



**Growing Inclusive Markets**

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# Creating Value for All

## Strategies for Doing Business with the Poor

### Overview

Report of the Growing Inclusive Markets Initiative

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# Overview

The extreme prevalence of poverty in the world today remains an urgent call to action. About 2.6 billion people earn less than \$2 a day.<sup>i</sup> More than a billion lack clean water, 1.6 billion lack electricity<sup>ii</sup> and 5.4 billion lack access to the Internet<sup>iii</sup>. Yet the poor, roughly half of humanity, constitute a potential for consumption, production, innovation and entrepreneurial activity that is largely untapped. This report shows how entrepreneurs can serve the poor as clients and customers and can also include the poor as producers, employees and business owners. It gives many examples of firms that—by doing business with the poor—are generating profits, creating new growth potential and improving poor people’s lives. The report’s main message: Business with the poor can create value for all.

The opportunities are vast, and so are the obstacles. Rural villages and urban slums are challenging environments for doing business. Systems rarely exist for collecting and delivering goods and providing services. Essential market infrastructure is limited or nonexistent. Without working financial systems, the poor inhabit a cash economy. Without reliable police and legal systems, all market actors can find it difficult or impossible to enforce contracts. For most firms, business with the poor will not be business as usual.

Perhaps the greatest obstacle is the lack of information about the poor. What goods and services do they need? How much can they pay? What goods could they produce and what services could they provide? The aim of this report is to help entrepreneurs and companies begin to answer such questions.

The report draws on 50 specially-commissioned case studies of businesses that have successfully included the poor, despite the constraints,—and created value for all. The cases afford a wealth of ideas for inclusive business models (box 1).

## **Box 1. What are inclusive business models?**

Inclusive business models include the poor on the demand side as clients and customers, and on the supply side as employees, producers and business owners at various stages in the value chain. They build bridges between business and the poor for mutual benefit.

The benefits from inclusive business models go beyond immediate profits and higher incomes. For business they include driving innovations, building markets and strengthening supply chains. And for the poor they include higher productivity, sustainable earnings and greater empowerment.



This report's conception of inclusive business models builds on and reinforces the work of the World Business Council for Sustainable Development and others with an interest in inclusive business.

### **1.1 Opportunities to create value for all**

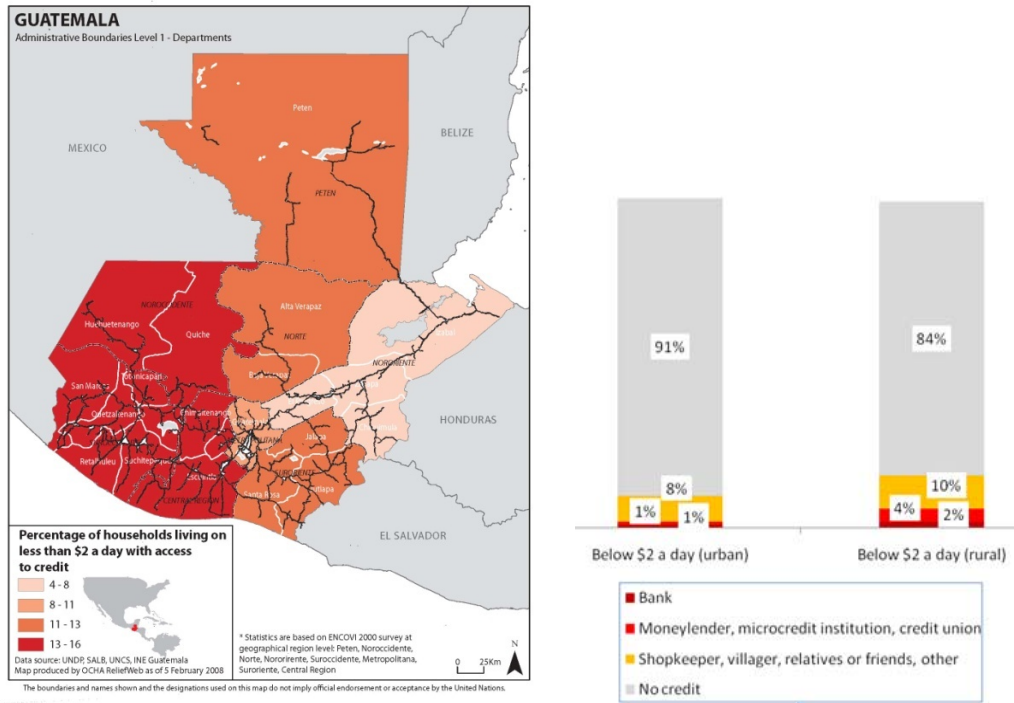
Doing business with poor people brings them into the marketplace—a critical step on the path out of poverty—and for entrepreneurs and firms it drives innovation, builds markets and creates new spaces for growth. Inclusive business models both produce and reap the benefits of human development.

