Prosperity for all: private sector development and pro-poor growth

Key Points

- The private sector in developing countries comprises a heterogeneous mix of very large multinational corporations and large numbers of very small micro and small enterprises.
- Broad-based and rapid economic growth, largely due to private sector development, can have a dramatic positive impact on poverty reduction.
- However, where equitable and efficient markets do not exist, the poverty reducing effect of economic growth is diluted. Private sector development programmes can strengthen the link between economic growth and pro-poor growth through: support to providing incentives for entrepreneurship; increasing productivity through competition and innovation; harnessing international economic linkages; improving market access; and reducing risk and vulnerability;
- The market development approach is now broadly accepted as an effective way to ‘make markets work for the poor’. It has emerged since the late 1990s and emphasis the need for poor people to be linked to the economic mainstream, not isolated for it.
- A range of tools can be used to identify promising private sector development opportunities which will be pro-poor, viable and deliver impact at scale.
- Based on the framework provided by the OECD guidance, practical examples of interventions illustrate action which donors and governments can take to stimulate pro-poor growth.

1. Why private sector development matters for pro-poor growth

The aim of this Briefing Note is to resent an overview of how private sector development can contribute to pro-poor growth. This contribution takes place in two different ways, one rather obvious and the other more subtle.

The first obvious point is that, in market economies, the private sector has an instrumental role in generating economic growth. Expanding private sector markets can generate employment, livelihoods, incomes, public spending and accessible goods and services – making them centrally important to the pro-poor growth story. Through interacting with dynamic markets large numbers of people can successfully and very rapidly exit poverty.

The positive association between economic growth and poverty reduction is illustrated in Figure 1. Rapid economic growth allows incomes to rise which tends to benefit for the poor. Or to put it another way, there has never been a sustained period of poverty reduction which has been achieved by an economy in the doldrums.
So the first obvious point is that private sector development is critical because economic growth is driven mainly by the private sector and sustained economic growth is a prerequisite for poverty reduction at scale. With the caveat that economic growth, per se is necessary – but not sufficient – for poverty reduction, it would be difficult to find a dissenting voice on this issue.

The second obvious point is that private sector development is important because it accounts for the overwhelming majority of financial flows in developing countries. People working in government, international development agencies and civil society commonly under-estimate the role of the private sector but public flows of official international development assistance (US$86 billion in 2006) are dwarfed by private sector flows both into and within developing countries. In 2006, foreign direct investment into developing countries and exports from the South amounted to US$367 billion and US$903 billion respectively. In 2006, domestic credit to the private sector in low and middle income countries equated to 57.3% of Gross Domestic Product – or some US$6,691 billion (World Bank 2009). On the whole, it is this private sector activity which is changing the lives of many of the 5.5 billion people living in the developing world, rather than activities funded by development related expenditure.

The more subtle point is that there are a number of factors which, with a given rate of economic growth, can address the terms on which the poor access markets. In this sense, private sector development is not only influencing the pace of economic growth, but also the pattern of who benefits from this growth.

The OECD has developed an analytical framework to identify the changes to institutions and policies resulting from private sector development initiatives that would help growth translate more effectively into poverty reduction.

The private sector is very heterogeneous. It includes many informal businesses, family-run farms and self-employed people – as well as formal and large businesses. Although not the main purpose of individual entrepreneurs, when viewed together, the private sector is the main engine of growth in national economies. Where the pattern of growth is inclusive, private sector development can provide jobs and income for poor people, and even when it is not it can generate government revenues to fund public expenditure, including redistribution to poor people.

This understanding is important if we are to design interventions that help markets develop in a way that delivers real and sustainable benefits to the economy and society as a whole and poor people in particular.

This briefing note is structured around five issues:
1. Why private sector development matters for pro-poor growth
2. Blockages to private sector development and for PSD to contribute to poverty reduction.
3. The emerging pro-poor agenda for private sector development
4. Examples of ‘best practice’ policy guidance to promote pro-poor growth
5. Conclusions

2. Blockages to private sector development and for PSD to contribute to poverty reduction

Private sector development does not inevitably transmit benefits to poor people. In some cases poor people can be negatively affected by the ways in which markets and private sector enterprises operate. This, and sometimes a poor understanding of how markets (and enterprises) function, means that the notion of markets can evoke suspicion and hostility. Some regard markets as instruments of oppression rather than hand-maidens of opportunity.
Sometimes, the way markets function may as well be detrimental – particularly to poor people and others with low negotiating power – when they exclude the disadvantaged. Understanding these blockages is essential to pro-poor private sector development policy formulation.

