

## Assessing the Applicability of Private Sector Development Instruments in Agricultural Economic Development

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## 1. Introduction

The starting point of this paper is the observation that private sector development (PSD) and agricultural economic development (AED) have historically been two distinct approaches in development cooperation. Both looked at ways to promote productive development in developing countries. But they were based on different disciplines, they were founded on different concepts, they applied different instruments and tools, and they involved separate communities of practice. The current effort to redefine intervention strategies in African countries under the header of “sustainable economic development” creates an opportunity to reflect on the two approaches. In this paper, the angle will be on contributions that PSD can make to AED.

**PSD** is an approach that is informed by concepts from management studies, and to some extent economics and social science. Its traditional focus has been on the promotion of small and medium sized enterprises (SME). Over time, this has been complemented with approaches like investment promotion and export promotion, and there are strong complementarities with neighbouring approaches such as financial systems development and skills development. In the 1990s, two things happened. First, a critical assessment of the impact of traditional approaches led to the reformulation of the principles of SME promotion under the header of “BDS Development”, where BDS stands for business development services and the main message is that development agencies should strengthen service markets rather than directly interacting with individual SMEs (Donor Committee 1998). Second, SME promotion was increasingly conceptualised from a territorial angle, i.e. as an important element of “local economic development” (LED) and through a new and improved perspective at sectors under the headers of “cluster promotion” and “value chain development” (Meyer-Stamer 1999).

**AED** is an approach that is informed by concepts from agronomics, and to some extent social science, ethnology and related fields. In the 1970s, a critical assessment of conventional approaches highlighted the need to pursue more systemic approaches, and a paradigm emerged that led to the implementation of “Integrated Rural Development Projects” (IRDP). While such projects had a significant impact, they also proved difficult to manage, and the sustainability of the organisational structures they created was often questionable. Initially at least, they tended to lack a business focus. The assessment of the IRDP approach led to the formulation of a different type of territorial approach, labelled “Regional Rural Development” (Rauch, Bartels and Engel 2001), an approach that called for complementary interventions under the umbrella of the principles of “sustainable development”. Simultaneously, the assessment of IRDPs led to the conclusion that the private sector had to be stronger involved or promoted in rural development. This ultimately led to the formulation of the “Rural Economic and Enterprise Development” approach (Davis et al. 2003). Most recently, the “value chain” approach has received increasing attention in the AED field, an approach that not only emphasises the importance of local businesses but also the need to

engage with major corporations who are the buyers that define the rules of the game in national and global value chains.<sup>1</sup>

The recent past has thus seen convergence between the two fields. Both PSD and AED are increasingly looking at territorial approaches and the relevance of value chains. Moreover, while AED concepts in the past tended to emphasise a strong role of government that was based on the observation of pervasive market failure in rural areas, more recent approaches have come to a more balanced perspective at the relative strengths and weaknesses of markets and governments and a stronger emphasis of entrepreneurship and business principles, as well as efforts to make markets work. As a result, today it is more difficult to explain the differences between the approaches than the points they agree on.

It is thus an appropriate moment to ask whether PSD experiences can still inform the further evolution of AED approaches. This paper will explore this question. Section 2 conceptualises three key determinants of AED. Section 3 discusses PSD approaches that may have value for AED. Section 4 looks at two types of rural regions that appear particularly promising for PSD-informed AED approaches. The overall objective of the paper is to provide background information for practitioners to reflect on the framework conditions they face in rural areas, to select (or not select) specific intervention approaches and to find entry points for innovative interventions.

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<sup>1</sup> Various donor organisations have developed methods for value chain development. For overviews see <http://www.sdc-valuechains.ch/> and <http://www.value-chains.org/>.

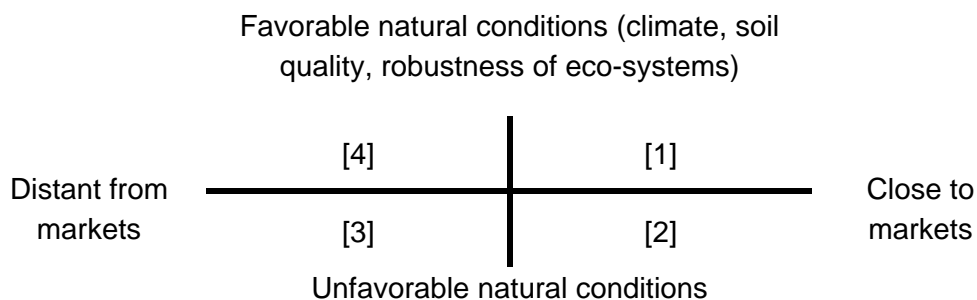
## 2. Conceptualising key determinants of AED

The first step in this exploration must be an effort to develop a clearer picture of some key factors that shape the conditions for AED. We want to highlight three such factors. First, there are quite different types of rural areas that require different types of interventions. Second, the demand structure for agricultural products is undergoing profound change. Third, agriculture is not the only economic activity in rural areas.

### 2.1 A typology of rural areas

Authors like Janvry and Sadoulet (2004, 4) have argued that in order to understand the dynamics of change in rural areas it is useful to distinguish between marginal rural areas and favourable rural areas. They define marginal rural areas as “areas with either poor agro-ecological endowments and/or isolated from access to markets and employment centers”. We suggest that it makes sense to unpack this definition and distinguish between endowments on the one hand and proximity to markets on the other hand. Combining the opposing expressions of each factor leads us to the following matrix.

**Figure 1: Four types of rural areas**



Constellation 1 refers to a location where one would expect dynamic agricultural development, even without a strong development effort. This is where markets and business acumen work well. Constellation 3 refers to the exact opposite, i.e. a type of location where even a strong and consistent development effort will only have a limited effect. Constellations 2 and 4 refer to locations where an economic development effort stands a good chance of making a huge difference.

It is important to note, though, that this is not a static constellation. The position of a given location in the matrix may change. In particular in high growth countries, both the distance to markets and the natural conditions can change in a short period of time. As urban centres grow, agricultural areas that recently served the townsfolk are converted into industrial estates, residential areas, and space for infrastructure. As infrastructure is upgraded, once distant locations move closer to markets. As industrialisation progresses and the lifestyle changes, the environmental impact grows, causing increasing levels of pollution, water

scarcity and other problems in areas that are close to urban and industrial centres, so that the quality of the location for agriculture deteriorates.