The poor participate in the private sector. All are consumers. Most are employees or self-employed. Yet fragmented and informal markets prevent too many of them from obtaining the resources they need, and from using their resources productively. Among the poor, much business is informal. Friends and family provide credit. Small and unregulated businesses deliver bottled water in trucks. Such informality limits efficiency and hinders growth. Competition is stunted, goods and services are expensive and many people are deprived of access.

Market heat maps reveal the fragmentation of these markets, showing how access to goods, services or infrastructure varies widely in a country. For example, in Guatemala's western regions more than 13% of people living on less than \$2 a day have access to credit, in its eastern regions fewer than 8% have that access (figure 1).<sup>iv</sup> That contrast reflects other differences between market conditions in the two areas, such as differences in road access. (In poor markets the constraints often overlap, compounding the challenges for business.)

**Figure 1. Market heat map for access to credit in Guatemala**

**Share of households with access to credit, by department, 2000 (percent)**



Note: Black lines in the map represent asphalt roads (Henninger and Snel 2002, p. 20).

Source: Based on Instituto Nacional de Estadística de Guatemala.

## 1.2 Opportunities for business: profits and growth

Business with the poor can be profitable. It can also lay the foundations for long-term growth by developing new markets, driving innovation, expanding the labour pool and strengthening value chains.

*Generating profits.* Business with the poor can sometimes yield higher rates of return than ventures in developed markets. Some microcredit institutions have earned more than a 23% return on equity.<sup>v</sup> Smart Communications, a company providing prepaid phone services mainly to low-income consumers in the Philippines, became the most profitable of the country's 5,000 largest corporations. Sulabh, a low-cost sanitation facilities provider in India, had a \$5 million economic surplus in 2005.

*Developing new markets.* The 4 billion people at the bottom of the income pyramid have a combined income of about \$5 trillion, similar to the gross national income of Japan.<sup>vi</sup> They are willing and able to pay for goods and services, but too often they suffer from a "poverty penalty". Sometimes they pay more than rich consumers for essential products and services.



People in the slums of Jakarta, Manila and Nairobi pay 5–10 times more for water than people in high-income areas of those cities—and more than consumers in London or New York. The “poverty penalty” is similar in credit, electricity and health care.<sup>vii</sup> Business models that offer better value for money—or entirely new products and services to improve the lives of the poor—can reap pioneer profits in return.

*Driving innovation.* The challenge of developing inclusive business models can lead to innovations that contribute to a company’s competitiveness. For example, to meet the poor’s preferences and needs, firms must offer new combinations of price and performance. And the pervasive constraints that businesses encounter when doing business with the poor—from transportation difficulties to the inability to enforce contracts—require creative responses. These forces drive the development of new products, services and business models that can catch on in other markets, giving innovative companies a competitive advantage in poor markets.

*Expanding the labour pool.* The poor are a large source of labour. The advantages of hiring them as employees go beyond cost savings. With adequate training and well-targeted marketing, the poor can deliver high-quality products and services. Or their local knowledge and connections may place them well to serve other poor consumers in their communities.

