# Goods, Services and Jobs for the Poor

**Ashish Karamchandani and Harvey Koh,** Monitor Deloitte

## EXECUTIVE SUMMARY

Market-based solutions have the potential to provide goods, services and jobs for the poor at scale. Success in microcredit and many exciting new ventures have led to an explosive growth in expectations, but the data on the ground are less rosy. Few models are reaching scale. The reason is that these solutions are tackling some of the world toughest problems in difficult environments, and hence they both require innovative solutions and must address ecosystem barriers. Addressing these twin challenges requires significant resources, time and persistence. There are also high chances of failure, and even with success, returns may be moderate. However, given the upside in terms of social impact at scale, it is important to support such solutions, and philanthropies and aid donors have a vital role to play.

## WHAT'S THE ISSUE?

Historically, efforts at development have focused on two relatively separate paths. The private sector focuses on economically attractive opportunities to provide products and services, and in the process grows the economy, generates tax revenues and creates jobs. The government focuses on providing an enabling environment for the private sector and, along with donors, philanthropies and nonprofits, addressing market failures and providing public goods, especially for the poor. Both paths have had limited success in effectively serving the poor. In the past 10 to 15 years, there has been an increasing recognition of, and interest in, a third path to development—leveraging the effectiveness of the private sector to benefit the poor—using market-based solutions to provide goods, services and jobs to the poor (or, as this segment is often called, the "bottom of the pyramid" (BoP)). Part of the attractiveness of these solutions is that they are commercially viable, and hence can be self-sustaining and scalable without requiring huge and ongoing subsidies.

Some exciting market-based solutions have demonstrated this potential. Microcredit has reached over 100 million low-income households. Mobile money has ten million active subscribers in East Africa. Solar lanterns are now serving 3 to 5 million households in India and Africa.

These successes have led to an explosive growth in expectations—from the investment community to governments. A recent J. P. Morgan report estimated the size of the impact investing market (i.e., investing in commercial ventures that create a social impact) as a "trillion dollar asset class."[1] Governments and philanthropic players have initiated Social Impact Funds to harness the private sector to address problems of poverty (e.g., the India Inclusive Innovation Fund and the Africa Enterprise Challenge Fund).

And while many of the solutions appear promising, few are reaching scale. A study by Monitor Inclusive Markets of the most promising market-based solutions in Africa identified 439 ventures, of which 130 were commercially viable and 59 were at scale or clearly on the path to scale.[2] A Monitor analysis of 50 inclusive businesses in Africa indicated that net operating margins were, at best, between 10 and 15 percent—a far cry from the "market returns" many investors are expecting.

Also, most of the solutions are being developed by social enterprises and not corporations. The hope that corporations would increasingly serve the BoP, including areas of social benefit, is not materializing at the rate required to produce scale impact. While corporations in some industries are extending their products and services to the BoP (e.g., companies that produce fast-moving consumer goods and pharmaceutical companies that use smaller pack sizes and telecommunications companies that use prepaid services), these are typically in situations where the business model for the higher end market can easily be extended to the BoP. Only a limited number of corporations have tried to develop new models that are required to engage this segment. And of those that have tried, relatively few have succeeded.[3]

## WHAT NEEDS TO HAPPEN, AND WHY?

This lack of scale from social enterprises and low interest from corporations is not difficult to understand. At the end of the day, these market-based solutions are tackling some of the toughest problems of society that the private sector, the government and the social sector have not been able to address. Tackling these problems requires *innovative business models* and *operating in difficult environments*.

Typically, an effective business model will require innovation in multiple areas. A good example is Husk Power Systems (HPS), which provides off-grid energy in Bihar, one of India's least developed states. Its core innovation is a pioneering technology that transforms rice husk into gas, which is used to generate electricity. In addition to this innovation, HPS had to create a distribution system (which it did using low-cost bamboo poles), develop a low-cost metering and theft protection system (the company says it has the world's lowest cost smart meters), and create a simple tariff structure and a corresponding billing and collection system (as its customers were not familiar with buying electricity). In addition, as it was difficult to source gas-powered generators, HPS developed the capability to convert diesel-powered generators. Finally, because it had difficulty sourcing skilled staff in rural Bihar, it started "Husk University" to train the workers they needed.

