, helping leadership, entrepreneurship and local groupings in the mean time. This is a promising finding if this applies to a range of projects supported. It is a different way of promoting growth which deserves further attention and assessments along side other approaches. For instance, what conditions are necessary for OVOP to work best and are these present in Malawi.

However, there are also challenges. While the specific interventions associated with OVOP relate well to theoretical considerations such as spatial economy and market failures, in practice there might be less benign effects. While some suggest the programme has been unusually shielded from political abuse, challenges cited by the OVOP Secretariat include issues such as ‘distorted beneficiary identification’. This links in to a wider point that selective BDS interventions stand in contrast with approaches that promote public goods such as those that promote the market for BDS.

## 6. Conclusions

Private sector development is crucial for growth, development and employment creation in Africa. This is being recognised by donors in their support programmes for the private sector. This study examines how one type of Japanese development and trade support, the One Village One Product (OVOP) approach, fits in with other donor approaches and how it relates to development of small and medium enterprises (SMEs). It also provides some preliminary insights from the experience of OVOP in Malawi.

While SMEs play an important role in Africa's economies (GDP and employment), cross-country and micro-level research is not conclusive on the causal link between SMEs and economic development – in other words, growth depends on all type of firms equally, small and big. Nonetheless, smaller firms may face larger and different growth constraints, which might explain the lack of SMEs' contribution to growth and which would call for a targeted or at least different approach.

We find that major constraints on the performance of SMEs include costs and access to finance, access to electricity, corruption, tax administration, level of skills and transportation. Within these categories, it appears that access to finance is the major (resource) constraint for SMEs. But there are also certain skill and knowledge constraints on the operations of SMEs (such as lack of market knowledge and contacts).

Many of the binding constraints are due to the presence of market and government failures. Public support for private sector development (PSD) is justified when markets fail to allocate resources efficiently. There are several examples of market failures in PSD, in the area of capital, skills, technological development and the co-ordination amongst them. However, public support can also fail, and it can be market distorting or favouring individual firms more than others.

On the one hand, firm specific intervention is justified by theory, but on the other hand this raises question about the ability of governments to fine-tune the market. Within much of the donor community, there is a change away from specific donor interventions in individual firms towards upstream support for the 'enabling environment' for the private sector, defined by policies, laws and regulations affecting PSD.

Together with partner governments, donors supporting the private sector need to assess the benefits and weaknesses of each approach and weigh up their respective risks. Donors can provide support at least at three levels:

- *The macro level:* which refers to the overall investment climate and is shaped, amongst other things, by the government policies and regulatory frameworks
- *The meso level:* which refers to labour and capital markets at the national, regional or sectoral level. Donor initiatives at this level aim to improve the functioning of markets are often come under the rubric 'making markets work'
- *The micro level:* This refers to a single business unit or a collection thereof. Private sector support at this level may be in the form of a business development service or firm specific assistance (e.g. in value chains).

The OVOP approach is clearly located at the micro end of the spectrum of donor activities since it aims to provide specific support for individual firms, groups of firms and / or households. Such an approach stands in stark contrast to the 'enabling environment' support, which tends to be non-discriminatory and aimed at improving overarching rules and regulations rather than helping a handful of firms. The OVOP approach has attracted a good deal of interest in Africa with Malawi providing one of the first test cases. The OVOP approach differs from mainstream donor approaches in so far as it aims to achieve regional economic development by developing products and services using locally available resources and adding value through processing and marketing. It encourages villages to develop specific products and promote them in such a way as to make them instantly recognisable and identifiable with their community.

We have begun to examine aspects of an assessment of OVOP in Malawi: firm-specific effects, the contribution to knowledge public goods and the effects on the wider institutional framework governance for private sector development in Malawi. It is clear that such an assessment will be a data-intensive exercise. The assessment offered in this paper is therefore preliminary and limited in scope and we have indicated some ways in which a fuller analysis can be undertaken. Having said this, it is already possible to highlight some issues. The OVOP programme is still small (\$500,000 with four dozen projects supported). Nonetheless, there is evidence that OVOP has supported companies to become more productive, helping them with leadership, entrepreneurship and forming effective groups. This is a promising finding, especially if this applies to the range of projects supported (which we have not yet examined). It is a visible way of support at the firm or farm level, more so than support that tries to remove regulatory constraints. It is a different way of promoting growth which deserves further attention and evaluation along-side other approaches. For instance, what conditions are necessary for OVOP to work best and are these present in Malawi.

However, there are also challenges for the OVOP approach. While the specific interventions associated with OVOP relate well to theoretical considerations such as spatial economy and market failures, in practice there might be unintended consequences. While some suggest the programme has been unusually shielded from political abuse, there are challenges related to the selective nature of the support. This links in to the wider point that selective BDS interventions stand in contrast with approaches that promote public goods such as those that promote the market for BDS and each approach may have its positive and negative approaches. It is fruitful that the various donors learn from each other's approach. This assessment is part of that process.

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