*Strengthening value chains.* For firms that procure locally, incorporating the poor in business value chains—as producers, suppliers, distributors, retailers and franchisees—can expand supply and lower risk. That allows them to reduce costs and increase flexibility, especially as the local businesses move into more specialized or higher-skill activities such as component production and business services.

### **1.3 Opportunities for the poor: advancing human development**

Businesses can also improve the lives of poor people, contributing broadly to what the UN terms ‘human development’—expanding people’s opportunities to lead lives they value.

*Meeting basic needs.* Food, clean water, sanitation, electricity and health-related services all meet people’s basic needs. In the Philippines, RiteMed sells generic drugs to more than 20 million low-income clients at prices 20–75% less than leading brands. In South Africa Amanz’abantu provides clean water and sanitation to periurban and rural populations in the Eastern Cape, where a quarter of people lack potable water.

*Enabling the poor to become more productive.* Access to products and services—from electricity to mobile telephony, from agricultural equipment to credit and insurance—improves people’s productivity. In Mexico, Amanco provides small-scale lemon farmers with water-efficient drip irrigation systems that allow for continuous production 8 to 10 months a year. The systems are expected to increase the farmers’ annual yields from 9 to 25 tons a hectare. In Morocco, Lydec



provides water and electricity to Casablanca's shantytowns, increasing the share of people with electricity and water services by 20%.

*Increasing incomes.* Including poor people in value chains as customers, employees, producers and small-business owners can increase their incomes. In the Amanco case in Mexico, productivity increases are expected to nearly triple the farm incomes. In China, Huatai provides alternative income sources for local tree farmers and significantly adds to the incomes of about 6,000 rural households. In Tanzania, A to Z Textiles employs 3,200 people (90% of them women) producing insecticide-treated bednets and pays them 20–30% more than competitors.

*Empowering the poor.* All these contributions support the empowerment of poor people, individually and communally, to gain more control over their lives. By raising awareness, by providing information and training, by including marginalized groups, by offering new opportunities and by conferring hope and pride, inclusive business models can give people confidence and new sources of strength to escape poverty using their own means.

#### **1.4 Constraints standing in the way**

With the opportunities so great, why haven't more businesses taken advantage of them? Simply put, market conditions surrounding the poor can make doing business difficult, risky and expensive. Where poverty prevails, the foundations for functional markets are often lacking, excluding the poor from meaningful participation and deterring companies from doing business with them.

The case studies in this report identify five broad constraints:

*Limited market information.* Businesses know too little about the poor—what poor consumers prefer, what they can afford and what products and capabilities they have to offer as employees, producers and business owners. This was a significant constraint when Barclays Bank started to offer financial products to the poor in Ghana.

*Ineffective regulatory environments.* The markets of the poor lack regulatory frameworks that allow business to work. Rules and contracts are not enforced. People and enterprises lack access to the opportunities and protections afforded by a functioning legal system. For example, Sadia, a food processing company, faced undeveloped domestic carbon credit regulations when it began using improved environmental methods to dispose of pig waste.

*Inadequate physical infrastructure.* Transportation is constrained by the lack of roads and supporting infrastructure. Water, electricity, sanitation and telecommunications networks are lacking. For example, Tsinghua Tongfang, a computer manufacturer seeking to distribute its products in rural China, had to overcome the lack of telecommunications infrastructure and internet service providers in those areas.



*Missing knowledge and skills.* Poor consumers may not know the use and benefits of particular products, or may lack the skills to use them effectively. Poor suppliers, distributors and retailers may lack the knowledge and skills to deliver quality products and services consistently, on time and at a set cost. For example, because rural farmers in Brazil did not know how to grow priprioca—a plant used as perfume essence—Natura had to train them..

*Restricted access to financial products and services.* Lacking credit, poor producers and consumers cannot finance investments or large purchases. Lacking insurance, they cannot protect their meagre assets and income against illness, drought or theft. And in the absence of transactional banking services, their financing is insecure and expensive.

