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What Do We Know About BDS Markets?

**By
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Abstract

The first half of this paper analyses data from studies of business services in Indonesia, Malaysia, and Vietnam to highlight a number of common characteristics of formal business services markets. Most providers of business services are themselves small or very small firms, depending in turn on the full range of business services inputs in order to provide quality service. Business service providers face significant competition not only from government agencies and donor-funded NGOs, but also from self-service by potential clients. The biggest barriers to the purchase of business services is not cost but rather a lack of awareness of the costs associated with a decision to self-produce and/or a lack of local business service firms with good quality controls and specialised expertise.

The second half of the paper makes recommendations with regard to how the effectiveness of BDS-focused projects are evaluated and the most useful roles donor agencies can play in addressing business service needs. Six roles are proposed: capacity strengthening, offsetting initial purchase risk, facilitating information access, modelling business services purchase decision-making, influencing government policies and practices, and researching and developing new approaches. How these roles might be executed would depend on characteristics of the market, differentiating among ones where demand for business services has been suppressed, demand is present but of low density, demand from high-margin businesses is growing rapidly, and easily-met needs are still high volume and high growth.

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Section 1: The Context

Every organization – whether public or private, for-profit or non-profit, large or micro-enterprise – has support functions that are critical to its survival and competitiveness but that are not their core mandate or competency. Examples include accounting (in non-accounting firms), training (in non-training institutions), market research (in non-market research firms), and computer services (in non-IT firms). No organization, no matter what its size, can operate for long without functions like these. These are the support functions that the donor community is calling *business development services*, or services that improve the management and productivity of the enterprise.

So the first question in surveying any economy is “how are business development services already being provided?” The answer will usually be a mix of in-house (self-production), private sector suppliers, government suppliers, and donor-funded non-profit agencies. The key development issue is not whether or not these functions will be performed, but rather whether they will be performed in-house or purchased from an external supplier – i.e., will they be provided by the owner-operator or by a firm that specializes in supplying such services. This means that, in addressing the improvements needed in business development services, the focus needs to be on how to enhance the effectiveness (including increased specialization and better quality) of existing service provision, rather than on creating or offering substitute services.

Taking a step back for a moment, let’s review the usual composition of developing economies by comparing Vietnam, Indonesia, and Malaysia¹ (noting that their service sectors are smaller than service sectors in regions like Latin America where services production may be at least 60 percent of domestic production). Table 1 compares the gross domestic product (GDP) data available at the time of each study, illustrating the preponderance of services in each economy and the fact that the distribution is similar across development levels.

¹The data reported in this paper come from three detailed studies conducted by the author and relevant local partners in Malaysia (1993), Indonesia (1995), and Vietnam (1997). While the terms of reference varied slightly, they were all focused on assessing the competitiveness of domestic business (intermediate) services as inputs to SME goods producers and other business service firms. The majority of firms studied had under 50 employees. For the service firms studies, the percent of firms with 10 or fewer employees was Indonesia (22%), Malaysia (14%), and Vietnam (8%). In Malaysia and Indonesia at least one-third of the firms were in rural/remote regions due to government interest in the less developed portions of the country. Suppliers of business services included both private and public enterprises. The sample sizes of the three studies were as follows: Malaysia = 500 firms; Indonesia = 424 firms; Vietnam = 153 firms. The author has been researching business services in developing countries since 1981, and has also studied 10 countries in Latin America and the Caribbean, 4 countries in Africa, and 12 additional economies in Asia. Her first comparison of 81 economies at four levels of development, *Service-Led Growth: The Role of the Service Sector in World Development*, was published in 1985.

Table 1: Percent of GDP by Industry Sector

Sector	Vietnam (1996)	Indonesia (1993)	Malaysia (1990)
Primary/Extractive	32%	32%	28%
Manufacturing	24%	21%	26%
Services	44%	47%	46%
Total	100%	100%	100%

Source: National accounts of each economy.

When we disaggregate services production, we find that there is a subset of “intermediate” services that are sold to other firms rather than to the government or to end consumers. These are the services of which business development services are a further subset. In the case of Indonesia (where detailed disaggregation was done), 38 percent of services production was intermediate services (see Figure 1). By comparison, a country like Canada averages 50 percent of services production as intermediate services. Research since the mid-1980s, initiated originally by the United Nations Conference on Trade and Development (UNCTAD), has shown repeatedly that a major differentiator between developing and developed economies is the availability of good-quality intermediate services.

One of the characteristics of services, especially intermediate services, is that they themselves purchase intermediate services (e.g., accounting firms use finance, insurance, telecommunications, consultancy, training, computer services, etc.). For both Indonesia and Malaysia, input-output data confirmed the “service intensity” of intermediate services (see Table 2). Over 22 percent of the total inputs purchased by intermediate service firms were intermediate services, and over 42 percent of all intermediate services produced were purchased by intermediate service firms. From these data, we can see that the quality and availability of intermediate services has a “ripple” effect on all other intermediate services – e.g., poor quality in one intermediate service affects the quality of all other intermediate services. Based on interview data, this effect is particularly noticeable for the subset we are calling “business services.”

Table 2: Who Buys Intermediate Services

Purchasing Sector	Indonesia	Malaysia
Intermediate Services as a Percent of Total Inputs Purchased		
Goods producers	8%	8%
Intermediate service firms	23%	25%
Distribution of Total Intermediate Services Produced		
Goods producers	35%	26%
Intermediate service firms	42%	49%
Other service firms	23%	26%
Total	100%	100%

Source: Latest input-output tables available (Indonesia = 1990; Malaysia = 1983).

We can group intermediate services by the function that they serve in an organization (see Figure 2). If we disregard the financial and transportation/logistics services, we find a core set of approximately 30 business and professional services that overlap with what is usually referred to as “business development services” (BDS). These are services that provide not only functional benefits but also generic (cross-functional) benefits such as increased strategic flexibility (through moving BDS provision from a fixed to a variable cost), optimized use of skilled resources for the core business, improved operational efficiency, and increased value-added.