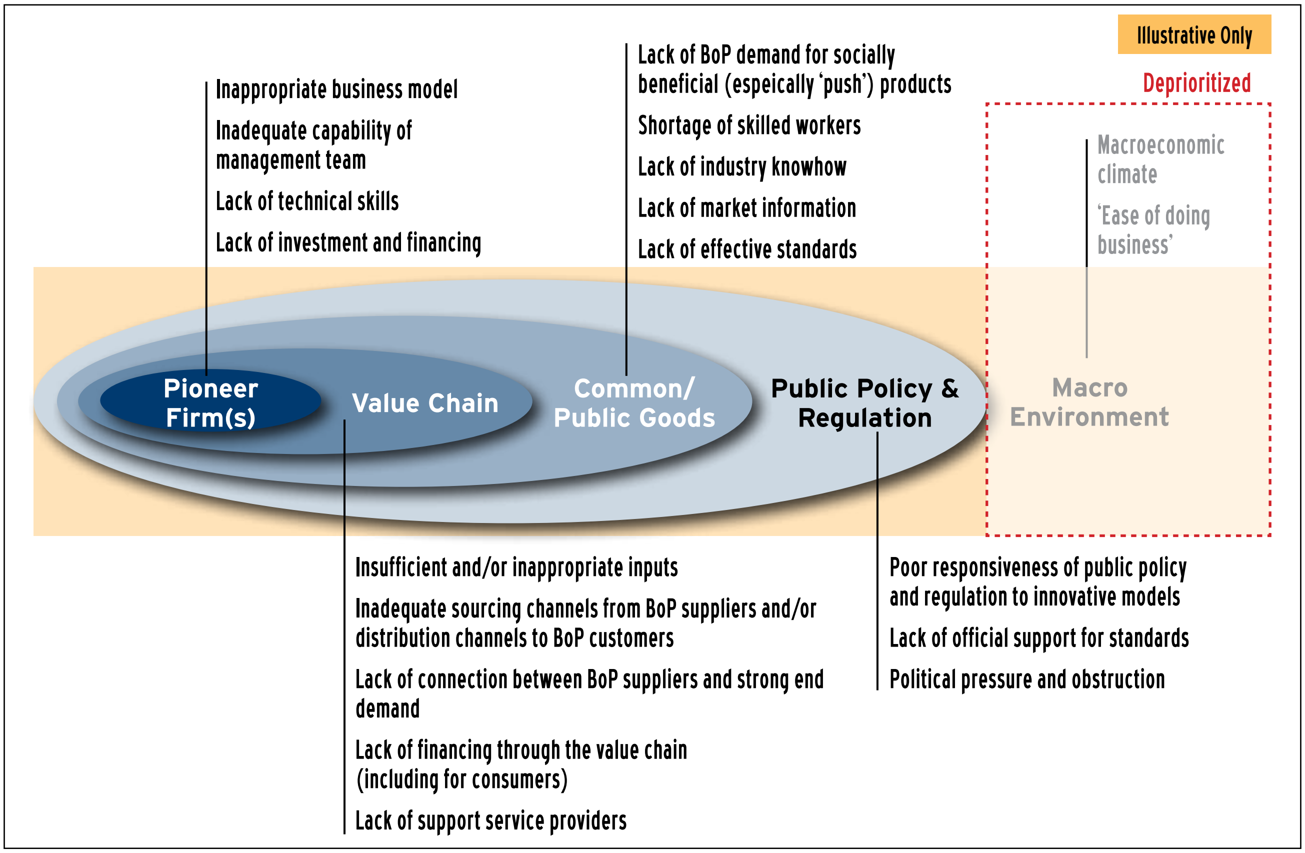
It is difficult to identify all the elements of the solution upfront. The core innovation may have been be created and tested, and a detailed business plan developed—what the customer will get, how it will be delivered and the economics of the venture—in other words a "blueprint" of the business. But the real work begins when one starts "validating" the business model on the ground. Issues one has not thought of crop up, plans must be modified, and new elements must be developed. Often, one must rework the entire business model.

The development and validation of the business model require creativity and business acumen, not to mention significant financial resources, time and persistence. And at the end of the day, the model may or may not work—and even if it works, financial returns may be limited, as margins tend to be low and, once a model is proven, copycats emerge.

Moreover, the challenge is not limited to the business model. As mentioned above, these market-based solutions need to work in difficult environments. Our experience with over a thousand ventures in this space has helped us understand the layers of challenges beyond the business model with which these ventures need to deal (see figure 1 below). In addition to the challenges for most new ventures (e.g., getting finance and building a team), these ventures also need to assemble the value chain to deliver their solutions (e.g., create a distribution mechanism and arrange for financing for the value chain, including for customers), work on what are typically considered public goods (e.g., educate the customer of the value of the product, especially for "push products" like insurance and clean drinking water) and also address regulatory issues and policy.

