

# ECONOMIC GOVERNANCE INDEX (EGI)

## Measuring Sub-National Business Environments

*The Provincial Business Environment Scorecard in Cambodia*

&

*The Economic Governance Index in Sri Lanka*

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And  
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**Rational and Overview of the two indexes:**  
**Measuring Economic Governance and Regulatory Policy in Cambodia and Sri Lanka**

**Sub-national imbalances and the importance of business environments**

In Cambodia, like in Sri Lanka, the imbalance between a few rapidly growing urban areas and often underdeveloped provincial areas, as well as among provinces, is a major concern for improved and sustainable economic development. The disparity of initial endowments such as location, infrastructure, the availability of raw material or human resources, partly justifies the natural propensity of certain areas to develop faster than others. However, irrespective of these initial endowments, the capacity of local authorities to create a business environment that is supportive of private sector development can explain why some provinces are doing better than others. If a dynamic private sector is widely considered as the engine of development and a dominant source of job creation and poverty reduction, private enterprises often have to operate in an un-transparent, unreliable and altogether unsupportive business environment. In many countries, including Cambodia and Sri Lanka, the ability of the private sector, particularly the micro, small and medium enterprises (MSME) that constitute the vast bulk of these countries' economy, to grow and create jobs has been inhibited by of a wide spectrum of institutional barriers and constraints. The micro, small and Medium business sector, which employs the majority of the poor, remains hobbled by lack of access to information and markets, low added-value, weak or unbalanced value-chains as well as with poor implementation of policies, regulatory barriers and distortive policies.

Although the general legal environment is still largely shaped at the national level, and despite the fact that decentralization and de-concentration are still on-going processes in both countries, the role of local authorities in implementing these laws and regulations proves to be decisive for private sector development. The first business environment in which MSMEs operate is their local environment, and irrespective of the other levels of government, the enabling economic environment at the local level is directly influenced by the services provided by the local authorities. Based on the assumption that local economic governance plays a crucial role in providing opportunities for the private sector to contribute to a more balanced and equitable economic growth, improving the business environment at the local level appears to be a pragmatic and efficient way to provide local MSMEs with increased opportunities to grow and expand. The Local Economic Governance Indexes, developed by The Asia Foundation in collaboration with local and international partners, are meant to address this need for information and analysis by providing reliable tools to measure the quality of economic governance at a sub-national level. Local Economic Governance Indexes (LEGI) use a set of quantitative and qualitative indicators to measure the quality of local economic governance. These benchmarking tools are meant to provide information and incentives for improving policy implementation and policy reforms. By comparing performances of different provinces or municipalities, the indexes highlight the fact that good economic governance practices have an impact on private sector development, and that improvements in economic governance practices can lead to enhanced private sector development even in the absence of changes in resource or structural endowments.

Cambodia, where the Provincial Business Environment Scorecard (PBES) was first implemented in 2006, and Sri Lanka where the first Economic Governance Index (EGI-SL) was

conducted in 2007, are the two most recent additions to the LEGIs developed by The Asia Foundation and its partners. These two indexes, based on the experience of The Asia Foundation in the Philippines, Indonesia and Vietnam, had to be adapted to the specific economic and administrative context of Cambodia and Sri Lanka. They have, however, the same objectives:

- Providing updated information to the private sector about the business environment in their area, and thus creating a demand for an improved business environment.
- Creating a frame of reference for local leaders and public officials as they seek to improve policies and economic governance practices in their area.
- Stimulating a proactive and competitive process involving all relevant stakeholders in their efforts to offer a more supportive business environment.

### **Using the Provincial Business Environment Scorecard (PBES) to foster policy reform in Cambodia**

In 2006, for the first time in Cambodia, The Provincial Business Environment Scorecard (PBES) highlighted the importance of local economies and local economic governance through a rigorous assessment and ranking of provincial business environments across 10 of the 24 Cambodian provinces/municipalities. Indeed, the PBES, a partnership between The Asia Foundation and the International Finance Corporation's Mekong Private Sector Development Facility<sup>1</sup> provides a thorough diagnosis of the comparative economic governance of these 10 provinces according to 10 basic criteria (sub-indices) while controlling for differences in resource and structural endowments. The 10 provinces selected represent the most economically active ones. Collectively, they represent 75% of Cambodia's GDP and 64% of the population.<sup>2</sup> The 10 sub-indices of economic governance against which provinces can be measured and ranked, highlight regional variations in the business environment across provinces in Cambodia and provide information on the specific strengths and weaknesses of each one of them compared to the others. Indicators such as entry costs, transparency, time costs or informal charges allows for an assessment and a comparison of the provinces according to the performance and efforts of provincial governments to develop business-friendly policy environments. Two types of data were used to construct this index. First, perceptions data were collected from a face-to-face survey of 500 formal and informal provincial private firms. The perceptions data was completed with data collected from published sources, such as national or provincial statistics when available, the annual provincial budget, first-person collection and interviews with third-parties like banks and real estate firms<sup>3</sup>. Collected data were compiled into the ten sub-indices and an index was created aggregating the results of each sub-index into a single figure for each province. The results allow comparing the provinces at the aggregated level or at the sub-index level, for a more detailed analysis.