Section 2.1 provides a list of key market failures, and sections 2.2 to 2.5, provide some specific illustration of failure from the market to provide equal opportunities for all to benefit of economic growth.

2.1 Key market failures

Under the guidance of world-renowned economists from Harvard, the ‘shock therapy’ applied to the Russian economy after 1991 was a disaster for the livelihoods of the poor. Similarly structural adjustment reforms and related market liberalisation in the 1980s and early 1990s had a mixed impact – benefitting some groups while intensifying the hardships of others. Citing examples like these, ‘... markets are sometimes seen to be the domain of the rich, ‘theirs’ and not poor people’s and therefore something from which the poor must be protected’.1

This view endures alongside others which see competitive, well-functioning and appropriately enabled and regulated markets as being fundamental to successful economies and important engines of development. However, using examples of where enterprise has not reduced poverty as evidence of how private sector development and pro-poor growth are antagonistic is to miss the point. Instead, these failures illustrate how the operation of distorted, weak or poorly-regulated markets (rather than markets per se) can create serious problems for economies and poor people within them.

The example of the liberalisation of export commodities illustrates this point (see Policy Implementation Note #5). In some instances the far-reaching liberalisation of the 1990s in the cotton and coffee sectors has resulted in sustained gains for African small-holders. Yet in others, the exposure of small-holders to the vagaries of volatile global markets has undermined incentives for producers to invest in their farms. Input and technical support for farmers from the state has been rolled back, with sometimes little to replace it. State-run marketing monopolies have been replaced by private sector organisations which may display a similar lack of concern with the livelihoods of producers in their supply chain. It is these market and state failures which often determine whether private sector development initiatives accelerate, or undermine, pro-poor growth.

Box 1 outlines some of the ways in which markets fail, and the implications of such failure.

Box 1: Factors encouraging pro-poor growth

1. Providing incentives for entrepreneurship and investment
2. Increasing productivity, competition and innovation
3. Harnessing international economic linkages
4. Improving market access and functioning
5. Reducing risk and vulnerability.


The next subsections detail some of the most frequent impediments to the adequate functioning of markets to allow growth to be translated into gains for the poor.

2.2 Barriers to business formalisation

Poor people engage in informal economic activities because the barriers to entry are lower than in the formal sector. Informal business is often characterised by high risks, inadequate statutory protection, and low wages for those who engage as labour. Because they offer better guaranties to consumers, formal forms of private enterprise are more likely to connect with higher value share of the market (except, obviously for illegal activities).

In many cases “formalisation” of the business may be a desirable objective, formal sector working conditions and security are often better than in the ‘informal sector’. Formalisation can allow entrepreneurs to access business services and benefit from networks, such as trade associations. An effective strategy to increase returns to entrepreneurs or workers is often based upon an upgrading strategy aimed at increasing the quality of the product or process – which should increase producers gross (and maybe also their net) incomes. Often government itself provides complex bureaucratic barriers to establishing and operating a formal sector business.

2.3 Unequal competition

Producers may face barriers to entry to markets which are dominated by cartels –
Joint Learning Event: Promoting Pro-Poor Growth

and these generally function to benefit the already-affluent to the detriment of emerging entrepreneurs. Workers suffer because anti-competitive practices tend to reduce the competitiveness of the economy which limits growth and job creation.

Consumers may also suffer from the lack of competition by paying more for goods and services than would be the case in a functioning competitive market.

2.4 Lack of incentives to private entrepreneurship

Many of the barriers against (or incentives for) enterprise are macro-economic in scope – such as predictable rules of exchange, macro-economic stability, good governance and the rule of law. The cost of doing business increases significantly in the context of endemic crime, corruption, lawlessness, heavy regulation, macro-economic volatility and opaque contract enforcement and property rights.

Many of these issues are covered in the Briefing Notes on the macro-economy and political economy of pro-poor growth.

In addition to these macro-economic barriers, obstacles at the firm level can also reduce the incentive for enterprise. Barriers to accessing factor markets (capital, adequate labour or natural resources), poor economic infrastructure and geographic disparities between richer and ‘lagging regions’ can also constrain the growth of enterprise.