It is also important to note that the suggested typology is not meant to imply any suggestions regarding the incidence of poverty, and thus the significance of development interventions in terms of their pro-poor effects. In many countries, it is not the very poor regions (Constellation 3) where the majority of poor people live. Thus, concentrating development efforts on Constellation 3 territories runs the risk of wasting the potential of developmental interventions.

The different constellations and their overlaps highlight that AED and PSD are very much linked to each other, and that there is an opportunity to pursue intervention approaches that enrich each other.

### **2.2 Structural change on the demand side for agricultural products**

Agricultural markets are changing. Agricultural producers, and this explicitly includes producers in Africa, are facing fundamental change on the demand side. More specifically, there are three types of change:<sup>2</sup>

1. Rising incomes and changing lifestyles: In many developing countries (and not only in high growth countries like China), the income of a significant number of consumers is rising. Also, lifestyles are changing, for instance due to urbanisation and the demise of traditional family structures. As a result, in domestic markets the type of demand for agricultural products changes. The demand for high value food commodities, i.e. fresh vegetables, ready-to-cook vegetables and fresh fruit, is growing much faster than the demand for commodities. The demand for convenience food, e.g. processed fresh vegetables, is growing fast.
2. Supermarketisation: Linked to this is a fundamental change in the retail sector, moving from traditional shops and markets to supermarkets and hypermarkets. While supermarkets initially tend to focus at packaged products, they tend to expand into fresh products relatively quickly, and have indeed established themselves as the main retail channel for fresh vegetables and fruit in some developing countries. Note that this observation does indeed apply to many African countries (Weatherspoon and Reardon 2003).

Integrated supply chains: A corollary of supermarketisation is a fundamental restructuring of supply chains. Reardon (2005) highlights four changes in retail procurement systems:

- (1) an extension and integration of the procurement catchment area,

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<sup>2</sup> For a detailed account of these trends see, for instance, Reardon (2005) and Gulati et al (2005).



(2) a shift from exclusive reliance on the traditional wholesale sector to the use of non-traditional specialized or dedicated wholesalers and logistics firms,

(3) an incipient shift from spot markets to implicit contracts or preferred supplier lists,

(4) the rise of private standards and private enforcement of public standards.

Note that global value chains, which have recently received a lot of attention, are much less important for most developing countries than regional and national value chains; “overall, developing countries export less than ten percent of fruit and five percent of vegetables produced by them” (Shepherd 2007, viii).

For economic development activities in agriculture and agribusiness it is crucial to develop a clear understanding of markets and available demand structures. Development practitioners cannot assume that anonymous commodity markets are easily available, and that any production will find some market somewhere. Changes in demand create opportunities for agriculture and agribusiness, while supermarketisation and the changing structure of supply chains create both opportunities and necessities for action at the national and the local level.

### **2.3 Agriculture and other economic activities**

Agricultural production is obviously not the only source of income for rural producers. Dynamic rural economies also involve agroprocessing and a variety of services that are related to agricultural production and processing. In the case of successful agricultural clusters this can include a significant share of knowledge-intensive services.

Another important activity in some rural areas is tourism. It is not only by itself an economic activity that often has significant income generating effects at the local level (e.g. Ashley 2006). Moreover, there is the option to leverage the demand of tourism ventures to educate local producers about sophisticated demand, so that over time they may be able to connect with sophisticated buyers elsewhere. Apart from agriculture, tourism also creates a demand for locally manufactured craft products. Craft production in any case tends to be a relevant source of income for rural households.

There is a connection between export-oriented agricultural development and international tourism regarding the type of transport used for the export of fresh fruit and vegetables that has recently surfaced. Fresh fruit and vegetables are a highly relevant export item for some African countries, and in all likelihood its importance will grow in the future. Two thirds of fresh vegetable exports are transported in the bellyload of passenger airplanes.<sup>3</sup> In other words, the attractiveness of African countries as tourism destinations is directly related to

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<sup>3</sup> Airfreight of fresh horticultural produce from least developed countries. A round-table seminar, 20 November 2006 held at Friends Meeting House, London. Paper available on 26 June 2007 at <http://www.agrifoodstandards.net/en/filemanager/active?fid=45>.

their ability to respond flexibly to the demand of foreigners. Moreover, in the light of the current discussion on climate change it is important to note that exports to the UK market alone directly and indirectly have a positive impact on the livelihoods of between one and 1.5 million Africans. Combining this with the pro-poor impact of tourism, a strong case can be made to counter the increasingly frequent criticism of overseas tourism and airfreighted imports of fresh fruits and vegetables. From a practical angle, the conclusion is that addressing both high value food commodities and tourism in rural areas offer a high potential for significant effects.

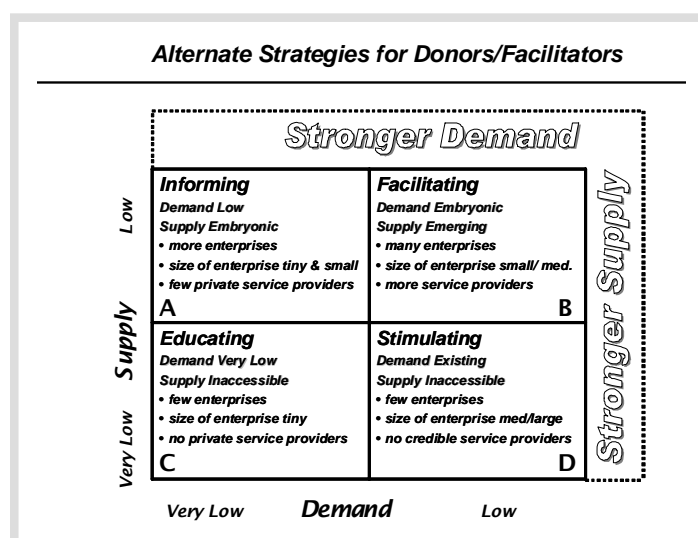
### 3. Introducing PSD instruments into AED

The convergence of AED and PSD has led to a high degree of overlap in approaches. In some areas, such as metrology and quality management, AED has in many countries even charged ahead of PSD since supermarketisation and/or integration into global agricultural value chains put a pressure on producers to set up effective certification and calibration systems. Nevertheless, there are still quite a few insights from PSD that are instructive for AED.

