



**TRANSFORMING BUSINESS RELATIONSHIPS**  
Inclusive business in Latin America



FORDFOUNDATION

**SNV**

**FOMIN**

Fondo Multilateral de Inversiones  
Miembro del Grupo BID

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# FOREWORD

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As an innovation laboratory, the Multilateral Investment Fund (MIF) focuses on testing new models that promote the inclusion of micro and small enterprises, small agricultural producers, and poor and vulnerable households. Working closely with our staff based in Latin America and the Caribbean, and with executing agency partners on the ground, we have always made sure to include the individuals and communities we serve in the process of planning, executing, and evaluating our projects. Exploring the emerging concept of “inclusive businesses”—which not only incorporate vulnerable populations into value chains as customers, providers, and distributors, but also treat them as co-creators of innovative solutions - was therefore a natural fit for the MIF.

Between 2007 and 2012, we partnered with the Dutch not-for-profit development organization SNV on three projects that provided technical assistance and training in implementing inclusive business plans to local firms and service providers in Nicaragua, El Salvador, Honduras, Peru, and Ecuador. Twenty-two private sector companies contributed not only financial resources, but also knowledge, time, and human resources to develop specific models in a range of industries, including tourism, agricultural production, biofuels, and construction. The interventions linked over 8,000 beneficiaries to value chains, generating a significant increase in their incomes. Additionally, over 250 local consultants and business advisors were trained in the development and implementation of inclusive business plans. The models created were shared in national and international events, leading an additional 25 companies in the region to develop their own inclusive business approaches.

To develop this study and contribute to the growing knowledge base in this topic, the MIF joined forces with SNV and the Ford Foundation, like-minded organizations that have developed their own inclusive business initiatives focused on creating sustainable commercial relationships for vulnerable populations. Based on the experience of the SNV and MIF projects, this study analyzes issues related to scale, governance, and degree of inclusiveness — for small producers and enterprises, as well as for anchor companies — in order to identify common success factors.

The MIF continues to feed the learning from these experiences into the development of new business models and strategies in partnership with large companies, in order to help small firms and farms capture greater value from supply chains across Latin America and the Caribbean.

Fernando Jiménez-Ontiveros  
Acting General Manager  
Multilateral Investment Fund





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# INTRODUCTION

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It is a great honor and pleasure to present this report produced by one of the early promoters of the idea of inclusive business, one of the main supporting institutions and advocates in the field, and one of the world's most knowledgeable teams on this issue. With this impressive report, SNV is closing the feedback loop, systematizing more than a decade of continuous thinking, designing, testing, advising, implementing, monitoring, and evaluating in the area of inclusive businesses. Some experts in the field might wonder: Another report on the subject—is there still something that we do not know? While an ample literature exists on inclusive businesses, there still seems to be a big knowledge gap on at least three simple but key questions, which this study aims to answer: (1) Is there a business case for inclusive businesses? (2) Is the model scalable? (3) How inclusive are inclusive businesses?

First, why is it important to have a business case for inclusive businesses? Because without a business case, inclusive businesses very likely will remain a hidden galaxy within the universe of businesses, with a significant impact but on a relatively small number of low-income suppliers or poor customers. In other words, the business case is a necessary condition for scale. Most of today's inclusive businesses have been created—or transformed from non-inclusive to inclusive—by visionaries who did not wait for a wave of evidence that a company can both be profitable and contribute to improving the quality of life of low-income people. Driven by social values, economic opportunism, or both, these pioneers are the artisans of the 150 cases reviewed and 27 businesses described in detail in this study. The problem is that, just as not everyone is an entrepreneur, not every entrepreneur is a pioneer. After a first batch of entrepreneurs had been convinced of the value of inclusive businesses, SNV identified a “ceiling,” with no second batch of followers in sight. Evidence is key for attracting these followers, and the hope is that this report will aid in convincing other entrepreneurs to follow the inclusive business model.

Second, the fact that there is a business case for inclusive businesses does not automatically mean that the model is scalable. The report highlights key conditions for organic growth and replication: changes within companies and their relationships with the community, changes within the larger value chain, changes in public goods and infrastructure, and changes in public policies. The tricky question here is: should there be specific incentives for the expansion of inclusive businesses? Lessons learned from similar fields say hopefully not, as each ad hoc incentive could eventually affect the scaling potential; but “smart incentives,” focused on specific market failures and bound in time, can be very useful to overcome barriers and improve markets. Three examples of public–private initiatives (PRONERI in Ecuador, the National Federation of Coffee Growers in Colombia, and PROBIOSAM in Peru) are extremely useful for understanding the importance of building conducive “ecosystems” for inclusive businesses, as well as the challenges involved.

Finally, looking at the impressive list of experiences selected for this study, it could seem too obvious to ask ourselves, “How inclusive are inclusive businesses?” as most of them are well known for their impact on low-income families (suppliers and consumers). But the answer isn’t overtly clear for a couple of reasons. First, beyond the indispensable and often significant economic impact on poor families’ ability to sell their products on better terms or to buy cheaper and higher-quality products, inclusive businesses also have non-economic impacts that transform lives: trust, mutual understanding, strengthened associations, co-creation, empowerment, formalization, and so forth—in a word, dignity. Many economists might consider these impacts to be mere positive externalities, a cherry on the cake but much less important than the cake itself. At the Ford Foundation, we consider these changes just as important as increased income and assets. Second, it is also important to look at the inclusiveness of inclusive businesses because very few so-called inclusive businesses actually gather information on who they benefit and how. Most often, the tools used to assess socioeconomic impact on low-income families are either rough proxies (“sales are increasing”) or individual stories (“Doña Juanita could pay the school fees for her daughter”). If the concept of inclusive business is destined to make its way in economic history, stronger evidence of its inclusiveness is dramatically needed. Other comparable initiatives using different concepts, such as inclusive value chains, fair and organic trade, sustainable procurement, and B Corporations, among others, are showing the importance of standards as well as strong monitoring and evaluation systems.

In summary, we believe that this report will be extremely helpful to a wide range of stakeholders, entrepreneurs, policy makers, advocates, technical supporters, researchers, and donors. It condenses in one document dozens of lessons learned the hard way and suggests how each of us can help to better “re-embed the economy in society,” in Karl Polanyi’s phrase, by fostering businesses that combine economic profitability and social impact. Inclusive businesses can help make a better world, as does this brilliant report.

Jean-Paul Lacoste  
Representative, Andean Region and Southern Cone  
Ford Foundation

# LIST OF ACRONYMS

BoP	Base (or bottom) of the pyramid
CEDES	Consejo Empresarial para el Desarrollo Sostenible
CIGRAH	Comercial Internacional de Granos de Honduras
CSR	Corporate social responsibility
FNC	National Federation of Coffee Growers (Colombia)
GDP	Gross domestic product
GIM	Growing Inclusive Markets
GORESAM	Regional Government of San Martin (Peru)
GPN	Global production network
IB	Inclusive business
ICA	International Copper Association
IDB	Inter-American Development Bank
IDB-MIF	Inter-American Development Bank Multilateral Investment Fund
IDB-OMJ	Inter-American Development Bank Opportunities for the Majority initiative
IFC	International Finance Corporation
INIBP	International Network for the Improvement of Banana and Plantain
ISO	International Organization for Standardization
LAC	Latin America & the Caribbean
MCG	Mercon Coffee Group
MDS	Ministry of Social Development
MFI	Microfinance institution
MIX	Microfinance Information Exchange
MNC	Multinational corporation

MSME	Micro, small, and medium enterprise
OECD	Organisation for Economic Co-operation and Development
PPP	Purchasing power parity
PRN	Novacero Recycling Point
PROBIOCOM	Program for the Promotion of the Use of Biofuels (Peru)
PROBIOSAM	Biofuel Program of the San Martin Region (Peru)
PROCASO	Programa para la Calidad Sostenible
PRONERI	Rural Inclusive Business Program (Ecuador)
SEA	Social Enterprise Alliance
SENAI	National Service for Industrial Education (Brazil)
SNV	SNV Netherlands Development Organisation
TRC	Tambopata Research Center
UNDP	United Nations Development Programme
UNIRON	Inter-American University of Porto Velho
VCD	Value-chain development
WB	World Bank
WBCSD	World Business Council for Sustainable Development
WRI	World Resources Institute

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## EXECUTIVE SUMMARY

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This report reflects the results of a research project carried out by SNV during 2011 and 2012 with funding from the Ford Foundation and the Inter-American Development Bank's Multilateral Investment Fund (IDB-MIF). The aim of the research was to investigate the extent to which inclusive business initiatives can make a substantial contribution to improving the living conditions of the poor while at the same time providing companies with enough financial or other incentives to scale up such initiatives—specifically, to a size commensurate with the problems of poverty and exclusion that emerging economies face. Inclusive business (IB) is defined as a profitable as well as environmentally and socially responsible business initiative that, while creating value for the company, contributes to improving the quality of life for low-income communities through their participation in the value chain of a business. It harnesses the growth potential already found in businesses and links this potential to social objectives. IB models can involve the poor as suppliers, distributors, or consumers of goods or services, or as shareholders and partners in the business initiative.

To generate clarity on the potential of IB to make a substantial contribution to improving the living conditions for the poor, while at the same time providing businesses with the financial incentives to invest in it, three questions are examined: (1) Is there a business case for different IB models—for the company as well as for the communities involved—that expresses the value generated for both parties? (2) What does “inclusiveness” in such models look like and how can it be assessed? (3) What conditions need to be in place to achieve IB results, and how can they be sustained and taken to scale?

To provide insights about the research topics, 27 IB initiatives in Latin America were selected for study. Criteria for selection included: being well established (i.e., having gone through at least one cycle of design–implementation–results); having been scaled or showing the potential for scale; and involving a target-group population with income levels under US\$8/day, including a segment with income under US\$2/day, at the start of the initiative. The selected initiatives include a set of projects that were developed within an IB program implemented between the Multilateral Investment Fund (MIF)—part of the Inter-American Development Bank (IDB) Group—and SNV. The primary research was exploratory in nature and focused on lessons learned, common challenges, key conditions, and successful approaches for achieving desired results and impacts. It aimed to provide insights for companies, community groups, policy makers, donors, NGOs, and others that support IB initiatives, and contribute to making IB practice effective and beneficial for all involved. In total, 20 IB cases were investigated that involve low-income communities as suppliers, three cases in which the IB initiative is geared toward products and services for low-income consumers (some of these cases also include low-income people as employees or partners in the business), and four cases in which low-income people form part of the company

structure as business partners or as employees (and products and services are not specifically geared towards low-income communities).

Apart from looking into individual IB initiatives, the study assesses the conditions that need to be in place to achieve and sustain results, and then take them to scale. Those conditions, although partially inherent to the relationship between a company and the communities involved in an IB initiative, in many cases are related to the extent to which the environment in which IB initiatives take place enables their development, sustainability, and potential to scale. The existence of supporting mechanisms for companies and communities, such as funding, infrastructure, technical assistance, and policy incentives, are influenced to a certain extent by public policy conditions. For this reason, policy contexts were studied in more detail for three South American countries: Ecuador, Colombia, and Peru. The role of public policy and the way it enhances an environment that enables inclusiveness was examined. The social and political contexts in which the policies were implemented, the implementation process and the institutions involved in that process, the results and impact of the policies, as well as the lessons learned were all observed. Public policy mechanisms were analyzed to provide insight on the role that public sector actors can play within the larger system in which IB initiatives take place, referred to as the IB ecosystem.

The research findings show that most of the IB initiatives studied actually help both the low-income participants and the companies involved to achieve their underlying goals. Where such a business case exists, the parties are able and willing to justify the expenditure of resources and capital and to decide to take action. The cases show that both companies and low-income participants take a conscious decision based on perceived benefits before entering into an IB initiative. In that sense, IB clearly differs from philanthropy and from working with low-income communities as beneficiaries in general: the low-income segment in IB is not a mere receiver of benefits, but a co-creator of them. The business case for an IB initiative is linked to the return on the investment, expressed as the increase in total value generated for the parties involved: low-income participants, companies, and eventual investors or donors. This increase in total value allows for sharing the additional value, beyond mere redistribution of the existing value. The research provided insights into what that value consist of and how it increases through the application of IB models.

For the companies, the economic gain of involving low-income communities as suppliers in their value chain is reflected in the improvement of their supply chain and a better response to market demands, which leads to an increased market share. In the case of low-income communities as consumers, companies increase their market share through gaining access to new markets. And, by working with low-income communities as partners or employees, companies gain access to local labor and in some cases to community assets under conditions approved by the community itself. In all types of IB models, companies improve their branding through working with low-income communities in a socially responsible manner and improve community relationships, thereby helping to sustain operations.

For low-income communities, being involved as suppliers with companies through an inclusive business relationship implies stability—and often an increase—in their income. Furthermore, they acquire improved access to markets and funding, as well as an opportunity to increase their capacities through

training and technical assistance. Low-income consumers gain access to quality products and services at affordable prices, and in some cases access to the formal economy, offering them an opportunity to lower the risks related to informal arrangements. Low-income distributors mention capacity development, along with stable and increased income, as the principal gains. In all cases, this leads to an increased potential to save money and/or reinvest in goods and services, resulting in improved social well-being.

The “inclusiveness” of IB initiatives, and what sets IB apart from business as usual, lies in the fact that at its best, an IB initiative transforms the business relationship between the company and the community, and their approach and attitude towards each other. For the relationship to be successful, it needs to be based on—and cater to—mutual interest, as the parties depend on each other to fulfill their objectives. It is clear that within that relationship of interdependence, a company can exercise more influence than the individual supplier, consumer, or distributor. Some of the successful cases therefore include the strengthening of community organizations—not only by guaranteeing the representation of community interests, but also by facilitating communication, coordination, and collaboration with a company, and generating efficiencies in transactions.

In addition, and as shown through the public policy cases, an IB relationship and its results do not solely depend on the nature of the relationship between company and community. The cases studied reflect how in an IB ecosystem, the roles of regulator, facilitator, and funder of an IB initiative may evolve around the core IB relationship between the buyers (companies) and the suppliers (smallholder producers) of a product. They show how different roles can be played in distinct manners, and what instruments are used by the actors that play them. In some cases, the inclusive relationships between buyers and producers were already present at the heart of the policy initiative. In others, a policy framework was developed to generate them.

Ideally, the mechanisms and roles present in the IB ecosystem represent a framework through which public, private, and social actors operate together in generating value. In the cases analyzed for this study, however—both IB and public policy cases—such a framework, with common objectives among the actors involved, was rarely found, and where it existed, it suffered many complications when put into practice. The cases do show, though, that specific policy mechanisms and instruments have proven to be successful in enhancing inclusion and generating added value.

In some of the cases studied, inclusion of low-income communities in a company's value chain, rather than being a separate project with its own goals and investments, was or became a matter of “business as usual” for the initiators (examples are Floralp in Ecuador, Eletropaulo in Brazil, and Edyficar in Peru). These experiences and their results to date suggest that mainstreaming inclusion in common business practices is one way of achieving sustainable results at scale. The companies in question acknowledge low-income groups' relevance for and importance to their business model. They indicate that their prime motivation is a business interest, since without returns on their investments in these groups, the companies would not be able to sustain the initiative; yet at some point they did take the decision and made the investment of designing (part of) their business around the groups, with mutual value creation in mind. Capital investment in inclusion in such cases becomes part of the business model

and is reflected in the bottom line, rather than being seen as funding for a separate social project, or a subsidy required to achieve social goals.

## METHODOLOGY



This study was primarily developed using qualitative methodologies, particularly structured desk research. First, existing IB initiatives were mapped at the global level, using publications from 2005 to 2010. General information on inclusive businesses was analyzed, hypotheses were made and generalizable guidelines and lessons learned identified. In the second stage, 27 Latin American cases were selected to deepen the research.

The case studies presented were developed by conducting ethnographic studies of the beneficiaries of the implemented business models, plus in-depth interviews with representatives of the anchor companies. Ethnography is a qualitative research tool based on direct and participatory contact with the target public (individuals or groups) for a defined time period. These studies are used to reveal and/or understand the meanings that underlie the actions and interactions implicit in the social reality of the group studied. In this case, the ethnographers lived with the beneficiary families for a period of time to gain a deep, evidence-based understanding of the impact of inclusive businesses on the quality of life of the families involved in the program, as well as improvements in their income and their relationship with the ecosystem, specifically with the anchor company. More than 100 families were visited in total, 500 informants were interviewed, and over 1,700 hours of materials (recordings, notes, and others) were gathered. The information collected covered 12 topics aimed at understanding the impact on food, income, social networks, education, health, services, new business, and other dimensions. When selecting informant families, a “typical sample” —i.e., the most repeated profile within the same group of people— was sought, avoiding isolated cases or cases with characteristics very different from the average.

The main field instrument was an observation guide, which is a flexible and permeable format that lists relevant aspects, emphasizing previously identified dimensions related to the targets. The guide is used mainly as a general structure that coordinates the process of collecting information so that the researcher does not lose sight of the study’s focus. Its main feature is that its application does not follow a normal sequence, since it has to accompany—not alter—the resulting social interactions of the fieldwork.



In some case studies, quantitative data from baseline surveys were available; these were used to enrich the analysis but not for comparative analysis. In-depth interviews were used to collect information from the anchor companies because quality information was needed. However, it was challenging to complete the process in a much shorter timeframe than the ethnographic portion of the research because of the informants' characteristics. The research consisted of face-to-face meetings between the researcher and company representatives who were directly involved in the implementation of the IB model, with the aim of understanding the informants' different perspectives on the business, its implementation, and the results. The purpose of using a structured guide was to understand the impact of inclusive businesses on the company's: economic performance, sustainability indicators, capacity, knowledge, and network building, brand, and reputation.

In many cases during an interview with the anchor company, in addition to the representatives, third parties, linked to the IB, were identified (such as the public sector or NGOs). These were also interviewed, bringing to 67 the total number of interviews conducted during the research.





CHAPTER 1

“INCLUSIVE BUSINESS”  
DEFINED AND COMPARED



# “INCLUSIVE BUSINESS” DEFINED AND COMPARED

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## 1.1 Market-based solutions to development

There is a growing acceptance within the international development sector that the key to reducing poverty in the Global South<sup>1</sup> lies in helping the poor access markets and in making markets work for the poor. In particular, market-based solutions that leverage the role of business as a contributor to development have taken center stage in discussions on poverty reduction. Such solutions recognize the market as the primary engine of economic growth, and a vehicle through which such growth can be made inclusive of the poor. They take the market and its forces as starting points for addressing both development and business constraints in a long-lasting and sustainable manner. Service provision is financed within the market system, and services and results have the potential to repeat, scale up, and renew themselves beyond temporary facilitation.<sup>2</sup>

Market-based solutions leverage the role of business as a contributor to development.

Underlying this perspective are two powerful currents of reasoning that shape the dialogue:

- **Traditional development strategies have not been sufficient:** Current approaches to development cooperation are not achieving results commensurate to the needs in developing countries. Subsequently, increased pressure on the development sector has ignited a sense of urgency to explore new—effective, sustainable, and scalable—approaches to reducing poverty. Development actors like the World Bank (WB), the Inter-American Development Bank (IDB), and the United Nations Development Programme (UNDP) have recognized that the private sector must participate in the design and implementation of a more inclusive, pro-poor process of economic development.
- **Doing business with the poor can generate mutual value:** A growing number of private sector companies are viewing the poor’s unmet needs and potential as untapped market opportunities.<sup>3</sup> They believe that the business community can, while ensuring their own economic interests, promote sustainable growth and development in society. There is an increasing recognition that the poor—beyond being mere beneficiaries—must be participants in the design of inclusive solutions, becoming true business partners.

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1. According to the United Nations, the term “South” or “Global South” refers to developing countries located in the Southern Hemisphere. For more information, visit [http://ssc.undp.org/content/dam/ssc/documents/exhibition\\_triangular/SSCExPoster1.pdf](http://ssc.undp.org/content/dam/ssc/documents/exhibition_triangular/SSCExPoster1.pdf)

2. UNDP-GIM 2008.

3. Prahalad, 2006.

Various academics and business researchers, such as Prahalad and Hart (2002), London (2007), and institutions, such as the UNDP (UNDP-GIM 2008) and the Organisation for Economic Co-operation and Development (OECD 2006), have concluded that the time is ripe for private sector companies and investment funds to take the lead in investment in developing countries, facilitated and followed by development organizations. Quick wins and innovation often start at the business end of the chain. With the private sector in the lead, new challenges come into view. Among them is the need to balance a sector focus on development with business-to-business initiatives, as well as an understanding of the role of “lead firms”: enterprises that can heavily influence standards and specifications applied to other stakeholders of the value chain and whose decisions highly influence the organization and power along the chain.

Inclusive business is a means through which companies contribute to development outcomes while creating value for the company.