Financial services are about much more than access to loans. They include savings facilities, insurance and cash transfers. Where the poor lack access to these services – as with basic services such as water supply - they have little choice but to use expensive and risky alternatives. As an illustration of this, the use of mini-cab drivers in East Africa to transfer cash from urban-based migrants to their families in the rural areas is a good example. Sometimes remittance funds go missing and often they take a very long time to reach the intended beneficiary. In either case, the consumer never has any right of redress. This lack of access to financial services is a good example of a market failure that seriously constrains the emergence of a functioning market.

Providing poor people with access to financial services can provide incentives for entrepreneurship and investment; indirectly increase productivity; directly improve access to capital markets through deepening of the financial markets; and, reduce risk and vulnerability.

Table 1: Types of market failure

<table>
<thead>
<tr>
<th>Type of market failure</th>
<th>Issue and consequence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market power through monopoly or imperfect competition</td>
<td>If a few producers can gain sufficient market power, they can exclude potential competitors, restrict supply and charge higher prices. This is the case in many developing country markets where investment costs are high. Where competition is limited or distorted, it is usually the weak and poor (as potential new entrants) who lose out.</td>
</tr>
<tr>
<td>Uneven access to information</td>
<td>For a market to operate efficiently, all buyers and seller need access to the same knowledge. If some producers or consumers lack knowledge (i.e. of the needs of the market) others can exploit this ignorance. Some of the most effective pro-poor market development projects have simply involved providing decent market information to poor producers.</td>
</tr>
<tr>
<td>Social exclusion</td>
<td>Markets where specific social groups, such as women, ethnic minorities or castes face specific discriminatory barriers that prevent or discourage market participation</td>
</tr>
<tr>
<td>Incomplete or ‘missing’ markets</td>
<td>Markets in some developing countries can be either non-existent or too ‘thin’ to function properly – this is typically the case in ‘lagging’ rural areas. Because of problems such as high risks, high transaction costs, high transport costs and short time horizons of investors, markets only provide for the needs of the wealthier few. This results in limited market reach.</td>
</tr>
<tr>
<td>Co-ordination failures</td>
<td>For markets to work, they often need complementary markets and functions to develop with them. Where price signals fail to cause the complementary market to develop, a co-ordination failure occurs, preventing the growth of the market or causing it to be incomplete.</td>
</tr>
<tr>
<td>Externalities and public goods</td>
<td>Some activities produce positive or negative effects which are not reflected in the market price (i.e. producers who pollute not paying the costs of this damage). Public goods (such as public transport networks, education and healthcare services) are very important in reducing the barriers to entry for low-income entrepreneurs and are traditionally supplied by government – although, in some cases, now delivered in partnership with the private sector.</td>
</tr>
</tbody>
</table>

Source: DFID (2008) Private sector development strategy
Although the relationship between financial sector development, growth and poverty reduction is complex, it is generally recognised that there is an association (OECD, 2006). In many African countries the proportion of people without a bank account reaches 90%. In this context, the lack of financial services is a constraint to economic growth.

2.5 Unequal opportunities for women

In many cases, gender divisions of labour and reward are very strictly observed. It is also important to understand that there are significant variations between and within countries. Gender divisions of labour may translate into significant barriers for women to benefit from opportunities created by economic growth and private sector development.

For instance, amongst artisanal fishers in Senegal, boats are owned by men and crewed by men and the only role for women is trading of fish and most of the processing activities. Elsewhere in West Africa, Ghana presents almost exclusively matriarchal artisanal fishery activity. Boats are owned by women who employ male crews and pay them with ‘shares’ of the catch. The wholesale markets are controlled by the market ‘queens’ – who set prices and control the distribution and retail network. Supporting the development of the fishery sector in either of these two West African nations would, therefore, have completely different gender impacts. A ‘women in development’ development project in the fishery sector in Ghana – which failed to appreciate either that women already own and control the fishery sector or the strong social mores against women working on fishing boats – succeeded in temporarily destabilising the livelihoods of women working in the sector.

3. Approaches to pro-poor PSD

Deliberate action is often necessary to counter market and state failures. Practical steps to help markets work to support the livelihoods of poor people might include removing barriers to formalisation; implementing a completion policy; recognising the role of the financial sector and enabling it to work better; enhancing women’s market access and encouraging inclusive public-private dialogue. This section is structured in two phases: subsections 3.1 reviews traditional approaches to PSD on their limits, while to 3.2 present the emergence of new approaches.

3.1 Traditional approaches to private sector development and their limits.

The traditional approach to private sector development focused on providing support directly to the areas of the economy deemed to poor people. These were typically identified by sector, activity and size of enterprise and focused on providing subsidised support directly to the people running micro and small enterprises.