#### 3.1 BDS

The BDS approach emerged since the second half of the 1990s as a response to sobering findings on earlier PSD development activities, in particular SME promotion projects that helped to set up government-run SME promotion services that created only a limited positive impact on SMEs while distorting existing service markets and crowding out private service providers. In its first incarnation, the BDS approach suggested a somewhat rigid approach where comprehensive BDS market assessments were supposed to lead to targeted promotion measure on the supply side. The main objective was to create effective business service markets. When it became obvious that in many countries and locations commercial BDS markets were not viable, the approach was adjusted and applied in a more flexible way, responding to conditions in different types of locations with weaker markets, like in many African regions.

The donor community and also the GTZ have developed differentiated interventions forms to strengthen the service market according to the local circumstances. The figure below provides an overview of different market constellations and possible intervention formats.



**In rural locations with weak supply of services and weak demand** (constellation C in the figure above), awareness creation in the farmer and business sectors through, for instance, basic entrepreneurial skills development, the creation of focal groups to identify real demands and needs and through the promotion of embedded services is an option. Available tools are rapid appraisal methodologies, CEFE, assessment tools to identify embedded services, as well as the promotion of informal services or basic business angel systems.

**In a situation where demand is somewhat stronger but with only weak supply** (situation D), as was the case in Ethiopia and in Nigeria, GTZ promoted the training of private consultants through training and the creation of a network of facilitators, moderators, business planners and local economic appraisal analysts for business advice to link the latter with other service providers. Available instruments for the training of providers are GTZ manuals (e.g. from Ethiopia and Nigeria or the GTZ project *Promotion of Private Sector Development in Agriculture* in Kenya), training concept certification tools and information handbooks developed to support these efforts.

**Where there is some supply of services (either public or private) but demand is relatively weak** (situation A), emphasis should be given to information transparency and capacity building of the service providers as well as to awareness creation on the demand side. In the short term, the focus should be on public providers that have reasonably skilled and motivated management and that are open to a change process that is designed to increase demand orientation. A possible instrument to promote information transparency combined with awareness creation are radio shows (e.g. GTZ Nigeria). Voucher systems are another instrument which has been frequently used yet has shown to provide only limited success due to the weak awareness element involved and weak control of the quality of the respective services. The Nucleus approach (GTZ's Sri Lankan German *Economic Strategy Support Programme*, ESSP) has become one of the most successful instruments for strengthening the demand of small businesses for BDS through the creation of sectoral working groups in business associations and chambers.

**In situations with a relatively good supply of services and demand** (situation B), i.e. a relatively well-developed market, the intervention focus would be on cost-recovery and promotion of private sector services and a clearer differentiation between the roles of the actors (like local and regional government, associations, public and private services).

There are some more lessons that AED can learn from the experiences of PSD.

- It is essential to understand that many business services are commercially viable, and do actually exist, although they are not always easily visible. This does apply to many rural areas as well.
- Comprehensive BDS market assessments are often not necessary, since a rapid appraisal of a local BDS market renders perfectly sufficient information on market segments that work and other market segments that don't.

- Business services are often embedded in other transactions. Thus, a focus that narrowly searches for stand-alone services may miss important delivery mechanisms.
- In places where private businesses has for a long time enjoyed cost-free government-offered services, even if they were of inferior quality, it may take some time to educate businesses about the fact that commercially offered business services offer value for money.

**Knowledge repositories, networks and events:** GTZ has been involved in the BDS concept development and its application since the very beginning. Wältring (2005) gives an overview of the evolution of GTZ's learning around BDS and of the different "BDS-generations" that have shaped the international discussion in the last years. The GTZ Sector Research Project *Knowledge Systems in Rural Areas* has developed innovative elements of an approach that even goes beyond the BDS approach and that gives the delivery of public services in rural areas specific attention.<sup>4</sup>

The international network of BDS practitioners revolves around an annual event that is organised by the ILO's International Training Centre, see <http://www.itcilo.it/bds/>. Over the past three years, the discussions in the network have evolved from a narrow focus at BDS to a wider focus of value chain development and making markets work.

### 3.2 Territorial development

For AED practitioners, the suggestion that there might be important lessons to be learnt from local economic development (LED) activities in PSD might appear odd, yet still it is the case. One of the main lessons that LED interventions have learnt is that it is crucial to avoid scope creep and objective overload. LED interventions often had to address a broad set of objectives, from the promotion of viable businesses to direct poverty alleviation to gender empowerment to creation of employment opportunities for youth. It has been an important learning process that such a broad set objectives may in fact involve trade-offs, and that ignoring the trade-offs can compromise the outcome of LED interventions. Trying to address both economic policy and social policy objectives in one and the same LED initiative tends to compromise the impact. Experience has shown that it is more promising to run local-level economic development (LED) and social development (or community development) initiatives that inform each other yet have distinct objectives, delivery structures and approaches.

LED is moving towards an approach that is informed by Michael Porter's concept of "competitive advantage" (Porter 1990, 1998) and the concept of "systemic competitiveness" (Eßer et al 1995). The main message is that competitive advantage is created, not inherited. Natural endowments and similar "comparative advantages" are much less important than the

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<sup>4</sup> See [www.gtz.de/en/themen/laendliche-entwicklung/6688.htm](http://www.gtz.de/en/themen/laendliche-entwicklung/6688.htm)

dynamism of entrepreneurs and the intensity of local rivalry, but also the ability of local actors to engage in effective collective action.

LED addresses locational factors in a different way than agronomy traditionally did. From an agronomical perspective, locational quality is primarily defined by factors such as soil quality, climate, and rainfall and other water availability. With respect to post-harvest activities, issues such as transport, communication, electricity and water infrastructure would come into play.

LED takes a wider perspective. It emphasises the importance of both tangible and intangible factors. Regarding tangible factors, it would look at the factors mentioned before, though to some extent from a different angle. For instance, regarding the transport infrastructure the question is less whether there are roads and whether they are paved, since these are the bare minimum conditions to compete. Critical issues are rather the extent to which the transport and communication infrastructure supports efficient multimodal transport systems and other requirements of sophisticated supply chains. Furthermore, LED looks at other tangible factors such as the cost and availability of skilled labour at all levels (i.e. from unskilled yet reliable workers to higher education graduates for highly skilled jobs). In the terminology of Porter, a main focus of LED is to improve “factor conditions” and create production factors that are not easily available elsewhere. LED would also tend to look at the issue of taxes, subsidies and grants, which despite all the doubts regarding their effectiveness still play an important role in territorial development initiatives.

Let us look at a practical example to understand the different perspectives at territorial development. In the perspective of many AED practitioners, a geographical information system (GIS) is a strategic asset since it allows a detailed analysis of the endowments of a region and the opportunities they create. In the perspective of competitiveness-oriented LED practitioners, a GIS is one of many tools that dynamic entrepreneurs may decide to use to explore opportunities, but it is unlikely to be of strategic importance.