Rankings for 2006 (see chart below) show that the eastern provinces of Kampong Cham and Svay Rieng, close to the Vietnam border, have the best business environments. Surprisingly

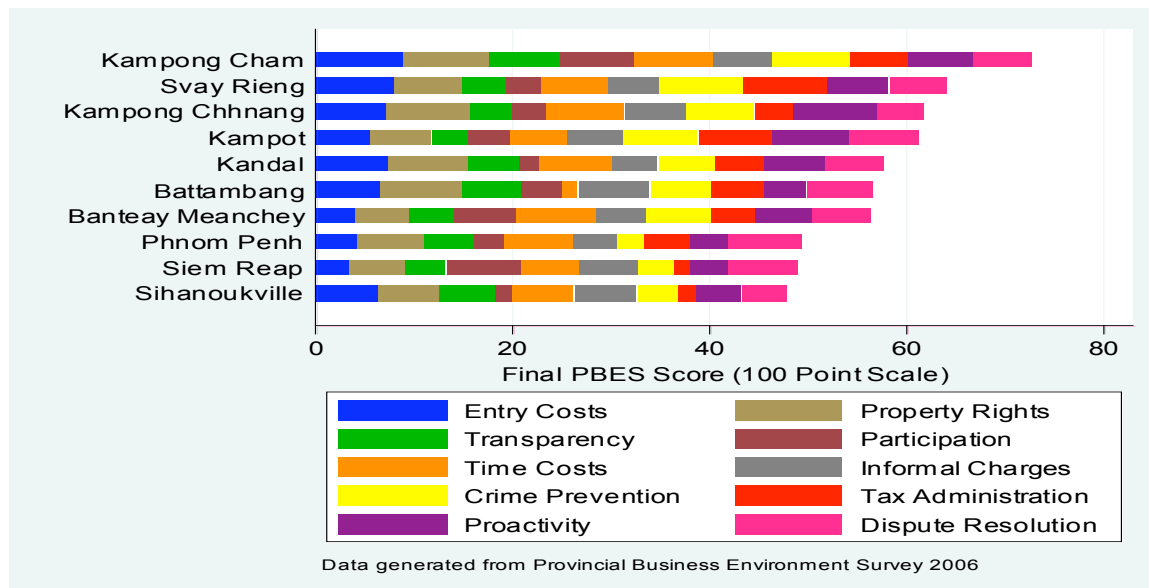
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<sup>1</sup> To implement PBES 2006 in Cambodia, The Asia Foundation received financial support from the Australian Agency for International Development.

<sup>2</sup> Calculation by technical advisor and author of the PBES report: Prof. Edmund J. Malesky, Ph.D.; Assistant Professor, Graduate School of International Relations and Pacific Studies, University of California, San Diego. Calculation based on Cambodian Statistical Yearbook 2004.

<sup>3</sup> See Appendix 1 for the list of indicators for PBES.

(or may be unsurprisingly), the lowest ranked provinces are also the most economically developed ones: the capital city of Phnom Penh, the touristy city of Siem Reap, and Cambodia's harbor of Sihanoukville rank eighth, ninth and tenth respectively. These last provinces, which obviously benefit from the best situation in terms of natural endowments and infrastructure, do not seem to be paying as much attention to their business environments as the other provinces. These results have to be analyzed in the view of another result of the PBES, confirming the impact of governance on economic development. Indeed, Statistical analysis of the PBES indicators suggest a strikingly high correlation between improved governance and an almost certain immediate effect on business expansion in the region<sup>4</sup>.



The 2006 PBES represents a first foray into understanding and documenting the impact of local institutions on private sector performance in Cambodia, identifying the provinces that have excelled at various aspects of provincial governance. Building on this success, the second PBES is currently being implemented by the Asia Foundation in partnership with the International Finance Corporation – Mekong Private Sector Development Facility (IFC-MPDF)<sup>5</sup>. This time the research is being expanded to cover all 24 provinces/municipalities in Cambodia. The results are expected to be made public by the end of 2008.

### Mobilizing constituencies on economic governance issues in Sri Lanka

In Sri Lanka, the first Economic Governance Index was published in 2007, building on the experience and methodology of the Cambodian PBES and of other similar indexes developed by The Asia Foundation and others before. For the first time in Sri Lanka, the EGI measures the enabling environment for private enterprise at a sub-national level, allowing for comparisons across municipalities. In the case of Sri Lanka, the decision was made to focus primarily on the

<sup>4</sup> The Provincial Business Environment Scorecard in Cambodia, Technical Report, March 2007.

<sup>5</sup> To design and implement the 2008 PBES, The Asia Foundation receives funding support from DANIDA/DFID/NZAid.

country's urban constituencies. A detailed analysis of the administrative organization and of decision levels lead to the choice of municipalities and urban councils (MCs and UCs) as the unit of reference and comparison for local business environments. The EGI thus ranks 48 Municipal and Urban Council localities across 7 of the 9 provinces in Sri Lanka. The northern and eastern provinces were intentionally excluded due to logistical constraints as issues of peace and order made it impossible to conduct the research in these localities.