Studies in the 1990s (e.g. the GEMINI series in Sub-Saharan Africa) sought to identify the binding constraints facing entrepreneurs. They commonly identified a lack of investment and working capital as the second most important constraint, with a poor investment climate often coming in as the most powerful constraint to business success. Because of the perceived difficulty of tackling the investment climate, international donors and civil society organisations commonly focused on attempting to improve financial service intermediation through the provision of micro-finance and building entrepreneurial skills for micro-enterprise development through technical training.

This approach was hailed at the time as being likely to help large numbers of people to exit poverty but has since been criticised.

Interventions sought to address the problems of very poor micro-entrepreneurs, rather than correct market or institutional failures. They were distortive, second-best solutions and did not always enable poverty escape or the development of viable enterprises. Such interventions were well intentioned but it might have been better to have provided poor entrepreneurs with a ladder out of poverty. This might be achieved over the medium to long term by building the skills and assets of poor people, providing social protection to improve well-being and enable human capital formation and savings.

2. For economists, the best solution is always one which enables markets to work better. A second best solution accepts that markets cannot be corrected, but seeks to work around the failure. In this case, markets are not providing poor people with savings, credit and insurance. Instead, financial services providers needed to be induced to provide these services – either through direct grants which created microfinance institutions (or microfinance wings or existing banks and building societies) or through regulation.
and then (and only then?) provide a sub-set of poor people with enterprise development and microfinance interventions. Another failure is that few recipients of subsidised training and microfinance graduated to use services provided through unsubsidised providers, arguably entrenching their dependence.

Ironically many traditional attempts to support pro-poor enterprise were based on a poor understanding of market systems and where poor people do (or could) engage successfully with them. The consequence of this failure was a series of ill-conceived, small-scale interventions which had limited cover and unsustainable impacts. Traditional enterprise support instruments reached small numbers. They were expensive per beneficiary and their design implied high transaction costs for donors. They also tended to create aid dependent institutions, unable to move from donor funding to more market-based approaches.

3.2 Emerging pro-poor agenda for private sector development

Perhaps the best advice for governments and external donors approaching some of the smallest and most fragile economies in the world with commendable aim of stimulating private sector development is to do nothing until you understand the market system in which you propose to intervene. This is because the worst that most development interventions can achieve is limited direct impact. However, in the field of private sector development it is possible to damage existing markets through ill-conceived projects, programmes and policies. The market development approach (also called M4P or ‘making markets work for the poor’) evolved from the late-1990s. Interventions aim to incorporate poor people into the economic mainstream

This approach is based on recognition that each transaction takes place within a wider system of supporting formal and informal functions and rules – in other words, an understanding of how markets work (see Figure 2). Interventions are only designed and implemented after understanding of why the market does not currently work for poor people has been achieved, and how market functioning might be changed to benefit disadvantaged groups. In essence it is these market systems, the ‘enabling environment’ surrounding transactions which should be the focus of interventions to benefit poor people. This enabling environment includes not only the rules that govern markets but also the supporting infrastructure and services. This contrasts with the ‘traditional’ approach of directly supporting the specific enterprise or transaction itself.

Over the last few years, the market development approach has been adopted by almost all leading multilateral and bilateral donors and many by non-governmental donors as well in the field of private sector development.

To turn this new agenda into practical action, it is really important to understand the market system to correctly identify the problems and potential solutions.

And to do this we need tools to help identify private sector development opportunities – so we now turn to these tools.

Four main types of tool can help identify private sector development opportunities which are consistent with the market development approach. The four main approaches are value chains and sub-sector analysis; clustering and networking; enabling environment; and local economic development. These are the subject of an excellent review by the Springfield Centre, which has pioneered the approach of making markets work for the poor (Ruijter de Wildt, M et al., 2006).

These tools allow practitioners to identify viable private sector development
opportunities from which poor people are either being excluded or are participating on adverse terms. These tools focus attention on the barriers (often a range of market and state failures) to engagement which, if overcome, will allow the meaningful participation of poor people in viable economic activity.

This contrasts with a more ‘traditional’ approach to private sector development which would take the existing activities of poor people (or perceptions of appropriate activities for resource-poor beneficiaries such as women’s groups making school uniforms) as a starting point and provide direct support to enterprises (often group-based) to encourage entrepreneurialism. What we know from experience is that often these approaches were based on fundamentally unviable business ideas. In addition, the stipulation of group enterprise models and the provision of heavily-subsidised support often resulted in projects which were unsustainable and lacking in impact. They also often failed to make the linkage between small informal enterprises and the economic mainstream, which is essential to reduce poverty at scale.