LED with a focus on competitiveness includes a variety of activities. Some activities have a clear focus and are selective, such as cluster promotion. Others should be selective, such as investment promotion. Other activities are generic in nature, such as efforts to create an enabling environment at the local level. Some LED activities are not exclusively conducted at the local level, such as investment promotion and the creation of an enabling environment. Often, LED activities need to be connected to initiatives at national level to have significant impact. A local red tape initiative can be useful in generating stories that convince national policy makers that certain regulations are inefficient or unnecessary; GTZ’s LED project in South Africa made this experience. Direct interaction between an LED initiative and a national-level value chain project can open new marketing channels to local producers; two GTZ projects in Sri Lanka complemented each other in this way. We will look at these activities in the following subsections.

Before we get there, it is important to highlight one more difference between PSD and AED at the local level. LED with a focus at competitiveness is about facilitation, while AED sometimes is about creation. LED as facilitation looks at existing structures, i.e. economic

sectors and support organisations, and tries to assist local stakeholders in finding ways of better using their potential. AED sometimes engages in efforts to turn barely visible potentials into competitive sectors. The latter approach comes close to “picking winners”, something that is usually frowned upon in PSD as it is perceived as an approach that is risky and that, even if it works out, distorts competition in markets.

Finally, it is important to highlight that LED projects, in particular in German technical assistance, rarely address urban growth centres and metropolitan areas. They are usually launched in less dynamic and prosperous regions, and they usually address secondary cities and rural towns and their environs. South Africa is not the only country where an LED project partnered with rural development projects. There is, in other words, already a significant amount of experience of shared approaches between PSD and AED around the topic of LED.

**Knowledge repositories, networks and events:** GTZ has been an early follower in the LED approach. In developing countries, it was pioneered by the ILO in the 1990s. GTZ’s experiences with LED were summarised by Becker (2005). There are several international communities of practice around LED which are not quite connected. The ILO alone is running two separate networks in Latin America (one around <http://www.redelaldia.org/> and <http://www.lednetupdate.org/>, the other around <http://www.itcilo.it/delnet/>). In Africa, a continent-wide network is about to emerge; the GTZ has established the Sector Network Rural Development Africa where GTZ practitioners from the projects of PSD and AED cooperate and exchange each other on concrete topics and contents (<http://www.gtz.de/de/weltweit/afrika/fachliche-netzwerke/9850.htm>). A good reference is the website of the South African LED Network at <http://www.led.co.za>. Annual events are organised by ILO (for its introductory course on LED see <http://www.itcilo.it/led/>) and by mesopartner (which is an event that targets experienced practitioners, see <http://www.mesopartner.com/summer-academy/>).

### 3.3 Cluster promotion

The term “cluster” in PSD is not clearly defined. Project proposals of the GTZ often refer to clusters in the context of SME promotion, especially in regard to the agglomeration of similar and related businesses, sometimes without referring to their linkages with the local or regional institutional environment. In other cases clusters are used as a synonym of value chains. The following closer explanation of the term and its meaning tries to point out specific elements of interventions that might be able to support the development of a cluster.

Clusters emerge, with very rare exceptions, as a result of market processes. Somebody starts a business somewhere, and as it thrives other entrepreneurs copy it. Employees leave the firm and start their own business in the same subsector, either doing the same thing or running supporting activities (such as manufacturing inputs or providing specialised services). Heirs fight, and an established business is split into two, three or four. Entrepreneur from elsewhere spot the business dynamism in this location and move their business there. At some stage, when a given local cluster becomes highly competitive, even

major corporations will consider to put a business unit into the cluster in order to benefit from its innovative dynamism.

Some clusters emerge randomly, purely based on the entrepreneurial drive of one or a few individuals. Other clusters emerge close to specific natural resources. Many clusters are located close to perennial fast running streams, because companies need a lot of water for their production process and perhaps also used water power before other forms of energy became cheaply available. Other clusters are located close to a key input; for instance, the famous ceramic tile clusters of Sassuolo in Italy and Castellón in Spain started in those locations because clay was locally available (however, their ascendance to a globally dominating position had nothing to do with the availability of clay and everything with strong local innovation-based rivalry plus collective action to create a locational competitive advantage). Another example are wine clusters in locations such as the Napa Valley in California, Central Chile, the Mendoza region in Argentina, the Cape region in South Africa or Southwestern Australia, which owe their existence to a certain extent to climatic factors and soil conditions, while their dynamism is the result of entrepreneurship, collective action and government support.

The GTZ and other donors have often defined the promotion of industrial parks as a tool to promote clusters. However, a cluster is profoundly different from other types of agglomerations, such as industrial parks. This distinction is directly related to business promotion efforts. There have been efforts to create clusters from scratch on the basis of an industrial park, and such efforts have tended to address peripheral and rural regions. Among researchers, there is agreement that this approach is doomed. It is not necessarily a bad idea to set up an industrial park in a rural area. But it is unlikely that this will turn into a cluster, and if it still does, it will do so by coincidence, not by design.

Also, a cluster is different from a mere network of companies in a given location. Clusters are based on endogenous entrepreneurship and a local bottom-up process. Initially, and perhaps for decades, they are driven by market forces. Local companies compete fiercely, but because there are so many of them, suppliers of key inputs co-locate with them. Thanks to the proximity, an ongoing communication process between suppliers and customers evolves. If rivalry is strong not only between producers but also between suppliers, that is even better, since then the incentive for suppliers to distinguish themselves by offering innovative products and services is even stronger. Thus, there will be a strong innovation drive, and an innovative milieu will emerge without anybody having taken a conscious decision to create it. Industrial parks lack this element. One type of industrial park is simply real estate operation that offers stands and reliable infrastructure and attracts companies from a variety of sectors who do not compete against each other. Another type of industrial park is full of factories from the same sector, such as garments or footwear. This type is frequent in developing countries, in particular in export processing zones. The companies located there may even be direct competitors. However, their upgrading process is not driven locally. Decisions on how to improve competitiveness and how to innovate are taken at headquarters, typically thousands of miles away. In a cluster, the owner of a company looks out of her window across the road, where a main competitor is located, and she starts contemplating what she can do today to beat her competitor. In an industrial park, the director of a plant looks out of



his window across the road, where the factory of a competitor is located, and he starts wondering whether his colleague there is also receiving almost unbearable pressure from headquarters to further reduce lead times.