### **1.5 Five strategies that work**

Despite these challenges, a growing number of businesses are operating successfully in poor markets. The examples in this report span a wide range of countries and industries. Each featured business developed a specialized solution set, allowing it to succeed in its local context according to its unique objectives. Yet the case studies reveal common patterns. Entrepreneurs respond to constraints by working around them or by removing them. To do that, they use five core strategies: adapting products and processes, investing to remove market constraints, leveraging the strengths of the poor, combining resources and capabilities with other organizations and engaging in policy dialogue with government. These strategies are consistent with the local context and objectives of each business. The critical added ingredient: the entrepreneur’s ingenuity. The report presents tools and examples to stimulate and guide that ingenuity, highlighting constraints, strategies and specific solutions for developing inclusive business models.

The Growing Inclusive Markets strategy matrix relates the five broad constraints to the five core strategies (table 1), showing how these strategies are most often applied: strategies highlighted in dark blue are used most often, those in light blue only rarely.



**Table 1. The Growing Inclusive Markets Initiative strategy matrix**

		<b>STRATEGIES</b>				
		Adapt products and processes	Invest in removing constraints	Leverage the strengths of the poor	Combine resources and capabilities	Engage in policy dialogue w/ gov'ts
<b>CONSTRAINTS</b>	Market information	Dark Blue	Medium Blue	Dark Blue	Medium Blue	Light Blue
	Regulatory environment	Dark Blue	Light Blue	Light Blue	Medium Blue	Dark Blue
	Regulatory environment	Dark Blue	Medium Blue	Medium Blue	Dark Blue	Light Blue
	Knowledge and skills	Light Blue	Dark Blue	Medium Blue	Dark Blue	Light Blue
	Access to financial services	Medium Blue	Medium Blue	Medium Blue	Dark Blue	Light Blue

Source: Authors' analysis of data as described in text.

The strategy matrix can help entrepreneurs and analysts scan possible solutions to the constraints they face. It is crucial to note that successful inclusive business models typically combine several strategies to address several constraints. To get from broad strategies to focused solutions one must not only identify each local constraint, but also understand its dynamics in the market—information that allows a business model to build on a market's specific strengths. .

*Adapt products and processes.* Many entrepreneurs work around market constraints by adapting business products and processes. Information and communications technologies have created the possibility for many such adaptations, including mobile banking, smart cards (such as those used in Africa to buy water) and telemedicine, which brings quality health care to remote areas. M-banking, as Smart, a telecommunications company in the Philippines has done, has freed banking processes from relying on the brick-and-mortar branches and ATMs, infrastructure that rarely exists in the places where the poor live. Customers can now wire money, receive remittances, pay for purchases, and service their credit, all through their mobile phones. But businesses are also using other technologies to address constraints in industries that meet basic needs, such as water purifiers and off-grid electricity production. In addition, some innovative technological approaches are reducing the use of resources, tying the goal of human development to that of environmental sustainability.



Restructuring business processes can be as important as using new technologies. For example, the global spread of telephony is driven by wireless technology. But bringing mobile telephone service to poor people has depended partly on a change in the business process—the move to selling air time on prepaid cards. With ‘smart’ payment and pricing methods, an inclusive business model can accommodate the cash flow of its customers and suppliers, who are constrained by low and unreliable incomes and a lack of access to financial services. Similarly, providing infrastructure to a group saves individual household connection costs. And simplifying the requirements—by making products and services easier to use, or by asking for less documentation—responds to the lack of knowledge and skills among the poor and to their exclusion from formal registration.

*Invest to remove market constraints.* Although removing market constraints might ordinarily be thought the province of government, companies with inclusive business models often must take on this task themselves. Investing to remove constraints is cost-effective for business when it creates—or can be made to create—private value that is tangible and capturable, ensuring sufficient benefits to the company. Denmor produces textiles in Guyana, mainly for export to the US. Denmor’s key value proposition is flexibility: it can produce high-quality garments in small batches and deliver them fast. The company employs 1,000 people, virtually all of them women from poor rural communities. Many of the women cannot read or write when they start working with the company. Denmor teaches them the basics, so that they are at least able to write their names, count, and read labels and garment specifications. It also trains the women in health and hygiene, as well as personal empowerment. All employees are cross-trained so that everyone is able to perform each step in the production process. In this way, employees can respond better to rushed orders and tight deadlines. In addition to such tangible and immediate value, removing constraints (in knowledge, skills, infrastructure or access to financial products and services) can create intangible and longer term value—in brand image, employee morale, corporate reputation and the power to develop new capabilities and strengthen competitiveness. Such investments can thus be cost-effective.