Applying one or more of the tools above allows the practitioner to identify private sector development interventions which will meet three different criteria: pro-poor potential, growth potential and intervention potential. See Figure 3 (overleaf), for more on how these criteria interact.

The pro-poor potential of an intervention relates to the number of poor people who could be impacted. The idea behind this

Figure 2: The market system

MARKET PLAYERS
(Delivering and resourcing different functions)

SUPPORTING FUNCTIONS
Information

Setting and enforcing rules

Non-statutory regulations

Informal rules and norms

Related services

Infrastructure

CORE FUNCTION

Supply

Demand

Governments

Private sector

Not-for-profit sector

Business membership organisations

Informal networks

Laws

Sector-specific regulations and standards

Informing and communicating

criteria is that it should encourage practitioners to focus on interventions which operate at a much larger scale than the ‘traditional’ support to individual small businesses (such as development of pro-poor linkages around a sub-sector or large formal sector enterprise).

It is important to recognise the potential of poor people as workers and consumers as well as producers. For example, some of the most successful traditional private sector development initiatives involved increasing the access of poor people to financial services (like insurance and banking), rather than focusing on production. The traditional approach to increasing financial service intermediation might be adjusted now by seeking to increase the outreach of the whole banking sector to poorer customers. This shift is not just important conceptually, but as the Unilever example illustrates, very large numbers of poor people participate in value chains as suppliers, traders, processors, retailers and consumers – as well as producers.

Selecting interventions with real pro-poor growth potential is important to avoid selecting initiatives which simply crowd poor people into businesses with limited viability. Applying the criteria will challenge the choice of many ‘traditional’ private sector development projects. For instance, the low price of school uniforms (arising from very large scale industrial production in SE Asia) seriously curtails the viability of small-scale production initiatives in Africa and although changes in trade policy might allow this sector to move into profit it is not clear that this is a plausible option for private sector development in the short-to-medium term.

Finally, the potential of interventions to create systemic change relates to the likely impact of the intervention. Supporting an agricultural cooperative with 50 active members to grow more cassava may benefit these farmers, but it does not change the market (in fact the gains in sales by the cooperative may be off-set by lost sales from other producers). However, creating a linkage between former subsistence cassava farmers in Tanzania and the biogas or animal feed processing sector in Dar-Es-Salaam is the development of a new supply chain which could impact on many thousands of farmers.

When conceiving of private sector development projects, it is important to recognise that many poor people do not want to (or cannot) be entrepreneurs. When asked, the main priority of poor people is often to get a regular income from a secure job - the enthusiasm to accept the uncertainty and risk associated with entrepreneurship is severely circumscribed. In Europe we do not usually see poor people as the main source of tomorrow’s entrepreneurs, but development practitioners frequently do see poor people in developing countries in this light. Because of this, private sector development projects are sometime unable to successfully involve the poorest of the poor – and rather work with people who are resource poor but nevertheless have assets (like skills and land) which provide them with the basis for trade. This suggests that private sector development projects should work hard to ensure that their investments generate employment-rich growth. While poor people may not want to be entrepreneurs, the reality for many is that self-employment is their only source of livelihood. If more jobs were created many would abandon their low return, drudgery intense microenterprises in favour of working for someone else. For more on this topic see the OECD guidelines (2009) ‘Promoting Pro-Poor Growth: Employment and Social Protection’.

**Box 4: OECD guidance to donors on increasing impact of private sector development on poverty reduction**

- Removing barriers to formalisation
- Implementing competition policy
- Recognising the financial sector’s contribution to pro-poor growth
- Enhancing women’s market access
- Constructing inclusive public-private dialogue

Source: OECD, 2006.
4. OECD guidance on increasing the pro-poor impact of private sector development

In this section, guidance is provided to policy makers and practitioners develop interventions which are more likely to achieve pro-poor growth. This section is based upon the five ‘hot topics’ contained in OECD guidance on private sector development and pro-poor growth.

4.1 Removing barriers to formalisation

Improving market access for poor producers often involves improving the quality standards of small-holder outputs, in order to access more viable market channels. There are many examples where low-income producers have successfully overcome these barriers to entry by, for example, collective action (forming a producer group to share the costs of formalisation or access support services) or entering long-term contractual relationships with buyers (who may then provide embedded technical and financial services to their suppliers).

However, the importance of being aware of barriers to formalisation are indicated in Box 6, which illustrates examples where certification can raise standards to the point that low-income producers are excluded from market access.