It is important to note that clusters are not necessarily defined by the fact that they involve a whole sequence of transformation activities. The wine clusters mentioned above certainly do, since they locally produce the grapes, process them, and a significant share of the final product is sold as a bottled product, ready to be put onto a supermarket shelf. Other agricultural clusters, for instance the melon cluster around Mossoró or the mango cluster around Petrolina, both in Northeastern Brazil, do not really do any processing except for packaging the fruit in such a way that they can be shipped to supermarkets without need for repackaging. What, then, turns these places into clusters, rather than simply agricultural production regions? The main reason is they are marked by a high level of specialisation and the availability of a variety of inputs and sophisticated services. Local rivalry is strong, and it drives productivity and thus competitiveness. But the availability of sophisticated inputs, supporting services and good factor conditions makes it also easier for local producers to compete with producers elsewhere.

To what extent can then cluster promotion be an element of agricultural development policy? In a couple of locations, development practitioners may already be pursuing an approach that comes very close to cluster promotion, except that they do not call it that. This would be locations

- that have a clear specialisation profile, typically in some high value food commodity (e.g. one or few varieties of fresh vegetables or fresh fruit); for instance, the Kenyan export-oriented fresh vegetable sector has many features of a cluster,
- where production and processing is not run by one or few big corporations but rather a mix of numerous small and medium producers, and perhaps also a few big ones. Many PPP projects of the GTZ are promoting cooperation between smaller and larger innovative companies and less so only between big and small buyers and producers.
- where a support structure of suppliers (who are competing with each other, for instance by offering a variety of embedded services), specialised consultants and skills providers, testing and certification providers etc. exists.

This is a kind of location where a cluster initiative would primarily aim at strengthening collective action, targeting issues like testing and certification, lobbying for improved physical infrastructure, expanding and deepening the skills development sector, joint efforts to upgrade technology and possibly joint marketing (which requires a high degree of trust among the involved players, though).

Locations that fulfil some of these criteria but where the support structure has only just started to evolve would be ideal candidates for LED activities that aim at targeted activities to accelerate the creation of a support structure. Typical mechanisms for this would be

- unilateral action by local government which works on infrastructure and lobbies with higher levels of government to get local branches of provincial or national services,
- collective action in the private sector to address issues such as skills bottlenecks,
- joint action between public and private sector, for instance to attract specialised suppliers and service providers to the location.

It is important to understand that it is extremely difficult to create clusters from scratch. Their evolution is for a long time an organic, market driven process. Only after some time does collective action emerge or local government begin to understand the potentials that a cluster offers.

At the current stage, there is little evidence that Africa has more than a few rural clusters with an obvious potential to become internationally competitive. What about the chances of development interventions that try to upgrade “potential clusters”, i.e. groups of producers in a given location? Altenburg and Meyer-Stamer (1999) have argued that there is little chance of upgrading “survival clusters” which are characterized by low skills, little specialisation and price- rather than innovation-based competition among local producers. This argument was primarily directed at manufacturing clusters, yet it probably also applies to agricultural “potential clusters”. In such a kind of setting, the introduction of outgrower schemes appears as a more promising approach. Over time, an outgrower scheme may evolve into a genuine cluster, where the lead company concentrates on core activities and increasingly starts to outsource specialised services.

**Knowledge repositories, networks and events:** GTZ has collected experience with cluster promotion in, among other places, Indonesia, Brazil and various countries in South Eastern Europe. An overview of some experiences in South Eastern Europe is given by Schwanitz, Müller and Will (2002). Internationally, the most relevant network is the Cluster Practitioners Network (<http://www.competitiveness.org/>) in which a regional cluster group of East African countries are promoting several cluster initiatives in partnership with EU promotion agencies and consultants. The Network has also published a number of manuals on cluster development. Additional information on cluster development is available at the OECD’s website (<http://www.oecd.org>).

#### 3.4 Investment promotion

Investment promotion is one of the activities that are conducted both at national and local levels.

In **local economic development**, the effort to attract external investors is one of the traditional approaches, in particular in peripheral regions. Ironically, in such regions it is also one of the less promising approaches, in particular when it is done in the traditional way.

Traditional investment promotion was based on grants and fiscal incentives. Often based on national government’s regional policy to support poor regions, it tried to compensate for the

locational disadvantages of marginal and peripheral regions by offering money to companies. This has often stimulated free riding, where investors took the grant and temporarily set up “screwdriver plants”, i.e. simple assembly factories. Yet it has hardly ever generated sustained growth processes in such regions.

Contemporary investment promotion thus comes from a different angle. As local and regional economic development efforts are increasingly driven in a bottom-up way, based on the endogenous potential, investment promotion is becoming much more focused. The question is no longer “Can’t we just attract some investor, never mind the sector, as long he creates jobs?” The question is rather “What kind of investor can we attract to strengthen the profile of our local economy and thus become more competitive?” In order to find an answer, local stakeholders need to analyse the local economy in order to locate inputs that are sorely missed by local producers and companies, and to identify potentials for further processing of locally available products. The next step is then to approach potential investors and to highlight the existing business opportunity. It is usually easier to attract an input or service provider rather than a processing operation. Investors tend to look for markets, and if local actors can plausibly demonstrate that a sufficiently large local market exists this may convince an investor. For precisely that reason, a downstream processor may decide to move close to the final market, rather than close to the source of a main input.

At the **national level**, efforts to encourage investors to set up factories in peripheral and rural areas by offering them grants and tax incentives still exist, even though their impact has always been limited. Investors seek resources or markets, and not rural areas that neither offer nor attract. National level approaches to target rural areas for investment promotion are promising in two kinds of settings. First, there are rural areas that neither offer good potential for the production of high value food commodities. Large food processing corporations increasingly run fully owned operations or contract farming schemes, and lead firms in value chains tend to interact with specialised providers that organise contract farming (Reardon 2005). Food processing operations and specialised providers will tend to go to places that offer competitive locational conditions, both in terms of endowments and in terms of locally created factor conditions and enabling environment. National government can expand the range of locations that are attractive by targeted efforts to improve factor conditions and locational quality.

Mainstream investment promotion techniques, such as location advertisement, stands at investment fairs and promotional road shows in major countries of origin of foreign investment, make sense to the extent that local and national actors can convincingly demonstrate the outcome of efforts to improve locational quality and to create an enabling environment.