Figure 3 provides a schematic of business services in Vietnam. This presentation can be reconciled with the very interesting continuum of business development services diagrammed for the Philippines by noting that within each of the business service categories we can identify generic services that are transactional in nature and customized services that are strategic or skills development in nature.

Before we go further, it is important to recognize that, in all of the economies focused on by the donor community, at least half of the enterprises in the formal and informal sectors are service enterprises. Service enterprises themselves have received very little attention as “productive” activities, although they typically show strong employment generation potential and are frequently headed by women. The management challenges in service enterprises are not the same as those in goods producing enterprises, and there is little reason to believe that donor interventions designed for handicraft producers or small manufacturers would generalize well to service operations. This means, for example, that training or marketing programs designed for managers of manufacturing operations need to be redesigned if delivered to service firms.

While the donor community recognizes that goods-producing enterprises need assistance to improve their quality and productivity, there has not yet been a parallel initiative for business service firms (other than training agencies and occasionally consultants). Since virtually all management training programs are geared to the manufacturing and marketing of goods (not services), this leaves the managers of business service firms with little technical support. The remainder of the data analyses presented in this paper provide a comparison of responses between goods producers and services producers, to show similarities and differences. An example of differences is in the reasons given for using purchased business services (see Table 3).

Table 3: Main Purpose for Using a Purchased Business Service: Vietnam

Main Purpose	Goods Producers	Services Producers
<i>Accountancy/audit</i>		
• Have better control over costs	60%	31%
• Satisfy a regulatory requirement	47%	52%
<i>Consultancy</i>		
• Improve firm's profitability	42%	23%
• Improve firm's efficiency	41%	25%
• Help with strategic planning	39%	33%
• Improve quality assurance	17%	33%
<i>Design/packaging</i>		
• Improve product attractiveness	64%	Na
• Improve product practicality	34%	Na
• Meet mandatory product standards	32%	Na
<i>IT/computer services</i>		
• Repair computer systems	Na	48%
• Install new software or hardware	Na	40%
<i>Market research</i>		
• Meet customers' needs	53%	56%
• Identify new market opportunities	38%	38%
<i>Training</i>		
• Upgrade staff's technical skills	61%	65%
• Improve time management skills	44%	25%
• Provide basic skills training	33%	20%

Note: The table includes all "purposes" selected by more than 30% of respondents.

Section 2: An Overview of Available Business Services in Three Markets

2.1 Who Already Provides Business Services

Competition from government agencies. In all three markets studies, private sector business service suppliers faced competition from public sector agencies as well as donor-funded NGOs. The "crowding out" is most apparent for training, consultancy, and market research services. Firms in these sectors survive mainly through foreign corporate clients or as contractors to the donor community itself. The smaller the business service firm, the stronger the need for foreign revenues to survive. In Indonesia, for example, a surprising number of the business service firms surveyed were exporting in order to have a large enough client base (see Table 4).

Table 4: Percent of Business Service Firms Exporting: Indonesia

Size of Service Firm	Percent Exporting
Small (less than 20 employees)	77%
Medium (20-99 employees)	41%
Large (100+ employees)	69%

In Vietnam, for example, while 74 percent of the organizations studied purchased training services, only 22 percent of all organizations (and 37 percent of private firms) used private sector training firms even though private sector trainers were rated as providing on average higher quality services (see Table 5). The degree of competition from government agencies depends in part on the policy environment – e.g., whether public/NGO provision is subsidized and therefore cheaper, or whether public sector provision is mandated (as is often the case for government departments or for private sector firms wishing to gain a given credential).

Table 5: Provision of Externally-Purchased Training Services: Vietnam

Training Purchased by:	Training Supplied by:	
	Public Agencies	Private Firms
Public Agencies	92%	8%
Private Firms	63%	37%

Competition from self-production. The primary competitor faced by private sector suppliers is not government or NGO provision but rather in-house production, or self-service. This form of business service provision has usually been invisible to the donor community. Whether or not business services are purchased externally depends in part on what the service is (see Table 6).

Table 6: Percent of Respondents Purchasing the Service Externally

Business Service	Vietnam		Indonesia	
	Goods	Services	Goods	Services
Accountancy/audit	26%	16%	-	-
Consultancy	30%	26%	-	-
Design/packaging	42%	na	-	-
IT/computer services*	na	83%	44%	48%
Market research	15%	18%	-	-
Training	77%	69%	22%	17%
Business services (aggregate)	-	-	32%	19%

*Note: The use of computer services was much less widespread when the Indonesian study was conducted than two years later at the time of the Vietnam study.

Table 7 shows a pattern of high reliance on internal resources for market research and accountancy/audit services (a problem if one values externally-audited financial statements). Interview data indicate that concerns about confidentiality and professional standards were paramount. Enterprises are most likely to turn to outside resources for training and computer services. Service firms were noticeably less likely to use external consultancy services, both because they are critical of the quality of assistance available and because they have difficulty finding consultants knowledgeable in issues facing the managers of service firms.

Table 7: Percent of Respondents Only Providing the Service Internally

Business Service	Vietnam		Indonesia		Malaysia	
	Goods	Services	Goods	Services	Goods	Services
Accountancy/audit	78%	84%	-	-	-	-
Consultancy	51%	74%	-	-	-	-
Design/packing	58%	na	-	-	-	-
IT/computer services*	na	17%	31%	24%	33%	44%
Market research	84%	82%	-	-	-	-
Training	22%	31%	35%	37%	32%	38%
Business services (aggregate)	-	-	33%	44%	22%	27%

*Note: At the time of the Malaysian study in 1993, the computer services industry was not well developed and so relatively few external options existed.

From the size-disaggregated data obtained in Indonesia, there is some evidence that there are differences based on sector and size (see Table 8). Small goods producers are, for example, particularly likely to rely on their own resources for training (e.g., on-the-job training, job shadowing).

