Getting to Zero: Tackling Extreme Poverty through Private Sector Development

- A pro-poor private sector development strategy is one that takes into account the heterogeneity of both the poor and the private sector, and acknowledges the importance of the informal sector as major employer of the poor. It seeks to achieve systemic change in markets and in the broader enabling environment through the cooperation of public and private actors.
- Measures to improve the enabling environment should include strong attempts to deal with petty corruption in the policy and judiciary, social services and natural resources.
- Promoting entrepreneurial activities among poor people requires transfers of resources. This can be in the form of a cash and/or asset transfer for very poor people and an upgrade to microfinance for poor people who already own a business.
- Business development services are the core of pro-poor private sector development, and can work well for poor entrepreneurs if business management training and grants or micro-loans are provided in tandem.
- Skills acquisition remains difficult for poor people. Modernising traditional apprenticeships may represent a way forward.
- Incorporation in value chains and upgrading can be important drivers of escapes from poverty, provided poor participants own key productive assets and have access to sources of natural capital as well as social and financial capital.
- PPPs and bottom of the pyramid initiatives need stronger processes of assessment of the impacts on the poor and poverty dynamics in their operations, both ex-ante and ex-post.

The two key challenges for a pro-poor private sector development strategy are the creation of decent jobs and the promotion of (formal and informal) micro, small and medium enterprises (MSMEs) with the potential for growth and transformation. These two are complementary actions that should be pursued through a combination of specific programmes and actions supported by economic and social policies and legislative reforms.

A pro-poor private sector development strategy is one that takes into account the heterogeneity of the private sector, acknowledges the importance of the informal sector and seeks to achieve systemic change in markets and in the broader enabling environment through the cooperation of public and private actors.

The term ‘private sector’ is used here in a broad sense, to include both the private corporate sector and the private informal sector. The dominance of the latter in developing economies and in the lives of poor people means this must be at the core of any pro-poor private sector development strategy. Broadly speaking, we can distinguish between three categories of firms operating in developing countries:

- Informal microenterprises, run by poor or near-poor people, whose establishment is often the result of a lack of alternative economic opportunities. These are found in both rural and urban areas. They are often referred to as
subistence entrepreneurs, meaning they are a source of livelihood for the entrepreneur and their family but do not grow or create new jobs.

- **Informal SMEs**, some of which have high transformational potential: they can grow and create jobs. These tend to be concentrated in urban and peri-urban areas, but can be found in rural areas too.
- **Formal SMEs**, which can be well established and often export-oriented companies in the formal sector but which may face some of the same challenges characterising firms in the informal sector. These are predominantly urban.

Because of this heterogeneity, different interventions will generate varied responses from entrepreneurs. For some poor entrepreneurs, interventions will contribute to sustained poverty escapes; for the very poor, they will mean faster upward mobility to the poverty line. It may be that benefits are intergenerational: poor microenterprises that are brought to the poverty line may not be able to grow further, but may create sufficient income to send children to school for longer and enable them to enter the formal job market or develop a more transformational business.

**Box 1: Definitions of poverty dynamics**

**Chronic poverty**: extreme poverty that persists over years or a lifetime, and that is often transmitted intergenerationally. The extreme and severe poor are also usually chronically poor.

**Impoverishment**: descent into extreme poverty.

**Sustained escapes from extreme poverty**: staying out of poverty and progressing towards a higher threshold (such as $2 per person per day).

A pro-poor private sector development strategy then includes interventions tailored specifically for poor households, microbusinesses and SMEs. In particular, it is a multi-pronged strategy that does the following:

- **It promotes an enabling environment (which includes social relations, economic and social policies, laws and legislation)**. This is key to remove the constraints and structural weaknesses private actors – in particular poor people operating in the private sector – face.
- **It creates capabilities for poor actors to participate in markets in a beneficial way and benefit from engagement with other private sector actors**. This involves various types of investment in human capital (e.g. business training) as well as the transfer of financial and non-financial assets (e.g. microfinance and cash grants).
- **It creates opportunities for the poor to participate in markets that are less risky and more inclusive**.