While these challenges are significant, the potential upside is huge, as can be seen from two models that have scaled, microcredit and contract farming. There are a number of stakeholders committed to seeing the field of market-based solutions succeed, and the key is to (1) have reasonable expectations and (2) provide the nurturing environment that will allow more market-based solutions to reach scale so they can be leveraged for developmental impact.[4]

Figure 1. Ecosystem Barriers to Bringing an Innovative Business Model to Scale




Source: Monitor Deloitte

## RECOMMENDATIONS AND NEXT STEPS

First, we need to have *realistic expectations* about both the applicability of these solutions and the effort it will take to get them to scale. Market-based solutions are not a panacea. While market-based solutions can be effective in many areas, in others commercially viable models do not exist, and services therefore need to be provided by government or by philanthropy. Even for market-based solutions that have the potential to create social impact at scale, getting these solutions to work and reach scale will take significant time, resources and effort—and many innovative efforts will fail. Also, financial returns are likely to be modest, especially for pioneer enterprises. These barriers need to be recognized by all stakeholders, including members of the impact investing community, among whom many feel they can get market returns from such ventures.

Second, *business models matter*, and we need to focus on getting them right. As mentioned above, these are tough problems where traditional solutions are not working and creative, new solutions are needed. These solutions usually involve multiple innovations and are not easy to develop. Even a great idea is unlikely to work at first. Instead, it requires significant on-the-ground validation and refinement, which in turn require resources, time and persistence.

Third, *we need to attract more of the right people and players into this space*. Our experience has been that the majority of the entrepreneurs in this field are people who have great ideas and passion but who lack experience in business or in scaling organizations. We believe that future success hinges on being able to attract more *business builders*—professionals who have experience in building scale businesses—into this field. It would also be good to attract more corporates into this space, as they already have many of the capabilities and resources required to develop and scale market-based solutions. It will be important, however, because financial returns may be modest or may take time, that corporates take a wider, longer-term perspective as they design, test and implement such initiatives.

Fourth, *we should build conducive ecosystems* to accelerate the scaling of effective business models. As mentioned above, even if one gets the business model right, because one is working in difficult environments, numerous *ecosystem* barriers must be addressed—from assembling value chains, to creating public goods, to addressing regulatory issues and policy. Many impact investors and companies are unwilling or unable to even think of addressing these barriers (particularly regulation and policy), yet, for the majority of market-based solutions, resolving these barriers is key to success. Policy and regulation are typically geared toward existing markets, models and players, and may unwittingly strangle new innovations before they have the opportunity to achieve impact at scale. Policymakers need to recognize this challenge and adapt policies to allow innovative market-based solutions to succeed and reach scale. Also, as new innovations come to market and scale, there is often a need to redefine or create standards and mechanisms for appropriate regulation.

Fifth, *"soft capital" from philanthropies, aid donors and governments is critical to the development of market-based solutions*, from nurturing pioneer enterprises to addressing ecosystem barriers. The development and validation of effective business models require significant financial resources, time and persistence. As our team highlighted in a recent report,[5] given the high level of risk and the modest rates of return even when pioneering ventures succeed, there is a need for funding and support that are interested in developmental impact, and are willing to accept low or even negative financial returns. Meanwhile, ecosystem building can create powerful externalities that can help many firms operate and successfully reach scale, but whose value is difficult for any one investor or firm to capture and monetize. We believe that philanthropies, donors and governments need to step into these gaps to provide much-needed support.

Sixth, last but not the least, we need *to become better at blending and coordinating a range of different types of capital and different interventions from players across the private and public sectors,* recognizing the complex, multifaceted nature of the challenge of scaling market-based solutions. The evidence suggests that market-based solutions can be helped in reaching sustainable scale by having dedicated *market facilitators* who can work with different actors to bring otherwise disparate elements together and help guide the development of new, inclusive markets over time. We are now conducting further research into this and hope to have findings to share in early 2014.

## ACKNOWLEDGMENTS

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## ENDNOTES

1. Nick O'Donohoe, Christina Leijonhufvud, Yasemin Saltuk, Anthony Bugg-Levine, and Margo Brandenburg, Impact Investments: An Emerging Asset Class (New York: J. P. Morgan Global Research, Rockefeller Foundation, and GIIN, 2010).
2. Mike Kubzansky, Ansulie Cooper, and Victoria Barbary, Promise and Progress: Market-Based Solutions to Poverty in Africa (Arlington, Va.: Monitor Group, 2011).
3. Ashish Karamchandani, Mike Kubzansky, and Nishant Lalwani, Is the Bottom of the Pyramid Really for You? (Boston: Harvard Business Review Press, 2011).
4. There is often an assumption that because such market-based solutions have the potential to create a social impact, they will create it. It would useful to monitor the impact and find ways to ensure that the impact is created.
5. Harvey Koh, Ashish Karamchandani, and Robert Katz, From Blueprint to Scale: The Case for Philanthropy and Impact Investing (Arlington, Va.: Monitor Group, 2012).