Investing to remove market constraints can create both public and private value. For example, when a firm educates and trains its employees, it creates a more skilled workforce—a shared resource as workers move on to other jobs and companies. The added social value opens up doors for cost-sharing with socially-minded funding sources. Such sources, which can include international donors, individual philanthropists, non-profit social investment funds and governments, enable the private sector to create social value by sharing costs in three ways: through grants and through reduced-cost and ‘patient capital’.

*Leverage the strengths of the poor.* The poor are often an inclusive business model’s most important partners. By engaging the poor as intermediaries and building on their social networks, a company can increase access, trust and accountability. Those qualities, in turn, help businesses to nurture their markets and expand participation in their value chains. One model



for engaging the poor into one's sales operations is micro-franchising. CFW is a micro-franchise system of drug shops and clinics in Kenya. Franchisees are typically nurses or community health workers from the local communities where they operate. The franchise provider, Sustainable Healthcare Foundation, supports the franchisees with quality drug supplies, start-up financing, ongoing professional development and other central services, while franchisees operate the shop on their own account. Firms can leverage local knowledge and trust—two key assets for doing business in poor communities—by employing the poor to gather market information, to deliver, collect and service products, and to train others. And poor people often have the best ideas for creating new products and services that meet poor consumers' needs. Generally, when the poor take over some tasks in a business model, the transaction costs for the business fall while the benefits for the poor rise—thanks to new income opportunities, new knowledge and skills and improved social standing.

Central to leveraging the strengths of the poor is building on their social networks. A community is more than the sum of its parts. Where poverty prevails, formal laws and regulations are often less effective than the informal rules that communities set and enforce. Such informal rules can make inclusive business models viable. In addition, a community can help its members to help each other and to share resources, facilitate co-operation to provide common goods (such as wells, mills or schools) or act as infrastructure for savings, credit or insurance mechanisms. Businesses can count on these communal processes to fill gaps in the markets of the poor.

*Combine resources and capabilities with others.* Like many business models, inclusive business models often succeed by engaging other businesses in mutually beneficial partnerships and collaborations. But they also make use of collaborations with nontraditional partners, such as nongovernmental organizations or public service providers. Doing so, they can gain access to complementary capabilities and pool resources to work around or remove constraints in the market environment.

By combining complementary capabilities with other organizations, inclusive business models can capture capabilities and resources that a business could not provide alone. Brazil's Votorantim Celulose e Papel (VCP), a pulp and paper company, wanted to provide its small-scale eucalyptus growers with access to credit under repayment terms that would match their cash flows (eucalyptus is harvested only after seven years). Since credit was not available on such terms, and since VCP had no interest in offering in-house credit services, the company established a partnership with a bank, ABN AMRO Real. The bank now provides credit to the growers, with the loan secured by a guarantee from VCP to buy the timber. The growers pay the loans back as the timber is harvested. In other examples, partner organizations fulfill all kinds of functions along the value chain, from market research to providing services.

Collaboration can also mean pooling resources to achieve a common objective. In India, access to credit for small and medium-sized enterprises was complicated by the fact-finding process:



each bank had to assess the risk of lending on its own. The high cost of assessing applicants meant that banks had no interest in dealing with loans below a certain size or interest rate. Then several banks, among them ICICI Bank and Standard Chartered, joined to create the Small and Medium Enterprises Rating Agency, which rates the creditworthiness of such enterprises and provides the information to all participating banks. By reducing the cost of due diligence to any one bank, the service makes it profitable for banks to lend to smaller businesses and at lower interest rates—increasing access to credit while expanding the market for credit providers.