Table 8: Percent of Indonesian Respondents Only Providing the Service Internally, by Size

Business Service	Goods Producers			Service Producers		
	Small	Medium	Large	Small	Medium	Large
IT/computer services	18%	46%	33%	29%	19%	29%
Training	86%	67%	27%	44%	37%	35%
Business services (aggregate)	46%	50%	31%	62%	42%	35%

Awareness barriers to purchase. A key challenge for suppliers of business services is a lack of awareness among their potential clients about the costs associated with the (often unconscious) choice to self-produce business services in an unskilled fashion. Most MSMEs show little awareness of the opportunity and economic costs associated with:

- a) Diverting skilled resources from producing core revenue-generating products and services to self-producing business services.
- b) Using generalist rather than specialist business services expertise.
- c) Purchasing low-cost and low-quality BDS inputs “to save money.”

At the same time, business service suppliers are not themselves necessarily well-informed users of other business services. Few of the firms interviewed could articulate supplier selection criteria, and many themselves self-produced.

When asked why they used their own scarce resources to produce a “non-core” function internally, respondents indicated primarily that external purchase was not a good use of their financial resources (see Table 9). Overall, internal production cost them less for value received and relieved them of concerns they had about confidentiality when using an external supplier. It is interesting that, while the primary motivation for Vietnamese firms to

self-produce was usually in order to have better quality inputs, cost was a primary factor in Indonesia. This may reflect changes in the global competitive environment over time, with “value for money” becoming increasingly important.

Table 9: Reason for In-House Provision, by Business Service (percent)

Business Service	Goods Producers			Services Producers		
	Lower cost	Better quality	More reliable	Lower cost	Better quality	More reliable
<i>Accountancy/audit</i>						
Vietnam	27%	54%	19%	35%	48%	17%
Indonesia	-	-	-	-	-	-
<i>Consultancy</i>						
Vietnam	22%	65%	13%	5%	78%	17%
Indonesia	-	-	-	-	-	-
<i>Design/packaging</i>						
Vietnam	19%	51%	30%	Na	Na	Na
Indonesia	-	-	-	-	-	-
<i>IT/computer services</i>						
Vietnam	Na	Na	Na	30%	17%	52%
Indonesia	38%	24%	38%	61%	11%	28%
<i>Market research</i>						
Vietnam	24%	59%	17%	32%	56%	12%
Indonesia	-	-	-	-	-	-
<i>Training</i>						
Vietnam	27%	58%	15%	10%	80%	10%
Indonesia	48%	39%	13%	31%	46%	23%
<i>Business services (aggregate)</i>						
Vietnam	-	-	-	-	-	-
Indonesia	63%	21%	16%	54%	18%	28%

Quality more critical than cost. Despite international assumptions that developing countries’ comparative advantage is lower labour costs, in all three countries the majority of firms reported that they competed internationally based primarily on quality or “value for money” rather than simply on lowest price (see Table 10). Data from all three economies showed large quality gaps for business services that were “very important” for competitiveness.

Table 10: Primary Basis of Competition, by Industry Sector

Basis of Competition	Vietnam		Indonesia		Malaysia	
	Goods	Services	Goods	Services	Goods	Services
Quality	55%	75%	86%	74%	56%	#1
Price	38%	9%	9%	15%	16%	#3
Unique product or service	7%	16%	5%	11%	28%	#2

Basis of Competition	Vietnam		Indonesia		Malaysia	
	Goods	Services	Goods	Services	Goods	Services
Total	100%	100%	100%	100%	100%	-

2.2 Characteristics of Indigenous Business Services

Uneven availability. In order for markets to function optimally, business services need to be available to enterprises across geographic regions, either on-site or virtually through the Internet. All three markets showed the same distribution pattern found in developed market economies – namely, that formal business services are concentrated in urban areas. The most detailed analysis of the consequences was done in Indonesia due to government interest in development issues for the far eastern portion of the nation (see Table 11). Far East Indonesian service providers rated the business services available in Jakarta as of better quality, though not necessarily less expensive.

Table 11: Rating of Local Business Services by Far East Service Providers

Indonesian Business Service	Hard to Find Service Locally	Jakarta Services as:	
		Better Quality	Less Expensive
Accountancy/audit	75%	-	-
Consultancy	92%	-	-
IT/computer services	62%	92%	67%
Training	100%	69%	58%
Business services (aggregate)	-	83%	58%

In an increasingly 24-hour operating environment, most Malaysian service firms wanted 24-hour business service availability; however, only 19 percent of the service firms responding themselves offered extended hours of service. When asked if they could get business services when they needed them (“on demand”), most Vietnamese goods-producing firms were satisfied (see Table 12). Service firms, however, were unhappy about their access to consultancy, computer services, and market research.

Table 12: Percent Rating Services as Available “On Demand”

Business Service	Vietnam	
	Goods Producers	Services Producers
Accountancy/audit	78%	67%
Consultancy	77%	10%
Design/packaging	68%	-
IT/computer services	-	29%
Market research	67%	0%
Training	76%	60%

Business services (aggregate)	51%	35%
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Cost is not the issue. There is a widespread assumption that the primary constraint on the purchase of business services is price. As a result, a number of donor-funded initiatives provide significant price subsidies to induce purchase. In all three countries studied, price was not the reason for non-purchase (see Table 13). The one exception was market research services and here the issue was “value for money” rather than simply price.

Table 13: Percent Rating Business Services as “Expensive” or “Very Expensive”

Business Service	Vietnam	
	Goods Producers	Services Producers
Accountancy/audit	29%	38%
Consultancy	22%	27%
Design/packaging	16%	-
IT/computer services	-	27%
Market research	57%	0%
Telecommunications	-	89%
Training	26%	33%
Business services (aggregate)	51%	35%

When asked about the comparative prices of domestic versus foreign business service suppliers, the only noticeable difference was the tendency of goods producers (the target market for donor-subsidized interventions) to say that foreign-supplied training was less expensive (see Table 14).