Like in Cambodia, the comparative analysis of local economic governance in Sri Lanka is based on 10 sub-indices that help identify and understand government-influenced constraints to private sector growth<sup>6</sup>. Survey data that represents the perception of business leaders on the local regulatory environment, as well as published data was used to construct the sub-indices. Data was collected in a threefold process that included: (1) an interviewer-administered structured questionnaire targeted at the private sector; (2) a series of interviews among Local Authority officials and experts in all 48 localities; and (3) review of published data related to economic development. The survey spans 4,969 firms within 48 Local Authority boundaries, consisting of 15 Municipal Councils and 33 Urban Councils. After compiling the results on a 9 point scale<sup>7</sup> - higher scores being more favorable - the 48 units of comparisons were divided into tiers for easier reference. Since the overall index scores often vary marginally from one municipality to another, even a slight change in any single indicator could change the overall rank, making the tier position of each municipality more relevant than the actual score. Within the first tier of the best performers, Horana and Nawalapitiya are the obvious forerunners with scores 6.65 and 6.63 respectively. They emerged as the best positioned in terms of enabling environment for private enterprise, while Puttalam scored lowest at 4.79. Results at the individual sub-index level highlight important differences among municipalities and can be used as interesting indicators for gauging the particular strengths and weaknesses of each locality. For example, Kuliyaipitiya placed first in the area of Registration, Permits, and Licenses while Haputale is best positioned on Government Attitudes toward Business and Nawalapitiya on Informal Charges, Favouritism, and Discrimination. Similarly some regions performed well in select sub-indices and poorly in others. Chillaw, for example, was the best performer in Land Access and Property Rights, but ranked low in Regulatory Environment, Compliance, and Costs. Conversely, Ja-Ela, a forerunner in Regulatory Environment, Compliance, and Costs, and in Tax Administration, Burden and Services ranked at the bottom for Infrastructure and Business services.

The variability among sub-indices illustrates the utility of a tool like the EGI to identify and prioritize areas that need special attention. In addition to highlighting the influence of economic governance on business and differences in business friendliness from one area to another, the EGI is being used in Sri Lanka to identify issues of economic governance that can be improved with direct impact on the overall business climate. The results of the EGI are already being used by constituencies to push for reforms in identified areas.

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<sup>6</sup> These sub-indices are described in the next section.

<sup>7</sup> After consultation of all actors of the research, the team decided on a 9-point scale rather than a 10-point scale to emphasize the impression that progress is always possible. This choice is purely subjective and has no impact on the results.

## **A sound methodology to ensure accuracy, reliability and confidence**

When developing the EGI in Cambodia and Sri Lanka, the research teams had two main concerns in mind:

1. *Methodological rigor*: not only the EGI aimed to provide a fair and accurate picture of economic governance within the country in a ranking that could potentially be controversial, but it also aimed to have policy implications that would affect businesses, local institutions and citizens. Keeping these implications in mind, extreme attention was brought to the development of a sound methodology to create confidence in the EGIs as a reliable tool for improved economic governance.
2. *Country-specific approach*: The credibility and effectiveness of the exercise depended on the capacity to adapt the methodology to the specificities of each country. The methodology had to be adapted to the reality of each country by: identifying the right level of administrative units to be analyzed and compared; adapting the indicators used to construct each sub-indices to the reality of doing business in each country; making sure that the questionnaire reflected local business constraints and environments; selecting the best ways to collect reliable data.

As with any applied field research, there were a number of logistical constraints, trade-offs, and challenges to be faced. However, building on the know-how and experience developed in other countries such as Vietnam<sup>8</sup>, the research team developed rigorous field research and statistical methods to ensure the collection of relevant and high-quality data, the creation of normalized sub-indices and the construction of a final index from which accurate and externally valid conclusions<sup>9</sup> could be drawn. Without coming back to the details of the methodology described in length in the technical reports for both the PBES and the Sri Lanka EGI, a few elements need to be highlighted.

## **Standardized sub-indices to capture the multi-dimensions of economic governance**

The Economic Governance Index in both Cambodia and Sri Lanka are composed of ten sub-indices—developed from the academic literature and former research on private sector development—that capture the multi-dimension of economic governance. These sub-indices were designed to highlight private sector priorities and focus on key elements of the local business environment that can be influenced by local policies, regulations, implementation practices and officials.

1. ***Entry Costs***: A measure of the time it takes firms to register and receive all the necessary licenses to start business, the number of licenses required, and the official costs of obtaining all licenses/permits.
2. ***Property Rights***: A measure of the formal rights to business premises and the security of tenure once land is properly acquired and titled.
3. ***Transparency and Access to Information***: A measure of whether firms have access to the proper planning and legal documents necessary to run their business, whether those

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<sup>8</sup> The Provincial Competitiveness Index (PCI) was first implemented in 2005 by the Vietnamese Chamber of Commerce and Industry (VCCI) as part of the Vietnam Competitiveness Initiative (VNCI).

