Goods, Services and Jobs for the Poor: Creating the Conditions for Private Investment

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The post-2015 Development Agenda that is envisaged to follow the United Nations' Millennium Development Goals will likely have a greater role for the private sector as a source of both development finance and development solutions that can improve the lives of the world's poorest people.

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The hope is that the application of private sector resources and skills to tackle global development challenges will spur innovative and affordable products and services, as well as the business models that enable these to reach poor communities everywhere.

How this vision can be realized is less clear. Commercial capital is likely to follow when business models are already proven and have been shown to generate sustained returns. But such models have proven hard to come by and are unlikely to emerge without more private sector talent—researchers, product designers and entrepreneurs—working on these issues.

Impact investing offers a possible answer to this conundrum. Many impact investors are willing to accept lower financial returns from their investments for the promise of social, environmental or development impact. Their investments can support nascent enterprises as they test and refine their business models until they demonstrate their profitability and are capable of attracting major investors. In this way, impact investments can play a catalytic role in precipitating and directing larger commercial finance flows.

However, this almost certainly places too great expectations on what impact investors can deliver on their own. For a start, some enterprises serving low-income communities may never be capable of achieving sufficient profitability to attract commercial interest, given the exacting demands of these markets. This is precisely what motivates some impact investors to support such enterprises in the first place. (Others, it should be noted, vociferously reject the assumption that it is not feasible to meet commercial standards of profitability when serving low-income customers.) Furthermore, the challenge of molding blueprints into a proven profitable business model is tremendous. Most impact investors opt to support enterprises that are already matured or maturing, in order to avoid the "valley of death" that pioneering enterprises encounter in their early stages.

A Monitor Inclusive Markets (now a unit of Deloitte) study from 2011 analyzed 439 organizations that claimed success in offering market-based solutions to the base of the pyramid in Africa.[1] On a closer look, only 130 were on their way to commercial viability; and of these, only 59 were operating at "scale"—defined here as reaching 100,000 customers per year or engaging 10,000 suppliers or producers. For those that were generating profits, margins ranged between a lowly 10 and 15 percent.

A hypothesis advanced at this year's roundtable is that investments in individual enterprises serving the base of the pyramid can be complemented by focused efforts to foster the industry "ecosystem" within which enterprises operate. A more supportive ecosystem has a direct impact on the viability and profitability of the businesses that operate within it, acting as a draw on private capital. Ultimately, this can increase the discovery of enterprise solutions and the speed with which they are brought to scale.

In their policy brief for the Brookings Blum Roundtable, Ashish Karamchandani and Harvey Koh of Monitor Inclusive Markets distinguish three components of an industry ecosystem: value chains, public goods, and policy and regulation.[2]

In industries serving the base of the pyramid, value chains often suffer from poor quality and reliability, pushing up costs for enterprises and prices for customers. Key challenges include strengthening the competitiveness of suppliers and distribution channels, and increasing the availability of financing through the value chain. Also relevant are the broader

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sets of ancillary services upon which enterprises may depend, such as lawyers and accountants.

Labor skills and consumer education are among those aspects of an industry that benefit all enterprises and are therefore designated public goods. These are often deficient in low-income markets, and their public good characteristics present obvious challenges for how their provision can be expanded and coordinated.

Unsupportive, ill-defined or absent policy and regulation are important constraints on many enterprises operating in the developing world. In extreme cases, enterprise activities can be explicitly forbidden; for instance, financial regulators in countries such as South Africa and India have prohibited mobile operators from offering mobile money services unless they partner with brick-and-mortar banks. More common is for consumer interests to be poorly served and for government policies and regulations to add to investor uncertainty.

Implicit in an ecosystem approach to enterprise development is the insight that a supportive industry environment cannot be assumed to emerge organically as enterprises grow. Market forces may be less responsive in low-income settings, and industry-enabling organizations such as industry associations and information exchanges do not arise out of nowhere but usually require cooperation between competing enterprises. Deliberate interventions to address ecosystem weaknesses are therefore justified to enable enterprise development and accelerate the propagation of market-based solutions.

A useful way to understand an ecosystem approach to enterprise development is in terms of an accounting standard. Just as impact investing distinguishes itself from commercial investing by its alternative, more expansive approach to accounting, so, in one sense, does a switch in emphasis from fostering individual enterprises to fostering entire industries. Impact investing places value on both the financial returns to investment that are private to the enterprise, and the social and environmental benefits that accrue externally, with the weightings attached to different benefits determined by the individual investor. Fostering an industry ecosystem implies consideration of the interests of all enterprises in an industry, including potential entrants. Whereas an investor in an individual enterprise may seek to minimize or internalize these industry benefits to avoid giving an advantage to competitors, an ecosystem approach, by contrast, demands that they be maximized.