Table 14: Percent Rating Foreign Suppliers as Less Expensive than Domestic Suppliers: Indonesia

Business Service	Indonesia	
	Goods Producers	Services Producers
IT/computer services	35%	24%
Training	67%	49%
Business services (aggregate)	61%	49%

Uneven and inadequate quality. The primary issue for respondents was with the quality of business services available to them. Notice in Table 15 that, when asked in general about the quality of services, the ratings were much lower than when asked about specific services that they were using. As one Vietnamese respondent put it, “There’s good quality out there if you have the patience to look for it. It took us two years of experimenting, but now we have some very good suppliers.”

Table 15: Percent Rating Service Quality as “Good” or “Very Good”

Business Service	Vietnam		Malaysia
	Goods Producers	Services Producers	Total
Accountancy/audit	55%	50%	50%
Consultancy	30%	56%	-
Design/packaging	25%	-	-
Equipment repair	-	-	13%
IT/computer services	-	32%	4%
Legal services	-	-	20%
Market research	80%	0%	-
Telecommunications	-	-	29%
Training	21%	31%	-
Business services (aggregate)	4%	33%	-

“High quality” services were defined by respondents as being of consistently excellent technical quality, delivered on time, error-free, with a rapid initial response rate. Malaysian respondents listed the following as the primary benefit of being able to purchase high quality business services:

- 73% able to meet own customers’ deadlines
- 61% improve the quality of the products produced
- 53% maximize internal operational efficiency

The primary sources of dissatisfaction with business services were:

- delivery deadlines missed
- lengthy initial response time
- unreliable content

Having foreign service suppliers present was not necessarily a solution to having good quality business services available (see Table 16).

Table 16: Percent Rating Foreign Suppliers as of Better Quality than Domestic Suppliers

Business Service	Indonesia	
	Goods	Services
IT/computer services	41%	53%
Training	52%	45%
Business services (aggregate)	40%	46%

Lack of specialty services and customer orientation. The business services that are available in developing countries tend to be generic or basic in nature. Repeatedly, respondents reported that local business service firms did not understand how to assess potential customers’ needs and adapt their services accordingly (see Table 17). Respondents were able to list specific specialty services that they would like to purchase if only they were available. Foreign-owned firms reported difficulty in training local staff to customize service provision appropriately. It would appear that, while there is difficulty convincing client firms to purchase generic business services (rather than self-serve), there is a market for specialty services if they were available and matched to client demand.

Table 17: Percent of Respondents Not Able to Obtain Needed Specialty Skills

Business Service	Vietnam	
	Goods Producers	Services Producers
Accountancy/audit	30%	16%
Consultancy	12%	50%
Design/packaging	16%	na
IT/computer services	na	45%
Market research	60%	60%
Training	57%	61%

2.3 The Impact of Business Services

Firms in all three economies indicated that business services were critical to their competitiveness. Table 18 summarizes responses to questions about the type of business services firms consider most important for present and future competitiveness.

Table 18: Importance of Business Services for Competitiveness, by Industry Sector (percent of respondents)

Business Service	Vietnam		Indonesia	
	Present		Future	
	Goods	Services	Goods	Services
Accountancy/audit	97%	88%	-	-
Consultancy	85%	83%	-	-
Design/packaging	82%	na	-	-
IT/computer services	na	97%	75%	85%
Market research	92%	88%	-	-
Telecommunications	-	97%	91%	89%
Training	94%	95%	62%	82%
Business services (aggregate)	-	-	86%	88%

Section 3: Improving Market Functioning

3.1 Supply-Side Issues

Characteristics of suppliers. There is generally a bimodal size distribution of local business service suppliers in developing markets. Most private sector suppliers are MSMEs themselves, with the notable exception of the large governmental agencies and the large foreign multinationals (major accounting firms, engineering firms, market research firms, etc.). Private sector business service suppliers may be either generalists or specialists in a particular business service. If specialty firms have developed, it is usually by acquiring foreign clients (either locally based or in export markets) in order to have sufficient demand to sustain the maintenance of specialty skills. Private sector business service suppliers may be sole proprietorships, partnerships, or affiliates of foreign multinationals (as is often the case for accounting firms). Some business service suppliers are “subsidiaries” of larger organizations – e.g., executive training provided by universities, market research provided by government trade development agencies – and so are protected from market forces.

Most business service suppliers in both developed and developing economies are concentrated in urban areas in order to be near a critical mass of potential customers. This geographic distortion curtails the availability of business services in rural areas for both formal and informal sector enterprises. The rapid growth in on-line service availability,

however, offers a creative solution as long as enterprises have cost-effective Internet access.²

Improvements needed in business services. Criticisms of indigenous business service suppliers by their clients typically include the following issues:

- Poor ability to identify client’s business service needs.
- Poor ability to promote/market own capabilities to meet needs.
- Failure to use current approaches/technologies.
- Slow initial response to client requests.
- Poor on-time delivery.
- Inconsistent performance.
- Unable/unwilling to problem-solve with clients.
- Lack of the specialized skills clients need.
- Lack of business experience and knowledge of MSME reality.
- Unprofessional behavior, including lack of confidentiality.

Malaysian respondents identified the four factors listed in Table 19 as being the most critical quality improvements needed.

Table 19: Critical Quality Improvements Needed: Malaysia

Improvement Needed	Goods Producers	Service Producers
Rapid response	99%	94%
On-time delivery	97%	94%
Fast turnaround	95%	93%
More convenient hours	84%	81%

Identifying root causes. The design of donor BDS interventions has rested on assumptions about what creates problems in the way in which BDS markets operate (see summary in Table 20). Other potential root causes include the following:

- Limited availability of appropriately trained staff for business service firms
- Clients unable to distinguish high-quality business services
- Lack of a client base willing to pay for high-quality business services
- Lack of economic incentives to provide high-quality business services
- Lack of articulated professional and quality standards
- Lack of cost-effective Internet infrastructure for distance service delivery
- Lack of market information for business service firms about potential client needs
- “Creaming” of high-margin MSMEs by donor-funded agencies
- MSMEs not viewed or developed as a “mass market”

²The International Trade Centre UNCTAD/WTO has just published a handbook, *Offshore Back Office Operations*, illustrating that virtually any business service is now offered through distance delivery by business service firms in developing countries.