Integrating poor and vulnerable populations through direct relationships with companies has become known as an inclusive business (IB) approach. Inclusive business is defined as a profitable, as well as environmentally and socially responsible business initiative that, while creating value for the company, contributes to improving the quality of life for low-income communities through their participation in the value chain of a business. It harnesses the growth potential already found in businesses and links this potential to social objectives.<sup>4</sup> IB models can involve the poor as suppliers, distributors, or consumers of goods or services, or as shareholders and partners in the business initiative.

Inclusive business has been promoted as a way for companies to contribute positively to development outcomes, such as basic needs fulfillment and increased productivity, income and job generation, and empowerment of the poor. An IB model starts from a business objective to generate profit and combines that with opportunities to generate value for low-income communities.<sup>5</sup>

## 1.2 A comparison of market-based approaches

Current practice of IB to a large extent builds on, and can be seen as an evolution of, experiences in market-based approaches to development that have been implemented over the past decades. These experiences have been driven by both the private sector and the development sector and include value chain development (VCD), corporate social responsibility (CSR), micro, small, and medium enterprise (MSME) development, social enterprises, shared value creation, and so-called BoP (base of the pyramid) ventures.

Value-chain development focuses on the distribution of added value throughout the chain.

### *Value chain development*

“Value chain” is a concept from business management literature that was first described by Michael Porter (1985) as a way to deconstruct an organization’s value-adding activities. His value chain concept has been extended beyond individual firms and is now applied to whole supply chains and distribution networks, which are usually referred to as “extended


4. SNV and WBCSD 2010.

5. Ibid.

value chains”, or “value systems”. When divided among several companies and spread across the world, they are referred to as “global value chains.” The focus is on the distribution of value added throughout the chain among different stakeholders, and on how these can acquire new technological, institutional, and market capabilities to make them more competitive through a process of upgrading

In addition to the traditional vision of the input-output structure of chains and their geographical proximity, or spatial distribution, increased emphasis has been placed on the governance structure of value chains.<sup>6</sup> At its simplest, governance is the way in which a system and its actors make decisions and put these into action. The concept, practice, and prioritization of governance have evolved rapidly since the 1990s. Within the value-chain system, this evolution has rebalanced the relative bargaining power and influence between actors in the system, with deeper integration, interdependence, and collaboration. However, certain key actors, lead firms, or “governors of the value chain” have the capability and power to define the parameters of contracts and subcontracts in the chain.

Prior to the 1990s, governance in value chains predominantly relied on vertical integration. Firms with relatively strong bargaining power and influence in the value chain led the dynamic. In the mid-1990s, the focus of large companies started to move away from vertical integration toward networks. The emergence of new actors and economic roles in value chains, and a shift in the focus of power from producers to retailers to consumers, changed the perspective of firms and their logic around value-chain governance. With that, flows of materials, semi-finished products, design, production, financial services and marketing services became organized both vertically and horizontally in complex and dynamic configurations, or global production networks (GPNs).<sup>7</sup> This shift implied major changes in how international production and trade systems are organized over time, and is an example of how the adaptation of governance frameworks in value chains is evolving with globalization and constantly changing economic, informational, market, and technological contexts. It also shows that the concept of value-chain governance as a defining feature of global industries is not static and encompasses all actors involved in the chain.



Governance of value chains: from vertical integration to horizontal networks

Value chain governance, horizontal networking, and clusters have become central issues in understanding and upgrading value chains’ competitiveness. Horizontal integration or networks between stakeholders—understood as longer-term arrangements among firms doing similar tasks—may be spread across geographical borders and between actors from different links and contexts in the value chain.

Networks have become valued as means through which actors in the value chain coordinate activities with the objective of reducing transactional costs, reaching economies of scale, and contributing to increased efficiency in the sector. The value chain and its actors become more competitive as a whole. Some examples are: coordinated efforts for input purchase or for marketing; complementarities in the division of tasks; and networking of externalities such as access to information and learning. Such networks are based on pooled interdependence, and they can reinforce the bargaining position of stakeholders within the chain.<sup>8</sup>

6. Gereffi 2002; Gereffi, Humphrey, and Sturgeon 2005; Gereffi and Korzeniewicz 1994.

7. Altenberg 2007; Gereffi 2001; Henderson 2005.

8. Ruben, Slingerland, and Nijhoff 2006.

A geographical perspective on value chain governance seeks to build competitiveness in the sector around a specific territory. This “cluster” concept adds a spatial dimension to the traditional sectorial-focused value chain development. Unlike the sectorial approach, clusters may involve organizations that do not have a direct role in the production process, such as think-tanks, consumer associations, and even competitors. Actors in a specific value chain are often concentrated in one geographical location, and a cluster strategy seeks to gain or enhance competitive advantages in the value chain by coordinating actors, resources, and strategies located in a specific territory

Clusters include inter-firm relations and other actors in a specific geographical location.

The cluster concept stresses two main elements: (1) the embedding of firms in complex inter-firm relations; and (2) geographical proximity. Additional and influential elements that are usually not addressed in value chain analysis are made visible through the cluster approach. Examples are: the

role of local sociocultural backgrounds with shared values that imply a common work ethic; a well-framed system of law between private and public institutions; the presence of local labor organizations; the existence of formal and informal mechanisms of knowledge transfer; and the dynamics of joint action between firms at the same stage of the value chain

Supply chain collaboration is of key importance for local producers (smallholder farmers and small enterprises) in developing countries who wish to participate in regional or global markets, gain access to new and profitable market outlets, and develop innovative product–market combinations.<sup>9</sup> Local producers should be not only cost-competitive, but also able to comply with quality requirements, guarantee reliable supply, and strictly maintain safety and health regulations. Initial market access is not enough, and attention should be given to the capacity of local producers to maintain constant deliveries and reliable and uniform appearance, taste, and quality in their products over time. Access to market information and network governance to enable timely responses to demands for capacity development and knowledge dissemination are becoming key dimensions for maintaining competitive advantage.<sup>10</sup> In addition, value chain development approaches increasingly recognize that producers are inextricably linked to the needs of consumers, and suppliers, processors, and retailers need to work closely to produce the specific goods required by consumers. In particular, food and agribusiness chains are now greatly affected by consumers’ concerns regarding quality, safety, and the sustainability of food production and handling methods. These concerns are expressed in increased consumer demand for certified products.

### *Micro, small, and medium enterprise development*

Often within the logic of VCD, specific attention is given to the inclusion of micro, small, and medium enterprises (MSMEs).<sup>11</sup> They form a very heterogeneous group that encompasses a wide array of business activities, with different levels of sophistication, competencies, and performance. In low-income countries, micro enterprises commonly are self-employment, family-run “survivalist” businesses operating in the semiformal and informal sector. In contrast, small and medium enterprises usually

9. Ibid.

10. Ibid.

11. MSMEs can be categorized in many ways. Micro-enterprises are usually defined as firms with less than 10 employees and large companies as firms with over 250-500 employees. Among and even within the categories, there is great variety in terms of the motivation, orientation, impact and needs of different enterprises (Nelson 2006).



operate in the formal sector, contract employees, and participate more fully in the organized market.<sup>12</sup> However, no “one-size-fits-all” definition exists that clearly determines the boundaries between one category and another. Each country has its own criteria to characterize MSMEs. These criteria are usually based on the number of employees, an economic variable such as the amount of sales, or a combination of the two. In most developing countries, MSMEs typically account, on average, for more than 90% of all firms,<sup>13</sup> are a primary source of employment, and generate a substantial share of gross domestic product (GDP). In Latin America, the proportion of MSMEs within the total amount of enterprises ranges between 82% in Chile and 99.9% in Brazil.<sup>14</sup> In terms of employment generation, MSMEs provide 42% of jobs in Mexico and 71–73 % in both Chile and Colombia.<sup>15</sup>

Due to these characteristics, **MSMEs’ role in promoting economic and social development and in fostering poverty reduction strategies in developing countries has been widely recognized.** However, MSMEs often lag behind larger firms in many dimensions of performance: they remain small and fail to export. A variety of programs have been put in place over the past 30 years and across many countries—developing as well as high-income ones—to offer financial and non-financial, often subsidized, services to MSMEs.

Such programs address the constraints MSMEs face to become more competitive. Program components usually include:

1. Access to finance (subsidized and/or credit)
2. Business development services, divided into:
  - Operational services (development of managerial and workforce skills, technology upgrading, quality control, and productivity improvement)
  - Strategic services (access to information about market opportunities, network formation, and export promotion).<sup>16</sup>

In many cases, MSME programs also address the cumbersome bureaucratic procedures for setting up, operating, and growing a business, which are more burdensome for MSMEs than for their larger counterparts. With regard to the bureaucratic obstacles to enter the formal economy, De Soto emphasizes the role played by public institutions in enhancing MSME potential.<sup>17</sup> According to him, the legal system is the main entity responsible for the reduced participation of micro and small enterprises in the market economy. Facilitating the formalization of unrecorded economic activities, or “dead capital,” would lead small enterprises to have easier access to credit, increase their business, and expand their activities.<sup>18</sup>

Little research is available on the effectiveness and conditions for success of micro, small, and medium enterprises as a model for income and employment generation.

12. Hallberg 2002.

13. Ibid.

14. Vives, Corral, and Isusi 2005.

15. Ibid.

16. Batra and Mahmood 2003.

17. De Soto 2000.

18. “Dead capital” is the term used to identify properties and businesses not legally recognized. The dead capital in 12 Latin America countries is worth US\$1.2 trillion (Institute for Liberty and Democracy figures from a 2006 ILD publication, reported in Hammond et al. 2007).

Combining MSME development with the establishment of market linkages improves access, innovation, knowledge, and skills in the MSME.

Despite the existence of numerous MSME development programs in many countries, remarkably little is known about whether and to what extent they work, which programs are more or less effective, and why this is the case. A 2011 study by the World Bank draws some initial conclusions. The study evaluates the impacts of SME programs in four Latin American countries (Chile, Colombia, Mexico, and Peru) and reports the statistical impacts of participation in any SME program on sales, as well as positive impacts on other measures of firm performance varying by country, and differences in impacts across programs. The study recognizes differences in the effectiveness of SME programs and attributes the ineffectiveness of some programs to poor design and implementation. It notes that failure to find positive impacts in other programs may also be the result of inadequate use of monitoring and evaluation tools. Therefore, the understanding of why some programs work while others do not, and how programs can be made more effective, remains quite limited.

As stated earlier, and as an alternative (or in addition) to MSME development programs, linkages between large firms and MSMEs may improve access to new markets, innovation, knowledge, and skills for small companies. At the same time, SMEs may offer large firms a channel to reduce costs, increase productivity, enhance reputation and license to operate, access local knowledge, and integrate into foreign or BoP markets.<sup>19</sup>

The application of CSR has evolved over time from corporate philanthropy, or social marketing, to applied corporate strategy, seeking the triple bottom line.

### *Corporate social responsibility*

The past 50 years have seen a series of debates and changes around the concept of social responsibility. In the past, “maximization of profits” was seen as the “social responsibility of business,” since this would lead to jobs and income creation in society. Today, companies are increasingly adopting an alternative business philosophy that integrates social responsibility. These socially responsible, values-centered, ethical, or sustainable enterprises attempt to be good as well as successful by simultaneously achieving economic, environmental, and social goals, now known as the triple bottom line.<sup>20</sup> This approach required a new mind-set, according to which responsible practices and profitable practices are one and the same.

Consequently, the role that a company plays in society (and the way that role is perceived) has changed over time:

#### **1950s: Company alignment with society’s values**

The first reference to “social responsibility” can be traced back to Howard Bowen’s 1953 work *Social Responsibilities of the Businessman*, in which the author stated that addressing social responsibility focuses on making decisions that are aligned with the goals and values of society. The company has

<sup>19</sup>. Jenkins et al. 2008.

<sup>20</sup>. Elkington 2004.

both an economic and a social purpose, indicating from a philosophical perspective that the company should pay attention to particular groups in society, especially to groups within the company.

### **1970s: Company responsiveness to society's needs**

After the mid-1960s, social activism gained strength and momentum, and the discussion changed from philosophical to strategic. In 1975, Robert Ackerman proposed, in *The Social Challenge to Business*, that the company must develop what he called "social responsiveness." Later that decade, Archie Carroll continued with "responsiveness" and developed the concept of "corporate social performance" through his "pyramid of responsibilities" model, based on economic, legal, and ethical principles and expectations.

### **1980–90s: Setting CSR targets and identifying stakeholders**

In 1984, Edward Freeman established parameters to identify a company's stakeholders: "any group or individual who can affect or who is affected by the achievement of the company's objectives".<sup>21</sup> In the same year, Peter Drucker proposed that companies should set targets for CSR based on tangible political and social conditions of the medium. Similarly, he stressed the need to establish CSR within the limits of the company's powers.<sup>22</sup> In the early 1990s, Donna Wood revisited Carroll's model of CSR and built upon it, incorporating principles that motivate responsible behavior in companies, the process of responsiveness toward society, and the outcomes of performance.<sup>23</sup> Wood related the four dimensions (economic, legal, ethical, and philanthropic) to the principles that motivate a company's responsibility actions at three levels of analysis: the institutional (social legitimacy), organizational (public responsibility), and individual (managerial discretion).<sup>24</sup>

### **2010s: CSR 2.0—taking CSR to mainstream business practices**

With half a decade of social responsibility programs underway, critiques arose as to how the concept was being implemented. Some companies adapted social-marketing campaigns to position themselves as corporately responsible, when in reality their core business practices were neither inclusive nor responsible as defined by the proper CSR concept. In some cases, CSR programs much more resembled corporate philanthropic ventures than fully responsible business practices.

In *The Age of Responsibility*, Wayne Visser argues that business should be encouraged to make the transition to systemic responsible behavior or responsible business 2.0 (the second generation of CSR).<sup>25</sup> The new dimensions that comprise responsible business 2.0 are innovative partnerships, stakeholder involvement, a shift in power from centralized to decentralized, and a shift from marginal to mainstream responsible business practices.<sup>26</sup> Within this same logic, the IDB has defined CSR as **"the corporate practices**

Companies really practicing CSR make the shift from marginal to mainstream responsible business practices.

21. Freeman 1984, 46.

22. Drucker 1984.

23. Wood 1991.

24. Rendtorff 2009.

25. Visser 2011.

26. CSR International 2015.

**that complement and support main business activities and explicitly seek to avoid damage and promote the well-being of stakeholders by complying with the law and voluntarily going beyond it”.**<sup>27</sup>

In 2010, the International Organization for Standardization (ISO) launched a standard with guidelines for social responsibility (SR) in the ISO 26000, also known as ISO SR. This standard stems from the principle that all organizations that wish to address social responsibility and related behavior should adhere to standards or rules of conduct. One of the advances made by the ISO SR is recognizing that a company’s social responsibility must be within a set of principles and related to core business, and not just a showcase of social projects without any real impact or scale, thus indicating in a way what CSR means in application. Although the ISO SR does not contain a set of requirements and is thus not certifiable, it does promote the concept that organizations need to act responsibly within the organization and with communities around them.<sup>28</sup>

### *Social enterprises*

The notion of social enterprise has emerged in the last 25 years to describe a variety of organizational forms; it is a result of the belief that business practices and managerial solutions will improve the performance of both the public sector and the third sector.<sup>29</sup> The concept is intrinsically ambiguous and tends to have different meanings, depending on the context in which the term was developed. Specifically, academics identify two parallel trajectories of the concept: one referring to the American tradition, also defined as the “social perspective”; and the other pertaining to the European context, also labeled the “socialization perspective”<sup>30</sup>.

Two major schools of thought are visible in the American tradition. The first refers to the use of commercial activities by nonprofit organizations in support of their mission. In this stream of thought, the Social Enterprise Alliance (SEA) distinguishes **social enterprises as having three main characteristics: their primary purpose is the common good; they address a social need through their commercial activity.** A social enterprise as described by the 2006 Nobel Peace Prize recipient Muhammad Yunus also pertains to this school of thought, since Yunus’ model is a self-sustainable, financially viable business that focuses on the provision of goods or services to poor consumers, reinvesting the profits in activities related to a social objective.<sup>31</sup> The second American school of thought focuses on “social innovation”,<sup>32</sup> referring to the innovative characteristics of social entrepreneurs. Such people are often defined as **“change makers,” individuals with creative solutions to pressing social problems, combining economic initiatives with a social purpose.** These initiatives may take the shape of a nonprofit enterprise or may well take place within the private for-profit sector.

In Europe, social enterprises were created as a reaction of civil society to the inability of the traditional welfare state to provide social and community services and to ensure employment, especially for

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27. Peinado-Vara 2006, 1.

28. See ISO 26000—Social Responsibility, available at [www.iso.org/iso/home/standards/management-standards/iso26000.htm](http://www.iso.org/iso/home/standards/management-standards/iso26000.htm).

29. Ridley-Duff, Bull, and Seanor 2011, citing Chandler 2007.

30. Ridley-Duff and Southcombe 2012.

31. Yunus 2010.

32. Defourmy and Nyssens, 2012.

those “hard to employ”<sup>33</sup>. The EMES International Research Network<sup>34</sup>, a network of universities, research centers, and individual researchers, defines social enterprises as **private, autonomous, entrepreneurial organizations providing goods and services with an explicit aim to benefit the community**. They are owned or managed by a group of citizens, and the material interest of capital investors is subject to limits. Social enterprises place a high value on their autonomy and on economic risk-taking related to ongoing socio-economic activity. **Social enterprises are either prohibited legally from distributing profits, or are structured in order to exclude profit as the main goal.**<sup>35</sup>

The approach proposed by the EMES consists of identifying a set of nine criteria that describe an ideal social enterprise and that thereby enable researchers to identify social enterprises. The criteria are grouped in three dimensions: an economic and entrepreneurial dimension; a social dimension; and a participatory governance dimension. Possibly the most distinctive elements of the European school of thought concern the participatory governance criteria. These include: a high degree of autonomy, which entails internal governance independent from public authorities; a decision-making power not based on capital ownership and which requires that voting power not be distributed according to capital share, but instead following the principle “one member, one vote”; and a participatory nature, which implies the participation of all the relevant stakeholders in decision making.

### *Base of the pyramid ventures*

The concept of base of the pyramid ventures was introduced by Professor C. K. Prahalad, of the University of Michigan’s Ross School of Business, and S. L. Hart, Professor Emeritus of Cornell University’s Samuel Curtis Johnson Graduate School of Management. In a seminal article titled “The Fortune at the Bottom of the Pyramid,” they invited multinational corporations to observe the aspirations of low-income people with “a new lens of inclusive capitalism” and to investigate the unexplored potential market formed by the world’s four billion poorest people.<sup>36</sup> In their view, this market comprises people earning an annual per capita income below US\$1,500, and it represents a “large unexplored territory for profitable growth” as well as a profitable market.<sup>37</sup> According to this perspective, multinational corporations should radically transform their business models, reorienting them towards the needs of the poor, investing in research and development strategies to develop innovative distribution systems, technology solutions, and new packaging, and reinventing their cost structure. Prahalad and Hammond argue that “by stimulating commerce and development at the bottom of the economic pyramid, MNCs could radically improve the lives of billions of people and help bring into being a more stable, less dangerous world”.<sup>38</sup>

“BoP ventures” are business initiatives that approach the poor as an underserved market and that seek to meet the poor’s needs as consumers, entrepreneurs, and providers of goods and services.

Initially within the BoP approach, the poor were viewed mostly as potential consumers and as an “underserved” market. As the concept evolved, the unmet needs of the poor started to be considered

33. Borzaga, Galera, and Nogales 2008.

34. Refer to the website <http://emes.net/>

35. Ibid.

36. Prahalad and Hart 2002.

37. Ibid.

38. Prahalad and Hamond, 2002, 48.

not only in terms of their needs as consumers but also as producers, although the emphasis has remained on the former.<sup>39</sup> A paradigm shift was later proposed by Hart and T. London, moving from the first generation of BoP approaches, which stressed the role of the poor as consumers, to a second generation, which puts more weight on doing business with the poor, entailing the more active participation of low-income people.<sup>40</sup> This second generation emphasizes a business model in which the poor are included as producers, entrepreneurs, service providers, and shareholders, demonstrating a change from “fortune finding” to “fortune creating” at the base of the pyramid.<sup>41</sup>

The term “base (or bottom) of the pyramid” is used as a descriptive concept rather than presented as a development strategy. In their early work, Prahalad and Hart described the world population as stratified in an economic pyramid. Each tier was defined by consumer purchasing power. At the very top of the pyramid were 75–100 million people, whose annual per capita income was more than US\$20,000. The middle of the pyramid was comprised of 1,500–1,750 million people, whose annual per capita income was between US\$1,500 and US\$20,000. The bottom of the pyramid consisted of the four billion people with an annual per capita income below US\$1,500, one billion of them with less than US\$1 per day.<sup>42</sup>

A more detailed description of the structure of the world economic pyramid was later carried out by the World Resources Institute (WRI) with the International Finance Corporation (IFC).<sup>43</sup> In their assessment of 110 countries, the WRI and IFC stratified the world’s population into three tiers:

- (1) People with annual incomes of US\$3,260 and below (in 2005 international dollars, adjusted for purchasing power parity, or PPP) were defined as BoP and consisted of four billion people.
- (2) Those with incomes between US\$3,260 and US\$21,731 were defined as the mid-market segment, which included two billion people.
- (3) Finally, the population with incomes greater than US\$21,731 was defined as the high-income segment and included half a billion people.<sup>44</sup>

However, the BoP is not defined just by its purchasing power but also by several other characteristics that limit people’s capabilities and potential, such as lack of access to modern financial services, inadequate housing conditions, and deficient access to a water supply, as well as lack of access to sanitation services, electricity, and basic health care. The BoP is also characterized by poor integration into the formal economy, and by the higher prices they often have to pay for basic goods and services.