Large corporations in agriculture-based sectors (e.g. Nestlé, Unilever) already tend to have a presence in the majority of developing countries and a robust understanding of opportunities that exist there. If they decide that certain rural areas have some potential yet do not merit investment, this will often indicate that a developmental effort is needed to raise the locational quality of those areas. This is where government and donors can come in with targeted interventions. Moreover, there is potential for public-private partnerships where the

public side assumes responsibility for addressing those issues that cannot be fixed in the time period deemed acceptable by a corporation. There are successful experiences of GTZ PPP projects from Africa as well as other developing regions that are especially trying to overcome such problems.

It is important, though, to focus investment promotion for rural areas not only on large corporations such as the Nestles of this world. There are also smaller yet still knowledge-intensive national companies that can be attracted to rural areas. Other investment opportunities can be lifestyle investors, i.e. individuals who are looking for a location with specific features due to their personal lifestyle preferences and who intend to start a business in such a location. While they will not create hundreds of jobs, at least not in the short or medium-term, they can still make an importance difference to the local economy, not the least because they bring an understanding of global economic matters and international business principles. For instance, GTZ's ESSP project in Sri Lanka's Central Province found that while the region was only of limited attractiveness to major corporations, some life style investors appreciated the local culture, climate and environment. Such investors played a role in connecting local producers to global markets.

**Knowledge repositories, networks and events:** Though GTZ projects in various countries have been involved in investment promotion, there appear to be no manuals or other assessments of experiences. The leading website on the subject is probably the one run by the World Bank's Multilateral Investment Guarantee Agency, <http://www.fdipromotion.com/>.

### 3.5 Entrepreneurship and start-up promotion

For agroprocessing operations, in particular small-scale operations, but also for farmers, it is important that the owners define themselves as entrepreneurs and their operation as a business. The CEFE method, an approach that addresses both the mindset and the entrepreneurial skills of potential business people, is one of GTZ's most robust products, and one that is supported by a huge community of practice. CEFE has a lot of potential for wider application in rural areas.

For small agroprocessing operations in rural areas, access to basic production factors, such as clean water and reliable electricity, is often an issue. The creation of business incubators and small business parks that guarantee availability of basic production factors is one way of addressing this. They are also easier to guard, which in some countries with a high incidence of crime and violence is a distinct advantage. Moreover, they raise the visibility of businesses, thus making it easier to establish business contacts at the supply and output side. They also create opportunities for sharing equipment, informal information exchange and joint learning among small business owners.

**Knowledge repositories, networks and events:** The CEFE website (<http://www.cefe.net>) and the CEFE community of practice continue to be the principal reference point on this subject.

### 3.6 Enabling environment

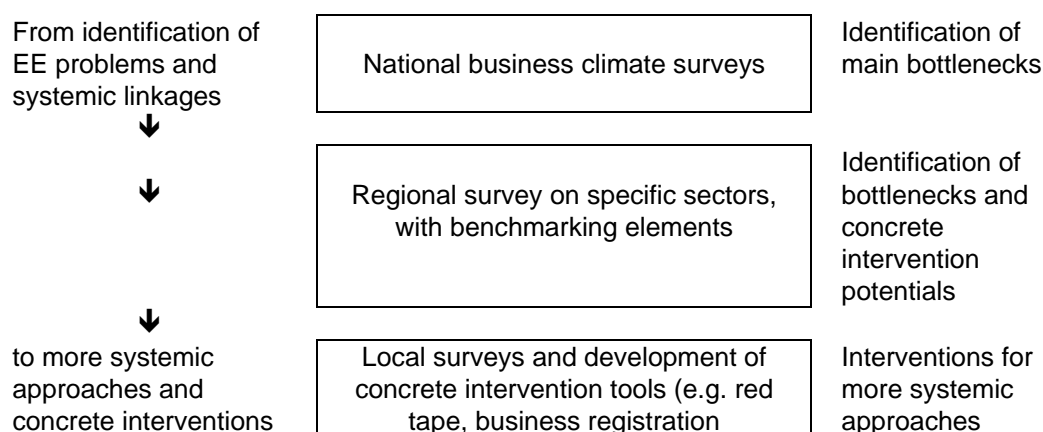
Another approach that is pursued at national, regional and local levels addresses the business environment, i.e. primarily the government-created obstacles and transaction costs (regulations and processes to obtain registration and permits), trying to create a more enabling environment (EE). In the field of PSD, EE has turned into a predominant approach in recent years. Similarly to the BDS approach, which was based on the discovery that often vibrant business service markets existed that were distorted or destroyed by government-run SME promotion activities, the EE approach starts with the observation that despite all developmental statements government is often a major obstacle to business growth.

GTZ has tested different private sector development interventions to improve the business environment especially for small-scale entrepreneurs in rural as well as in more vibrant economies. Several survey formats have been developed in recent years which have increasingly moved from national to subnational levels (see figure below).<sup>5</sup> Small and medium-sized enterprise projects (e.g. in Vietnam and Philippines) started with the identification of national investment climate constraints before moving into regional and local approaches. Among the available tools are city-competitiveness indexes to benchmark different cities and analytical tools to identify bottlenecks for business registration. Interventions focused on strengthening the public-private dialogue, building demand for reform, and tools to simplify business registration (service centre, development of data base for local government units and increasing awareness and capabilities through training of local personnel). Regional business climate surveys with sector-based and benchmarking approaches are another survey format (e.g. in GTZ's regional economic development (RED) project in Indonesia), providing a picture of local/regional as well as sector-specific competitiveness and facilitating benchmarking efforts between districts. GTZ's rural trade and industry promotion (RUTIPP) project in Ghana conducted a local-regional business climate survey to encourage local and regional strategy planning and to promote public-private forums at district level.

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<sup>5</sup> Presentations on the following experiences can be found on the ILO website rather than on the GTZ website: see [www.businessenvironment.org](http://www.businessenvironment.org).

**Figure 2: Evolution of EE approaches**



In many African rural areas reducing bureaucratic obstacles at the local and regional levels is an important aspect of “enabling environment”. It requires a systemic approach to reduce red tape and business obstacles from the local macro level upwards. GTZ’s LED project in South Africa has developed several tools, training concepts and process designs to promote the reduction of red tape at local and regional levels. Its systemic element is the facilitation of coordination efforts between the national, regional and local levels and the promotion of practical activities to reduce red tape. The project currently supports the training of facilitators of the process and training of the government entities. GTZ’s SMEDSEP project has developed tools to identify and to improve business registration procedures.<sup>6</sup> Further GTZ approaches and instruments designed to tackle bureaucratic obstacles in rural areas include, for example, one-stop-offices (e.g. in the GTZ private sector development programme in Ghana and many other projects), often with varying degrees of success due to the resistance of many agencies and departments formally involved in the process.