<sup>9</sup> External validity refers to the ability to use a sample to draw conclusions about an entire population (Posavac and Carey, 2007).

documents are equitably available, and whether new policies and laws are communicated to firms and predictably implemented.

1. **Participation:** The flip-side of Transparency, measuring whether firms are consulted in the creation of provincial policy and whether their interests are represented in policy discussions by business associations or other interest groups.
2. **Time Costs of Regulatory Compliance:** A measure of how much time firms waste on bureaucratic compliance and waiting periods, as well as how often firms must endure inspections by local regulatory agencies.
6. **Informal Charges:** A measure of how much firms pay in informal charges, how much of an obstacle those extra fees pose for their business operations, and whether payment of those extra fees are predictable and result in the expected results or “services.”
7. **Crime Prevention:** A measure of how much firms pay in explicit costs as a result of crime due to property that is lost or stolen, as well as the implicit costs of preventing crime through security and protection money.
8. **Tax:** A gauge of both the administrative and fiscal burden imposed by tax regulation in the province.
9. **Proactivity of Provincial Leadership:** A measure of the creativity and willingness of provinces in both implementing central policy, designing their own initiatives for private sector development, and working within the often unclear national regulatory framework to assist and interpret in favor of local private firms.
10. **Dispute Resolution:** A measure of the satisfaction firms have in the outcomes of formal and informal modes of dispute resolution in the province.

With slight alterations, the same sub-indices were used in both Cambodia and Sri Lanka. The difficulty of the exercise lied more in the choice of the indicators used for each sub-index as they had to be adapted to reflect the reality of each country.

### **Data collection: When theory has to adapt to reality**

To construct these sub-indices, a series of indicators were identified<sup>10</sup>. In both Cambodia and Sri Lanka, these indicators were informed by data collection from (1) a survey of firm perceptions, (2) the collection of supplementary data by interviewers, and (3) the collection of published data such as statistics, from reliable sources.

### **Data availability and reliability**

As for any field research, the question of availability of reliable data is crucial. For both the PBES and the Sri Lanka EGI, the perception survey represents 60% of the data used to compile the indices. To make sure the survey was covering a representative sample of the MSMEs present at the local level, special attention was drawn on the sampling, which lead to the question of the availability of reliable and up to date lists of enterprises from which to draw the sampling. In Sri Lanka, a reliable sample frame was drawn from a dataset constructed and managed by the local research company Nielsen and a dataset compiled by the World Bank for its Rural Investment Climate study. In Cambodia, the lack of reliable and updated lists of enterprises per province made it necessary to add an initial stage to the survey by conducting a “census” in each

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<sup>10</sup> See Appendix 1 for the list of indicators for PBES.



one of the ten selected province, in order to establish the listing from which to draw the survey sampling. Researchers traveled to each province to undertake a complete census of business activity in and around the capital city. Every business operation in a fixed location was considered an active enterprise for PBES analysis. Basic information was collected for each business: the location of the business, the name of the business when available, the activity, the gender of owner, etc. This listing became the basis for drawing random samplings of MSMEs and large enterprises in each of the provinces. Apart from the list of enterprises itself, the lack of available data from published or official sources and the weakness of statistical information at the provincial level was a serious constraint to the studies-especially in Cambodia-explaining partly the weight given to the perception data. Necessity being the mother of innovation, the lack of available data often led to the development of original proxies to measure elements of the index.

### ***Including informal firms in Cambodia***

The necessity to conduct a “census” of enterprises at the provincial level, despite being an expensive and time consuming exercise, had the major advantage of allowing for the inclusion of the informal sector in the study. A former study conducted by The Asia Foundation in three provinces some years before had highlighted the overwhelming importance in number of what is usually called the informal sector and that represent the large majority of local firms. Pretending to analyze the constraints faced by the private sector at the provincial level and to reflect on the perception of local firms on their business environment without including this vast majority of informal enterprises would have been nonsense. This is particularly true as this label of “informal firms” is particularly misleading in the case of rural Cambodia. Although not officially registered at the provincial and national level, all these enterprises, even the smaller ones, have regular interaction with local authorities and are directly impacted by economic governance issues. As a result of the census including all firms, registered or not, the sampling was a more accurate reflection of the reality of the economic activity at the local level. 58% of the firms sampled are neither registered with the Ministry of Commerce, nor possess the less formal one-year registration through Municipal/Provincial Department of Commerce. However, 73% of them are registered with the local tax authority to pay the Patent Tax.