- Government regulations prohibiting extended service hours
- Government regulations limiting access to working capital by business service firms
- Lack of government support for instituting quality systems
- Delayed payments by government agencies to business service suppliers

Table 20: Apparent Donor Assumptions about BDS Markets

Apparent Assumption	Proposed Design Solution
BDS not available	Donor supplies BDS
BDS not available in rural areas	Donor supplies BDS in rural areas Donor builds rural capacity
BDS available but of poor quality	Donor supplies BDS Donor trains local BDS suppliers
BDS demand low due to inability to pay	Donor supplies or subsidizes
BDS cannot be provided profitably to MSMEs	Donor supplies or subsidizes
BDS available but not customized to MSME needs	Donor develops new “products” for local suppliers
BDS available but not valued by MSMEs	Donor subsidizes initial BDS purchase

Addressing cost concerns. One of the ongoing challenges for business service firms is access to working/growth capital. None of the 14 developing/transitional economies in Africa and Asia studied in 1998-99 by the author³ had provisions for business service firms to acquire an overdraft (or operating line of credit) against accounts receivable, which is the most common form of finance in developed markets. Instead, business service firms were entirely dependent on the financial resources of the owner and the owner’s extended family.

In addition, data from Malaysia documented the frequent delays that service firms experience in collecting on accounts receivable (see Table 21), with the exception of training firms who typically collect 50 percent of the fee up-front as a deposit. Delays of up to 18 months were reported by Kenyan business service firms in receiving payment from government agencies for work completed.

Table 21: Average Collection Time for Accounts Receivable: Malaysia

Industry	Collected within 30 Days	Collected within 60 Days
Manufacturing	15%	60%
Services:		
IT/computer services	12%	47%
Training	58%	83%
Business services (aggregate)	8%	31%

³Bangladesh, India, Indonesia, Kenya, Malaysia, Mongolia, Nepal, Pakistan, the Philippines, Tanzania, Thailand, and Uganda.

Private sector business service suppliers usually work on an hourly or daily billable rate – i.e., what they sell is their time. To at least break-even, they may well target SMEs with higher margins and growth rates. Their willingness to work with clients where margins are lower or the cost of delivery is higher will depend on their perceived ability to recoup additional costs such as redesign (e.g., to meet MSME needs more effectively) or marketing (e.g., to convince MSMEs that the investment in purchased business services is worthwhile). Table 22 provides some suggestions for how various cost factors can be addressed effectively.

Table 22: Suggested Ways to Minimize Delivery Costs to MSMEs

Source of Increased Cost	Strategy to Minimize Cost
Low density/number of clients	Work with groups of client firms Train local paraprofessionals to assist
Low margin clients	Transfer effort cost through self-service
Need for customized, redesigned services for multiple client groups	Create small standard modules to “mix and match”
Need for wider geographic access	Deliver electronically or on-line Train local paraprofessionals to assist
Need for extended/24 hours access	Deliver electronically or on-line
Need for specialized skills or equipment	Supplement client base with clients demanding/paying for specialty services
Need to invest in quality control	Put quality system in place, plus recruit clients willing to pay for quality

Addressing staffing issues. Most developing economies have a scarcity of highly-skilled workers, due to either lack of access to education or out-migration of skilled workers. As data from Indonesia (see Table 23) and Malaysia (see Table 24) illustrate, service firms need more highly educated staff than manufacturers do. Recruitment of highly skilled staff for donor-funded projects (often at very favourable terms) can inadvertently restrict further the staff available for local business service firms to hire.

Table 23: Percent of Workers by Educational Level: Indonesia

Educational Level	Goods Producers	Service Producers
Less than secondary	56%	34%
Secondary	18%	18%
Post-secondary	26%	48%

Table 24: Percent of Highly Skilled Workers by Industry

Industry	Percent of Highly Skilled Workers
Manufacturing	19%
Services:	
IT/computer services	79%
Training	52%
Business services (aggregate)	69%

In Indonesia, small service providers allocate on average 10 percent of all expenditures for ongoing staff training in order to stay competitive (see Table 25). This figure should be compared to firms in North America that typically spend between three and five percent maximum on staff training.

Table 25: Percent of Expenditures on Staff Training: Indonesia

Size of Firm	Goods Producers	Service Producers
Small	1%	10%
Medium	3%	8%
Large	8%	6%

Although staff are critical to the success of business service firms, few firms other than training firms have formal human resource development plans (see Table 26).

Table 26: Percent of Service Firms with Human Resource Development Plans: Malaysia

Business Service	Percent with HRD Plans
IT/computer services	24%
Training	46%
Business services (aggregate)	9%

Focusing on staff skills is particularly important in business service firms since it is the staff who create and customize the service delivered, often in interaction with the customer. In fact, in response to questions about how to improve service quality in business service firms, Malaysian respondents focused exclusively on staffing issues (see Table 27).

Table 27: Strategies for Improving Service Quality: Malaysia

Strategy Proposed	Percent Mentioning the Strategy
Improving staff knowledge about service delivery techniques	68%
Regular staff supervision and mentoring	67%
Regular staff meetings to problem-solve challenging situations	56%
Expanding/improving staff training	53%

3.2 Demand-Side Issues

The purchase decision. As we have already seen, many MSMEs are not even aware that there is a business services purchase decision to be made. The basic decision to “make” (provide in-house, or self-serve) or “buy” (purchase from an external supplier) is influenced by whether or not the enterprise believes that a present cost will lead to a future benefit. In other words, the enterprise needs to be able to justify the business service purchase cost as an investment in future profitability. The issue of internal production or external purchase is the

best use of scarce resources. The optimal use of an MSME's resources is for their core productive/profitable activity.