Notwithstanding, the BoP as a whole constitutes a very important market: a US\$5 trillion consumer market out of a total global US\$17.5 trillion consumer market. In Latin America, the BoP market represents US\$509 billion and includes 360 million people; Brazil and Mexico are the most attractive markets, with US\$172 billion and US\$105 billion aggregate household income, respectively.<sup>45</sup>

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39. London, Anupindi, and Sheth 2010.

40. London and Hart 2011.

41. *Ibid.*

42. Prahalad and Hart 2002.

43. Hammond et al. 2007.

44. *Ibid.*

45. *Ibid.*

## Creating shared value

Shared value creation refers to the strategic integration of philanthropy in corporate core business to generate an impact in the social domain through corporate strategy.<sup>46</sup> Shared value was introduced as a way for companies to achieve economic success, focusing on all the stakeholders of a company. It states that the purpose of the corporation must be redefined as creating shared value, not just profit per se. Shared value is about expanding the total pool of economic and social value generated through the company, rather than about sharing the existing value, which would imply redistribution.

The ability to create shared value is meant to apply equally to advanced economies and developing countries, although the specific opportunities will differ, as will the opportunities across industries and companies. Shared value is created by:

- reconceiving products and markets (consumer side)
- redefining productivity in the value chain (supply/production side)
- enabling the development of local clusters that involve actors from the community surrounding the business.

The concept of creating shared value promotes the creation of economic value in a way that also creates value for society by addressing its needs and challenges.<sup>47</sup>

Shared value creation integrates the generation of social impact into the core business, redefining the purpose of the business beyond mere profit.

Table 1: Comparison of Market-based Approaches.

Concept	Nature of the Concept	Main Focus	Sustainability of interventions	Link with company core business
Value chain development	Approach to production chains, with a focus on the value generated for different actors in different links	Maximize the value generated in selected links of the chain; the objective of the application defines for whom value is generated	Sustainability depends on the focus of the intervention and the availability of the required investment	Not Applicable

<sup>46</sup>. Porter and Kramer 1999, 2002, 2006, 2011

<sup>47</sup>. Ibid.

Concept	Nature of the Concept	Main Focus	Sustainability of interventions	Link with company core business
Micro, small, and medium enterprise development	Approach to production chains, with a focus on the value generated for different actors in different links	Maximize the profitability, growth, and sustainability of MSMEs	Sustainability depends on the focus of the intervention and the availability of the required investment	Not Applicable
Corporate social responsibility	Social aspects of business management (sometimes a company's separate social initiative)	Contribute to the social, economic, and environmental well-being of companies' stakeholders	Sustainable investment in CSR depends on the company's results	CSR activities are not necessarily linked to the core business, but more and more companies strive for this strategic integration
Social enterprise	Type of enterprise focused on generating social value	Maximize social impact through the company's benefits	Sustainability depends on the results of the enterprise; profit is reinvested in the enterprise	Generating social benefits is part of the core business; in fact, it's the company's mission
Base-of-the pyramid ventures	A model for profitable and sustainable business in low-income markets	Access for companies to low-income markets while creating value for the poor	Sustainability depends on the results of the model in the market to which it is applied	Generation of social value is a requisite for the business to have sustainable results
Social value creation	Opportunities within a business model that imply value generation for the company and society	Generation of social value through profitable business	Sustainability is related to the results of business performance	Social value is generated as a product of a business initiative and is part of its competitive advantage
Inclusive business	Business model that generates value for the company and for the low-income communities involved	Economic and social inclusion of the poor in companies' value chains	Sustainability is related to the investment and performance of both the company and the community involved in the model	Generation of social value is part of the inclusive business opportunity and responds to a company's need or interest



## Market-based approaches compared

Over the previous decades, many strategies and approaches have been used to leverage market forces to respond to social and environmental needs and problems. The differences between these approaches are centered on who takes the center role, the strategies and interests behind their participation, and the particular results sought from the venture. How do these approaches relate to IB development, and how can their strengths and weaknesses be assessed?

Value chain development (VCD) as a development approach has been adopted by an increasing number of governments, donors, and NGOs aiming to reduce rural poverty. It has focused primarily on improving the capacities of small producers as suppliers of raw materials, and on the related opportunities to increase their capital base. The designs of these interventions often assume that poor households can generate sufficient resources to effectively participate in VCD and are able to assume increased risks when reinvesting capital and labor. The designs do not explicitly recognize a positive role for larger companies on the basis of their decision-making power in the value chain, or their potential to achieve scale and innovation. Inclusive business builds on VCD while at the same time emphasizing companies as influencers in the value chain able to create favorable conditions for scaling.

Inclusive business starts with a business opportunity and integrates low-income communities in strategies for growth and competitive advantage.

CSR focuses on companies' active involvement in dealing with current social issues affecting their stakeholders—including workers, suppliers, and distributors, as well as the communities around them. CSR is increasingly linked with the concept of core business, as the awareness of the mutual benefits of "doing well by doing good" increases. In spite of that, CSR within many companies still remains a separate area of work, not necessarily linked to or working together with the commercial areas. In the more advanced cases, CSR is embedded in the commercial operations; in these instances, CSR is part of a responsible commercial relationship that the company establishes with its stakeholders (suppliers, distributors, employees, customers, etc.) from the base of the economic pyramid, similar to inclusive business initiatives.

Social enterprises fill in a "missing middle" between nonprofit, government, and business responsibilities, combining the development of a business initiative and principles with commitment to addressing social and environmental issues. Social business results come from commercial activity, the revenues of which are used to maintain the business and feed the social or environmental mission. The business is set up for a social purpose and not necessarily to maximize profits. The question remains of how to reach scale through this approach. Inclusive business attempts to bridge that gap by finding ways for companies to continue operating their businesses while contributing to social and environmental objectives, without straying from their established focus on profit.

BoP ventures represent a way for large companies to develop business strategies that involve low-income populations, which are seen as a market opportunity—initially mainly as a consumer market, but later also including roles as suppliers and distributors. Moreover, the focus has shifted from a business advantage to be found at the BoP to the joint creation of business opportunities between companies

and the poor. In that sense, there is a clear convergence with the IB approach, especially where large companies are involved. The concept of shared value creation coincides with the notion of combining a business opportunity with social impact, but does not focus on low-income communities.

### **1.3 Inclusive business: furthering private sector-led development**

Inclusive business—as an initiative that creates value for a company while contributing to improving the quality of life for low-income communities through their participation in the business’ value chain—combines as its defining characteristics the inclusion of the low-income segment, mutual value creation, and the potential for scale. It integrates some of the principles from other market-based or development initiatives described in this chapter while combining private companies’ potential for growth and innovation with low-income communities’ needs for access to markets, goods, and services.

The premise of inclusive business initiatives is the identification of a business opportunity to continue a company’s growth strategy and build competitive advantage. Investments are viewed through an economic lens of benefits and risks while at the same time weighing the social outcomes. Ideally, implementation of such enterprise-led initiatives proceeds cautiously via pilot programs designed to test and fine-tune the design of the solution. Implementation proceeds in an iterative fashion until a robust business model is found or the initiative is terminated. The initiative’s scalability depends on the generation of competitive advantage and the development of transferable skills.

A growing number of private sector and socially oriented organizations are viewing the poor’s unmet needs as untapped market opportunities and consequently focus more heavily on the role of enterprises in addressing poverty. IB, as a firm-led initiative, represents a convergence of the social and business objectives of private and for-profit enterprises, the inclusion of low-income groups in value chains, and a focus on market demands. While taking advantage of a market opportunity, a company can at the same time work towards poverty reduction at a potentially larger scale than development cooperation and government initiatives by themselves have been able to do.

### **1.4 Inclusive business experiences worldwide**

At a global level, organizations such as the UNDP, the Monitor Group (now Deloitte), the IFC, and the IDB-MIF, among others, have documented numerous examples of IB initiatives, and many cases are publicly available in the literature. Within the framework of this research, an analysis of secondary sources was conducted on over 150 cases that have been documented worldwide. This analysis illustrates how the concept of IB is currently being put into practice. It also shows that IB initiatives can be found in a myriad of different sectors and geographies, which reflect distinct models of involving low-income communities and are motivated by different drivers and enablers. Of the cases reviewed, Asia and Latin American and the Caribbean (LAC) accounted for 65 percent of the total, with 43 cases. Africa is not far behind with 36 cases, while the ex-Soviet Union countries, along with the Middle East and North Africa represent a much smaller number of the cases reviewed.

The most-cited country within all the reviewed cases was India, with 21, representing almost 50 percent

of Asian IB cases. In Latin America, Peru was most cited, with eight cases. In Africa, nine cases came from initiatives in Kenya. Five of the Middle East's and North Africa's seven cases were based in Morocco.

## *IB models*

The cases reviewed show that what distinguishes IB models is mainly the way in which the low-income segment is involved in companies' value chains. The two predominant models described in the literature are the IB supplier model and the IB consumer model. The IB supplier model can be initiated by a new business endeavor or an existing firm that includes the participation of a low-income group within its supply chain. This may also include transferring knowledge and training low-income suppliers in order to enhance, add value to, or secure the product or service. In doing so, the IB improves incomes and livelihoods for the low-income group involved. The IB consumer model can be initiated by a new business endeavor or an existing firm that sells an affordable product or service to low-income groups. The consumption of the product or service should have a direct positive impact on the livelihoods, quality of life, well-being, or overall development of the low-income group.

About half of the IB cases reviewed focus on the low-income actor as a supplier of products or services, while around 30 percent include them as consumers. Another 15 percent involve the BoP as employees of the firm, while in only five percent of the cases do they play a role as distributors of a firm's services or products. The main business sectors where the IB supplier model has presence are agriculture, forestry, and handicrafts. Most examples of this model (over 50 percent of cases) come from the Latin America region. On the other hand, Africa and Asia together account for over 60 percent of the IB consumer models.

## *Companies' drivers for IB*

In 30 percent of the cases reviewed, companies indicate that the main driver to initiate an IB is their own interest in creating new business opportunities with low-income groups. Another 30 percent refers to the need to enhance suppliers' or employees' practices, while 20 percent indicates that the IB initiative is born from the values of the company's founder. Some 20 percent of cases were initiated by NGOs, bilateral or multilateral development organizations, and/or the public sector, which presented the IB initiative to the companies. In these cases, the initial investment costs often were shared.

## *IB enablers*

From the cases it can be concluded that for IB initiatives to succeed, companies need to be able to rely on enabling factors that they are not always able to provide themselves, such as: expertise in inclusive models, understanding of and proximity to the BoP, access to funding sources, and involvement from the public sector and third-party actors as well as multilaterals. It was very apparent that in all cases reviewed, some public, private, or civil society partnership and engagement played a role during the initiative. In many of the cases,

The three focus areas of this research are: the business case for IB, defining and assessing the "inclusiveness" of IB models, and the necessary conditions to sustain and scale results.

significant initial funding for the IB (mostly soft-risk capital, not subsidies) was provided by a multilateral organization such as the IFC or the IDB's Opportunities for the Majority initiative (IDB-OMJ), often with a third-party organization close to the targeted low-income communities, acting as broker between them and the firm.

### *Private sector interest in IB in Latin America*

In 2008, in the framework of a Private Sector Mapping project carried out for the IDB-OMJ, SNV interviewed 521 top management executives from large and medium-sized firms that currently work or are interested in working with low-income communities in IB initiatives in 13 LAC countries.<sup>48</sup> These interviews provided first-hand information from corporate decision makers to further understand current motives, strategies, incentives, benefits, and obstacles to the integration of the low-income segment in companies' value chains.

The sample of companies interviewed included firms that apply IB consumer models as well as IB supplier models. The interviewees expressed that economic incentives are the main driver for IB; the relevance of IB as part of the mission statement, sustainability policies, and risk minimization are secondary drivers.

Companies expressed that levels of organizational and technological innovation increase as the IB models scale up or replicate. Issues raised included the need for increased productivity within the production chain, the creation of strategic alliances to mitigate risks or to improve access to markets, and financial incentives. Companies saw tangible economic benefits in incorporating the low-income segments as providers or consumers.<sup>49</sup>

## **1.5 The focus of this research**

Central to this research is the question of whether IB can be considered a viable development solution, able to make a substantial contribution to improving the living conditions of the poor while at the same time providing business with the financial incentives to scale up to a size commensurate with the problems of poverty and exclusion that emerging economies face.

To come to conclusions around this question, three questions are explored in detail:

- (1) Is there a business case for different IB models—for the company and for the community involved—that expresses the value generated for both parties?*
- (2) What does "inclusiveness" in such models look like, and how can it be assessed?*
- (3) What conditions need to be in place to achieve IB results, and how can they be sustained and taken to scale?*

### *The business case for IB*

Plenty of current research on IB focuses on different models of inclusive business, and on the scalability

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<sup>48</sup>. SNV and IDB-OMJ 2008.

<sup>49</sup>. Ibid.

of their results. A distinction is often made between “company returns” and “community impact,” with an underlying assumption that the expected returns for a company differ in nature from the expected impact on the communities—the former often with more emphasis on the economic, the latter with more attention to the social. This is illustrated by the fact that different assessment frameworks and criteria are used for the different sides of the IB “equation”: for the company, profit margins, return on investment, increased efficiency, and access to new markets; for the community, economic benefits, developed capacities, and improved relationships. The underlying idea seems to be that communities are the beneficiaries of an IB initiative, while the company is considered the protagonist.

In each IB initiative, both company and community act on the basis of a business case to be made for the initiative: both company and community, implicitly or explicitly, assess investments and returns before entering the initiative and/or deciding to continue it. This implies that company and community both have a choice to make: Is the relationship between them, and the subsequent interdependence, to their benefit, or is it not? It also suggests, provided that this decision is a choice, that there are alternatives available over which the IB model is chosen.

### *The inclusiveness of IB*

This research starts from the assumption that any IB model is based on a combination of a business opportunity and a development solution, and that IB contributes to development by including poor people in the value chains of companies. When IB as a development solution is emphasized, the following issues become relevant:

- How and to what extent does the inclusion of BoP communities in a company's value chain lead to improved conditions for the communities' development?
- What potential for inclusiveness do the different types of initiatives have?
- How is the inclusiveness of such initiatives expressed?

The IB model is meant to generate win-win situations, for the company and for the low-income community involved. The assumption is that these wins are implicit to the model, and that they do not occur at the expense of either the company or the BoP, in a zero-sum fashion. The question then becomes: Are such gains about a different distribution of the available means (goods/services, resources, assets, returns), or does the model generate an overall increase in means, and therefore a larger share for one or more of the parties involved? In other words, does IB create new value or merely redistribute existing value?

### *Mechanisms for scale and sustainability*

Experiences described in the literature show that IB initiatives should be embedded in an environment of stakeholders that support the development and scalability of such projects, to help ensure sustainable results for low-income communities and society as a whole. While some companies have only conducted IB initiatives in the margins of their business, as pilot projects, others have been able to integrate IB into part of their regular business, multiplying the company's community base to reach attractive economies

of scale and involving third-party actors such as government, service providers, researchers, and donors in the process. Scalability in this sense can refer to the expansion of an IB initiative by a specific company, its replication by others within a certain context or sector, or the creation of external conditions for its growth and sustainability at a broader national or regional level. Sustainability in its turn then refers not only to sustained results for companies and communities, but also to the development of a sector of industry as a whole and includes aspects of environmental sustainability.

Within this research project, different aspects of the scalability and sustainability of IB initiatives are explored, along with the mechanisms, actors, factors, and contexts that favor scaling the results. The IB initiatives are looked at from several perspectives, starting with the company and the community as the principal actors of an IB initiative, and continuing to include third-party actors that play a role in its development.

CHAPTER 2

INCLUSIVE BUSINESS  
IN PRACTICE





# INCLUSIVE BUSINESS IN PRACTICE

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## 2.1 Approach

The purpose of this research project is to help substantiate the IB approach as a potential mechanism for reducing poverty and improving the economic inclusion of low-income populations.

The research team investigated this premise through a structured research process that started with a mapping of existing IB initiatives worldwide, published between 2005 and 2010 and available in the public domain.<sup>50</sup> On the basis of the findings of this initial study and additional literature research, the project team formulated research questions for primary-source case studies. The researchers then selected IB projects in Latin America to be studied as specific cases to provide insights on the research questions. This primary research was exploratory in nature and focused on providing information on the outcomes and success factors of individual IB cases, as well as an understanding of situations in which the expected outcomes were not generated. The team then analyzed the findings across the cases to identify more generalizable lessons learned, common challenges, key conditions, and successful approaches for achieving the desired results and impact; the aim was to provide insights for companies, community groups, policy makers, donors, NGOs, and others supporting IB initiatives, and thereby contribute to making IB practices effective and beneficial for all involved.

An initial group of approximately 50 potential IB cases was collected on the basis of the following criteria:

- Well-established IB initiative that had gone through at least one cycle of design–implementation–results
- IB initiative with potential for scale or already scaled
- Income levels of population involved were under US\$8/day and included a segment of people under US\$2/day
- Willingness of stakeholders involved (company, communities, third parties) to provide information on the initiative

The composition of the final portfolio of 27 selected cases (see Figure 1) took the following into account:

- Combination of initiatives with a potential for scale and/or already scaled initiatives

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50. See Annex 1 for a full list of the cases.

- Balance between different IB models (community as suppliers of goods and/or services, community as consumers of goods and/or services, community as partners—co-owners or employees—of a company)
- Geographical spread (throughout Latin America)
- Different political contexts
- Different sectors: agriculture (including a variety of production chains), tourism, consumer products, consumer services
- Combination of multinational and national anchor companies
- Externally funded and company funded

The team selected IB cases developed as a company initiative, as well as cases developed by companies and communities as part of an externally supported project or program. The latter group includes a set of projects developed within an inclusive business program implemented between the IDB-MIF and SNV. The majority of these projects involve agribusinesses—an industry in which a great number of IB initiatives are found in Latin America and on which SNV has focused a considerable part of its practice—but they also include initiatives in the construction, tourism, financial services, or pharmaceutical distribution sectors.

In total, 27 IB cases were investigated: 20 that involve low-income communities as suppliers, 4 in which the IB initiative is geared around products and services for low-income consumers (with some of these cases also including low-income people as employees or partners in the business), and 3 in which low-income people form part of the company structure as business partners or as employees (and products and services are not specifically geared towards low-income communities). IB with suppliers is, by far, the most extended modality of inclusive business in Latin America; each modality has its particularities, so it is important to analyze the conclusions for each. However, mutual value generation applies for every modality and is the main characteristic of an inclusive business.

IB WITH PROVIDERS		IB WITH CONSUMERS	
Agriculture	17	Forestry	1
High value / Export	6	Furniture	1
PERHUSA Atlantic Mercon	Sogimex Dole Agroexport	COLINEAL	
National Markets	8	Tourism	1
ILE Favorita Canolandina Pronaca	Repsol Dinant Palmar del Rio Pronaca	Eco/ Experiential Condor Travel	1
Dairy national export	3		
Floralp Delizia CENTROLAC		Metal Industry	1
		Novacero	
		Financial Services	1
		EDYFICAR	
		Construction	1
		FIRTH	
		Pharmaceuticals	1
		FARMAENLACE	
		Electricity Services	1
		ELETROPAULO	
		IB WITH EMPLOYEES/ PARTNERS	
		Energy	1
		ODEBRECHT	
		Agriculture	1
		ACOPAGRO	
		Tourism	1
		RAINFOREST	

Figure 1: Overview of Cases Studied

The case research focused on the following questions: Have the inclusive business models substantially contributed to improving the living conditions of the poor while at the same generating advantages for the companies? If so, to what extent? Can the results achieved be taken to scale?

The issues investigated to answer these questions included:

- (1) What was the **motivation** to initiate and continue the IB initiative?
- (2) What are the direct and indirect **results of the IB initiative** for the company and the low-income communities involved, and over what period of time?
- (3) What **investments** (type and amount) are made by the company and the low-income communities in the IB initiative, and over what period of time?
- (4) What **organizational changes** were made by the company and the low-income communities involved for the IB initiative to succeed?
- (5) What are the opportunities and mechanisms used for **scaling the results of the IB initiative**?
- (6) What roles have the **public sector and other stakeholders** (NGOs, investors) played in the initiation, development, and/or scaling of results of the IB initiative?