### ***A Face to Face interview using a structured questionnaire***

If the PCI in Vietnam is based on the results of a survey questionnaire mailed to a stratified random sample of firms, this solution was not feasible in Cambodia and Sri Lanka. First, the mailing system is not reliable, especially in Cambodia, and second, the type of enterprises covered - mainly small enterprises - would not have allowed for acceptable response rates. The solution of face to face interviews, conducted by trained local interviewers, using a structured questionnaire appeared as the only possible one in order to capture the perceptions of business owners on critical aspects of provincial economic governance. A lot of attention was put on the development of the questionnaire. Questions meant to inform each sub-index were carefully selected and tested, taking into account the interviewees’ capacity and willingness to answer. Most of the indicators and questions are similar in Cambodia and Sri Lanka, although they had, of course, to be adapted to the administrative and regulatory reality of each country. In addition to adapting the questionnaire, some specific issues were added or highlighted to take into consideration country-specific issues. In Sri Lanka, for example, special emphasis was put on the

potential impact of the conflict on the private sector's perception of their business environment, when, in Cambodia, questions regarding land issues were added.

### ***Stratified random sampling***

In both countries, for the survey data, a firm is included in the study only if it meets the criteria of having at least one paid employee besides the owner and is a non-farm business that operates in a fixed location. Enterprises were selected from dataset by using a stratified sampling framework, based on the number of employees and the type of business (manufacturing, trade, and services). Random selection within these strata ensured an accurate and reliable representation on the provincial population of private enterprises. Rather than extrapolating provincial-level results from a national level sample, it was decided to draw different provincial-level samples in order to fit to the reality of each province. In Cambodia, 500 firms were interviewed from a total of 41,775 business operations identified during the census. In Sri Lanka, where the units of analysis were more numerous (48 MCs and UCs) and the business network more dense, 4,700 firms were covered by the survey.

## **Construction of the sub-indices and final index**

### ***Checking for anchoring problems and validity***

In addition to information from the survey, supplementary data was collected to reduce the **'anchoring' problem**. The anchoring problem refers to potential biases that may result from respondents assessing a situation based on their current and personal experiences, without knowledge or understanding of their relative position. This supplementary data is collected from government institutions, from interviews and focus group discussions, and performing observational assessments such as the availability of information on registration costs of tax payments in the relevant public offices. Finally, in order to ensure the data collected is valid and accurate to a certain degree of confidence, internal and external validity checks are performed. Validity of data plays an important role in the acceptance of the findings, although no research can be 100% accurate. The internal validity tests consist of quality checks that address the logical accuracy of the data. The external validity test is conducted with the aid of published data collected from various sources such as the Central Bank or statistical yearbooks. Figures from these sources are compared to that of the collected supplementary data.

### ***Weighting or not weighting?***

Once the data collection was complete, each indicator was standardized to a ten-point scale in Cambodia, and a nine-point scale in Sri-Lanka, with the best performing provinces receive a high score and the worst performing provinces a low one. In this way, the PBES and the EGI compare economic governance against practices that already exist in Cambodia or Sri-Lanka rather than against a theoretical standard of governance. The indicators were then averaged into their respective sub-indices. In both the Cambodian PBES and the Sri Lanka EGI, all sub-indices are treated equally in the calculation of the final index and the overall score is calculated by a simple aggregation. Early analysis indicates that some sub-indices have a greater impact on the business climate than others. However, after considering a number of weighting alternatives, the un-weighted approach proved to be the least biased and the least prone to measurement error. Individual businesses and policymakers are invited to re-weight the final index according to their own needs and priorities.

## **Local Economic Governance Indexes as a demand driven tool for development**

By helping to identify and facilitate an understanding of government-influenced constraints to private sector development and economic growth, the EGIs help disseminate information and create a demand for an improved business environment.

### **A powerful source of information for increased transparency and accountability**

For the first time in Cambodia and in Sri Lanka, the Economic Governance Indexes provided clear and accurate information to business owners, citizens and the media on economic governance at a sub-national level and on local authorities' actions (or lack of actions) to support the private sector. While much was being said on the constraints faced by the private sector in general, little had been done to actually identify, measure and document these constraints at a sub national level. EGIs publicly established that local business environments and local economic governance do matter and may vary tremendously from one area to another. Mobilizing constituencies on economic governance issues through the publication and discussion of the EGIs results appeared to be an efficient way to create a public demand for economic reforms and for a more balanced economic development. The dynamic for change at the local level is enhanced by providing clear and reliable information about the local business environment to both the public and private sector. Using the results of the EGIs is an on-going process as it is an excellent instrument to attract the attention of national and local authorities on the importance of local business environments. In this aspect, the role of the media is crucial and is valuable complement to more focused dissemination efforts towards the public and the private sectors. Both the PBES in Cambodia and the EGIs in Sri Lanka received extensive media coverage, at the national and sub national level. Even with limited mechanisms of accountability in Cambodia and Sri Lanka, the provision of such widespread information is powerful way to highlight economic governance issues and build public support for reform.