However, this is not always the case. Inherent to all initiatives to formalise standards are exclusionary pressures (the only way to improve standards is to exclude those who do not meet them). There is increasing evidence that certification schemes in the fishery, forest, organic and even – most controversially – the fair trade sector tend to exclude poor countries and/or the poorest people within them. This paradox, that consumers in affluent markets seeking to exercise their market demand in an environmentally or socially progressive way may actually be having regressive impacts on the poorest people in developing countries is a reminder that simply formalising the

---

Box 5: Certification and poor people

**Fisheries:** Stefano Ponte examines the case of Marine Stewardship Council (MSC) certification (including issues of food safety, environmental sustainability and labour relations) to the hake industry in South Africa to illustrate the danger of exporting certain models of certification to the South. Beneath the value-free and impartial science of conservation and competition, MSC certification in South Africa was employed as one of the tools against the redistribution of fish quotas away from ‘white-owned companies’ to the possible benefit of ‘black-owned enterprises’. Developing country fisheries ‘have been marginalised in the MSC system’ – being reluctant to participate in the eco-labelling initiative. These highlight the ‘embedded protectionist elements in some of these initiatives’ – where standards are raised beyond the reach of almost all but fisheries of three upper-middle income developing country (2006).

**Forestry:** Benjamin Cashmore et al examined the impact of the Forest Stewardship Council certification scheme (management of forests and labour standards) across developing countries. He notes the irony. ‘Forest certification was initiative primarily to protect good forest management in tropical developing countries, but has been adopted by developed-country operators seeking a market advantage from their comparatively lower cost of compliance’ (2006). 80% of certified areas are in developed countries with Africa, Oceania and Asia having only 8%, 5% and 4% of certificates, respectively (Kristi Thornber et al 1999).

**Ethical Trade:** Whilst ‘fair trade’ schemes can yield a higher price for producers – the costs of compliance is usually borne by developing country producers themselves rather than developed country buyers, importers or retailers. This can result in the exclusion of producers who cannot afford the compliance costs and constrain the overall development impact of the schemes to about one million farmers (ethical trade in the UK – the second largest market after the US -represents 0.4% of total UK spending on food and non-alcoholic drinks). The term ‘fair trade’ does also imply that conventional mainstream trade is somehow ‘unfair’ (Karen Ellis and Jodie Keane, 2008). There is an inherent tension between the need for ethical trade to work with the conventional markets to achieve the volumes to register an impact, without undermining their original objectives to offer an alternative to mainstream trade (Taylor 2004).

---

Box 6: Competition and Zambian cotton

Out-grower schemes often create monopsony buyers. The example of the Zambian cotton sector illustrates how important it is for government to act to avoid large cotton buyers using their market power to exploiting smallholder producers.

The Zambian Competition Commission (ZCC) investigated the cotton sector and concluded that, whilst out-grower schemes can significantly reduce poverty, lower prices offered by buyers can undermine this potential. The ZCC reviewed the imbalance of power in negotiating cotton prices in out-grower schemes and concluded that Dunavent and Cargill Cotton were disproportionately passing the impact of low global cotton prices onto small-scale cotton producers. As a result of the investigation Cargill Cotton changed their pricing system, which had the effect of reducing input costs for farmers. This resulted in the net income of Zambian cotton farmers increasing 75% in 2006.

Source: UNCTAD (2008)
Box 7: Development impact of enterprise – a case study of Unilever in Indonesia

Direct effects: Unilever Indonesia’s (UI’s) core workforce is composed of roughly 5,000 people, of whom about 60 per cent are employees, most of them permanent, and a little less than 40 per cent are contract workers, employed directly or through contracting agencies. Employees enjoy good employment conditions. However these benefits decrease as one moves from the core workforce and further down the supply and distribution chains.

Indirect impacts: About 300,000 full-time equivalent livelihoods are generated from UI’s value chain. Strikingly, more than half of this employment is found in UI’s distribution and retail chain. UI’s distribution chain can be divided into modern trade, which consists of large accounts such as Carrefour, Hero, and Indomaret (about 80% of sales), and the general trade, which consists of 385 distributor firms and 1,267 sub-distributors. Similar to Coca-Cola’s Manual Distribution Centres, which are renown simultaneously for enabling market penetration into some truly remote areas and for providing livelihoods to poor intermediaries and retailers, UI’s use of a sub-distribution system was a business-motivated decision enabling UI to more effectively reach new types of consumers in over half-a-million local retail outlets. However, it has pro-poor implications as it opens up opportunities in the supply chain for a large number of smaller (poorer) entrepreneurs and their (commonly poorer) workforce.