Quantitative baselines and the results of outcome and impact measurements were not available for all cases. Where they were available, the choice of indicators and/or the differences in the nature of the intermediate and final results did not allow for a structured comparison across cases. For that reason, this study—although it uses quantitative information wherever available—is based largely on qualitative information, obtained through the following approaches:

- (1) Company side: Independent researchers interviewed relevant actors within the company, using a predefined protocol. As a result of the company interview, relevant third-party actors connected to the IB (e.g., government, NGOs) were identified and, in some cases, interviewed as well.
- (2) Low-income community side: Ethnographic studies were carried out by independent ethnographers in the communities involved in the IB. For each IB case, three families were studied, following a predefined ethnographic design. (The step was conducted only for cases that had gone through a cycle of design–implementation–results.)

Ethnographic studies involve analyzing the way a group of people lives—by observing what they do, how they behave, and how they interact with each other—to describe their beliefs, values, motivations, and perspectives and how these change over time and under different circumstances. Ethnography allows for observing people’s “natural” behavior by avoiding or limiting as much as possible the types of interference that other research mechanisms might generate. It is based on direct and participatory contact with the group being studied for a specified period of time. It combines different methods, such as participatory observation and in-depth interviews. Ethnography was chosen as a relevant tool for this study because it allows for the creation of a realistic image of the communities studied, providing rich information on their economic and social realities as viewed from an insider perspective, obtained in situ.

The ethnographers in this research studied three primary dimensions:

- The family—as the basic or main unit impacted by the inclusive business
- Living conditions and quality of life—social and economic conditions
- The inclusive business—the function of the inclusive business in family life, the reasons for becoming involved in the IB initiative, and the people’s relationship with the anchor company.

In instances where quantitative information on the cases studied was available from other sources (project documents, baselines, outcome and/or impact measurements, and business plans), that information was used to contextualize and enrich the description of the results.

The following sections of this chapter describe the different models of inclusive business that were studied in the case investigations, as well how they are applied in different economic sectors. The descriptions include the processes of implementation, motivations, investments, results, and organizational changes related to IB development, illustrated by specific examples from the cases.

## 2.2 IB with suppliers

In IB models with suppliers, the low-income segment is involved as providers of goods and/or services to the company. In Latin America, the IB supplier model has been applied most widely. It can be found in different sectors of the economy, such as agriculture, forestry, tourism, and handicrafts, as well as in any industrial activities requiring a supply of raw materials that can be provided by small entrepreneurs.

An IB supplier initiative usually starts out with a problem, a need, or an opportunity for a company, leading it to improve or develop its supply chain for a given product or service. The IB model then provides the opportunity to involve low-income producers or suppliers in the company’s value chain, enhancing efficiency, volume, or quality of production in such a way that value is generated for both the company and the suppliers.

In this section, a fully described IB case (Dole in Peru with smallholder banana producers) illustrates the fundamental components of inclusive business initiatives involving low-income communities as suppliers. After that, different applications, additional components, and variations on the basic model are illustrated, using selected aspects of other cases.

## DOLE AND SMALLHOLDER BANANA GROWERS IN PIURA VALLEY, PERU

- Increasing productivity through small producers' associations that became responsible for the packaging and transportation processes.

From the Chira Valley in northern Peru to premium markets such as the United States, Japan, and Europe, small-scale Peruvian producers are learning to work competitively in organic markets. From this valley, Dole Peru exports organic bananas under a model that involves small-scale producers in its value chain as suppliers of high-value agricultural products. The strategic proposal of this inclusive business is to strengthen the capacities and optimize the efficiency of producers so they can enter the international market; at the same time, the company is able to improve its competitiveness, enhance export process efficiency, and increase sales. The proposed business model should yield benefits for both the company and the producers.

### *Background*

Dole Food Company Inc. is the world's largest fruit and vegetable producer and trader. It also markets a growing line of frozen and canned foods. The company's principal markets are the United States, the European Union, and Japan, where one of its main products is certified organic bananas. Over the past years and aligned with the strategic focus of the company, Dole has dedicated efforts to increasing its participation in niche markets that allow for attractive margins. In terms of banana production, although a larger part of Dole's revenue comes from green plantains, a few years ago the company began introducing high-value products—like organic bananas—increasing the profitability of this particular part of the business, which generates 28 percent of the corporation's income.

In 1998, the Peruvian Ministry of Agriculture, with the support of Dole Ecuador and the International Network for the Improvement of Banana and Plantain (INIBAP), launched a program for the promotion of organic bananas, including the use of organic fertilizer among producers and certification for organic production by private companies. As a result, Dole made the first exportation of organic bananas from Peru in June 2000. By the end of 2011, 99 percent of bananas exported from Peru were organic, representing 20 percent of the global demand for organic bananas. This case shows how Dole managed to expand its volume of organic banana for export through sourcing from smallholder producers.

### *Opportunity*

Banana production in Peru is concentrated in the Chira Valley, which produces 75 percent of the country's bananas and is located in the northern department of Piura. The area is characterized by small land holdings of less than one hectare (2.5 acres), making it difficult to achieve economies of scale. Also, low levels of productivity, efficiency, and sustainability in banana production limit banana producers in

reaching the capacity needed to satisfy a growing international demand. For the small producers, the lack of financial resources to obtain organic certification is one limiting factor that confines them to local markets, in which demand for organic bananas is almost insignificant. As a result, banana producers have to negotiate individually with middlemen, thereby earning as little as one-third of what they could earn from the export market for organic bananas. The net profit for a producer in this region is estimated at US\$1,400 per year; approximately 27 percent of families in the Valley have a daily per capita income of less than US\$2.

Since Dole started to operate in the Chira Valley in 2001, the company has worked with small-scale producers as value chain suppliers. The crop is bought directly from the individual producers on their fields and handed over to processing and packaging centers owned by the company to prepare the product for export. In response to the needs and interests of both small producers and the company, in 2008 and with the support of the SNV/IDB-MIF IB program, Dole designed an IB project that included the development of farmers' associations and their involvement in the company's production process. These associations would work together with the company in improving the production, harvesting, and packaging of bananas for export.

## *Development*

The project partners designed the inclusive business model around three components:

- 1. Increasing farmer productivity.** Focused on strengthening producers' technical capabilities through training and technical assistance, farmers were able to increase their productivity by decreasing the number of trees per hectare (generating greater banana production per tree), while applying new irrigation schemes and introducing specialized organic fertilizers. Dole provided the technical assistance while SNV strengthened producers' organizations, facilitating farmers' access to the support provided.
- 2. Development of associations' capacities in the post-harvest process.** Farmers' associations were strengthened to facilitate negotiation processes between Dole and the farmers. Building on this, Dole then developed processes for post-harvest treatment and packaging of bananas, together with each of the associations. This component included installing the necessary infrastructure, purchasing packaging equipment that was then donated to the associations, and training the farmer groups responsible for the handling stage in the post-harvest processes.
- 3. Access for farmers to organic certification.** The third component involved transferring the organic certification from the company to the associations. To support the transfer, Dole helped strengthen the producers' entrepreneurial capacities and enabled them to develop the administrative processes and internal controls necessary for the certification through training sessions.

Parallel to this process, the Dale Foundation (a not-for-profit entity that implements social projects for Dole in Peru and Ecuador) accompanied the producers and their associations in the implementation of social projects, focused on education and health care. These projects and Dale's presence in the communities have contributed to a trust-based relationship and to increased loyalty between the company and the communities. By mid-2012, the associations were successfully selling certified and

packaged organic bananas to Dole. The fruit is being exported to Dole's companies in the United States, Europe, and Asia. Dole Peru is now dedicated to facilitating the export and commercialization process and no longer needs to be involved in harvesting and packaging.

### *Investments*

This IB initiative was initially facilitated by the SNV/IDB-MIF IB program. Over a period of three years, the MIF provided funding of US\$115,000 to guarantee technical assistance for the IB initiative and accompanied the process, while SNV contributed another US\$50,000 worth of advisory services to the company and the associations, facilitating IB development. Dole started the project with a commitment to invest US\$100,000 in the initiative, dedicated to technical assistance and inputs in increased banana production through the associations.

Over time, and when the opportunity became clear for the associations to take over packaging the fruit, Dole increased its investment to US\$395,000, which included handing over its packaging facilities to the associations. During the project period, the Dale Foundation has invested in the development of social projects with the communities, emphasizing access to education and health services. The fund for this investment was generated by a contribution from the foundation of US\$1 per crate of bananas produced.

### *Company results*

Through this initiative, Dole has secured a sustainable supply of organic bananas from the Chira Valley, in the volume and with the quality required by their customers, as well as with the required certifications. With this quality organic product, Dole has enhanced its competitive position in international markets. Dole's operative and transaction costs have decreased, as the company shifted from purchasing the product from 1,600 individual smallholders to a model in which the company buys from the nine farmers' associations, allowing for increased efficiency in the transactions. The entire logistical operation, which used to be outsourced to service providers, has been transferred to the associations. The associations, since they handle their own product, deliver a more efficient and higher-quality service—as they have a vested interest in preserving their products' quality—than the previous provider.

### *Impacts on the community*

The IB model developed with Dole involved 1,600 organic banana producers, organized in nine associations. These producers had less than one hectare of land each, elementary-level education, limited access to financial services (such as credit, savings, and insurance), and were not familiar with the technical aspects of organic crops. While the company, through the IB, secured its supply of organic bananas and reduced its costs by handing over the processing activities to the associations, the communities involved were able to increase their income as well as access loans, credit, and other financial services and improve their quality of life.

Specific results of this IB initiative among members of the communities include the following:

- (1) The main source of income of the families involved in the IB is organic bananas. The annual income of the families researched ranged from US\$2,700 to US\$8,300 at the outset of the IB. The differences are explained by the amount of land owned, as well as by the fact that some families had access to other sources of income (e.g., salary from non-agricultural activities). The lowest-income family, through its involvement in the IB, increased its income by 185 percent to US\$7,700—increased banana production being combined with increased income from working as paid laborers for other farmers, based on the capacities they gained during the IB. The highest-income family increased theirs to US\$15,360—the 70 percent increase coming mainly from their own banana production.
- (2) The families dedicated their increased income to nutrition (an increase of 10 percent of the budgetary allocation in households with the lowest incomes), as well as to education (10 percent), basic services (eight percent), loans (22 percent), and transportation (11 percent).
- (3) Based on their involvement in the IB, all 1,600 families were able to enter the formal financial system. The associations receive payments in their bank accounts, and members and workers are paid from those accounts, in some cases into their personal accounts. The families now apply for loans with various formal financial institutions (as opposed to loan sharks in the past), with the back-up of the payments from the company.
- (4) The families are using the loans for home construction and improvement, transportation (e.g., purchasing motorcycles or trucks), and investment in banana production. The loans allow them to improve their quality of life and realize a sustained increase in income. The size of the loans has increased over time (from around US\$300 to over US\$1,500, and in some cases up to US\$15,000). The stability of the income from the IB, however, and the surplus in income it generates, allows the families to ensure they make the payments, which they consider a priority to maintain a good credit history with the bank.

Dole's approach and initiatives, especially the investments in technical assistance, the organizational strengthening, and the social investments facilitated by the Dale Foundation, have been fundamental for the success of the inclusive business. Their approach took into account the families' social needs in the communities and developed strategies adjusted to those needs. Dole's field staff plays an important role in facilitating connections and the relationship between the associations and the company. Although the associations existed before the inclusive business, with this initiative they developed into a platform that enabled the farmers to establish a direct commercial relationship with Dole. The business agreement between Dole and the associations helped reduce production costs, enabled farmers to negotiate with the company, and generated an economy of scale. Additionally, the associations are now the intermediaries for making training and technology transfers provided by the company available to farmers.

In this context, the Dale Foundation has played a complementary part by supporting the families in accessing healthcare services, facilitating the development of productive infrastructure, and providing



training. The foundation had a key role, co-constructing improved community conditions in line with the IB results and dynamics, which contribute to the sustainability of the families' increased income and better quality of life.

Dole's IB initiative with the banana producers in the Chira Valley is an example of generating mutual value by including small producers in an export specialty commodity chain. The intervention strategy initially focused on increasing small farmers' productivity and quality. The opportunity for banana growers to move up in the value chain was identified later on, and Dole and the associations were able to take advantage of this opportunity because the associations had been strengthened. The responsibility for the certification process was then transferred from Dole to the associations, as they were ready to take responsibility for the packaging facilities.

As shown in Figure 2, the IB interventions took place at both company and community levels, focusing on increasing producers' and associations' productivity and added value on the one hand, and supply chain efficiency for Dole on the other. Capacity development on both sides allowed the company to develop effective relationships with the producers, and the producers' associations to assume more responsibility in the value chain—taking charge of an activity that Dole did not consider part of its core business, since it focuses on trading. Consequently, producers secured a more stable and higher income, and about 1,000 employment opportunities (around 100 jobs per association, in nine associations) were generated for the community as part of the banana packaging process. Since in this case the company's focus was on trading bananas, and therefore it was interested in outsourcing the productive aspects, they were happy to be able to transfer that part of the process to the associations.

This case illustrates that an IB initiative, if it successfully generates value for both company and community, is not about redistributing value between the parties, but rather about increasing total value, so that all can benefit. Furthermore, it illustrates the importance of enhancing small-scale producers' organizations to establish an effective relationship with the company, achieve economies of scale, and enable participants to move up in the value chain. The value generated for both sides is sustainable, since Dole connects the associations to a stable market that is able to absorb their increased production. This stability allows the smallholder producers to reinvest the generated revenue not only in banana production, but also in additional economic activities (such as transportation of the bananas, and commercialization of other products), and in improving their quality of life.

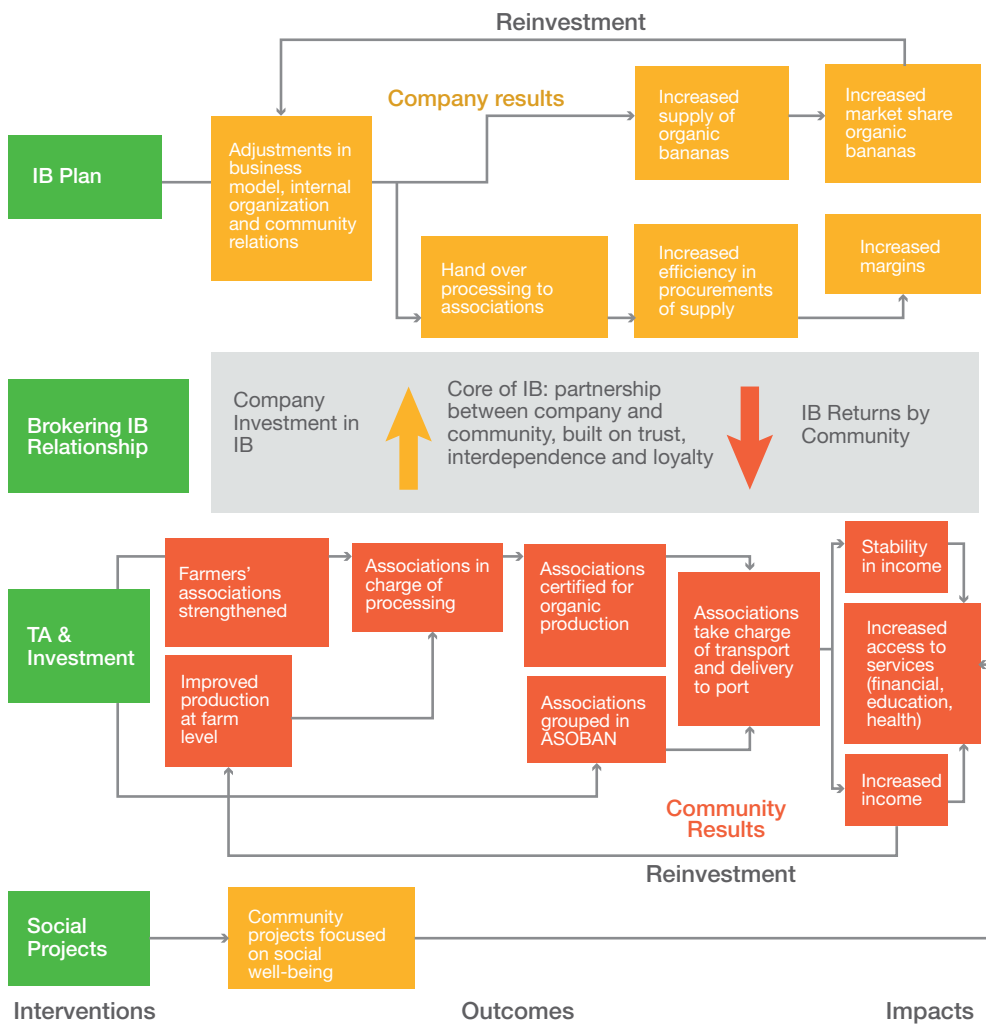


Figure 2: Interventions and Result Chains of IB between Dole and the Chira Valley Banana Producers

## PRONACA AND SMALLHOLDER MAIZE FARMERS IN ECUADOR

- Scaling IB results through increased productivity and public-sector measures

The importance of increasing productivity as a basis for sustaining IB results has become evident in many of the cases studied. The Ecuadorian food-processing company Pronaca, for example, Ecuador's seventh largest company, with annual sales of US\$658 million and over 6,500 employees, uses yellow maize as feed for raising poultry. The company needs 310,000 tons of yellow maize per year, of which it imports 10 percent. Of the maize that Pronaca buys from Ecuadorian farmers, large and mid-size farmers produce 95 percent of the annual total (280,000 tons) and small farmers 14,000 tons.

In 2007, large- and medium-scale farmers were reaching their production capacity limit, while the company's demand continued to grow. Pronaca therefore needed to create new supply sources to meet its demand. At the same time, the Ecuadorian government started implementing protection programs requiring companies that utilized maize to first buy the entire local harvest before being granted permission to import. Given that the opportunity for increasing production lay in the hands of small-scale farmers, the company became interested in including smallholder farmers more directly in its supply chain.

With support from the SNV/IDB-MIF IB program, Pronaca developed an IB initiative to respond to this opportunity and challenge. The total budget for this project was US\$204,432, of which the company contributed US\$91,307 and IDB-MIF US\$113,125. The model involved a contract between Pronaca and the smallholder farmers, eliminating intermediaries and applying a price scale conditioned by the market and the quality of the corn.

The main components were:

- 1. Strengthening the capacities of small-scale maize producers in production management.** Including land preparation, harvest and post-harvest handling, farm administration, safe management of agro-chemicals, and adoption of irrigation systems for a second production cycle.
- 2. Training of farmer leaders.** Forming a group of farmers who developed business skills to become service providers for small-scale farmers and strategic partners for the company.
- 3. Innovation.** Via experimental plots on participants' farms to test best agricultural practices, irrigation systems, crop rotation for sustainable resource use, and an increase to two crop cycles per year.

Over the course of four years (2009–2012), more than 900 small-scale maize producers were involved in the program, from which the company managed to source over 25,000 tons of maize. This was almost twice the volume they had sourced previously from small-scale producers. The farmers increased their crop yields from an average of two tons per hectare to seven. Their production costs rose (as a result of using better techniques), but they still increased their net income by 350 percent and went from an

average of US\$864 per year in 2007 to US\$3,024 in 2012 (nearly reaching the Ecuadorian minimum annual salary of US\$3,504). They also received a more stable price from Pronaca than they had from intermediaries.

The farmers now have savings accounts in banks and have access to loans at competitive rates. For those farmers who do not have direct access to loans from financial institutions because they are unable to meet the requirements, the company provides seeds, pesticides, and fertilizers, to be paid for when the harvest is sold to the company. On top of that, the company provides technical assistance through its own field staff of agricultural engineers, who have become facilitators between the farmers and the company, establishing a horizontal, trust-based relationship.

Based on the results obtained through this initiative, the Ecuadorian government intends to support expanding this type of program and has asked Pronaca to lead additional IB initiatives involving communities with similar characteristics. During 2013, the company expected to scale up the IB results to include an additional 780 small-scale farmers, then another 1,000 in 2014. Furthermore, Pronaca will develop similar programs for other crops, such as beans, rice, and sunflowers, which have been tested for inclusion in the IB project.

## **MERCON, ECOM, AND PERHUSA INCLUDE SMALLHOLDER COFFEE FARMERS IN DIFFERENTIATED MARKETS**

- Incentives for increased productivity and quality.

Increasing crop productivity, as shown in the Pronaca case, is one way to generate additional value that is then redistributed among the actors involved in the IB initiative. Additional value can also be generated by increasing the quality and market value of the crop. The following cases show how smallholder coffee farmers in Nicaragua and Peru, supported by export companies Mercon, Ecom, and Perhusa, were able to increase their coffee supply for differentiated, higher-value markets.