**The enabling environment**

Improving the enabling environment means creating the conditions for the poor to participate in and benefit from private sector development. At the national level, there are five sets of interventions that are particularly effective to this end. These are:

- **Strong policy and investment support for smallholder agriculture**, including a focus on asset accumulation and asset protection, infrastructure, pro-poor market arrangements and local institutional development.
- **Land tenure reforms** that enable the poor to accumulate land, as land accumulation is often a key driver of poverty escapes, while losing land is often a part of stories of impoverishment. Reforms that recognise the coexistence of multiple legal systems (such as communal/community, customary and common property resource management) are necessary to achieve inclusive outcomes.
- **Anti-corruption initiatives** that focus on the forms of corruption that most strongly affect the poor: the small-scale everyday corruption and bribery in the police, in social services, and in natural resources, by lower level public functionaries and actors within the private sector. Key actions include ensuring that all policies, services and entitlements targeted at the poorest are made publicly available and accessible.
- **Reduction in harassment of informal sector operators**, which requires consistent regulation as well as challenges to corruption. This is especially important for the large numbers of street vendors, who are often subject to inconsistent regulation, leaving too much discretion to local officials (Box 2).
- **Improving working conditions in the informal sector and valuing the contribution to the economy of informal enterprises**, for example through integration into local and national economic planning. **Formalisation** is important because it enables firms to grow and increases
the number of workers covered by pension plans and health insurance. However, different types of firms may require a different approach: formalisation should be pushed among SMEs which are ready to make the shift through the design of tailored incentives, such as tax exemptions; while it may be more appropriate to strengthen existing poor micro and small businesses in the informal sector before pushing for their formalisation.

Box 2: Shadow puppet business at Preah Khan temple, Angkor Thom district, Cambodia

Duong Kiri is 25 years old and has lived in an orphanage most of his life. There, he learnt how to make shadow puppets, and, with their encouragement, he decided to set up a small business producing and selling shadow puppets to tourists visiting the temples in Siem Reap. He rents a stall in front of a smaller temple, 5 km from Angkor Wat temple. Five young men who also used to live in the orphanage help him with the business, expecting a salary only if the business becomes profitable.

One of the problems facing Kiri is the high rental cost: he has to pay $40 rent and another $40 for the police guarding the temple territory. He is not sure of the purpose of the additional $40 taken by the police; he knows such bribes are requested from all business operators in the area, but the latter pay a lower amount. His attempts at bargaining a lower fee failed because the police claimed part of the money they took went to upper-level authorities.

Kiri receives no institutional support and does not know who to ask for help. Yet his business would have a good chance of prospering if given support to attract more visitors and reduce the fixed costs.

Promoting capabilities

TVET and traditional apprenticeship. Getting the skills to engage in private sector development is no easy task for poor people. Technical and vocational education and training (TVET) is often inaccessible because of cost (and often still poor quality) and lack of the necessary human capital to gain entry. Including the poorest would involve removing financial constraints (e.g. through subsidy) as well as material costs (e.g. transport) and social and cultural constraints (e.g. lack of time for young mothers). Improving quality would require the close involvement of the local private sector in TVET governance and processes (Hossain, 2012). Traditional apprenticeships are more accessible, although they are based on social relationships and networks, so poor people with low social capital may find them inaccessible too. Improving apprenticeship schemes targeted to poor young people can be done involving existing business associations; strengthening the apprenticeship contract, adding new skills through training master crafts-persons and linking the informal apprenticeship system with national formal training institutions (OECD, 2014).

Business Development Services (BDS) are the core of pro-poor private sector development. They can benefit the vulnerable non-poor, helping them deal with risks that might otherwise force them out of business, and can also play a fundamental role in triggering the transformative potential of SMEs in the informal sector. BDS can also address the needs of the poorest people, provided they are integrated (financial and non-financial) and subsidised.

Business management training can sustain poverty escapes and trigger the transformative potential of SMEs in the informal sector, and also tackle chronic poverty if properly targeted and designed.

Business training needs to be tailored to the needs, characteristics (including size of the business) and pre-existing skills of the beneficiaries. Chronically poor micro and small entrepreneurs with low education levels may make better use of training providing simple instructions or ‘rules of thumb’, to improve their daily (financial, commercial, productive) operations (Beaman et al., 2014; Drexler et al., 2014). Management training for small firms should include human resource management, to encourage employers to take on and train (poor) unskilled workers and provide them with tools for improving productivity, wages and work satisfaction.