### **An effective policy analysis tool for national and local authorities**

In both Sri Lanka and Cambodia, the first positive reaction to the publication of the economic governance indexes came from the public sector. One of the most important uses of the EGI is certainly to serve as a policy analysis tool for national and local governments to diagnose and address economic governance. The EGIs respond to an often heard complain from policy makers that researches often fail to provide practical information for policy actions. Through their organization in sub-indices, the indexes help identify relevant issues in an easy way, while providing accurate and transparent information on specific issues that need to be fixed. The positive reaction of the public sector also lies in the fact that the EGIs are not designed to point a finger on any individual local-level policy-makers or institutions as this would undoubtedly cause resistance and undermine the impact of the exercise as policy-makers and institutions seek to defend their positions. Evidence shows that, on the contrary, in both countries, the publication of specific information regarding local business environments are perceived as an incentive to change. This incentive is particularly strong as the indexes are meant to be implemented and published on regular basis overtime, thus providing a tool to measure progress and evaluate policy impacts. Moreover, in both countries, where most policies and regulations are essentially

decided at the national level, the indexes have highlighted the importance of implementation and the fact that policy reforms at the national level are not sufficient to ensure improved business environment at the local level, creating additional incentives for the national level to be more responsive to the needs of local authorities. In Cambodia, the PBES has received strong support from the highest levels of the Royal Government of Cambodia, including the Ministry of Commerce (MoC), the Ministry of Industry, Mines and Energy (MIME) and the Ministry of Interior (MoI), as this approach to improved local business environment fits the overall national economic development strategy and the “Small and Medium Enterprise Development Framework” (developed by the Sub-Committee on Small and Medium Enterprises with support from the Asia Development Bank). The Ministry of Commerce even decided to use the results of the PBES as a monitoring tool to help focus economic governance efforts and measure progress overtime. In Sri Lanka, the report has been very well received by policy makers and actions are already underway in various localities to analyze the findings with a view to improving their rankings in the future.

### **An incentive for the private sector to be proactive**

The indexes have already proven to be a useful tool and baseline for increased engagement of the rural private sector into active policy advocacy at the local level. By providing clear and practical information on the constraints faced by local firms, the indexes help increase the capacity of the business community and business associations to productively engage in policy dialogue with government counterparts and to better represent member interests. The information collected and disseminated by the PBES and the EGI directly supports and complements other Asia Foundation’s program activities with business associations at the local level and provides increased credibility and efficiency to rural private sector’s policy advocacy actions. In preliminary research conducted by The Asia Foundation in provincial Cambodia and Sri Lanka, the lack of reliable information on their legal environment, cumbersome administrative processes, un-transparent implementation of regulations or informal fees, were mentioned by local MSMEs as important constraints to their development. The EGIs not only document these aspects of local firms environments but provide evidence that some areas are doing better than others and that there is therefore room for improvement at the local level. The Asia Foundation works closely with local business communities, business associations, and government officials to address the myriad of obstacles that currently confound entrepreneurial activities throughout Cambodia and Sri Lanka. In this exercise, the information provided by the PBES and EGI have proved very useful to enable local firms to work closely with local officials to prioritize and target their reform interventions and address issues that are shown to have the greatest impact on provincial business expansion and employment. As a result of these activities, the provincial business associations have gained in confidence, credibility and visibility.

### **A tool for development practitioners and development research**

Development practitioners interested in private sector development are already using the EGIs’ results to identify areas of intervention and tailor programs to fit the demand for improved business environments. The indexes have moreover, an obvious role in measuring progress over

time. In recent years, many scholars and development practitioners have advocated the use of rigorous social science research to design and evaluate development programs (Banerjee, 2007; Duflo, 2006; Overseas Development Institute, 2004). The need to clearly identify the impact of development programs or policy reforms on the general welfare of a country or a population has created a strong demand for research that can provide reliable information and analysis to identify problems, design adapted solutions and measure the impact of policies or programs. The creation of a ranked composite index implemented on regular basis overtime responds to this demand for a tool to help design and monitor progress. The indexes open to a wealth of information that can be directly used to design focused activities addressing the demand for an improved business environment. In countries where reliable information is a scarce commodity, the indexes are providing a valuable source of high-quality data for researchers and practitioners interested in private sector development. They also open the doors to further research to document issues and get a better understanding of the impact of the lack of economic governance on the local economic activity or reasons why some provinces or municipalities are underperforming.

### **Concluding remarks: Opportunities, constraints and limits of EGIs**

Since neither economics nor statistics are exact sciences, discussions do not fail to arise about how the methodology could be further improved. There are always avenues for improvement, by further fine-tuning the questionnaires, expanding the coverage, adding new indicators, etc. The EGIs will, no doubt, gain from experience and improve over time. One of the main methodological options that will help improve the analysis of the data is the introduction (as in the 2008 PBES edition) of a *panel group* that will follow-up a selected group of firms over time. Apart from the overall evolution of each province within the index, the analysis of the changes in the situation of a group of enterprises and of the evolution of their perception of their business environments will provide valuable information to all stakeholders. This panel group will show how firms developed over time, and how this growth is correlated to economic governance; whether formalization has taken place and what the impact has been on the firms; it will provide information on firm survival rates, or an opportunity to see if and how firms have diversified or invested, whether they have expanded their market, and how some policy reforms have been perceived. This is an opportunity for more detailed analysis of the evolution of the business environment overtime that will advantageously complement the analysis of the index itself.