Global demand for coffee, especially certified and specialty coffees<sup>51</sup> has increased in recent years. This context has motivated coffee traders to work closely with suppliers to comply with quality standards, often in collaboration with certifiers who facilitate the implementation of required practices. Since the large majority of coffee growers in Latin America are smallholder farmers, exporters see an opportunity to support them in increasing productivity and crop quality, and to include them directly in their value chain in response to the growing market demand.

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<sup>51</sup> This category includes gourmet, designation of origin, fair trade, organic coffee, and those bearing sustainability seals like UTZ Certified and Rainforest Alliance.

## *Exportadora Atlantic – Ecom: increased productivity for new markets*

Exportadora Atlantic S.A. in Nicaragua is part of the Ecom Industrial Corporation Ltd., world leader in coffee, cocoa, and cotton trading. Worldwide, Ecom has a policy of closely collaborating with farmers to help them increase their crop yield and quality, contributing to supply chain development and loyalty. Ecom began operations in Nicaragua through Atlantic in 1997 and today is one of the largest coffee exporters in the country. It has a 30 percent share in the national market, exports of over US\$80 million, and works with more than 10,000 farmers who supply the 500,000 quintals<sup>52</sup> that the company trades.

With support from the SNV/IDB-MIF IB program, in 2009 the company decided to invest in increasing and improving the production of smallholder farmers living below the poverty level (i.e., an annual family income under US\$3,200). This project included technical assistance and financial mechanisms to enhance technological innovation and improve production levels. During the three years that followed, a group of technical advisers from Atlantic supported the farmers in applying good agricultural practices and introducing technological innovations. Through a non-exclusive commercial contract, the farmers would pay back the credit to the company after harvesting. Additionally, farmers were put in touch with international buyers to improve their understanding of and access to new markets.

Through this initiative, Atlantic included 1,100 new producers in its supply chain. These producers now meet the company's quality standards; they are capable of sustainably securing an increased supply of quality coffee and have gained access to credit (a total of US\$2 million provided by Atlantic) at below-market interest rates. They have also improved their farm management—and in some cases were able to extend the planted area—and improved post-harvest coffee treatment.

Project results show that families' income from coffee has increased by 150 percent. The families studied indicated that for them, the success of this IB initiative was not primarily that they were paid higher prices, but rather that the company guaranteed them a more stable income and that they increased their overall productivity. Farmers with an income of less than US\$1 per day are extremely susceptible to periods of scarcity between harvests, so having relative stability in their income allows them to reduce the impact of that scarcity. All of the studied families increased their productivity by between 25 and 60 percent.

The producers reported having a good relationship with the company, and that this was being continuously strengthened through the services the company provided, access to new markets, access to financial services, and the company's support with obtaining land titles and loans. They also highlighted the important role the company was playing in their ability to establish networks that supported their economic opportunities (with buyers, service providers, and other communities).

## *Mercon Coffee Group: certification as an incentive for productivity and quality*

CISA Exportadora, in Nicaragua, and CIGRAH, in Honduras—both member companies of Mercon Coffee Group (MCG)—work with smallholder producers as part of MCG's sustainability strategy. By making inclusive business part of that strategy, the companies generate economic progress as well as

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<sup>52</sup> According to the Merriam-Webster dictionary, a quintal is "a unit of weight equal to 100 kilograms (about 220 pounds)." See <http://www.merriam-webster.com/dictionary/quintal>.

positive social and environmental impacts for the low-income communities involved. At the same time, the smallholder farmers help to increase MCG's supply of high-quality and certified coffee to satisfy its clients' demands.

From 2008 to 2011, CISA worked with 300 small-scale coffee producers in Nicaragua, and CIGRAH with another 500 producers in Honduras, within the framework of developing a long-term relationship between the producers and the company. This initiative included a series of services, such as technical assistance for good agricultural practices, support for improving administrative practices, access to finance for commercialization, and processing facilities. A technical team, responsible for implementing the UTZ Certified Code of Conduct, was appointed and provided training to the producers. The initiative was supported by SNV in alliance with Fundación Solidaridad, in the framework of the PROCASO<sup>53</sup> program.

Through its projects with smallholder coffee farmers, CISA and CIGRAH increased their volume of certified coffee for export by 129,300 quintals while also strengthening the capacities of their technical assistance team and of the coffee producers. Consequently, the producers increased their production efficiency and coffee quality. They now sell to differentiated markets for better prices than before, receiving a premium in the case of certified coffee. The producers who participated in a certification program and received specific technical assistance have also improved their environmental conservation activities.

In this case, market demands for quality and for certified specialty coffees were an incentive for smallholder producers to adopt new technologies as a condition for them to gain access to those markets. At the same time, the companies developed ways to include the smallholder farmers in their supply chain, providing them with access to financial services and technical assistance tailored to their needs. Rather than providing assistance to individual producers - which had been their traditional approach with medium to large-scale farmers— the companies worked with producer groups, which enabled them to reduce costs and achieve a greater potential for scale.

### *Perhusa: inclusive organic production for sustainability and scale*

Certification, apart from enhancing quality, may also enhance the sustainability of production—especially if the certification standards require producers to decrease the use of fertilizers and pesticides and treat wastewater used in the post-harvest process, as is the case in organic certification. The Perales Huancaruna Group (Perhusa), a family-owned Peruvian company dedicated to producing and trading coffee, brings organic certification to a growing number of smallholder coffee farmers to increase its volume of organic coffee exports. It is the principal coffee exporter in Peru,<sup>54</sup> and in 2011, the company exported over a million quintals of coffee, valued at US\$300 million. With 120 employees and 40,000 coffee growers as suppliers, it is one of the largest agribusinesses in Peru.

In early 2000, Perhusa created a business unit dedicated to producing and trading high-quality specialty coffee. Unlike Colombia and Brazil, Peru does not have large stretches of land where coffee is grown. Rather, Peruvian coffee is grown mostly on small plantations in the Andes, close to the tropical rainforest.

<sup>53</sup>. Programa para la Calidad Sostenible, or Program for Sustainable Quality, implemented by SNV and Solidaridad.

<sup>54</sup>. Perhusa's sales represented 25% of all coffee exports.

Perhusa, in response to a growing international market for organic coffee, decided to develop a plan to strengthen smallholder coffee farmers, to guarantee that coffee production and post-harvest treatment comply with international market demands.

With this objective in mind, in 2008 Perhusa, supported by the SNV/IDB-MIF IB program, designed a project to increase small-scale producers' productivity and enable them to gain access to organic certification for their coffee. To that end, the company provided the farmers with technical assistance and training in good agricultural practices as well as with direct access to financing. Perhusa supported the farmers in the application and monitoring production processes required for certification. The company committed to buying the coffee directly from the producers, at the price established by the New York Commodity Exchange. The IB plan also included strengthening farmers' organizations to mitigate difficulties related to geographical spread and to contribute to an effective and efficient relationship between Perhusa and the producers.

As a result, Perhusa doubled its volume of specialty coffee sold in international markets (from 57,000 quintals in 2008 to 120,000 quintals in 2011). The company's technical assistance was delivered through a network of technical staff to guarantee that coffee production met market standards. Meanwhile, over 9,000 producers, with an original annual income ranging between US\$1,370 and US\$3,700, improved their production quality and increased their productivity by 20 percent. This led to an increase in their income of around 30 percent. The families researched indicated that they gained access to a new market and felt that they were important partners of the company. The coffee certification motivates farmers to use good practices, given that certification opens opportunities for better prices. Farmers also value the price stability of export coffee (as opposed to conventional coffee for the national market), as it allows their families to anticipate and plan for savings and investments. Perhusa has already scaled the initial IB project, which involved 4,000 producers, to include another 5,000. To support the expansion, the company invested an additional US\$600,000 of its own resources.

## **DAIRY COMPANIES DELIZIA (BOLIVIA), FLORALP (ECUADOR), AND CENTROLAC (NICARAGUA)**

- From inclusive business to inclusive industry.

In several Latin American countries, dairy companies are concerned about meeting the demand for raw milk, especially in the dry season, when productivity is low. In this context of competition for milk supply, some companies have started to shift their focus from working with their existing individual suppliers in an IB model to increasing overall productivity and quality within the chain—working towards inclusion within the industry as a whole.

### *Delizia: increased supplies through improved livestock for smallholder farmers*

Delizia is one of the most important dairy companies in Bolivia and has annual sales of US\$36.5 million. In 2007, an analysis of Delizia's supply chain showed deficiencies in milk production in the highlands region: small-scale farmers' productivity levels were low, averaging five to seven liters of milk per cow per day, with an average herd size of five cows. Additionally, there was a lack of basic production infrastructure. In spite of these challenges, dairy farming represented between 50 and 60 percent of the farmers' monthly income, with productivity levels in the dry season falling by 30 to 40 percent due to decreased fodder availability. In this context, Delizia, supported by SNV and CEDES (Consejo Empresarial para el Desarrollo Sostenible, the Bolivian chapter of the World Business Council for Sustainable Development), decided to develop an IB initiative to improve cattle productivity in the highlands, thereby increasing milk supply for the company and improving small-scale dairy farmers' income.

The IB introduced hydroponic fodder as a way to quickly improve livestock productivity. The fodder was grown by the farmers in greenhouses, funded by microfinance institutions involved in the initiative. The producers committed to selling and delivering their daily milk production to Delizia and authorized the company to retain a percentage of their payment to pay off the fodder production loan they had obtained. This model was modified after the producers indicated that they preferred to invest the loan (around US\$1,000 per family) in buying improved cattle instead of in the greenhouse infrastructure. Delizia invested in cooling tanks and collection centers in the farming areas, and in tankers for collecting fresh milk. The company also provided technical assistance to the farmers on their land, through its newly created Agriculture Department.

As a result, Delizia's milk collection increased by over 40 percent and its supplier base increased threefold, generating trust and loyalty-based relationships which are a competitive advantage and a valuable asset in the local market. The dairy farmers have doubled—and in some cases tripled—their income from milk production and have increased their productivity between 30 and 50 percent, mainly through replacing their cattle with improved livestock.

### *Floralp: investing in greater supplies of quality milk from smallholder farmers*

The Ecuadorian dairy company Floralp is a family-owned dairy business founded in 1964, with current annual sales of US\$17 million, 140 employees, and an annual growth rate of 10 percent. Over a decade ago, the company started sourcing milk from small-scale dairy farmers to increase its supply. Floralp's technical assistance was aimed at small-scale suppliers (i.e., those owning between three and six hectares and a herd of cattle of around 20 head) and focused on improving productivity and milk quality. By setting up a price scale based on quality standards, Floralp has been able to effectively increase the quality of the milk they purchase, while generating a stable and higher source of income for small-scale farmers.

The company has a dedicated technical assistance unit, which is responsible for training and strengthening small-scale farmers' associations and subsequently integrating them into the company's value chain. The company's interest in developing a network of small-scale farmers was a strategy to



reduce and diversify its risk by avoiding dependence on a small group of large and medium-sized providers. Floralp also developed a training and technology transfer program, which has helped increase the small-scale farmers' loyalty to the company. A crucial factor in this initiative has been the trust relationship developed between the associations and Floralp's technical staff, which is based on creating and honoring mutual agreements regarding support and supply.

To accelerate the inclusion of more low-income communities in its supply chain, between 2010 and 2012 Floralp - with support from the SNV/IDB-MIF IB program - set up and developed a credit facility to fund producers' fixed investments and working capital for infrastructure, machinery, and investments aimed at reducing environmental impacts. The credit facility was accompanied by technical assistance and enabled 300 smallholder dairy farmers and 30 medium-scale producers to invest in their productivity and the quality of the milk they produce financing, among others: pasture improvement, silos, fences and water-capturing and milking facilities. These beneficiaries were able to sell their milk to Floralp, whose smallholder milk supplier base totaled 1,500 farmers. Within the project, IDB-MIF funded the credit facility with US\$437,000, bringing the total of Floralp's existing facility to US\$675,500. The average loan size was US\$1,818 for smallholders and US\$6,314 for the medium-sized farmers. The credits are being paid back through farmers' milk sales to the company.

The smallholder farmers' associations (14 in total) have been crucial in allowing farmer participation by acting as an important intermediary for technical assistance provision. The associations themselves were also strengthened in the process, in terms of financial and administrative management.

Floralp has created a network of suppliers that guarantees its long-term supply of fresh milk. The 14 smallholder associations involved in the IB initiative produce about 54 percent of the milk that the company sources, whereas the company used to source only 30 percent of its total supplies from smallholder farmers. The long-term relationship between Floralp and the farmers has helped generate loyalty to the company, which is especially important in periods of milk scarcity during the dry season.

Over the course of the project, the productivity of the smallholder producers' farms has increased from 10 liters to 25 liters per hectare per day, basically due to better pasture and other technological improvements. The quality of the milk has also improved: formerly, the company turned down 10 percent of production, but this has been reduced to 2 percent. Through their relationship with Floralp, the small-scale producers at the end of the project obtained higher and more stable prices for their milk production (US\$0.42/liter, whereas formerly they received US\$0.39/liter). On the basis of these results, the farmers have been able to increase their income from US\$5.85/day in 2010 to US\$12.22/day in 2012. Milk production also accounts for a larger share of farmers' total earnings; income from other agricultural activities and off-farm employment has decreased, since milk production has become the most reliable and stable income source. Farming families indicated that on the basis of that stability, they are in a position to plan for the family's well-being in terms of access to loans for housing improvement and appliances, as well as better education for their children.

Although Floralp started implementing its IB initiative on its own, over time it realized the importance of

partnering with IB facilitators and funding organizations to scale up the IB results. The company sought like-minded organizations to create partnerships that would allow Floralp to continue generating sustained growth that includes low-income communities. Floralp management indicated that including low-income producers in its value chain and generating mutual value have become “business as usual” for the company. Apart from the IB case described above, the IDB-MIF’s Social Entrepreneurship Program<sup>55</sup> increased access to finance for the small-scale farmers and their associations through a US\$715,000 fund to be operated by the company. This initiative focused on strengthening the associations, allowing them to grow and offer additional services to their members, such as savings and storage facilities for producers. Furthermore, the company has implemented IB models in their processing plants in Peru and Colombia.

### *Centrolac: value chain improvements beyond the company’s suppliers*

Centrolac is a Nicaraguan dairy producer and exporter of ultra-pasteurized (UHT) milk, founded in 2007. With the use of ultra-pasteurization technology, Centrolac quickly became one of the leading enterprises in the industry. In 2012, it employed 150 staff and exported part of its production to Venezuela, El Salvador, and other Central American countries.

In 2007, Nicaragua produced 3.7 million liters of milk per day, of which only one million was processed industrially, the rest was consumed unpasteurized in the rural areas or it was used for artisanal cheese production. In the last case, the milk was bought by middlemen who paid good prices but did not demand high quality.<sup>56</sup> Consequently, farmers did not traditionally pay much attention to the quality of their milk. Additionally, milk production in Nicaragua is highly influenced by seasonal effects: in the rainy season (May–November) production increases by 50 percent compared to the dry season. The fluctuations in supply make milk prices volatile over the course of the year.

To meet its required levels of quality, Centrolac was aware that improvements were necessary along the entire value chain: from the milking process to the delivery at the collection centers. With support from the SNV/IDB-MIF IB program, the company developed a project with smallholder dairy farmers involving 175 smallholder producers that owned fewer than 20 cows each, produced fewer than 80 liters per day during the rainy season, and had a yearly income below US\$3,200. The project focused on improving their competitiveness by increasing milk quality and production levels. The project set out to:

- 1. Increase the quality of the milk received in the collection centers**, working with farmers on good practices as well as with transporters on raw milk handling.
- 2. Strengthen general management and quality control capacities of four selected collection centers** managed by farmers’ associations.
- 3. Provide financing to the farmers through their associations**, to fund improvements in their production systems (against weekly payments of the milk they produced).

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<sup>55</sup>. Also known as SEP. For more information, visit <http://www.fomin.org/en-us/Home/Projects/Financing/SocialEntrepreneurshipProgram.aspx>

<sup>56</sup>. Quality is measured according to the fat, protein, and bacteria-count content.

As a result of the project, farmers have increased their productivity and milk quality. At the same time, especially in the dry season, other buyers (the middlemen that sell to the artisanal cheese factories) continue to be interested in the farmers' milk and offer the collection centers better prices than the company does. Some of the producers' associations decided to sell the milk to the middlemen, taking advantage of the better price. In these cases Centrolac has continued to provide technical assistance to the farmers; the company is aware of the industry's need for continued investments and its dependence on improving the value chain as a whole—especially in terms of the quality and quantity of production. The company is currently developing strategies to increase farmers' loyalty, to ensure returns on its investments in the value chain.

## MANUFACTURERS NOVACERO AND COLINEAL IN ECUADOR

- The importance of a stable market for low-income suppliers of raw material.

Apart from IB initiatives in agribusiness, several cases were studied in which low-income populations provide raw materials for manufacturing industries. The following examples highlight the effect that end product market conditions have on the potential for sustained impact on the supplier communities involved.

### *Novacero and the scrap metal suppliers in Ecuador: from waste collectors to valued partners*

Novacero S.A. is an Ecuadorian company that manufactures and trades steel products such as covers, piping, metallic greenhouses, and steel reinforcing bars. Its current annual turnover is more than US\$160 million, and it directly employs more than 950 people. Novacero's average annual growth in the past five years has been over 20 percent, and as such, it is considered one of Ecuador's fastest-growing companies in the last decade. This growth is based mainly on an increasing demand for construction materials as a result of new investments in infrastructure. Novacero's best-selling product is the steel reinforcing bar for construction, accounting for 33 percent of the company's total sales. To manufacture it, Novacero used imported steel billets.<sup>57</sup> In 2007 the company decided to include scrap-steel melting in its manufacturing process to replace imported steel billets.

The market for scrap steel in Ecuador is monopolized and controlled by wholesale scrap-steel sellers that make good profits from their business. They source their material from waste collectors: mainly low-income people, who collect different materials (scrap metal, plastic, and paper) from houses, dumpsters, or small businesses. In many cases, the intermediaries use altered scales for weighing scrap metal, paying the collectors a lower price for their products. This practice caused the collectors to not trust the buyers and encouraged them to look for ways to compensate for these losses: for example, by cheating intermediaries through practices such as filling pipes with soil to increase the weight (and thus the price

<sup>57</sup> Steel billet is a byproduct obtained from melting scrap steel. It is then used to manufacture end products such as steel reinforcing bars for construction.

they received). These practices caused serious problems for steel factories, as mixing soil with scrap metals makes the material unusable.

Given these distortions in the scrap metal market, Novacero decided to create a specialized area responsible for supplying its plants with scrap metal. This business unit established a network of recycling entrepreneurs located throughout Ecuador who bought scrap steel from collectors in their respective geographic areas (see Figure 3). Through this model, the company was able to gain the loyalty of a group of recyclers helping them to become direct scrap-metal suppliers who meet quality and environmental standards. These centers are called Novacero Recycling Points (the Spanish acronym being PRNs).

Through the SNV/IDB-MIF IB program, in which Novacero participated, SNV and MIF supported the improvement of PRN management within Novacero's IB initiative. The project included two components, addressing the two levels of the collection network: (1) improvement of business management at the PRNs and (2) improvement of collectors' skills in separating steel from other metals.

SNV facilitated the design and implementation of the project. Consultants provided training on business management tools and techniques to improve the PRNs' interpersonal and work relationships. Novacero provided direct training to the collectors on identifying and handling scrap steel. The company appointed one management staff member as a focal point for the SNV/IDB-MIF IB program to ensure that the company met its goals.

Novacero realized that weighing the recycled material was the bottleneck that needed to be addressed to reduce collection times. Therefore, the company decided to buy electronic scales to weigh small trucks loaded with scrap steel and loan them to the PRNs. The company also placed trailer platforms in each recycling point so the PRNs could load scrap steel directly onto the platform and have the

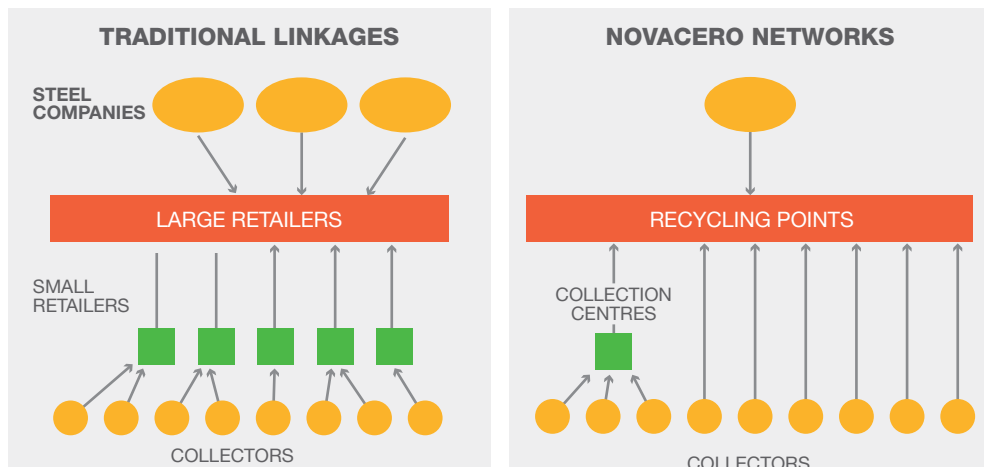


Figure 3: Scrap-steel Purchase Chain Before (left) and After Novacero's IB Initiative.

material ready for pick up by Novacero. This IB initiative enabled the PRNs to offer small-scale scrap-steel collectors a guaranteed purchase at a fair weight and price. This, in turn, created a reliable and growing network of suppliers for the company. A communication campaign carried out by Novacero has helped prevent the community from thinking poorly of waste collectors and has contributed to the public’s understanding of the collectors’ and recyclers’ importance in society.