If the enterprise elects to stretch its resources to "make" or self-produce a support function, it is usually for one of the following reasons:

- Lack of awareness that the service is needed/useful
- Lack of awareness that providing the service takes skill (i.e., a belief that "anyone can do it")
- An over-estimation of their own competence to provide the service
- An inability to find an appropriate business service supplier
- An inability to find a business service supplier that offers good quality service
- A lack of financial resources for outsourcing the support service
- A strategic choice to control the production of the support function

Any decision to "buy" is influenced by both the type of business service being considered and the stage of enterprise development. For some services, enterprises typically begin by self-serving and then move to external purchase (e.g., training, accounting). For others, enterprises begin with external purchase and then bring the function in-house as demand for it increases (e.g., logistics management). Whether or not an enterprise will "buy" externally-produced business services may also depend on:

- The choices available and the perceived "value for money"
- The information available on the benefits to expect from purchase
- The degree to which the skill is actually possessed internally
- Whether or not the service is seen as critical to competitiveness

There are also cultural factors that influence the purchase decision. Cultures differ in the extent to which persons are willing to trust strangers with competitive information, and whether or not there is perceived "loss of face" if external help is sought. Cultural norms also influence concerns about confidentiality (e.g., not reporting financial data to tax authorities), and political beliefs influence whether or not business services are viewed as "productive."

If an enterprise elects to "buy," it may buy from a subsidized source (e.g., government, donor, patron, parent company, related firm) or on the open market (e.g., local business service supplier, foreign imported service). As a number of donor-funded projects have demonstrated, subsidized initial trials (e.g., vouchers) do not necessarily lead to ongoing non-subsidized purchase. For that to happen, there typically needs to be some formal review of the benefits achieved so that the enterprise is aware of the value or impact of the business service that has been received.

One of the most common ways to offset the risk of a service purchase is through the use of recommendations and referrals. MSMEs trying to decide whether or not to buy externally-produced business services can use that same dynamic by seeking purchase-related

information from credible sources and by visiting model firms that do purchase business services.

Barriers to effective purchase decision-making. Very small enterprises (less than ten employees) face human resource constraints in acquiring and analyzing information on alternate sources of business services. They are also less likely to have formal exposure to analyses of the relative benefits of investing in specialty business services. Should they decide to make the purchase, they may still face challenges in finding staff time to manage the external business service supplier.

Another type of constraint is that of mandated purchasing. For example, family-owned firms may require purchasing from within the family, foreign-owned subsidiaries may be required to purchase from within the corporate structure, donor agencies may require purchase from donor nationals (“tied aid”), or government agencies may require their officers to purchase from other government agencies.

Business service firms as purchasers. In general, business service firms tend to be more demanding of other service providers in terms of access and quality control. They know from their own experience what is possible. As they tend to be small, they are also usually unable to spare staff for extended periods of time for off-site training or to oversee suppliers. Other factors that make them likely to self-produce include the lack of services designed to meet their needs (e.g., training on how to manage and market service operations), or a lack of expertise in how to establish quality systems in business service firms.

Impact measures. When evaluating the impact of business services on the enterprises purchasing them, it is easy to unwittingly select factors that equate success with size. A word of caution is in order. Economic development and successful enterprise operations do not necessarily equate with increase in organizational size. Alternate economic benefits (such as quality of work life or enhanced balance between family and work responsibilities) may be associated more frequently with smaller firm size – i.e., there exists a rationale for favoring MSME development other than simple job creation or productivity growth. MSMEs can avoid the negative consequences of increased size (e.g., increased fixed costs), while realizing some of the competitive benefits, through increasing market diversification and strategic alliances.

Government and donor agencies as purchasers. In developed market economies, the most frequent mechanism used to strengthen business service suppliers is through the “buy local” procurement practices of local government. All too often, though, in developing countries, governments and donor agencies utilize foreign service suppliers in order to ensure good quality control. Government and donor agencies may be unaware that such procurement practices, in addition to their policies and programs, have the potential to strengthen or distort existing business service provision.

3.3 Access to Transactional Information

One of the common sources of market distortion is a lack of information. Suppliers

lack information on potential clients and what matters to them. This lack may be due to their own inexperience or due to lack of access to market research. Purchasers lack information on which to compare potential suppliers and determine benefits. Table 28 summarizes the types of information needed in order for informed decisions to be made.

Table 28: Types of Transactional Information Needed

<p><i>Customer needs:</i></p> <ul style="list-style-type: none"> • generic needs, by volume and location • speciality needs, by volume and location • priorities in terms of willingness to pay
<p><i>Benefits of business services:</i></p> <ul style="list-style-type: none"> • success stories illustrating benefits • economic and financial data illustrating benefits • specific benefits from the use of generic business services • specific benefits from the use of specialist business services
<p><i>Selection criteria:</i></p> <ul style="list-style-type: none"> • decision rules for the “make-buy” decision • criteria for selecting the best business service supplier
<p><i>Supplier availability:</i></p> <ul style="list-style-type: none"> • directories/Yellow pages • capabilities information (experience, languages, locations) • quality ratings

Section 4: Maximizing Donor Effectiveness

4.1 Criteria for Effectiveness

A number of donors have already noted that a paradigm shift is required in how local business services capacity is developed. Based on research to date, the following comments are offered on the current criteria for evaluating effectiveness:

a) *Scale/Outreach*

A major shift that could be very effective would be for donor agencies to see business service firms (especially those owned by women or the poor) as their primary clientele. If local business service firms are functioning effectively, they should be able to assist local goods producers to operate profitably. Also, it is usually more cost-efficient to work on strengthening intermediaries (in this case, business service firms) than to try and help every enterprise individually.

b) *Impact*

In addition to fiscal measures such as increased profits or increased size, we could also consider measures that are size-neutral, such as:

- Improved quality of services
- Improved availability of services

- Increased outsourcing of various aspects of service delivery
- Increased number of new business service firms supplying other business service firms

c) *Cost effectiveness*

In order to demonstrate that donor funds have been well-spent, some additional measures could include the following for business service firms:

- Reduced cost of new technology adoption
- Reduced cost of customizing services

d) *Sustainability*

In order for business service delivery to be truly sustainable, business services need to be provided by the private sector on terms that are financially realistic. The true test of sustainability will be for donor-funded agencies to have only an initial research and development role.