**Knowledge repositories, networks and events:** GTZ has been one of the pioneers of the EE approach, both at national and local levels. Various documents are available that document experiences for instance in the Philippines and in South Africa. The main reference on the topic is a website that is run by the Donor Committee on Business Development (<http://www.businessenvironment.org>), which also has since 2005 started to organise an annual conference on the topic.

### 3.7 Clean production

Another robust GTZ product that has been widely applied in SMEs is the “Profitable Environmental Management” (PREMA) method (cf [www.premanet.net](http://www.premanet.net)). PREMA is based on the observation that a negative environmental impact of SMEs in developing countries if

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<sup>6</sup> Several workshop tools as well as process tools have been developed in the GTZ project in South Africa and can be downloaded under [www.led.co.za](http://www.led.co.za). Further tools can be found in the private sector development toolbox.

often the result of inefficient use of materials and inefficient internal organisation in general. Win-win options exist where an SME reorganises its production process, uses less inputs, reduces cost and minimises its environmental impact. The method has been successfully applied in agroprocessing companies.

The principle of using material inputs in a more efficient way is universally applicable and has significant potential in rural areas where biomass is often wasted. Tracking materials flows and looking for business opportunities based on the profitable use of “waste” is a practical approach for economic development in rural areas. At this stage, methodologies to do this exist that have been developed in industrialised countries and that are rather complex. There is a need to develop rapid appraisal tools that detect the – often obvious – potentials for improved use of materials in a quicker and more efficient way, including a strong reliance on local participation and much less reliance on external experts.

**Knowledge repositories, networks and events:** GTZ has been addressing the subject from several angles, for instance through the development of the PRUMA method and in the ETC project. A leading German competence centre in this field is the Institute for Materials Flows at the University of Applied Science Trier’s Birkenfeld campus which champions initiatives such as the “zero emission village” (see <http://www.materialflows.net/>).

### **3.8 Technology and innovation**

The focus of innovation promotion in PSD is shifting from creating technology- and innovation-related organisations (technology transfer organisations, contract research institutes, technology incubators etc.) to building and strengthening innovation systems, often at a territorial level. Current practice operates with communication and facilitation tools to stimulate and intensify interaction between higher education institutions, technology organisations, and companies.

In many developing countries, agricultural research and extension services were weakened or have effectively collapsed in the course of structural adjustment. To some extent, they have been substituted by embedded services that are offered by providers of inputs and by core companies in outgrower schemes, and to a limited extent by buyers. There is still a need, though, to strengthen innovation systems in agricultural production and processing. There are some experiences from PSD can be useful in this regard, for instance the Technikon project in South Africa (where some of the Technology Stations at Technikons actually specialise in agroprocessing technologies) or the Tecnotrans project in Northeastern Brazil. Other projects demonstrate different approaches at the macro-, meso- and micro level in the cooperation with Technology Transfer Centres and Institutes at the policy-, research- or personnel level. They include e.g. study tours, development of bilateral networks between research institutes, the promotion of institutions like incubators, telecommunication and information centres for businesses, E-learning-facilities and other support mechanisms.

**Knowledge repositories, networks and events:** GTZ has a long experience in the field. A recent overview is provided by Janischewski (2005). There are also numerous networks in

the field, particularly of policy-oriented academics. One of them, with strong participation from developing countries, is Globalics (<http://www.globalics.org>).

### 3.9 Innovative financial instruments

The excitement about microfinance has distracted attention from other innovative financial services that have emerged in the recent past. For instance, in some countries factoring is now one of the most important financial services used by SMEs. There is also evidence that leasing is becoming more important. Moreover, innovative approaches to insurance are gaining importance.

The lack of financial services is one of the main bottlenecks in agricultural development in developing countries. Microfinance can at best be a partial response, as credit periods in agriculture tend to be longer than those usually accepted by microfinance operators. Thus, there is a potential for rural development to be informed by innovative financial instruments that emerge in PSD. Conventional financial services for rural areas are often risky and associated with higher brokerage costs. Vital components of an efficient rural finance system – and thus important factors for rural development – include sensible interest-rate setting and risk assessment for loans, long-term refinancing facilities, fixed-term deposits and sufficient equity capitalisation. In rural areas, it is important to offer credit for agricultural activities but also to non-farm businesses. The GTZ has developed the product rural finance providing specific emphasis on developing loan durations and volumes, developing a credit ‘culture’ by educating borrowers, building links with non-financial services, e.g. provision of agricultural inputs or support for product marketing. In the last years the GTZ has encouraged a new approach that is very much based on adjusted product development and the support of financial institutions in rural areas. This includes the strengthening of cooperative savings and credit associations, the development of municipal financial institutions and making them more efficient, developing sustainable agricultural credit and insurance products, equipping small financial institutions in rural areas, and last but not least financial support for specific interventions like specific (agricultural) value chains.

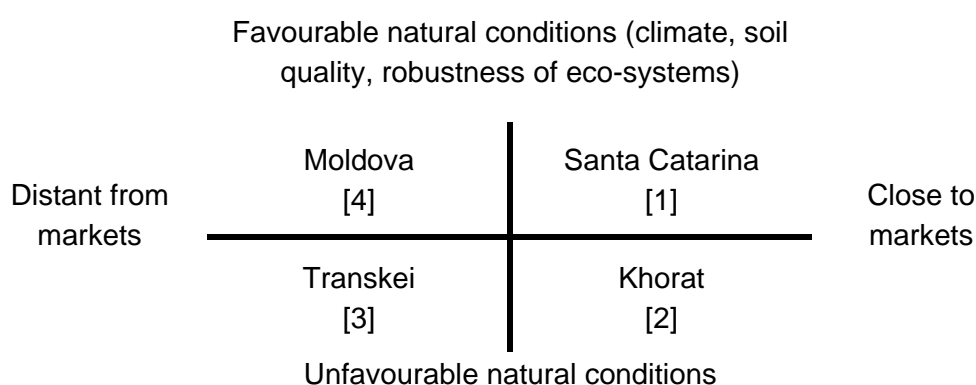
**Knowledge repositories, networks and events:** The dominant, agenda-setting organisation in this field is the World Bank. Nonetheless the GTZ has developed their product in this regard providing information of how to engage in the promotion of more sustainable financial systems. First tools are on the way of being implemented. Further information can be found on <http://www.gtz.de/en/themen/laendliche-entwicklung/14872.htm>



## 4. Promising development approaches for two types of regions

We have argued above that it makes sense to distinguish four different types of rural areas. This typology is particularly relevant in countries that are subject to supermarketisation or have a potential to be integrated into global value chains. In order to facilitate an intuitive understanding of each type, we have added an example for each type.