Even more interesting than the technical improvements are the opportunities that EGIs offer in terms of development; opportunities that would be best exploited if one remain aware of the limits of the indexes.

In both Sri Lanka and Cambodia, the EGIs have become a unique source of information on factors restraining private sector development and an inexhaustible source of inspiration for development actors, program developers and researchers. But, as importantly, EGIs are *a source of questions*. National and local authorities and policy makers will ask: How is our area performing in terms of economic governance? In which sub-indices are we performing less well than other provinces or municipalities? Why? What can be done to improve this performance? What can be done to help existing enterprises develop? How can we help entrepreneurs lower their costs of operation? How can we attract outside investment? Etc. When the entrepreneur will

ask: How is my province or city performing compared to others? What areas could be improved? What improvements would have the more direct impact on my business? What needs to be done to lower my administrative costs? Etc. Using the *EGIs as the basis for more in depth diagnostics* stakeholders will still have to analyze the reasons for their strengths and weaknesses and develop adapted strategies to improve the situation. The EGI data also offers opportunity for identifying potential correlations that would help better understand the dynamics of private sector development. If the EGI helps identify issues and constraints, strengths and weaknesses, it does not provide answers as to how to improve the situation in any other way than by identifying best practitioners and opening the door to exchanges of best practices. With not much additional efforts, committed stakeholders can complement the index with more detailed, practical analysis in order to obtain concrete recommendations for tangible results.

Highlighting the importance of economic governance on private sector development does not prevent stakeholders from being lucid on *the importance of other factors*. First, the Economic Governance Indexes in Cambodia and Sri Lanka measure economic governance; they do not pretend to measure overall competitiveness and purposely do not include important factors for private sector development such as infrastructure, availability of raw material or education and training. In the same way, although statistical analysis of the PBES indicators suggest a high correlation between improved governance and an almost certain immediate effect on business expansion in the region, EGIs do not pretend that economic governance is the only, or major, determinant for private sector development. Depending on the level of development of the country, on the sector, on the size and structure of the firm, some factors will be more important than others. The importance of these factors also varies over time. In making the decision to invest, expand, diversify or just remain operational, a firm enters into a complex process of risk evaluation. Economic governance will weight differently in the decision making depending on the structural, financial, technological or commercial characteristics of the firm. A local water producer or a small hair dresser will not have the same criteria as a capital and energy intensive producer of cement. The Province of Siem Reap in Cambodia, will continue to attract investments and enjoy high private sector development growth, despite disappointing performance in economic governance. Municipalities close to Colombo in Sri Lanka will continue to present a definite advantage in terms of location for firms that need to export by air. Despite a favorable business environment, a remote rural area will have difficulties attracting investments in sectors that need access to quality infrastructure. The role of the EGIs vary depending on the context. It also varies from country to country. In a country like Vietnam, with a large variety of potential locations for new industries, the PCI may be useful for foreign direct investors when in Cambodia and Sri Lanka, local MSMEs are more likely to use it and more often to push for reforms than to invest or relocate. However, in all these cases, the EGIs remain an informative tool and an incentive for all to improve the overall business environment. If economic governance is not sufficient to explain economic growth and investments, it remains a basic necessity for private sector development and a necessity that policy makers have a direct control on.

Finally, policy making, like entrepreneurship, is a dynamic process that requires constant adaptation to the situation and the capacity to be flexible and reactive to changing environments. The Economic Governance Index intends to provide an effective way to measure progress over time and can be used as part of an **evaluation and monitoring scheme** of policy reform. Since

changes in business environments can take time, a yearly measure of sub-national business environments would probably not show much progress. Conducting the survey every two to three years seems to be more reasonable and effective.

In conclusion, the economic governance index is part of an initiative that is attempting to promote the use of monitoring tools in policy-making as a way to encourage better gathering and use of data, promote more private sector engagement in public policy, enhance transparency and public accountability, and produce more supportive and more effective government policy.

While poor governance is a clear source of constraints to private sector development, an economic approach to improving governance appears to be a pragmatic and efficient way to mobilize constituencies for reform. The dynamic for change at the local level is enhanced by providing clear and reliable information about the local business environment to both the public and private sector, but this would remain ineffective without the commitment of local authorities to respond to the private sector demand. If the EGI is the catalyst for reform and economic development, the engine remain the engagement of the private and public sector.