Furthermore, the IB helped consolidate a trust-based relationship and loyalty between Novacero and the PRNs. These links are so strong that although Novacero’s competitors have approached the PRNs to buy scrap steel at a higher price, the PRNs have continued to sell exclusively to Novacero.

The number of PRNs participating in the network has increased, respecting internal rules set by the company to help ensure that new PRNs do not compete with existing ones located nearby. Through consolidating the recycling network, the company has a more stable, diversified supply that does not depend solely on imports or intermediaries. As the number of PRNs has grown, the amount of scrap metal purchased through them has increased accordingly (see Figure 4).

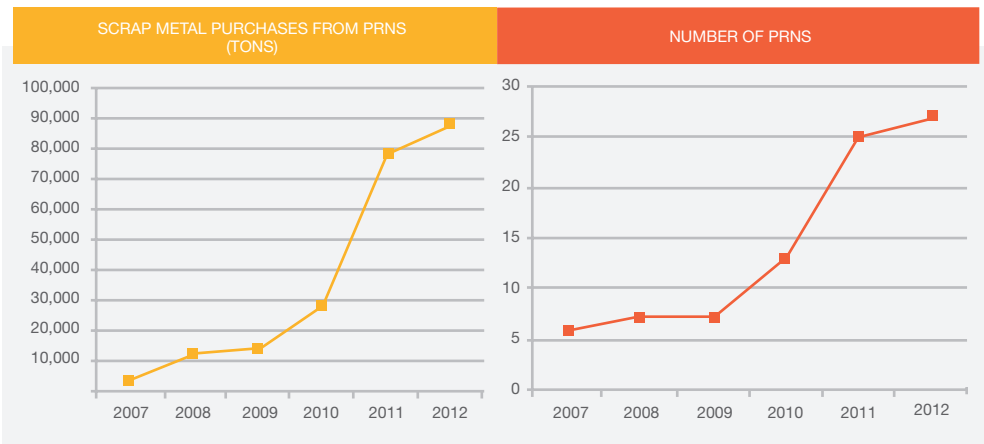


Figure 4: Number of PRNs Established and Scrap Metal Purchases from PRNs Over Time.

In 2011, Novacero purchased 61 percent of its total scrap steel from the PRN network, 12 percent from importers, and 27 percent from companies and wholesalers. By mid-2012, the company was producing 120,000 tons of steel, and due to the success of the model, it is now purchasing equipment that will allow it to reach a total production of 250,000 tons.

At the same time, the net incomes of both the PRNs and their suppliers have increased, environmental management has improved, and the relationships between the families, workers, and suppliers involved in the model have been strengthened. The increased income (from US\$500 at the outset of the project to US\$2,000, and in some cases US\$10,000, in 2012) has allowed the recyclers to invest in housing, to

develop their businesses, and to create new ones. Novacero increased its network from 17 to 25 PRNs, which in their turn involve an estimated 3,000 scrap-metal collectors now linked to the company's supply system.<sup>58</sup>

The yearly training sessions at Novacero's facilities have resulted in an increased number of recyclers. Participants are able to specialize using their knowledge of proper recycling techniques and management of steel materials, among other topics. The project has also helped formalize and humanize collectors' activities, placing them at a higher social level, benefiting society through a responsible and technically solid recycling system, and generating new income sources among the poorest members of the population.

### *Challenges with market connections: Colineal and small furniture manufacturers in Ecuador*

Colineal is a family-owned Ecuadorian company founded in 1940 as a workshop for manufacturing wooden furniture. At the end of the 1970s, Colineal transformed the workshop into a company, purchased new machinery, and hired additional staff. By 2012, the company had operations in eight cities in Ecuador, represented specialized brands, and owned stores in Peru, Panama, and Colombia, adding up to sales of US\$28 million. It operates in two main areas: production and commercialization of home and office furniture. About 75 percent of its production is sold through its stores in Ecuador and the rest is exported to Peru, Panama, Colombia, the United States, Spain, New Zealand, and Canada. Colineal's growth is based on the introduction of new technologies and designs. Recently, the company became involved in interior design and furniture supply for hotel chains.

The furniture industry is highly competitive, and clients are increasingly demanding in terms of quality, price, and timely product delivery. Colineal obtained its leading market position on the basis of the quality of its products, but the competition is forcing the company to increase the efficiency of its supply chain. To achieve higher supply chain efficiency, the company decided to formalize the relationship with the micro and small enterprises that are part of its supplier network, while at the same time extending the network. In 2007, Colineal structured an IB initiative - in collaboration with the IDB-MIF/SNV IB program - to improve its supply of wood and semi-finished furniture pieces as well as its product line in closet manufacturing and installation.

The suppliers selected for the project were small enterprises that did not have their own stores and were already part of Colineal's network (with the exception of one newly included supplier). Based on an analysis of the enterprises' potential and needs, Colineal created a supplier development program. The program included the development of guidelines for the processes, activities, and quality standards applied by Colineal. Training workshops were held with the participating enterprises to share these guidelines and integrate them into their production processes. The workers from the enterprises involved in the program received training about the techniques required to produce, package, and store the required pieces. The training was meant to increase the quality of the pieces and reduce costs

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58. Each of the 25 PRNs in the network has around 20 to 25 suppliers, who are households made up of four or more members.

by optimizing the production process. Finally, the enterprises' employees and supervisors were trained in administrative skills to contribute to their businesses' financial sustainability.

The enterprises significantly improved product quality and production efficiency: the volume of products sold to Colineal increased by more than 30 percent. This increase created a total of 49 additional jobs within the enterprises and boosted the workers' salaries (from US\$269 to US\$325 per month, a 21 percent increase). The company obtained access to higher-quality products and achieved greater efficiency in its supply chain. Colineal rejected fewer products and introduced new product lines.

The 2009 financial crisis caused a decline in the global demand for furniture which affected Colineal's sales and its relationship with the enterprises, which registered lower income from sales to the company than they had expected. The impact was stronger for enterprises that relied on Colineal as their sole buyer and therefore had not diversified their client portfolio or product offerings. Because of the decline in sales, Colineal had to suspend part of the IB activities and purchase fewer products from the enterprises. By 2012, only two out of five enterprises still had a commercial relationship with Colineal; the others had gone back to operating as independent entities—and in some cases had opened their own stores.

This experience shows the effects of a certain level of dependency on a company within an IB initiative. If for some reason the company has to reduce the size of the initiative or withdraw from it entirely, the suppliers may be left without a market for their products or services. In this case, however, the suppliers were able to use the technical, operational, and commercial skills they had gained through the IB project and access new local markets.

In spite of the fact that Colineal had to suspend the initiative, the company acknowledges the benefits of including small suppliers in its value chain. At the end of 2012, Colineal was considering several alternatives for IB development, including:

- Leverage the strategy for international expansion, with a focus on a particular product to be developed with specialized small enterprises.
- Develop an IB initiative around the supply of wood.
- Train small supplier enterprises in advanced furniture manufacturing techniques.

### **Conclusions on IB with suppliers**

Drawing on the cases described above as well as on other cases analyzed during the course of the research study, this section outlines the main conclusions related to IB models with suppliers.

#### **Motivation**

The reasons to participate in an IB initiative are often expressed differently by companies and communities, but are frequently directly linked to a perceived or calculated business opportunity.

Communities anticipate that they will be able to acquire services or skills that may lead to increased production or better prices for their work, and to access a secure market under attractive conditions. Companies, on the other hand, look to improve their response to market demands. In some cases, companies also explicitly mention the alignment of IB with the company's values and/or brand, and the opportunity to access funding for an IB initiative.

### *Investment*

Most of the researched IB cases involving suppliers started with an initial financial investment provided by an external donor. This type of funding was usually used for investments that improved suppliers' production methods (e.g., through training, technical assistance, and technology packages). In most cases, and once results and returns on investment started to show, companies invested additional funds to scale the initiative. In other projects, working with small producers was already inherent to the company's practice and any investment made to increase their involvement was seen as part of their regular business model, as opposed to a special or additional investment.

### *Results*

With regard to IB results, the participating supplier communities highly valued the stability in prices, next to the fact that they often also obtained higher prices for their products. In many cases, this has allowed smallholders to open savings accounts and gain access to other financial services, such as credit and loans. Furthermore, the communities value the improved relationship with the company and with other stakeholders, as well as the strengthening of their own organizations. In some cases, the families are able to invest in housing and education from the revenues earned from the IB. Companies highlighted their improved ability to respond to market demands and/or to become more efficient. In most cases, intermediaries or middlemen that formerly brokered between the company and the producers had disappeared from the chain.

### *Timeframes*

In terms of length of investments and time required to achieve results, the cases analyzed presented many differences. Some companies have applied IB mechanisms over a long period and claim this is the only sustainable way to conduct business. Others have recently initiated a particular IB initiative, with support from an external investor, and have perceived results for the company within a year—either on the balance sheet or as an opportunity for brand awareness or improved image/reputation. In most cases, once the payoff becomes evident, companies start to invest their own funds. Some companies indicate that, although the IB initiative has not yet generated results in terms of profit, they believe in the importance of generating inclusion and creating loyalty mechanisms with small-scale suppliers and will continue the effort despite a lack of short-term results, as part of a more sustainable business model. As for the communities involved, most IB cases researched showed improvements in productivity within one to three years.



## *Risks*

Any IB supplier initiative involves company investments in suppliers' production efficiency, volume, and quality, as well as in setting up and implementing a model that allows for a mutually beneficial relationship. The models can include mechanisms for technical assistance, and various approaches for working with associations or small enterprises. The returns on such investments only pay off if the suppliers decide to sell their products to the company. Loyalty mechanisms therefore prove to be of great importance. If they fail to work, and/or if other buyers offer better prices than the company, the company runs the risk of losing the investment made. The cases analyzed provide different examples of mechanisms to enhance loyalty ranging from providing credit with favorable conditions, to investing in good relationships between technical personnel and suppliers, and to ensuring stability in prices and guaranteeing purchases. Suppliers' investments in an IB initiative include production inputs and time dedicated to developing their skills. In the end, the promise of access to new markets and better or more stable prices depend largely on the company's ability to be successful in its market and generate the extra value that results in a profit margin for both parties. Market changes may lead the company to not pay the expected price or to not purchase from the suppliers at all. The cases provided insights into how communities spread this risk by not committing to sell exclusively to one company or by obtaining price guarantees from the company.

## *Mutual agreements*

An inclusive business with suppliers usually starts off with an agreement between the company and the suppliers involved in the initiative. In most cases the agreement is informal; in only a few of the cases analyzed was a negotiation formalized with a signed agreement. For businesses, the agreement may then be expressed in an IB plan (especially in cases explicitly supported and facilitated by third-party actors). Such a plan will typically include the investments that the company will make to improve suppliers' production capacity. Usually, the plan's main goal is to reflect the conditions under which the inclusive business initiative will be developed, rather than to be a commercial contract. Although agreements are not necessarily documented, in most cases there is an explicit decision made by both the company and the supplier communities to get involved in the initiative and make the necessary investments. The cases studied show that producers are not bound by contractual agreement to deliver exclusively to the companies involved. In the examples studied, top management's commitment to the IB initiative was an important factor for achieving results and ensuring that middle-management and technical staff dedicated time and resources to the IB initiative.

## *Organizational adjustments*

An IB initiative usually leads to changes in the relationship between the company and the community and causes organizational changes on both sides. Especially when a company and community establish a direct relationship, new dynamics are generated within communities and within companies, as well as between them. To respond to community needs and improve their supply chains, companies often

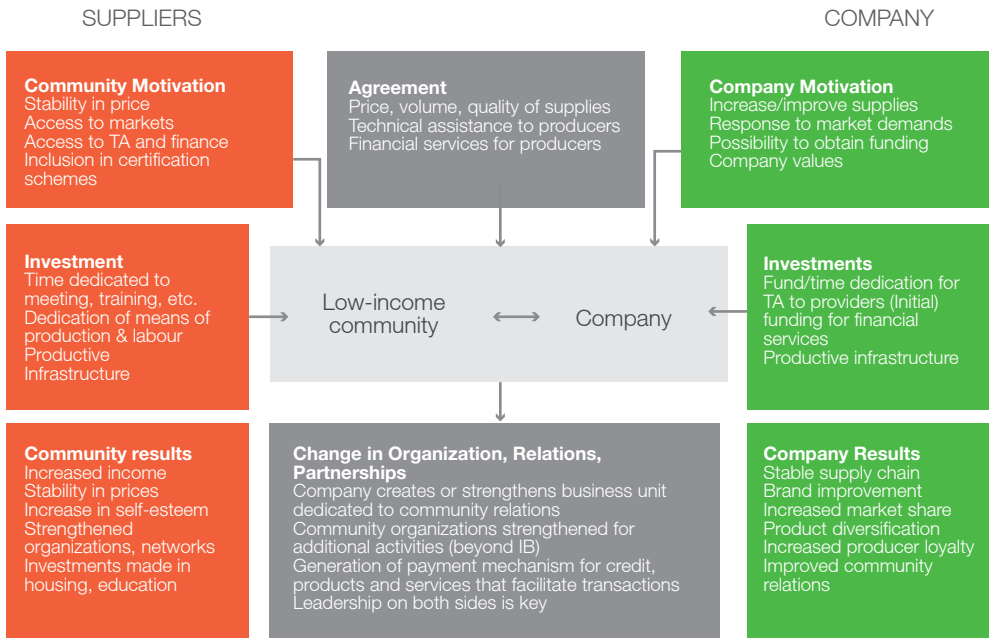


Figure 5: Overview of General Motivations, Investments, and Results of IB Initiatives with Suppliers.

create or strengthen a business unit dedicated to community relations and/or develop new loan and payment mechanisms. At the same time, communities indicate that involvement in an IB initiative leads them to establish new organizations and/or strengthen existing forms of organization, to facilitate transactions with the company and receive services, or to collectively manage aspects of the production process. This is beneficial not only for implementing the IB but also for additional purposes. Some cases suggest that community organizations (or units within existing community organizations) set up for the specific purpose of the IB initiative are more effective in terms of achieving IB results than existing community organizations that were set up for a different purpose; this is likely because the former have an explicit focus on the development of the business and on managing the relationship with the company.

### Additional support for inclusion

In many of the cases researched, the IB initiative was supported by other organizations interested in advancing social development in the participating communities. While the relationship between company and community typically focuses on benefits in terms of community's income and productivity, additional social results (e.g., education, health, and access to services) are often achieved through the involvement of other organizations, such as local governments, NGOs, or company foundations.

## *Environmental impact*

IB initiatives contribute or promote environmental sustainability to the extent that environmental measures are included in, or inherent to, the initiative. Although in most of the cases reviewed, environmental benefits were not explicitly included in the objectives, many of them generated some positive environmental impact. For example, in the cases where certification for organic products or certification based on good agricultural practices was implemented (or transferred) to groups of small-scale producers, the IB initiative allowed both the company and the producers to contribute to environmental sustainability and generate value not only for the two parties, but also for the broader society in which they operated.

## *Difficulties, doubts, and downsides*

Although the cases included in this research were selected because they had completed a cycle of planning–implementation–results, not all of them were equally successful, nor did they all lead to the desired outcome. Some of the difficulties and doubts encountered are:

- Not all IB initiatives start with clarity from the company or the community about the potential outcomes of the experience, and not all IB initiatives represent, from the beginning, a business case for both parties. Especially when an initiative is not based on the “pull” from a market opportunity but rather on the “push” from a funding opportunity, the partners may enter it from a perspective of “nothing to lose,” thus potentially lacking the motivation needed later on to make it a success and, more importantly, running with the risk of an unsecured demand for their suppliers.
- Many of the companies involved in IB initiatives not only mentioned an initial hesitation in building a trust-based relationship with the participating communities, but also indicated that constructing such a relationship requires hard work, time investment, and willingness to overcome frustrations and misunderstandings. The ethnographic studies carried out in the communities pointed out that not all companies managed to develop good relationships with the communities. Some companies outsourced their technical assistance services, which could hamper their ability to develop a direct relationship; or they opted to work through existing community organizations, which sometimes were not well suited to or equipped for managing community involvement in the IB initiative.
- Among those analyzed, the more successful IB cases with suppliers showed a relatively large impact per family, sometimes doubling or tripling family income. The total population impacted per case, however, especially in comparison with results from the IB consumer model, is relatively low. Scale can then be addressed by replicating the model with new supplier groups but the real potential for scalability depends on market opportunities as well as on the presence and accessibility of potential suppliers.

## 2.3 IB with consumers

In IB models with consumers, the low-income segment is involved in the business approach as consumers of goods and/or services provided by a company. The IB model with consumers is applied most successfully in larger markets where the low-income customer segment represents an opportunity for investment in the development of a product or service. The model is most commonly utilized for mass consumer products like cellular phones and food and household products, but it can also be found in sectors like construction, pharmaceuticals, electricity, microfinance, and health services.

An IB consumer initiative starts out with a problem, need, or opportunity for a company, related to entry into a new market or expansion of an existing market. The IB model provides the opportunity to reach the low-income market segment by developing products or services specific to their needs—which should be good quality and affordable, often offered in quantities that lower the price per unit. The model may also include low-income people not only as consumers but also as distributors of the products or services.

In this section, four different full cases illustrate the components and processes of IB initiatives that involve low-income communities as consumers of goods and services tailored to their needs. Limitations and success factors are illustrated through cases from different industry sectors, including financial services, construction, pharmaceuticals, and energy. In most of these cases, the low-income communities are not only consumers of the products and services offered but also actors involved in service provision or product distribution.

### EDYFICAR IN PERU: FINANCIAL SERVICES FOR LOW-INCOME CLIENTS

- Quality financial products and services designed for inclusion of employees and customers.

Microfinance is probably the best-known and most successful expression of inclusive business with consumers.<sup>59</sup> Disbursement of financial services in small sizes to low-income people has, in many cases, proven capable of yielding commercial returns and has enabled initiatives started by NGOs and philanthropic foundations with an explicit focus on poverty reduction to become financially viable. Edyficar in Peru is an example of an NGO initiative that has developed into a financial institution. The business model includes low-income population not only as customers but also as employees. Its mission is to provide access and deliver financial services to low-income people, preferably owners of micro and small enterprises, thereby helping to improve their quality of life.<sup>60</sup>

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<sup>59</sup>. Chu, 2010.

<sup>60</sup>. [www.Edyficar.com.pe](http://www.Edyficar.com.pe)

## Background

Edyficar is a large and well-regarded Peruvian financial institution that specializes in providing financial services, mainly microcredit, to low-income clients. In 2010, Edyficar was considered one of the best 100 microfinance institutions in Latin America (ranked 32<sup>nd</sup>) according to the IDB-MIF and the Microfinance Information Exchange (MIX), given its growing portfolio, number of clients, profitability, and risk rating. Edyficar integrates two IB approaches in its business model: with consumers who access Edyficar's financial services (particularly credit for microenterprises), and with the company's employees. A large portion of Edyficar's credit analysts are from lower-income families in Lima and other provinces and undergo a structured recruitment, selection, training, and compensation process.

Edyficar has its origins in the Small Enterprises Development Program, which was launched in 1985 by CARE in Peru.<sup>61</sup> Over time, the program became institutionalized and converted into a regulated microfinance institution (MFI), and later into a financial institution. The organization has grown considerably becoming one of Peru's lead banking and finance sector institutions.

Edyficar owes its success in part to the commitment and experience of its management staff, to strong focus on its mission, to its personnel, and to the transparency in its operations, as well as to a highly favorable policy environment in Peru. In 2012 and for the fifth consecutive year, Peru was ranked as the world's most favorable business environment for microfinance, according to the Global Microscope 2012.<sup>62</sup> Edyficar has provided financial services to more than 250,000 micro and small entrepreneurs and families. With regard to its inclusive practices with employees, more than 1,300 of them (more than half of its total workforce) are from low-income backgrounds.

## Opportunity

For Edyficar, the opportunity to develop its inclusive business with consumers was two-fold: financial and branding. With regard to the financial aspects, Edyficar has been able to achieve a higher rate of profitability than the industry average, has a higher-quality portfolio than its closest competitors, and has a sustainable client base of micro and small enterprise clients.