4.2 Assessing Market Needs

Not all markets are at the same stage of development or have the same characteristics. Centrally-planned economies, for example, will have suppressed the overall development of business services for political reasons. In economies with large conglomerates, most business service suppliers are likely to exist as subsidiaries of the parent company. Here, for example, are four kinds of markets that would require different approaches:

- a) *Demand has been suppressed* (e.g., political philosophy, subsidization).
Demand would need to be stimulated through local purchase by donor agencies, plus marketing the benefits of external purchase to MSMEs.
- b) *Demand is present but low density*.
Local business service suppliers would need to be convinced of the viability of MSME demand, and then assisted to manage costs in targeting MSMEs (see Table 22).
- c) *Demand from high-margin businesses is growing rapidly*.
Local business service suppliers would need to be convinced that diversification of one's client base is ultimately of value, and then helped to market to MSMEs.
- d) *Easily-met needs are still high volume and high growth*.
Incentives would need to be developed for targeting more complex MSME needs.

Another market assessment issue has to do with the specific needs of micro-enterprises. Research by the author has indicated that, if micro-enterprises wish to be viable economic supports to their owners, they have the same need as larger firms for the support services. When they receive inputs informally from family or community members, they

face the challenge of having little “marketplace” recourse in the event of uneven or poor quality. It is often the presence or absence of quality support services inputs that makes the difference in whether or not a micro-enterprise will become economically viable.

Based on a review by the author of the many conceptual papers and case studies that have been produced for the recent series of BDS conferences, there appear to be five basic models being used by donor agencies to address business service needs: direct supply, brokering volunteers, brokering private sector suppliers, training private sector suppliers, and subsidizing costs. As an alternative, the author would like to suggest the following six donor roles, which are elaborated briefly in the remainder of this paper:

- #1: Capacity strengthening
- #2: Offsetting initial purchase risk
- #3: Facilitating information access
- #4: Modeling business services purchase decision-making
- #5: Influencing government policies and practices
- #6: Researching and developing new approaches

4.3 Role #1: Capacity Strengthening

In order to intervene effectively on the supply side, the objective needs to be to strengthen local capacity to deliver quality business services at prices that are affordable for MSMEs and that allow the private sector supplier to make a profit. Expecting private sector firms to provide business services at or below break-even prices or on a volunteer basis will either drive them out of business or encourage them to seek more profitable client groups in order to survive. A first step in capacity building is to assess the current supply of business services in terms of variables like those in Table 28.

Table 28: Variables for Assessing Business Services Capacity

<ul style="list-style-type: none">• generic and specialty services available• adequacy of service and service delivery design to meet MSME needs• geographic distribution• accessibility of services in terms of hours, languages, etc.• quality of service, including speed of response and delivery• telecommunications and Internet infrastructure• availability of staff with secondary education and appropriate skills• incentives for ongoing staff training• incentives for adoption of quality management systems• presence of service industry associations with codes of conduct and requirements for ongoing professional education• availability of managerial training in services marketing and management

Best practices that have been reported in strengthening local capacity to provide a wider range and better quality of business services for MSMEs include the following:

- a) Providing information on international best practices, including relevant websites and case examples.

- b) Underwriting the cost of specialty skill development, including how to design or customize services⁴.
- c) Providing training and coaching in how to assess and address client needs.
- d) Providing research and development monies for adapting existing services to the specific needs of MSMEs.
- e) Strengthening/establishing service industry associations with standards of practice, certification/licensure, codes of conduct and continuing professional education requirements by “twinning” new associations with already-established service industry associations.
- f) Helping create and implement human resource development plans in business service firms.
- g) Helping business service firms develop internationally-recognized quality management systems (i.e., ISO 9000⁵).
- h) Underwriting the redesign of service delivery for distance or web-enabled delivery channels.
- i) Providing annual training monies per staff member if the firm has a quality system in place with standard procedures and performance measures.

In order to ensure success in capacity-building initiatives, the following standards of practice are proposed:

- a) All business services should be supplied by local business service firms, selected through a competitive bidding process.
- b) Donor agencies should only use firms that meet standard industry criteria for professional competence (e.g., certification).
- c) Donor assistance should be available to all locally-owned business service firms provided they have met any relevant criteria (rather than “picking winners”).

⁴See the material on service design and customization in the International Trade Centre UNCTAD/WTO 1999 publication for business service firms in developing and transitional economies, *Innovating for Success in Exporting Services*.

⁵See the International Trade Centre UNCTAD/WTO 1997 workbook to help business service firms in developing and transitional economies: *ISO 9000 for Service Firms in Developing Countries*.

- d) The objective should in all instances be to improve the local capacity that exists rather than to create a parallel delivery system.
- e) Program initiatives should be expanded to include strengthening local business service industry associations in their quality assurance role.

4.4 Role #2: Offsetting Initial Purchase Risk

Any time a business service is purchased there is a risk involved because services are not created until the purchase contract is concluded. This means that business services are not available for inspection prior to purchase in the way that goods are. MSMEs face uncertainty both about whether they need business services and about how best to offset or reduce purchase risk.

In order for MSMEs to make an informed purchase decision, they will need the following types of information:

- why the particular business service is important to their success
- the consequences of self-provision if they lack the necessary training
- the criteria to use in selecting an external supplier
- the suppliers that are available from which to choose
- how to manage the external supplier so that their needs are met

Best practices in helping MSMEs make appropriate business services purchase decisions include the following:

- a) Providing information on the availability and capabilities of business service suppliers (who provides what for how much), plus quality ratings.
- b) Funding informational campaigns by business service industry associations to educate MSMEs about the benefits of business services and how to select a supplier.
- c) Sponsoring “show and tell” events that give MSMEs a sampling of the types of business services that are available and their benefits.