Business training needs to be followed up with consultancy for a significant period after a training intervention, and it should come with some form of capital transfers when possible, for both men and women, to remove the material constraints facing the poorest entrepreneurs (De Mel et al., 2013; Klinger and Schündeln, 2011). Cash grants would be more appropriate for chronically poor micro-entrepreneurs; loans may be more efficient for the more established self-employed, helping sustain escapes from poverty, and for small firms, especially if they are used to borrowing money.
Microcredit can loosen a major constraint for poor entrepreneurs and informal micro and small businesses. However, entrepreneurs may be risk averse, partly because they have few risk management tools, and partly because the risks are often substantial; as such, measures that reduce business risk are an important complement of microfinance interventions. Disbursement of loans and repayment work best for chronically poor and vulnerable agricultural households when they are coordinated with the pattern of cash flow associated with the farming cycle, which is characterised by seasonal fluctuations of income.

For the poorest, financial services should be preceded by other processes that build up their capability to satisfy their basic needs, save money and eventually manage credit – managing a savings account and saving consistently, literacy and numeracy are critical (as in BRAC’s Graduation Approach, de Montesquiou and Sheldon 2014). Initially raising asset levels may best be done through grants rather than loans. For less poor entrepreneurs who have transformational potential, achieving a degree of formality (e.g. business registration) is the next step, which then enables greater access to a wider range of financial services.

Overall, sustaining escapes from poverty through entrepreneurship requires an integrated approach – with the provision of financial services linked to BDS, especially business and technical training.

Promoting women’s entrepreneurship

Women’s economic empowerment is critical for the eradication of poverty. Simple inclusion in the workforce may not be enough if jobs are insecure, low skilled and low paid. In this situation, promoting women’s entrepreneurship can be a way out of poverty. A key aspect of this is reducing the additional obstacles women face as a result of social norms, land and property inheritance, norms and the power dynamics of social relationships in the family and wider community.

In addition, women already running SMEs need tailored financial products and services and specific training to improve their entrepreneurial skills (Valdivia, 2011). For the poorest women, the most appropriate intervention is a capital (cash or asset) transfer combined with some form of training or assistance (as in BRAC’s Empowerment and Livelihood for Adolescents programme in Uganda, see Bandiera et al., 2012).

It is also important to seek new roles for women beyond production, lest they end up being relegated to basic and non-influential roles in producer organisations. For example, they can be encouraged to take charge of processing and manufacturing (King et al., 2012). Measures targeted exclusively to women seem to have a greater impact, but the involvement of men is essential to achieve longer-lasting results.

Promoting opportunities

Pro-poor(est) value chains. Value chains can be exclusionary, but inclusion does not necessarily guarantee reduced poverty.

Upgrading in a value chain can but does not always lead to improved welfare. If the demands of upgrading are prohibitive, downgrading can be better, especially if it involves having access to stable and growing domestic and regional markets (Box 3).

Box 3: Downgrading as a strategy in the Senegalese green bean value chain

In Senegal, the tightening of quality standards on the production of green beans induced by demand from EU supermarkets contributed to poverty reduction by creating employment opportunities that were more accessible to the poorest households. The tightening of standards induced structural changes in the supply chain, including a shift from smallholder contract farming to large-scale integrated estate production. While only households with larger landholdings were able to participate in the contract farming schemes, poorer producers and landless households were able to participate as wage labourers and gain significant benefits as compared with non-participants (Maartens and Swinnen, 2006).

Including the poorest on good terms requires a package of measures: 1) commitment by private sector actors to labour and other social (and environmental) standards, in particular a living wage for labourers including casual workers or a living income for self-employed suppliers, and safe working conditions; 2) participants having or gaining access to assets and/or skills that improve the quality of their participation; 3) adequate/greater bargaining power for the poorest achieved through organisation –
recognised trade unions, associations; and 4) sustained support for the poorest from third parties (e.g. NGOs). Certified standards, such as Fairtrade certification, must be inclusive of and beneficial for all people involved the product’s value chain, including the most vulnerable categories such as young women and migrants (Cramer et al.,2014).

