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Growing Inclusive Markets: A Permanent Way out of Poverty?

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Roughly a little under half of the world's population is mired in poverty, most in the developing world, and many of them trapped in the base of the economic pyramid. The poor and near-poor represent a vast and largely untapped market for goods and services, as well as a potential source of entrepreneurial initiative and productive capacity. Despite the promise of this possible shared gain between business and development, there is growing evidence that the vast majority of the world's poor remain marginalized even as markets continue to expand within countries as well as become more integrated across borders. In some extreme cases, the poor even face a *poverty penalty*—they end up paying more for the same goods and services compared to the rest of the population. Thus the twin challenges faced by both business and development practitioners is to get at the root causes of why markets are not inclusive for the poor, and to formulate possible solutions when and where warranted and feasible.

How do more inclusive markets contribute to human development?

Clearly, not all of the challenges related with poverty are best addressed through markets. Governments can and should continue to play a key role, especially in helping to make markets function in more inclusive ways. A significant body of literature now shows how lack of access to markets, such as those for credit and insurance, could reinforce low asset levels and poverty traps which many of the poor face. Lower access to credit markets and insurance could limit the poor's capacity to smooth consumption and investments (e.g. education, healthcare, etc.) which might ultimately reinforce their poverty. Market access is a critical aspect of the economic lives of many of the poor and near-poor, and successful participation in markets is, perhaps, *sine qua non* in permanently exiting poverty. In certain areas where the public sector has been deficient or even absent, markets (notably informal markets) are in fact the *de facto* recourse of the poor.

Broader access by the poor to markets for goods and services comprising basic needs (e.g. housing, water, sanitation) and those potentially enhancing their economic empowerment (e.g. finance, insurance, money transfer services), could not only contribute to human development, poverty reduction and achievement of the Millennium Development Goals (MDGs)—it could also comprise business opportunities and serve to spur more robust private sector development and perhaps even over-all economic growth.

Furthermore, development can be seen as the process of enlarging and expanding people's choices and freedom. Drawing on this definition, there are several markets for which the poor's

participation is expected to have a large and positive impact on human development, thus comprising the focus of our recent work:

1. Markets for goods and services that could be considered to help satisfy basic human needs of the poor and thus directly improve their welfare and underpin their broader human capabilities (e.g. access to healthcare, housing, water, etc.).
2. Markets for goods and services that could be crucial to opening up opportunities for the poor to enhance their standard of living, increase their income, and further expand their choices, in large part, through economic empowerment (e.g. credit markets, insurance markets, markets for information and communications technologies (ICT) applications, labor markets, etc.).

Markets are therefore inclusive if they provide the poor more affordable access to key goods and services; and if they function in ways that are not exploitative and truly begin to open up opportunities for the poor to pursue economic empowerment and enhance human development.

Innovations to make markets more inclusive for the poor

Market failures, government failures and some of the characteristics of both the poor and business actors, as well as their environment, could act as barriers preventing the poor from more actively participating in markets, both as consumers and as producers. To help make markets more inclusive for the poor, one avenue of response could focus on removing some of these barriers, in an effort to change the environment itself. This line of action might involve, for example, institution-building and extending legal empowerment to the poor, and perhaps even a significant part of the non-poor but still low-income population. However, these types of investments may take time to bear fruit, and in the meantime, a possible alternative might be to work within the present environment. Private actors—including for profit and not-for-profit entities and often in partnership with the public sector—have been able to mitigate some of these constraints through innovations that have helped to make markets more inclusive for the poor, enabling them not just to gain access, but to participate in ways that enhance their economic empowerment and human development.

Some of the innovations, for instance, in the areas of financial services and ICTs include:

- **Smart ATMs:** Prodem FFP, a privately held financial fund, deployed new technology-based products and systems in Bolivia in order to better reach the vast majority of the country's unbanked population. In order to make their services more user friendly in areas associated with low literacy rates, smart cards and digital fingerprint recognition technology have been deployed; and some branches contain *Smart ATMs* which offer services in local languages with color-coded screens.
- **e-Choupals:** ITC, an Indian company, has introduced *e-Choupals* which are internet kiosks which serve both as a social gathering place for exchange of information and an e-commerce hub. The internet-ready computer, typically housed by one farmer, serves an average of 600 farmers in 10 surrounding villages within a radius of about five kilometers. By spreading the costs of maintaining internet access in the village, farmers are better able to maintain access to market information, which in turn is expected to increase their bargaining power.
- **M-banking:** ICTs could help enhance access to banking services. *Mobile phone banking (or m-banking)* is now being offered in a number of countries; and WIZZIT Bank in South Africa is one example. An account offered by WIZZIT costs less than the lowest cost full-service bank accounts offered by South Africa's four major banks or other m-banking providers in the country.