About one-third of livelihoods generated by UI are in the supply chain (Clay 2005, 18). In 2003, UI purchased goods and services valued at more than $254 million, mainly from Indonesian companies. The company’s top ten suppliers by value are all Indonesian. They account for 34 per cent of purchases and have supplied UI consistently for 15 years on average - although these are not ‘bottom of the pyramid’ suppliers, their involvement in the supply chain does distribute economic activity, employment, profit and income more widely through the Indonesian economy than might otherwise be the case.

Dynamic effects: Average taxes of $130 million (19% of Unilever revenue) paid each year.

Conclusions: This is an important case study because it explains why a well integrated private sector can have such a large impact on poverty reduction. The failure to recognise that a single company can have such a broad impact, through stimulating activity throughout the value chain is common; it is also the case that the managers of large corporations themselves have little idea of their development impact.

Source: Clay (2005) Exploring the links between international business and poverty reduction: A case study of Unilever in Indonesia – An Oxfam GB, Novib and Unilever Indonesia joint research project
Increase productivity; directly improve access to capital markets through deepening of the financial markets; and, reduce risk and vulnerability.

Although the relationship between financial sector development, growth and poverty reduction is complex, it is generally recognised that there is a correlation (OECD, 2006). In many African countries the proportion of people without a bank account reaches 90%. In this context, the lack of financial services is a constraint to economic growth.

Box 8 illustrates how development agencies can work with existing financial and information service providers to broaden the coverage of financial services to the poor.

In both cases above, the effect of development agencies has been to work with mainstream service providers and propose services which are viable for commercial service providers to deliver and therefore of sustainable and scalable benefit to the poor.

### 4.5 Enhancing women’s market access

There are also instances when changes to market rules will have a clear gender bias. For instance, in a recent pro-poor value chain analysis of business and conference tourism in Accra, Ghana – sex workers were identified to be one of the main mechanisms for transfers of resources from tourists to poor people at the destination. The Tourism Bill of June 2009 will, if it passes into law, criminalise sex work in Ghana. Inferring the likely impact of this from the introduction of similar legislation in similar destinations, this is unlikely to result in reduced demand for services but the new legislation is likely to be associated with increasing violence by the police and others against sex workers.

This is an illustration of the difficulties marginalised workers often have interacting with government agencies and accessing basic public services, like security.

This example illustrates the need for policy-makers to understand the impact of policy changes on vulnerable groups as part of the policy analysis process. In societies with a clear gender division of labour, often policies proposals which appear progressive may inadvertently exclude a social group from participating in economic activity. Women may, for instance, be able to trade on the homestead but face serious sanction if they trade in a central market-place.

### 4.6 Constructing inclusive public-private dialogue

The Government Private Sector Forum (G-PSF) in Cambodia is a good example of what can be achieved in a relatively challenging institutional environment. Through providing support to targeted bottlenecks, the Forum has delivered important tangible improvements in the regulatory framework (new legislation to operationalise sector strategic plans; reforms to encourage competition in the economy; removal of infrastructure blockages to economic development).

### Box 9: Government-Private Sector Forum in Cambodia

One of the more effective participatory dialogues between government and the private sector is the Government Private Sector Forum (G-PSF) in Cambodia. This advises governments, private companies and industry sectors on how to grow business sustainably and how to create a healthy investment climate. It is supported by the International Finance Corporation through the Mekong Private Sector Development Facility with support from a broad range of bilateral (Australia, Canada, Finland, Ireland, Japan, New Zealand, the Netherlands, Norway, Sweden, Switzerland) and multilateral (European Union) donors. The G-PSF was set up in late 2006 and has eight Working Groups, each with a specific focus (manufacturing and SMEs; laws, tax and governance; tourism; energy, infrastructure and transport; industrial relations; export processing and trade facilitation; and agriculture and agro-industry).
The Working Group structure has allowed meetings to have relevance to a broad range of stakeholders and has allowed progress at different speeds with different sectors.

5. Conclusion

Private sector development in market economies drives economic growth and this growth is a key determinant of the incomes flowing to low-income households. However, the relationship between economic growth and pro-poor growth is not automatic.

A broad range of market and state failures can provide obstacles to prevent the benefits of economic growth reaching poor households. These obstacles can include: barriers to business formalisation; unequal competition; lack of incentives for entrepreneurship and unequal opportunities for women.