Bottom of the pyramid initiatives. The BoP business model, and more generally inclusive businesses, can lead to pro-poor outcomes if they trigger behavioural changes on the side of the poor (in the sense that they consume cheaper goods that increase their wellbeing) and on the side of corporations. The existing evidence so far suggests the impact on tackling chronic poverty is going to be limited because of the extremely limited purchasing power of extremely poor people. However, those closer to the poverty line, who are already on a trajectory out of poverty, may enjoy benefits from involvement in BoP initiatives as both producers and consumers.

Pro-poor outcomes cannot be taken for granted, however; they need to be explicitly designed into the business model/process, and to be compared with the possible negative effects on poverty. The case of Rent-to-Ow (Box 4) offers an example of how this can be done. Suppliers of goods and services to the poor (and especially poor women) need to make sure their products are not ambiguous in the way they impact wellbeing and do not create consumption habits that may have negative effects on people’s wellbeing.

Box 4: Designing pro-poor business models – the case of Rent-to-Ow

Rent-to-Ow is a company supplying productive assets, such as irrigation pumps, to small-scale farmers. Purchasers of irrigation pumps typically do not start generating an income from the pumps until a number of months later. It is difficult for those customers to make repayments in those months, but they have the capacity to make larger repayments during busy months. Rent-to-Ow analysed the seasonal cash flow streams of its customers and started offering repayment schedules matched to its customers’ erratic income streams, rather than expecting a single, constant repayment stream (Sida 2013).

Involvement in BoP activities as independent sellers or ‘entrepreneurs’ can benefit poor people on a trajectory of escape from poverty, provided that the level of financial risk (coming from upfront and ongoing investment costs, regularity of sales and amount of compensation) for the single entrepreneur is feasible and context-compatible; this may require that the lead company takes on some risk, capital costs or promotion activity. Flexibility of procedures (e.g. in working time) and sufficiently strong local demand for the product or service are also necessary conditions (Dutt, 2012: 1).

Public–private partnerships and challenge funds should be an important part of a pro-poor private sector development strategy, but more research is needed to identify what types of partnerships are more likely to benefit the poor.

So far, few PPPs have had a focus on the poor built in from the beginning in a strong way, so the effects are likely to be accidental or indirect, through growth (e.g. stimulation of new firms and greater competition) or because the sector supported includes many poor people (e.g. agriculture). Further, there may be a trade-off between long-term profitability of ventures supported and direct benefits for the poor.

Box 5: AusAID’s Enterprise Challenge Fund (ECF)

AusAID’s 2012 Annual Portfolio Review of the ECF finds that over half of the 21 funded projects had invested further funds to scale up their operations, demonstrating input additinality. A case study in the review that also demonstrates behavioural additinality is that of WING, a provider of mobile phone payment services that enable customers to transfer, store and cash out their money using a mobile phone. For WING, the cost of rural expansion was too high to justify on commercial grounds. The ECF matching grant funded 25% of the cost of extending affordable payment services to rural Cambodians, and was used for education programmes and marketing. By the end of March 2011, two years after the grant was awarded, WING had reached more than 200,000 customers, most of whom were previously ‘unbanked’. The company’s money transfers are 50% cheaper than other locally available methods. WING is training around 200 new sales agents each month, and partnering with MFIs, which – by processing payments electronically – can reduce the cost of loans (Coffey International 2012).

Challenge funds can constitute a shortcut to achieving change and can be employed as an
instrument of economic policy to influence the behaviour of firms, and so to trigger pro-poor private sector development. Challenge funds can also help raise and tackle issues in the business enabling environment (Box 5). However, evidence of pro-poor impact is limited as yet. Assessments should show whether the fund achieves additional effects over and above what would have been achieved without the fund – in terms of inputs, outputs, development and systemic change in behaviour (reflected in the adoption of the innovative business model by other firms). It is the latter that is particularly important. They should also look for displacement effects – where new enterprises displace existing enterprises that may involve or benefit poor people.

**Conclusion**

Overall, evidence suggests that there is no single set of interventions that will always work, or one that will always guarantee a larger impact on poverty. Rather, it is the combination of different interventions in a broader context-specific strategy to make the development of the private sector pro-poor that will be more effective. Ensuring economic growth is accompanied by poverty reduction and improvement of poverty dynamics therefore requires countries designing national strategies for pro-poor private sector development, tailored to the characteristics of their (poor and non- poor, formal and informal) private actors.

**References**


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