On the clients' side, doing business with Edyficar is a good opportunity that provides them with the ability to significantly grow and improve their micro and small businesses. In fact, a considerable part of Edyficar's clients that started with small loans of around US\$200 for their micro enterprises were accessing loans of up to US\$7,750 for small businesses. Many clients were also able to secure credits from the traditional financial system. These clients have strengthened their enterprises and improved their families' quality of life.

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<sup>61</sup> CARE International is a global confederation of 14 member organizations working together to end poverty. CARE started its work in Peru in 1953 and now has a presence in more than 80 countries. See also <http://www.careenperu.org>.

<sup>62</sup> For more information, visit [https://www.eiu.com/public/topical\\_report.aspx?campaignid=microscope2012](https://www.eiu.com/public/topical_report.aspx?campaignid=microscope2012)

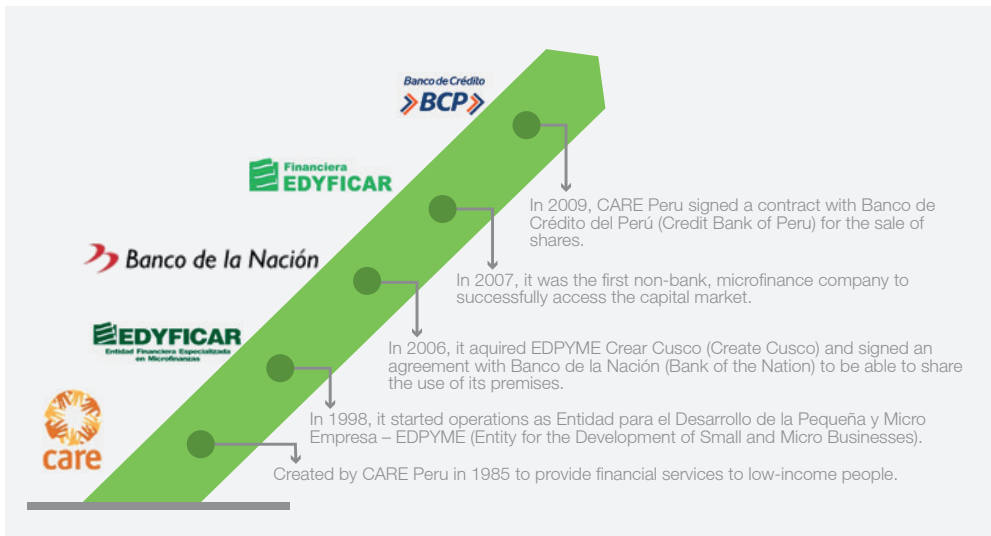


Figure 6: Edyficar's Growth and Partnership Development.

## Development

In Edyficar's case, and unlike many IB initiatives that develop within or next to an existing conventional business strategy, Edyficar has been offering financial services to low-income clients since its inception. While Edyficar grew and developed new partnerships, as outlined in the Figure 6, it maintained its mission to serve low-income populations with limited access to the traditional financial system.

One of Edyficar's keys to success was its ability to select clients who were likely to keep their financial commitments and whose microenterprises had a strong growth potential. Another vital element has been its ability to form solid partnerships, including those described in Figure 6. In addition to these alliances, Edyficar also signed a partnership with the IFC for a technical assistance program focused on institutional strengthening during its transition period to becoming an officially recognized financial entity. Aspects of IFC's support included: revising and updating Edyficar's strategic plans, evaluating its products and services, strengthening its financial management department, and implementing a new Continuous Improvement Unit. Plans were also developed to design microsavings and rural microcredit products.

Various financing sources have helped fuel the growth of Edyficar's inclusive business, including international institutions, second-tier banks, local banks, mutual funds, pension funds, insurance companies, and commercial and public companies. At the end of 2010, Edyficar's financing portfolio was worth more than US\$400 million, while over 2011 it grew to US\$490 million.

62. Más información en [https://www.eiu.com/public/topical\\_report.aspx?campaignid=microscope2012](https://www.eiu.com/public/topical_report.aspx?campaignid=microscope2012)

The management team, comprised of people with a long history in the institution, has played an important role in motivating the team members. The motivation and commitment of the credit analysts are especially important, as they interact with clients daily and are the face of Edyficar. Edyficar's inclusive practices with its employees play a crucial role in strengthening its client relationships. Because many of the credit analysts come from lower-income backgrounds from throughout Peru, they are able to relate to and understand the realities that Edyficar's clients face.

### *Investments*

Edyficar's physical infrastructure includes a new ten-story main office building in the heart of Lima's financial district and the opening of 16 new offices throughout Peru, plus four in Lima. Edyficar's main investments over the past years are largely focused on enhancing its relationship with its low-income clients through closeness and service improvement.

To improve its services and processes, in 2010 Edyficar strengthened the main qualities for which it is valued by its clients—accessibility and fast response time—through modifying approval processes, differentiating the product offering by client segment, and making the loan requirements (for obtaining credits up to US\$7,750) more flexible. Edyficar also invested in designing new products to respond to its clients' needs, including a micro-insurance policy and micro life insurance, which the company plans to offer for as low as US\$1 per month.

### *Company results*

In 2010, Edyficar served 285,780 clients, a 34 percent increase from 2009, while in 2011 the portfolio had grown to include 356,000 clients. Of these, 54 percent are exclusively clients of Edyficar, which is to say that they do not have credit with another financial institution. The remaining 46 percent have a higher level of credit with Edyficar than they have with other financial institutions. Edyficar's loans in 2011 reached a record level of US\$490 million, representing a 37 percent increase over 2010 figures.

Of Edyficar's portfolio, 56 percent are microenterprises, 23 percent are small enterprises, and 19 percent are households. It is worth noting that the household category has grown by 60 percent, based mostly on strong demand for the Edyvivienda (housing) credit. This reflects that Edyficar seeks to expand its coverage based on creating financial products that respond to the needs of the low-income population.

During the period studied, Edyficar was the second leading institution in the sector, measured by the number of customers accessing financial services for the first time. In 2010, the number of first-time financial service users who were Edyficar clients reached 54,537 people, a 38.3 percent increase over the 2009 total of 39,269. Edyficar in 2010 had 1,894 employees throughout Peru in 23 agencies, 45 special offices, and 34 offices shared with Banco de la Nación (Bank of the Nation).

In 2011, Edyficar's net profit was approximately US\$23 million, which was a 34 percent increase from 2010, due mainly to the solid performance of Edyficar's two inclusive businesses, which work in tandem.

The average size of Edyficar loans in 2011 was approximately US\$1,360, which was the lowest among the 15 major companies in Peru's microfinance sector. This indicates that Edyficar is effectively reaching low-income clients to offer manageable loans.

### *Impacts on the community*

Clients highly value the quality and speed with which Edyficar operates and the respect with which Edyficar analysts treat them. They point out that the credit analysts are able to understand them, are interested in their projects, and treat them as equals, in contrast to their experiences with other financial institutions, especially large banks. The clients feel that they have achieved something important in gaining access to credit, and once they feel that the institution is placing its trust in them, their confidence increases. The improved access to better-quality services has had the following impacts:

- Family budgets increased notably as a result of obtaining credit. Not only has the credit itself allowed more room in the budget and the ability to now "live better," but as a result of receiving credit, families made more effort to plan their expenses and to look for ways to save money in areas that were not priorities for them.
- Many of the clients with at least four years of history with financial entities had taken out more than one loan for building or expanding their home and for household appliances, most notably, refrigerators, stoves, and ovens. These purchases are important for the family's nutrition and health, as the appliances enable them to have fresh food in hand and cook safely.
- After receiving credit, families were able to and chose to spend more money on food for the family (at least 50 percent more in the cases studied), including introducing meat, chicken, and fish, resulting in more balanced and nutritious meals. Previously, they had used fried eggs instead of meat or chicken as a source of protein.
- In the majority of cases, women's access to credit has meant an increase in their economic contribution to their household. With credit, some women have actively started new roles as providers or workers/entrepreneurs, while others have been able to expand the work they were already doing. This has had an important effect on household dynamics. Women participants indicated that they feel more confident after obtaining credit and becoming responsible for its management and repayment. Being able to take on important family responsibilities and earning money at a level that they had not previously achieved has generated great satisfaction and self-esteem.



## FARMAENLACE IN ECUADOR: MARKET EXPANSION THROUGH FRANCHISED MEDICINE DISTRIBUTION IN RURAL COMMUNITIES

- Access to quality healthcare products and services involving pharmacies from small, rural communities.

Rural areas with a scattered low-income population constitute a difficult market for pharmaceutical products and healthcare services. Although this market does present potential in terms of social impact, low-income people in many cases exhibit less health-seeking behaviors than other segments of the market, require a lower price point, and often live in areas difficult to access. The Ecuadorian company Farmaenlace set up a business model that allows it to penetrate rural markets by working through existing pharmacies in small towns, selling products at accessible prices, and offering the services of a physician.

### *Background*

Farmaenlace was established in 2005 after the merger of two well-known drug distribution companies with over 20 years of experience in the country. Farmaenlace's core business is selling medicine, chemicals, and hospital inputs, as well as other healthcare and beauty products. It owns two drugstore chains, which segment the market according to the consumer's purchasing power: Medicity and Farmacias Económicas. It also owns two distribution chains called Farmadescuentos and DiFarmes. Farmaenlace's network includes over 1,250 distribution points in more than 18 cities in Ecuador and employs 1,400 people. With an annual turnover of around US\$95 million, it is one of the largest companies in Ecuador's pharmaceutical industry. Over the past years it has grown about 20 percent annually, compared to 10 percent growth in the Ecuadorian pharmaceutical industry overall. In 2002, as new drugstore chains entered the market, the urban market became saturated and offered very limited growth perspectives for Farmaenlace. Therefore, the company decided to make expansion to rural areas a strategic objective.

### *Opportunity*

In the largest cities of Ecuador, the major drugstore chains over the past five to 10 years have largely replaced the small, family-owned drugstores. As more drugstore chains launched their businesses, they started to compete among themselves in the urban markets and were left with little room for expansion. In rural towns, the small drugstore model still exists but experiences poor quality supply through intermediaries. This model has several limitations, such as relatively high distribution costs for drugs and the tendency to sell products that result in a greater profit instead of those that are really necessary to improve health.

In Ecuador, many people living in smaller towns face difficulties in accessing basic health services and quality medicines. Often, to meet these needs, populations in rural areas have to spend their scarce savings to travel to larger towns to visit hospitals, which in many cases offer inadequate health

services and lack the necessary equipment or medicines. Having to travel increases the cost of access to healthcare, and impacts quality of life.

In this context, and with support from the SNV/IDB-MIF IB program, Farmaenlace launched a project to distribute pharmaceutical products in very poor rural areas. The company chose the province of Chimborazo as the initial area for implementation, based on the population's specific characteristics: the majority of the population belongs to indigenous groups, 80 percent lives in rural areas, the sanitation coverage rate is below the national average, and only 33 percent has access to basic health services.

### *Development*

This inclusive business was designed as a model involving distributors and consumers. The distribution model was based on a franchise system, working with local drugstore owners who provided medicine to rural populations. As a first step, the project identified existing drugstore owners as possible business partners for Farmaenlace. They would continue to own their stores but would share investments, costs, and profit with Farmaenlace, and they would receive bonuses when they reached sales and business-development goals. In turn, the partners would only sell products authorized by Farmaenlace.

A contract was signed with a pilot drugstore, establishing the rights and obligations for exclusivity, such as maintaining the image of a low-cost drugstore and reaching increased sales quotas and goals. The greater the sales, the larger the financial benefits to be received by owners and employees. Farmaenlace took responsibility for paying a full-time employee in the drugstore, as well as for frequent advertisement and promotions and for a physician to work three full days per week at the drugstore. They also supplied furniture, software, and signs. In addition, Farmaenlace established a strict control system to ensure and verify compliance with basic guidelines related to the job-functions manual, product display, order, and cleanliness.

Based on exclusivity contracts with Farmaenlace, the owners of the participating local pharmacies that follow the pilot received management, pharmaceutical, and customer-service training; advertisement through healthcare campaigns sponsored by Farmaenlace; and bonuses according to their sales levels. In this model, the employees of the small drugstores became Farmaenlace employees, thus ensuring control over product quality and preventing them from using the brand to sell low-quality products.

SNV, as the main project implementer, contributed methodologies and expertise on how to involve indigenous people and low-income populations in the project. SNV helped establish partnerships and contributed to the design and implementation of the health campaigns. It also helped Farmaenlace to engage more effectively with the beneficiary population.

### *Investment*

Farmaenlace and the SNV/IDB-MIF IB program invested US\$79,000 in this project; 45 percent was funded by the IDB-MIF, while the remaining 55 percent was financed by Farmaenlace. The owners of the drugstores invested US\$10,000 in products supplied by Farmaenlace. Project resources strategically

invested in trainings on how-to establish franchises, and in consultations related to the design and assessment of different models that were tested before the franchise model was selected. In the short term, Farmaenlace expects to repeat this project in other rural areas.

### *Company results*

Farmaenlace's intervention started with identifying the opportunity to expand to rural areas and validating a growth strategy through a franchise model. The results show that the franchised drugstores sold up to 50 percent more than the company's own drugstores. The fact that the owners of the small drugstores received more incentives to maximize their sales than the company's own employees is likely a related factor. Also, Farmaenlace improved its entry into a rural, previously unknown market, by creating a partnership with existing drugstores that have an established market, loyal customers, and knowledge of the area.

### *Impacts on the community*

The franchise partner researched for this study indicated that the income generated by the drugstore increased significantly. The sales went up from US\$2,000 to as much as US\$20,000 on a monthly basis, allowing for an average monthly income of US\$2,400 after expenses (expenses have increased with the implementation of the franchise model). Before the franchise, the drugstore was just above the break-even point.

The higher and more stable income generated by the IB has enabled the partners in the drugstores to invest in basic services and food, generate savings, and gain access to financing. Previously, they did not attempt to apply for credit due to financial uncertainty. By the end of the project in 2012, however, they felt confident enough to borrow money to invest in their business. The increase in the families' savings capacity also allowed them to plan for the future. Their expectations for creating a better life in the future are one of the greatest impacts they have received from the IB. The community has benefited from reduced expenses for health services as a result of the conditions generated by the IB.

The partners received access to ongoing training in business management, pharmaceutical regulation, basic pharmacology knowledge, drugstore software, industrial safety, human resources, and customer service. They were also registered in the Ecuadorian social security system. With regard to the relationship established between Farmaenlace and its partners, a strong interdependence has grown between them. In this franchise model, there is joint investment and risk sharing. The importance of the brand influenced the drugstore owners' decision to join the franchise system.

The communities gained improved access to higher-quality and lower-priced drugs (10–20 percent lower prices than in traditional drugstores). The population participated in health campaigns and had access to free health services. Through the franchise relationship with Farmaenlace, one of the most important benefits has been diversified supply and better prices for medicines. By having access to medicines and health services, people from these rural communities have less need to travel to a larger city for these purposes.

## ELETROPAULO IN BRAZIL: REDUCED COSTS AND IMPROVED EFFICIENCY OF ELECTRICITY SERVICES IN THE FAVELAS OF SÃO PAULO

- Access to safe electricity and reduced energy consumption per household in low-income market segments.

The majority of the population living in the favelas<sup>63</sup> of São Paulo, Brazil, secures its access to electricity through illegal connections. This leads to losses for the electricity distributor, Eletropaulo. The company developed an IB model that improves the electricity infrastructure, reduces electricity use, and promotes treatment of the favela population not as mere users but as customers, providing them with adequate services and raising awareness around energy efficiency and safe usage of electricity.

### *Background*

Eletropaulo, Latin America's largest electricity distributor, is part of the AES Corporation, headquartered in the United States. Eletropaulo distributes electricity to 24 cities in the São Paulo metropolitan region, with a concession area of 4,526 km<sup>2</sup>. This area includes the most important socioeconomic region of Brazil, with approximately 5.5 million consumers. The company's gross revenue in 2011 was around US\$8 million. Eletropaulo's inclusive business initiative involves the low-income residents of the favelas in São Paulo and highlights the benefits generated for both the company and consumers after Eletropaulo developed a new approach for relating to this market segment.

### *Opportunity*

The opportunity for this IB grew out of Eletropaulo's need to cover losses after the Brazilian government privatized the electricity sector in the late 1990s. At that time, the vast majority of favela residents were not paying for their electricity use, as they were obtaining it through illicit means with precarious, homemade devices referred to in Brazil as "gatos". One of the new reforms made by the Brazilian government under privatization was to cap subsidies to electricity companies for client non-payments, thus creating a strong motivation for companies to formalize the provision of and charging for electricity use.

The company's motivation for initiating the inclusive business was to reduce Eletropaulo's financial losses and to position itself in transforming the quality of life for people living in favelas. Eletropaulo understood that, to develop a favorable business environment and sustainable gains, the company

<sup>63</sup>. Informal urban settlements in Brazil.

would need to be seen by the communities as a partner - particularly taking into account that many favela residents were not accustomed to paying for electricity. The company had no philanthropic objective with the IB program, but rather insisted that it was part of their business.

## *Development*

The IB experience first started 14 years ago in the Paraisópolis favela in partnership with USAID, the International Copper Association (ICA), national and international NGOs, and the São Paulo municipal government. The population in Paraisópolis, which is the second largest favela in São Paulo and the fourth largest in Latin America, is very poor compared to other areas of São Paulo.<sup>64</sup> After testing approaches in Paraisópolis—which, like numerous favelas, lacked many municipal services until recent efforts to improve its infrastructure<sup>65</sup>—the company and partners developed a business plan to assess the technical and economic feasibility of these investments and their return on the investment.

This inclusive business consisted of three main components.

- 1. Reducing favela residents' electricity bills.** Eletropaulo helped reduce residents' electricity costs through (i) reducing their consumption by introducing more energy-efficient appliances (e.g., new refrigerators as part of a government-subsidized program, and more energy-efficient hot water showers) and (ii) enrolling eligible low-income residents into a government program that offered lower electricity rates. These measures lowered the rate of non-payment and helped eliminate electricity theft.
- 2. Regularizing electricity users into customers.** One hundred Eletropaulo social assistants were physically present in the favelas to respond to customers' questions regarding energy use and bill amounts, support them with bill payment, and listen to and dialogue with them. These assistants visited customers door-to-door, which significantly helped build a relationship between the company and the communities and reflected a major shift from how Eletropaulo related to favelas previously.<sup>66</sup> In partnership with local NGOs and the municipality, the IB project also conducted awareness-raising campaigns around energy efficiency and the safe use of electricity.
- 3. Improving electricity infrastructure in the favelas.** This aspect included improving network technologies and installing new electrical lines, including using infrastructure that does not cause injury if people come in contact with it, which has reduced the number of accidents. Further, in partnership with the municipal government, the project urbanized, named, and numbered streets and houses, allowing for formal service and bill delivery. Numbered streets and houses also provided residents with the benefit of having an official address, which is useful for obtaining other services. Improved infrastructure has resulted in better-quality, more reliable, and safer electricity for residents who previously had to deal with frequent outages and damage to appliances.

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<sup>64</sup>. Approximately 70 to 75 percent of the sample population in Paraisópolis earned more than one minimum salary (approximately US\$350 per month) but less than three minimum salaries (US\$1,000 per month) per family. Considering that the average family monthly income in São Paulo is around US\$2,500 per month, residents in Paraisópolis earn significantly less.

<sup>65</sup>. USAID 2009.

<sup>66</sup>. Prior to the IB project, the company assumed that favela residents were like other customers, who preferred to use the call center to resolve problems.

## *Investments*

After achieving success with the initial project in Paraisópolis, Eletropaulo scaled the model to include other favelas and has invested a total of US\$180 million in the program of transforming residents into formal customers, installing electricity in the favelas, and reducing energy consumption (e.g., with new, more energy-efficient fridges and showers). Of the total amount, 50 percent was invested in the distribution networks for electricity and the other 50 percent in awareness-raising and educating consumers around energy efficiency in their electricity consumption. These investments included payments for salaries, NGO partnerships, and installment and replacement of energy-efficient equipment. USAID and the ICA also contributed financial resources for implementing new network technologies, educational campaigns, and energy efficiency measures, as well as helping Eletropaulo in developing the business plan for the IB initiative.

## *Company results*

The company has made revenues of US\$395 million from this program from 2004 to 2011, which represents an over 100 percent return on the investment. If the company were not to invest any additional resources, it would still make an annual return of US\$140 million from its low-income customers located in favelas.

Apart from that, Eletropaulo now has legitimacy to operate, given the trust it has gained through its social assistants working in the favelas. Company staff can enter the favelas without any problem, including in areas where the police or the municipality are not welcomed. This close relationship with the communities has been built in large part by the social assistants and through partnerships with local NGOs. The commitment of company leaders to spending time in the favelas and understanding the communities' different needs and communication and negotiation styles has also been a key element.