This Note outlines the critique of traditional approaches to private sector development. The market development approach is explained in both conceptual terms and in how applying it influences the choice of development interventions.

The final section of the Note takes the policy advice from OECD on how private sector development can better distribute the benefits of growth to poor people and provides examples of this. These include: removing barriers to formalisation; implementing competition policy; recognising the contribution of the financial sector; enhancing women’s market access; and, constructing inclusive public-private dialogue.

<table>
<thead>
<tr>
<th>Policy issue</th>
<th>Cause, consequence and examples</th>
<th>Policy recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor incentives for enterprise and enterprise</td>
<td>Complex bureaucratic barrier to establishing and operating a business increases the cost of doing business. High unemployment in formal sector. Endemic corruption and high crime rate.</td>
<td>• Predictable rules of exchange (i.e. transparent contract enforcement; property rights; competition on a ‘level playing field’); • Macro-economic stability (i.e. political and social stability, monetary and fiscal discipline, broad tax base and redistributive investment in poor through public expenditure); • Governance: rule of law, access to justice and protection of human rights and low level of corruption;</td>
</tr>
<tr>
<td>Low level, and growth of, productivity.</td>
<td>Lack of access to factor markets (finance, labour and natural resources) by low-income groups. Lack of business infrastructure.</td>
<td>• Improve access to factor markets: financial sector deepening, flexible labour markets and secure access to natural resources on a sustainable basis. • Improve business services and networks, including research organizations.</td>
</tr>
<tr>
<td>Weak international economic linkages</td>
<td>Lack of trade and foreign direct investment flows.</td>
<td>• Trade facilitation – tariff and non-tariff policy, enhance domestic capacity to trade, competitive exchange rates, access to productive resources. • FDI facilitation – lower regulatory risk, knowledge transfer to domestic firms; attractive environment for business.</td>
</tr>
<tr>
<td>Improve market access and functioning</td>
<td>Monopolies or oligopolies and restrictive business practices; inequalities of access to information; insecure rights to natural resources and unsustainable exploitation of natural resources. Poor wages and safety standards in the labour market. Discrimination denies market access to vulnerable groups.</td>
<td>• Enact competition policy and establish competition authority to take action against unfair competition. • Secure rights to natural resources. • Core labour standards and investment in human capital (health, education and training). • Develop pro-poor value chains. • Encourage social cohesion and take action against gender and ethnic discrimination.</td>
</tr>
<tr>
<td>Address risk and vulnerability</td>
<td>Financial volatility disproportionately damages the livelihoods of the poor. Low income groups, particularly those in ‘lagging’ regions are highly risk adverse and excluded from markets.</td>
<td>• Macroeconomic stability and access to factor markets. • Access to insurance and savings instruments, social safety nets and smart transfers. • Public investment in ‘lagging’ regions in economic infrastructure and human capital.</td>
</tr>
</tbody>
</table>
The Joint Donors’ Competence Development Network Train4Dev (www.train4dev.net) is an open forum for donor agencies and multilateral organizations. The overall objective of the network is to promote improved aid effectiveness for poverty reduction through enhanced donor co-operation in the field of competence development and training. It aims to create an environment of mutual support for better competence development by sharing resources, exchanging experience and identifying and following up on useful areas of co-operation.

The Network on Poverty Reduction (POVNET) of the OECD’s Development Assistance Committee (DAC) is a community of practice and a source of expertise on understanding and tackling poverty. Its core membership includes donor governments and multilateral organisations. In recent years, POVNET has developed, and is now disseminating, a set of policy guidance for donors on promoting pro-poor growth (available on the Internet at: www.oecd.org/dac/poverty). This work stresses the importance of supporting developing country-led processes aimed at fostering rapid and sustained economic growth in which poor women and men participate directly, as both agents and beneficiaries.

**Key Readings**

OECD (2005) Accelerating pro-poor growth through support for private sector development


**References**


This briefing note is one in a series commissioned by GTZ on behalf of the Executive Committee of the Joint Steering Committee on Pro-Poor Growth (Train4Dev and OECD DAC POVNET). The views presented are those of the author and do not necessarily represent the views of ODI, ITAD, GTZ, Train4Dev or the OECD.

The paper was written by Henri Leturque, Chris Coles and Dan Harris, Research Officers, Kate Bird, Research Associate and Jon Mitchell, Research Fellow and Director of Programmes, at the Overseas Development Institute. www.odi.org.uk