**Appendix 1: Information summary of the Economic Governance Indexes**

	<b>SRI LANKA</b>  <b>Economic Governance Index</b>  <b>2007</b>	<b>CAMBODIA</b>  <b>Provincial Business Environment Scorecard (PBES)</b>  <b>2006</b> <b>2008 (in process)</b>
<b>PARTNERS</b>	AUSAID / DFID	International Finance Corporation (IFC), Mekong Private Sector Development Facility (MPDF)
<b>BASELINE DATA</b>	World Bank : Rural Investment Climate Survey - Sampling framework; ACNielsen : RMS Census Data for FMCG	PBES Census covering 10 provinces (41,775 businesses total)
<b>SAMPLE POPULATION</b>	Updated RMS Census Data; New Listing of all other business establishments; Survey of 4900 enterprises & Hard data collection of 48 localities	Covers 10 out of 24 provinces
<b>METHOD OF SAMPLING</b>	Listing/Census in 48 Localities(universe of MCs & Ucs); Survey : random sample by size & sector; Hard data from the universe of 48	Perceptions data (face-to-face survey of 500 private firms in 10 provinces) and hard data (published sources, first person collection and interviews with third-parties like state-owned banks and real estate firms)
<b>RATIO PERCEPTION/ HARD DATA</b>	60/40	60/40



## **Appendix 2: Detailed Descriptions of Sub-Indices and Components Indicators**

### **1 Costs**

- % of firms registered with the Ministry of Commerce or Municipal Commerce Division
- Total number of registrations, licenses and permits a firm needs to operate
- Official fee for One-Year Operating License
- Waiting period for Registration Certificate from Municipal Commerce Division
- Official fee for Registration Certificate from Municipal Commerce Division
- Waiting period for One-Year Operating License
- Official fee for One-Year Operating License
- Waiting period for Patent Tax from Local Tax Authority\*\*
- Official Patent Tax Fee from Local Tax Authority\*\*

### **2 Land Access and Property Rights**

- % of firms with land documentation
- % of firms with Solid title to land
- % of firms who feel expropriation is a risk
- % of firms renting land from government
- % of firms who deem rental changes a risk
- Effective land prices (adjusted for differences in supply and demand)\*\*
- Rental Revenue per Firm\*

### **3 Transparency**

- Transparency of - and access to - local planning and decrees/decisions
- Firm's access to provincial budget
- % of time that a relationship with a provincial official is necessary for receiving access to land or property documents
- Favoritism toward firms with political connections is an obstacle to business.
- Regularity that representatives from the provincial governor's office meet with firms to discuss changes in laws or policies
- Degree that firms are informed about new economic and finance regulations that affect their business
- Regularity that a firm receives advance notice about new or changing central government laws
- Request to Department of Commerce\*\*
- Request to Departments of Industry Mine, and Energy\*\*

### **4 Participation**

- Provincial government solicits advice from affected firms on new laws, rules, regulations or decrees
- There are business associations or clubs in the province
- Firm membership in any business associations or clubs in the province
- Number of business associations per 10,000 firms in province\*\*

## **5 Time Costs**

- % of management time spent dealing with requirements imposed by government regulations
- Total number of inspections per year
- Time it took a firm to receive their land title

## **6 Informal Charges**

- Giving gifts to public officials is sometimes required to pass customs, obtain licenses, receive public services, or meet tax requirements
- % of firms that paid informal charges in application for Patent Tax
- Firm's assessment of corruption in province
- Information regarding available public procurement contracts is transparent
- Importance of government connections for winning public procurement contracts
- % of firms who believe firms in their industry often pay commissions when doing business with government
- % of firms that believe government agencies assess additional fees based on what their counterparts are able to acquire
- Firms usually know how much additional payment is required in their industry
- Regularity that services are delivered as expected when a firm pays the required additional payment

## **7 Crime**

- % of firms that experienced losses due to theft, robbery, vandalism, or arson in last year
- Monetary Value of firm's losses caused by crime
- % of firms who believe firms in their sector make protection payments to the police
- % of firms that know firms who have made protection payments in the Past

## **8 Proactivity**

- Provincial government officials' attitude toward private business
- Attitude of the provincial government toward private business is improving
- Provincial government interprets law in favor of local firm if certain government regulations are unclear
- Provincial departments of line ministries tend to interpret in firms favor when central regulation lacks clarity
- Provincial government is good at working within central laws to create a profitable business environment
- Provincial government is creative and clever about solving new business problems.
- Provincial government willingly risks punishment from the central government to pass decisions to aid local businesses
- There are no initiatives at the provincial level

## **9 Tax Burden**

- % of Firms that believe bribes to public officials to avoid taxes and regulations are a significant business obstacle
- % of firms that pay taxes

- Rate that a firm makes extra payments to expedite tax process
- % of firms that believe negotiating with tax authority is part of business
- Tax rates as obstacle (mean)

## 10 Legal Institutions

- % of firms who are confident that the legal system will uphold contracts and property rights in disputes
- Firms ability to go to another official to successfully dispute unjust charges
- % of monthly total sales in 2005 that were not paid within the agreed time
- % of monthly sales never repaid in 2005?
- Firm satisfaction with government dispute resolution
- Firm's success at recovering money owed to it
- % of firms in province that believe there is a fair process to dispute
- changes in rent contracts

**Notes:** \*Denotes component uses both hard and soft data; \*\*Denotes component uses only hard data; All other indicators are derived from perceptions data; “Derived from factor analysis; In all sub-Indices each primary component is given equal weight (i.e. Entry Costs has four primary components each worth 25%).