**Figure 3: Four types of rural areas**



Let us briefly have a look at the four types of regions:

- The “Santa Catarina” type, named after a southern Brazilian state, is a kind of region where thanks to a combination of favourable endowment, location and entrepreneurship agriculture and agroprocessing is thriving. This kind of region will rarely be the object of international development interventions, which due to the focus at poverty alleviation concentrates at less fortunate regions.
- The “Khorat” type, named after a region in northeastern Thailand, is a region that thanks to its location may offer significant potential for rural development, and which due its unfavourable endowments will display a relatively high proportion of poor and thus qualify for donor support.
- The “Transkei” type, named after a region in South Africa, has only a very limited potential. It will tend to be a focal area of donor interventions, which, however, tend to be informed primarily by the sustainable livelihoods approach.
- The “Moldova” type, named after the former Soviet Republic of Bessarabia which is now an independent state, is a type that in principle offers huge potential for agriculture yet suffers from its distance to markets. It has a high share of poor and is thus another focal area for donor support.

Below, we will have a closer look at the “Khorat” and “Moldova” types of regions since they display both a strong problem pressure and a potential for competitiveness-oriented rural

development activities. These two regions offer potentials to introduce PSD experiences into AED interventions. The “Santa Catarina” type is not the preferred intervention area of German technical assistance. The “Transkei” type is a kind of region where other approaches, in particular sustainable livelihoods, are more promising.

#### **4.1 Regions with unfavourable endowments that are close to markets – the “Khorat” type**

With the surging demand for fresh fruits and vegetables and the availability of robust production technologies (e.g. hydroponics) that do not depend on what was traditionally understood as favourable locational conditions, the potential for agricultural development in “Khorat” type regions is significant. What is needed is thus an enlightened agronomics approach that is informed by past experiences with cooperatives or training & visit extension. Both collective action and training are needed to make innovative types of agriculture work, and it is crucial to avoid the mistakes of the past. First and foremost local actors must understand that it is crucial to pursue an agrobusiness approach, i.e. apply business principles and educate producers and processors, including small farmers and small scale processors, accordingly.

Apart from direct work with producers, it is essential to upgrade locational quality, in particular in terms of “supporting industries” and “factor conditions”, following the terminology of Michael Porter.

- Supporting industries here refers to the availability of quality inputs, from seeds and fertiliser to robust tunnels and other equipment.
- In terms of factor conditions, one of the most important elements is availability of affordable credit, since this type of production is more capital intensive than traditional production methods. Another important factor is skills. Also, issues like water management need to be addressed effectively.

Innovative production methods to produce high value food commodities are feasible to the extent that producers can be linked up with national or global value chains. Integration into such chains requires producers that are embedded into a local production system where a variety of services are easily available. In many regions, such services will only be available to some extent. An effort of developing services around agriculture needs to be informed by the principles for and lessons learnt in the promotion of BDS.

Promoting development in a “Khorat” type region requires strong agronomics competencies which need to be complemented with efforts to create an enabling environment and improve locational quality. This is the kind of region where one would expect markets to work relatively well, so that interventions would have to be designed in a way that does not inhibit the emergence of businesses and markets. The lessons learnt from the BDS approach can be an important guidance in this regard.

## 4.2 Peripheral regions with favourable endowments – the “Moldova” type

In “Moldova” type regions, the potential to stimulate agricultural economic development through bottom-up initiatives exists, but it is a limited potential. Most of all, it is an approach that takes a long period of time to bear fruit. Many local citizens tend to be less patient and prefer to migrate elsewhere to earn money now rather than leading a miserable life now and maybe become prosperous sometime in the distant future.

In “Moldova” type regions, the main challenge is not primarily related to hard core agronomics. The main task is not how to educate farmers to produce the kind of products markets want. The single most important challenge is the distance to markets, whereby distance is measured in time and transport cost, not in kilometers. As pointed out before, the business opportunities that exist around high value food commodities are enormous, yet they can only be realised if the food is still of high value after transport.

Moreover, “Moldova” type regions tend to suffer from a combination of market failure and government failure. Market failure is linked to the low level of income, which makes many business opportunities unfeasible. Government failure manifests itself in the absence of measures that provide public goods and address market failure.

Intervention approaches for “Moldova” type regions thus need to focus at two main areas: infrastructure and market failure. Lack of infrastructure is one result of government failure, persistent market failure another one. Promising development initiatives in “Moldova” type regions depend on a minimum capacity and willingness on the side of government to pay more attention to this type of region. If and when that is the case, intervention strategies would focus at

- expanding the infrastructure, both in terms of roads and air transport facilities,
- addressing market failure (e.g. underprovision of skills, inadequate provision of financial services, lack of investment in sorting and processing facilities, lack of testing and certification facilities),
- strengthening the enabling environment in order to be able to attract external investors, and promote the location to external investors.

Promoting development in a “Moldova” type region requires both top-down and bottom-up approaches, combining infrastructure development with business promotion and agricultural upgrading activities. It requires a combination of agricultural know-how with business principles and the creation of an enabling environment.



## 5. Conclusion

GTZ's recently published Value Links Manual highlights the opportunity to widen the scope of agricultural economic development. Hardly anybody these days would suggest that agricultural development is primarily about introducing high yield varieties and the package of inputs that comes with that, and about teaching farmers how to employ this efficiently. But it also becomes obvious that an effort to create sustainable livelihoods, rather than promoting small-scale agribusiness, is not the most adequate approach in many regions that actually have good development potential around agriculture, especially given the increasing global demand for fresh fruit and vegetables. Moreover, there is a potential for agroprocessing close to farms, in particular with respect to cleaning, cutting and packaging shelf-ready fresh vegetables. Agricultural economic development has a lot of potential if and when it is based on business principles and connected to growing domestic and international markets.

Informing AED with insights and methods that have been developed in PSD is to a large extent an issue of mindsets and comfort zones. Not all AED practitioners are comfortable with an approach that emphasises business principles and competitiveness. Those who find these principles plausible tend to seek for insights that have come out of PSD. With regard to them, the main issue is one of explaining PSD tools in an effective way.



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