- **Purchasing Through Savings:** Through its *Patrimonio Hoy* program, CEMEX (a Mexican construction company) is able to extend construction and housing services to Mexico's low income population. The centerpiece of PH is a well-planned savings program which allows low-income families to obtain access to services, cement and other building materials on credit. Put differently (and perhaps more creatively) the flexible payment scheme allows them to "purchase their house in installments".

In addition to these, innovations in insurance instruments, notably with the creation of index-based risk transfer products (IBRTPs) could prove useful in overcoming some of the challenges linked to traditional insurance, such as information problems. The payouts of IBRTPs are based on an underlying index (e.g. the amount of rainfall or the total livestock mortality rates), and they differ from traditional insurance products which pay indemnities when realized losses exceed a given threshold. Instead, IBRTPs make payments when the realized value of the underlying index either exceeds or falls short of a given threshold. This design allows it to sidestep the asymmetric information problems of traditional insurance products as policy-holders will not be able to influence the index outcome. And because farm level expected yields or losses need not be undertaken anymore, this also lowers transactions costs and thus enables the product to be offered at a much more affordable price. Examples of these innovations include:

- **Index-based livestock insurance in Mongolia:** Beginning in 2005, insurance companies offered herders in three provinces in Mongolia an IBRTP based on annual livestock mortality rates. The insurance companies make payouts if these mortality rates fall between 7 and 30 percent. Mortality rates in excess of 30 percent trigger government payouts. In addition, the government has also formed a reinsurance pool that covers insurance companies against losses in excess of 105 percent of herder premiums in order to "crowd in" private insurers. As of the completion of the second sales season of the pilot in 2007, 14 percent of eligible herders are participating in the IBRTP.
- **Index-based weather insurance in India:** Beginning in 2003, ICICI Lombard General Insurance Company offered IBRTPs to farmers in some parts of India. First offered in the state of Andhra Pradesh, IBRTPs are marketed through the microfinance institution BASIX. These instruments help to protect farmers against the impact of insufficient rainfall during the sowing and crop growth phases of the Kharif (monsoon season) and against excessive rainfall during the harvest phase. Rainfall-based IBRTP offerings by the company have exceeded 7,600 policies across six Indian states by 2005.
- **Index-based natural disaster insurance in Mexico:** Since 2003, Mexico's Agricultural Natural Disaster Fund (FAPRACC) has provided assistance to small farmers in the event of weather-related shocks such as those resulting in frost and wind damage. The cost of providing this assistance is shared between the federal and state governments on a 70-30 basis. FAPRACC has turned to weather index insurance in order to transfer some of the risk exposure from the budgets of the federal and local government onto international markets. AGROASEMEX, the state-owned reinsurance company, issues insurance contracts which are in turn reinsured internationally.

Further Research

Are all these initiatives going to be successful in achieving financial viability, or even perhaps achieve competitive rates of return? Is there a trade-off between financial viability and penetrating deeper into low-income markets? Will the positive development impact be significant and sustainable? Is the majority of the poor—for instance, those living on less than \$2 a day—going to be reached? And perhaps most important, are these strategies and innovations reflective of an emerging trend? For the most part, we find that the answers to these questions are still largely based on inference rather than on conclusive empirical evidence. Though there are a number of impressive success stories, most of what we find are still preliminary. Nevertheless, change seems to be underfoot—the direction and scope of how

private actors and their innovations are reshaping the low-income market landscape is clearly a fertile area for continued research.

Some General Sources:

This issue of *HD Insights* draws on research undertaken by the Office of Development Studies in the context of the Growing Inclusive Markets Initiative, a multi-stakeholder effort led by UNDP exploring opportunities for business and human development advancement (www.growinginclusivemarkets.org)

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