In order to help MSMEs offset the initial risk of business services purchase, the following standards of practice are proposed:

- a) Any subsidized purchase program must show how ongoing non-subsidized purchase will be induced.
- b) Interventions should be matched to the specific constraint(s) that exist in the market, for example:
Lack of information on suppliers → supplier directories.

MSMEs doubt benefits → sponsor “show and tells.”

4.5 Role #3: Facilitating Information Access

Access to information is always a challenge in developing/transitional economies. The following are best practices in providing transactional information to help with decisions regarding the purchase of business services:

- a) Conducting market research on MSMEs’ business service needs and sharing that information with business service suppliers.
- b) Preparing articles for service industry association newsletters on how to identify business service needs and promote one’s business services.
- c) Creating flyers that can be distributed on the benefits of business services, when to use an external supplier, how to select a business service supplier, and model contract terms.
- d) Providing articles in the general media about the benefits of business services for MSMEs.
- e) Publicizing success stories that analyze the impact of business services.
- f) Preparing directories of business service suppliers and their capabilities (like a Michelin guide).

Standards of practice for the provision of information include:

- a) Incorporating the education of MSMEs regarding business services in any program planning.
- b) Ensuring that impact analysis is provided, not just information.

4.6 Role #4: Modeling Business Services Purchase Decision-Making

Since donor organizations themselves need to use business services, this provides an opportunity for donors to model the purchase decision through their own procurement processes. By purchasing from local business service suppliers in a transparent manner, donor agencies can use program monies to strengthen local capacity and demonstrate how to select and manage business service suppliers. The following are suggested standards of practice:

- a) Contract out all possible business service inputs to locally-owned business service firms locally rather than either self-producing or using established

international service suppliers.

- b) Use only local business service suppliers who have met relevant quality standards (e.g., licensed, certified, ISO 9000).
- c) Advertise the criteria being used to select business service suppliers, along with an explanation about why those particular criteria are being used.
- d) Draft a contract for business services that is explicit about performance expectations and measures.
- e) Monitor the performance of the selected business service suppliers and provide timely performance feedback to improve delivery quality.
- f) Provide seminars on how to bid successfully for providing business services to donor agencies.⁶

4.7 Role #5: Influencing Government Policies and Practices

Because of providing needed funding, donor agencies have an opportunity to influence government practices to a certain extent. There are a number of areas where the donor community could have a positive influence with government officials in helping to “grow” local business services capacity, such as:

- a) Educating government officials on the importance of business services.
One of the challenges faced by local business services firms is that their own governments are not aware of the role played by services in general and business services in particular. It is still common for business services to be overlooked in national development plans.
- b) *Providing technical assistance in gathering statistics on business services.*
One of the reasons why developing country governments do not support the development of business services is that they have little or no statistical data on their economic contribution. An excellent starting place would be the creation of a business registry to identify existing business service suppliers so that they can be surveyed.
- c) *Encouraging governments to outsource their own needs for business services*

⁶As a model to examine, the U.S. state procurement officers provide this type of training in an annual seminar to all firms that would like to sell products or services to state governments.

to locally-owned business service firms instead of self-producing.

As mentioned earlier, government procurement can be a powerful mechanism for strengthening local capacity.

- d) *Encouraging the removal of any bias against the use of locally-owned business service suppliers in IFI-funded projects.*

In some developing countries, governments routinely contract to foreign business service firms as they are either unaware or skeptical of local capacity. Requirements under the GATS to help increase business service exports from developing countries could be used as a rationale for requiring the use of local business service suppliers on donor-funded project teams.

- e) *Supporting the provision of operating lines of credit against accounts receivable for local MSME business service suppliers.*

At issue here is the definition of the “collateral” or “security” required by central banks when loans are issued. Traditionally, such collateral has been defined only as physical plant and equipment or real estate. Donors could offer technical assistance in assessing the risks associated with accepting various types of accounts receivable as “collateral” instead.

- f) *Advocating for the removal of additional taxes on business service firms.*

In some economies (like Vietnam), business service firms are taxed at a higher rate than manufacturers. Lowering the tax rate would make it possible for services to be priced at a lower rate.

- g) *Advocating for education and training relevant to the needs of business service firms.*

In virtually every economy there is a need to rethink the types of skills that are emphasized in secondary and vocational training. Typically such skills training focuses on technical or manual skills. Research in Malaysia has shown that the following skills are those needed by business services staff:

- Interpersonal communication
- Computer skills
- Literacy and numeracy
- Knowing how to learn
- Self-management skills
- Problem-solving skills
- Teamwork
- Leadership and decision-making skills

- h) *Funding improvements in Internet access (both cost and speed) in rural communities.*

As the International Telecommunications Union has acknowledged, telecommunications and the Internet are critical infrastructure services for a “level playing field” among economies and between urban and rural areas.

- i) *Encouraging timely payment of fees due for donor-funded projects.*
If donors are supplying the funds, it should be possible to require fee payment to local suppliers within 45 days.
- j) *Encouraging the provision of seminars on how to bid successfully for government business services provision.*
Once donor agencies develop a seminar for how to bid successfully to supply business services to donor agencies, that model could be modified for government procurement and then shared.

4.8 Role #6: Researching and Developing New Approaches

The most financially challenging tasks for local business service firms are those related to developing or customizing new services. Donor agencies can assist by focusing any direct supply of business services on experimentation with new methods of delivery. In order to ensure that capacity building includes strengthening the capacity to design new services, the following standards of practice are suggested:

- a) Any direct supply of business services by donor agencies should be to a geographic area or a type of MSME currently without documented access to any business services and should be designed as a research prototype.
- b) Any research prototype should include an exit strategy for transfer to local business service firms (e.g., through franchising) once a successful model has been demonstrated.
- c) Priority should be given to training local business service firms in how to design and implement new services, rather than creating such “products” for them.