An ecosystem approach also implies a different vision for how enterprise solutions might reach scale. Investors typically conceive of scale in terms of a winner-takes-all model, whereby a single enterprise comes to dominate a market through a superior busi-

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ness model, along the lines of Coca-Cola or Google. However, other routes to scale exist and may prove to be especially relevant for bringing solutions to the poor. For instance, microfinance has reached over 100 million people through a replication-and-adaptation model, in which many microfinance institutions coexist and tailor their products to different customer segments. Contract farming, which has incorporated hundreds of thousands of African farmers into formal value chains, has followed a similar model. Another model is exemplified by the social franchising of health care, whereby existing, often informal, health providers have been rolled up and trained to improve and expand the provision of care. In these models, the pursuit of scale hinges on the performance of the industry as a whole rather than any one of its members.[3]

Discussions at the roundtable illuminated how closely the prospects of individual enterprises reaching scale are tied to ecosystem conditions. This was especially evident in terms of the optimism expressed for seeing new infrastructure platforms, such as mobile payments and the Internet, as stand-alone ecosystems or at the very least as a means of by-passing critical weaknesses in many industry settings. These technology-driven platforms are capable of unleashing entire new sets of business models delivering goods, services and jobs to poor communities by driving down transaction costs and achieving the right price point. This suggests that the ability of technology to transform the lives of the poor may be greater in terms of its ecosystem effects than in conceiving innovative final products, as is commonly assumed.

Evidence suggests that businesses are quick to respond to the establishment of new infrastructure platforms. Much of the response triggered is local, with domestic businesses emerging to take up market opportunities; these are the types of businesses that generally know best what the poor need, and can adapt quickly to their demand. Examples cited at the roundtable discussion included the rise of digital entrepreneurship and mobile-first markets. In Kenya, the world leader in mobile money, increasing business usage now largely accounts for the growth of the industry. M-PESA, the leading mobile money service, has over 1,400 bill partners and 500 bulk payment disbursers and is connected to 140 financial institutions, facilitating a variety of transactions, both business-to-person and person-to-business.

Of course, new infrastructure platforms do not have to be technology-driven. The hard-won success and scaling of microfinance have created a network infrastructure that reaches into remote communities across large swaths of the developing world, and on which countless businesses are now trying to piggyback. This is testament both to the strength and credibility of the microfinance infrastructure but also to the lack of attractive alternatives for businesses serving the base of the pyramid that cannot afford to build distribution channels from scratch.

An ecosystem approach to business development implies a role for a broad array of actors beyond the investment community. Initiatives to improve ecosystem conditions may be led by NGOs, foundations and governments. The risks and opportunities of

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such efforts have parallels with an activist industrial policy, where success hinges in part on how accurately industry constraints can be identified and targeted.

On the supply side, one well-documented gap in the ecosystem for market-based solutions is the skills required to build and scale up businesses. Roundtable participants were encouraged by the growing interest in business schools for learning about and working with social enterprises, and the impressive cadre of organizations dedicated to supporting enterprise skills, such as TechnoServe, Endeavor and Bizcorps. However, it was also noted that some of the traditional approaches to supporting the emergence of market-based solutions, such as "grand challenges" and other competitive grants, may be fostering the wrong set of skills by rewarding passion, creativity and grant-writing, which do not necessarily coexist with the skills required to manage and grow a business. One roundtable participant reported that two-thirds of the winners of competitions to design mobile applications for development in Kenya were out of business within one year.

Female entrepreneurs and business leaders can often face deeper ecosystem constraints—namely, limited access to credit, training, networks and information, alongside legal and policy constraints. Finance is a particularly common barrier; female entrepreneurs have less capital to start with, and struggle to grow their businesses beyond the scope of microfinance loans, given their limited access to equity finance. According to a report commissioned by the Group of Twenty, women-owned businesses around the world face an annual financing gap of $290–360 billion. Evidence shows that productivity differentials among companies owned by men and by women are mainly the result of differences in access to productive inputs.[4] Addressing these gaps through targeted—and ideally multipronged—interventions can have a transformational impact on the estimated 224 million women around the world running their own businesses or leading established businesses. Roundtable participants discussed some such promising interventions, often led through partnerships between the public and private sectors, including Goldman Sachs's "10,000 Women Program" and the Coca-Cola Company's "5by20 initiative."

For more information on the ecosystem approach to enterprise development, see the Omidyar Network's report *Priming the Pump*, and the research study by Harvey Koh, Ashish Karamchandani and Nidhi Hegde of Monitor Inclusive Markets, *Beyond the Pioneer: Getting Inclusive Industries to Scale.*

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