*Engage in policy dialogue with governments.* Engaging in policy dialogue is an important part of doing business with the poor, where companies are typically first movers and much of the environment for doing business has yet to be built. All five market constraints identified in this report are more or less in the domain of public policy. In many of the case studies businesses have found creative ways to work around or remove the constraints—say, by adapting products to run on solar power, by investing in education and training to increase skills among the workforce, by leveraging social networks to enforce contracts or by joining with other companies in self-regulation. For other businesses, though, it is possible to work around or remove constraints only on a small scale or not at all. Their strategy is to engage in policy dialogue. Policymaking is complex and continual, and businesses can provide good information about the problems and possible solutions.

Inclusive businesses often have fairly limited goals, such as encouraging government to provide the public goods or services they need to operate in a particular location. So engaging with governments individually can at times be effective. At other times, the individual efforts of entrepreneurs and companies can have larger implications, such as changing market structures or even opening new markets. Tiviski, a camel dairy in Mauritania, is an example: through the individual efforts of Tiviski’s founder, the European Union is creating a market for camel dairy imports where none existed before.

Businesses can also rely on demonstration effects to promote the strengthening of regulations in developing countries that lack them, or where they are not effective. When the Rural Energy Services Companies started up in Mali, the country did not yet have a regulatory framework to cover private electricity provision. Through the companies’ actions—and with additional support from the World Bank—the Malian government established the required rules and procedures.

Collective engagement by businesses is another way to inform public policy. Since business engagement in policymaking can be controversial, companies and policymakers need a space to engage in frank yet transparent dialogue about how to improve the business environment. Collaborative efforts can open such a space. Often companies that operate in the same industry or region have shared policy interests. And if they are doing business in ways that contribute to economic opportunity and human development, organizations outside the private sector may

have complementary policy interests. Where business models are inclusive, collective action can give businesses a strong and legitimate voice in policymaking.

## 1.6 Taking action

How can a business leader develop an inclusive business model? In a few words: by responding to local conditions. The entrepreneurs behind the case studies featured in this report acted in this spirit. They identified opportunities, understood the contexts and found solutions with open minds and through much experimentation.

The report encourages people in the private sector to be the main agents of change for human development. But the private sector cannot succeed alone. As important as the entrepreneurial spirit is to business leaders, it is also important for donors, policymakers, philanthropists and leaders of public service and not-for-profit organizations. They can partner with the private sector to fund investments in better market conditions, to collaborate in operating business models and to facilitate and lead dialogues for policy change.

Building business in the markets of the poor works best when all stakeholders contribute their strengths. When this happens, inclusive business models will proliferate and grow. Markets will include more poor people. And value will be created for all—through profits, through increased incomes and through concrete progress in human development.

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<sup>i</sup> Chen, S., and Ravallion, M. *How Have the World's Poorest Fared Since the Early 1980s?* World Bank Policy Research Working Paper 3341, June 2004.

<sup>ii</sup> Population without electricity in 2005: 1.6 billion people (OECD/IEA 2006, 567). Reference: OECD/IEA (International Energy Agency). 2006. *World Energy Outlook 2006*. Paris.

<sup>iii</sup> ITU World Telecommunication/ICT Indicators Database. Available at: <http://www.itu.int/ITU-D/ict/statistics/ict/>

<sup>iv</sup> Data Source: UNDP, SALB, UNCS, INE Guatemala. Map produced by OCHA ReliefWeb as of February 5<sup>th</sup>, 2008 as referenced by Instituto Nacional de Estadística de Guatemala

<sup>v</sup> Chu, Michael (2007) "Commercial Returns at the Base of the Pyramid" *Innovations: Technology, Governance, Globalization* 2 (1-2).

<sup>vi</sup> World Development Indicators Database. April 2007.

<sup>vii</sup> See Mendoza, Ronald U. February 2008. *Why Do the Poor Pay More? Exploring the Poverty Penalty Concept*. Office of Development Studies. UNDP