## *Impacts on the community*

Although the IB has resulted in favela residents having to pay for services that they previously were able to obtain (illegally) without charge, in general, they are pleased to pay for their electricity, as they recognize the benefits of doing so. They identify the advantages of having better, safer, and more reliable electricity, which has resulted in an improved quality of life. Concretely, this translates into fewer power outages or cuts, no damage to appliances (previously, the poorer supply quality meant that fuses would burn out, damaging appliances), fewer interruptions to people's lives, and fewer injuries from trying to obtain electricity illicitly.

As part of the urbanization process to formalize and regulate the electrical infrastructure, streets were named and houses were numbered, allowing many people to have a formal address for the first time. Favela residents now receive electricity bills with their name and address, which provides them with an official document; this facilitates their ability to conduct business that requires proof of address, such as obtaining credit, applying for jobs, and even registering their children for private schools.

## Other results

Another key objective of this IB initiative was to reduce energy consumption in the low-income market segment. Through energy efficiency measures and consumer awareness campaigns, on average, electricity consumption halved from 200–300 kWh of energy per month per household to 100–150 kWh. The model has been replicated throughout the São Paulo metropolitan area, supplying a total of two million people in 1,200 favelas with regularized electricity.

This IB initiative, motivated by the company's need to reduce losses from non-payment and theft of electricity in favelas, resulted in an improved relationship between the company and favela residents, as well as improved bill payment, turning heavy losses into healthy profits for the company. It also brought about a better service quality for residents and increased formalization of favelas, which translates into other benefits such as access to additional services and greater social inclusion.

### **FIRTH IN PERU: A RESPONSE TO HOUSING IMPROVEMENT NEEDS OF THE POOR**

- Access to affordable concrete floors for low-income families through a distribution network with low-income women trained as entrepreneurs.

For Firth Industries, the poor housing conditions of the low-income segment in Peru imply a market for a specific cement product for floor installation, with properties that make it durable and easy to use. The company developed a distribution model that allows for penetrating the low-income market while generating a positive impact on the living conditions of the poor.

## Background

Firth Industries Peru S.A. is part of UNACEM, the largest cement-producing company in Peru. Firth Industries started operations in Peru in 1955 and is dedicated to producing and commercializing cement as well as pre-fabricated concrete, blocks, and tiles. Their production plant is in Villa El Salvador, south of Lima, with 700 employees and US\$30 million in annual sales.

## Opportunity

At the end of the 1990s, Firth introduced a mix for concrete ready to be combined with water and poured. The product specifically targeted the middle-income segment of the population that carries out do-it-yourself construction work in their homes. In 2011, Firth identified a new market segment where this product might be introduced. The company realized that 44 percent of Peruvian homes have earthen floors. This translated into 2.8 million homes, implying a potential market demand for

139 million square meters of concrete floors. And more specifically, this potential market included 64 percent of the houses of the low-income population segment.

The concrete product introduced by Firth is easy to mix and very resistant, and it is relatively simple to use for installing a concrete floor quickly and without major expertise. Firth decided to initiate a project that would bring their concrete product to the low-income population segment, through microenterprises led by women. That is how the Mi Piso (My Floor) project was born.

Although the product is 10 percent above the market price of traditional concrete, it is twice as resistant. The investment guarantees the customer a durable product for the long term. With these characteristics and a large potential market, Mi Piso became an opportunity for Firth to position itself in the low-income segment of the Peruvian population.

### *Development*

The model involves engaging women in selected communities who receive training to become distributors for Firth. They become responsible for promoting, selling, and installing the concrete floors in houses in their communities and receive a sales margin in return. The initiative started with a pilot project in South Lima, in the Villa El Salvador district. The pilot project included 100 women entrepreneurs, grouped in 24 teams of four or five women, each forming a small enterprise. These enterprises would become responsible for sales, administration, and floor installation.

The process started with the adaptation and design of the distribution channel for the product in the selected areas. To that end and in the frame of the IDB-MIF/SNV-supported projects, an integrated team of company staff and SNV advisers was formed. The team ensured that soil studies were carried out in the areas selected, to assess the potential need to adjust the product. Then, the team developed the installation manuals that would be used to train the product distributors in the communities. The team convened the communities and organized sessions to identify women with an interest in commercializing the product.

The newly identified entrepreneurs received training in the technical and administrative skills necessary to develop their business. The program included training on how to start up a business (including administration, sales and marketing, investments, equipment) and on installation of the floors. Additionally, the project included financial solutions for the women entrepreneurs and their clients, involving microfinance institutions to ensure that both entrepreneurs and clients would be able to meet the requirements for accessing finance. The project team identified institutions with potential interest in developing a specific product for the families to be involved, focusing on the ones that guaranteed a good penetration of the low-income market. In the end, an agreement was signed with Edyficar, which included low interest rates (three to five percent below market) and training of the women entrepreneurs on the condition of providing credit to their families.



## *Investments*

The investment in the pilot phase of this project was US\$137,000, of which IDB-MIF contributed US\$80,000 as part of the SNV/IDB-MIF IB program. Firth invested US\$57,000. The resources were used for training the women entrepreneurs as well as for publicity and marketing purposes.

## *Company results*

Through this project, Firth entered a new market segment that it sought to consolidate, leading to an increase in company revenues. According to the company's projections, the pilot in the South of Lima would generate revenues of US\$2 million. Up to mid-2013, 50 floors had been installed. If the introduction of the product in the low-income communities was successful, it would help Firth develop its brand in these communities and allow for the introduction of other products in this market segment. Furthermore, given that the Villa El Salvador district is close to Firth's plant in Lima, the project was expected to contribute to Firth's positive image in the community.

## *Impacts on the community*

The women entrepreneurs involved in the project earned a monthly income of between US\$350 and US\$570, generated through the sales and installation of the concrete floors. They had access to training on enterprise development, as well as on basic construction activities and the impact of the floors on the families' health. Furthermore, they were trained in how to set up and enhance the growth of their business, as well as in how to provide the targeted families with access to finance mechanisms.

The communities benefited from access to a quality product that would improve their living conditions, and from services for its installation and financing. Changing from a dirt to a concrete floor has proven to achieve remarkable results in improving young children's health and family welfare: covering earthen floors with concrete leads to a 78 percent reduction in parasitic infections, 49 percent reduction in diarrhea, 81 percent reduction in anemia, and 36 to 96 percent improvement in cognitive development in children.<sup>67</sup> This is particularly true for urban areas with well-nourished children and access to safe water, like the ones targeted through this IB initiative. It may work out differently in rural settings, where covering an earthen floor with concrete is less likely to have as much of an effect, as children have many other ways to come in contact with parasites and pathogens via the countryside's unpaved streets, farm fields, domestic animals, and potentially unsafe water supplies.

## *Conclusions on IB with consumers*

Drawing on the cases described above, this section outlines the main conclusions related to inclusive business models with consumers and/or distributors.

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<sup>67</sup> Cattaneo et al. 2007.

## *Motivation*

The IB consumer model is based on a company's analysis and decision aimed at extending or solidifying its market and/or strengthening its brand in that market. The companies studied for this research then engaged with the consumers and/or distributors to design and implement their specific model. In cases where the low-income segment is included as distributors, the value for the individuals or small enterprises involved lies in the opportunity to access a new income source or to increase the current one. The interest of low-income consumers in taking advantage of an IB initiative is linked to the opportunity either to save money or to gain access to a new service or product. Oftentimes, IB consumer and distributor models are built around a product or service specifically developed for the low-income market; the involvement of low-income distributors allows for the creation of a nontraditional distribution channel to penetrate this new market.

## *Investment*

In the IB cases that directly involved consumers, the companies either invested resources in the model, such as with the Eletropaulo example, or the models were expressly set up for the low-income segment, as in Edyficar's case. Once the Eletropaulo model proved to be successful, several funding organizations offered financing to take it to scale. The IB examples that entered new consumer markets through low-income distributors received initial funding from external parties. The funding was dedicated to market intelligence, skills development of the distributors, and marketing of the product developed for the low-income market segment.

## *Results*

Consumers assess IB results in terms of the accessibility and quality of the product or service, as well as the savings made on the purchase. This is clearly related to the fact that the products and services in the cases described (housing, finance, health, and electricity) were designed by the company to improve people's quality of life, as part of the company's strategy to enter and be successful in this particular market segment. The distributors involved in the cases either accessed a completely new job opportunity or were able to increase their sales through the company's involvement in their enterprise. They also indicated their satisfaction about the fact that they were now providing a service to their community, and said that they derive a certain status from their new position. The companies, on the other hand, especially the ones in the more developed cases (Edyficar and Eletropaulo), generated a clear return on their investment in the low-income segment of the market. The pilots that are described in the other two cases (Firth and Farmaenlace) have shown the initial benefits from the model and will enter a process of expansion.

## *Time frames*

In terms of time frames for making investments and achieving results, the cases investigated show that once the product or service is on the market, it impacts the target consumers (through lower costs,

accessibility, and better services). The two pilot cases, on the other hand, indicate that before this can happen, a company needs to carefully conduct market research and ensure that the product or service as well as its distribution model allow for maximum acceptance, market penetration, and impact. In the case of Farmaenlace, for example, several other models to reach and impact low-income communities were identified, piloted, and discarded before the franchise model was developed.

### Risks

In all of the cases described, the companies carried out detailed market studies to gain intelligence on the type of product or service to be offered, its acceptance potential, and the strategies to be implemented to effectively reach the targeted population. This often includes ethnographic research as an important input for product development. In spite of that, the actual process of conquering the market remains one of trial and error. For companies dedicated to the low-income segment, this process is part of their business as usual; for established companies that seek to enter the low-income segment as a new market, it may involve an additional risk of investment capital loss. For the low-income distributors involved in some of the consumer-market models described in this study, risks were kept at a minimum since most of the capital investments were made by the companies.

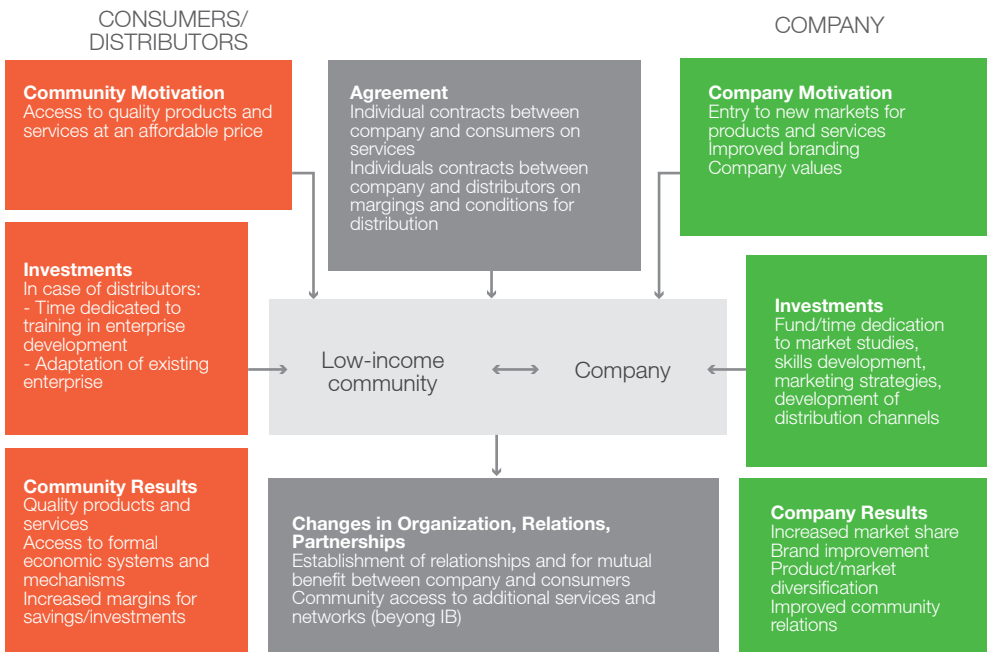


Figure 7: Overview of General Motivations, Investments, and Results of IB Initiatives with Consumers

## *Relationship between company and community*

The IB cases described in this section started off as company initiatives. The processes of conducting market studies and designing intervention models that substantiated the company's business case involved, in most of the projects, the participation of the low-income communities. Although the agreement that defines the relationship between company and community, and the agreed mutual benefit of the transaction, is individual (between company and customer, as in the case of service provision such as electricity and finance, or between company and distributor in the case of goods), the value created is perceived by the beneficiaries as a benefit for the community overall.

## *Organizational adjustments on both sides*

In the IB initiatives with consumers, whether the model provides goods or services, companies dedicated resources to understanding and serving the low-income customer market segment. Organizational changes are required to guarantee focused investments in (i) developing techniques to obtain market intelligence, (ii) marketing the product or service, and (iii) designing distribution channels that are tailored to respond to BoP needs and consumption patterns. On the community side, organizational changes are likely to take place if a certain product or service is offered to a collective of consumers or distributed by groups or networks of individuals.

## *Additional support for inclusion*

In some of the cases researched, the IB initiative was accompanied from the beginning by third-party actors with an interest in advancing social and economic development in the communities involved (such as in the case of CARE with Edyficar, and the SNV/IDB-MIF IB program with Firth and Farmaenlace). In the case of Eletropaulo, which initially was an initiative developed by the company itself, other stakeholders were attracted to contribute to the project, such as the municipality through the process of urbanization.

## **2.4 IB with employees and partners**

In IB models with employees and/or partners, the low-income segment is included within the company structure—either as shareholders or co-owners, or on its payroll. An IB model with the low-income segment as partners can take the shape of a cooperative or community enterprise—in which case the anchor company is (partially) owned by the community.

Companies that involve the low-income segment as employees do so for different reasons: beyond a mere social objective, low-income employees can be part of the company's competitive advantage as part of their workforce, sales force, or image, or to facilitate the penetration of low-income markets (such as is the case in some IB consumer models, like Edyficar and Farmaenlace).

The IB cases described in this section involved the low-income segment as employees or partners, without necessarily focusing on low-income markets at the same time. They illustrate different mechanisms of involvement.

## RAINFOREST EXPEDITIONS: THE CREATION AND EXPANSION OF A COMMUNITY ENTERPRISE IN THE PERUVIAN AMAZON

- Local native community co-owns an ecotourism enterprise that provides employment opportunities for the local population.

Rainforest Expeditions, an ecotourism company, set up a community enterprise that provides tourism services in Tambopata in the Peruvian Amazon. It is an example of an IB initiative that combines several objectives: involve the local native community in tourism activities as an alternative to use of natural resources in nature reserve areas that are attractive for tourism and important for biodiversity, while providing tourists the opportunity to get to know the culture of the native community and, at the same time, support its social and economic development.

### *Background*

Rainforest Expeditions was created in 1994 as a small ecotourism company that operated within the Centro de Investigación de Tambopata (TRC—Tambopata Research Center, set up for the study of parrots) in the Peruvian Amazon. It consisted of a small, rustic inn located within the Tambopata-Candamo nature reserve and received 150 tourists in its first year and 500 in the next. In 1996, the company decided to open Posada Amazonas, another inn located on the road to the TRC, for tourists to spend the first and last night of their visit and for those who wished to spend less time in the forest and not go all the way to the TRC within the nature reserve.

Posada Amazonas is located in the territory of the Infierno native community, who owns the inn. From its inception, Posada Amazonas was conceived as a community enterprise to be administered by Rainforest Expeditions. After careful consultation with the community members, it was decided that the profit generated by the enterprise would be divided between the community and the company with a 60:40 ratio. The company and the community are both represented on the enterprise board, each with 50 percent of the votes for decision making. For common decisions, a majority of 51 percent is required, while key decisions require two-thirds of the votes. In practice, this imposes the need for the company to reach a consensus with the community.

The construction of the Posada was funded through the Peruvian Canadian Fund, as a loan to Rainforest and as a donation for the share corresponding to the community. While the Posada was being built, community members were trained to become enterprise employees. Posada Amazonas opened its doors in 1998; by 2007, it was receiving 7,000 tourists annually, with an occupancy rate close to 80 percent. The Posada is managed between the company and the community, and benefits are generated in the form of utilities (for Rainforest and the community), employment opportunities for the members of the community, and improvement and sustainability of the offering for tourists.

## *Opportunity*

The creation of Posada Amazonas combined several purposes: eliminate hunting and deforestation activities that affect the fauna in the nature reserve area, by providing an economic alternative for community members; attract tourists who are interested in experiencing the Amazon and its biodiversity, as well as the Esa Eja culture of the native community; and support social and economic development of the community as a whole. Over time, the need for ongoing training and skill development for the local tourist guides became evident so they could improve and expand their services. Furthermore, an opportunity was identified in the expansion of the offering as such, by the creation of additional facilities and attractions for tourists, to be managed by the community.

## *Development*

In 2007, Rainforest Expeditions presented a proposal to be implemented within the SNV/IDB-MIF IB program, focused on further development of the IB it was implementing together with the Infierno native community. This intervention took place within the existing IB process. The original IB agreement, structured between Rainforest Expeditions and the Infierno native community, was designed for the operation of the Posada Amazonas as a community enterprise. The following four components were included in the new IB program:

- 1. Strengthening the capacities of the tourist guides from the local communities.**
- 2. Broadening the offering of tourism products and services.** Through the development of an existing center for traditional healing (Centro Ñape, owned by the community) into a place where tourists could stay overnight and learn about traditional healing and the Esa Eja culture.
- 3. Obtaining concession rights and securing management for a new natural reserve area.** Formerly not owned by the community, the additional nature reserve area was relevant for the ecotourism activities that the Ese Eja culture would administer.
- 4. Strengthening the community's Cultural Center,** where traditional culture is promoted among the youth. All the activities were geared towards improving the families' economic situation, creating additional employment opportunities, and transferring knowledge relevant for the development of the business.

These interventions were included in the original business model, strengthening its focus on collaboration between Rainforest and the community and at the same time allowing for an additional business element to be managed by the community: Centro Ñape.

This led to the following structure, based on the original IB model:

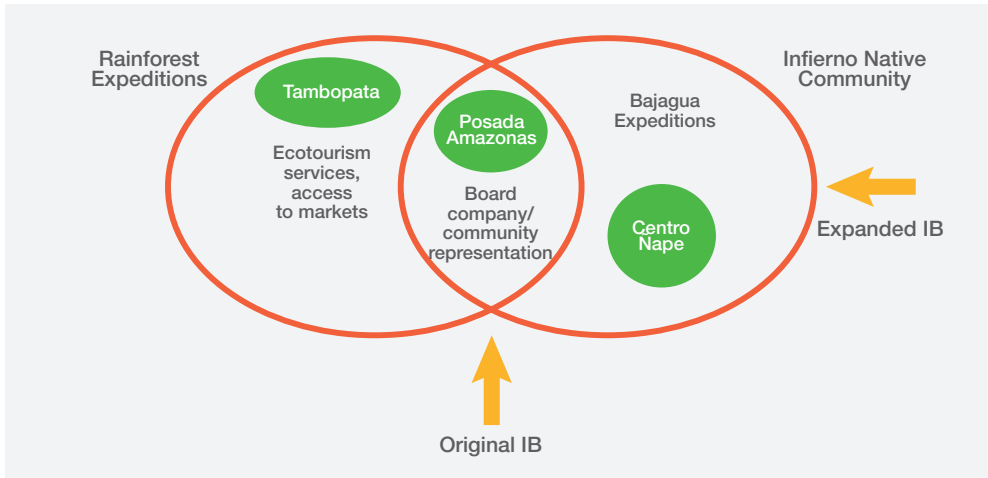


Figure 8: Structure of Rainforest's Inclusive Business Model

### Investments

The SNV/IDB-MIF program activities required an investment of US\$150,000, of which US\$60,000 (40 percent) were contributed by Rainforest Expeditions. Over time, the IB has attracted capital from other parties: the World Bank supported the construction of a center for handicrafts that are manufactured by the community and sold in the Posada, and several NGOs provided support in the management of the nature reserve areas.

### Company results

Since its opening in 1998, Posada Amazonas has received an increasing numbers of tourists from 7,000 guests in 2007 to 15,000 in 2012. Rainforest has received innumerable accolades for the quality of their ecotourism operations. They also are one of the first companies to develop an inclusive business that involved indigenous groups as business partners, with full participation in the enterprise's main governance bodies. By training the tour guides, Rainforest was able to guarantee quality service for the tourists, while developing a pool of trained providers who comply with the company's quality standards.

### Impacts on the community

Since the start of operations in 1998, the Infierno community has received over US\$41 million in profit from the Posada. Of that amount, 37 percent was handed over to the community as dividend and 29 percent as salaries to the employees of the Posada. The rest (34 percent) has been reinvested in the Posada. Part of the utilities handed over as dividend has been invested by the community in social projects like schools and piped water.

The community members who work as employees in the Posada receive an income that is twice—in some cases three times—as much as what they earned before. They invest their earnings in the purchase of land, transportation, housing, education, and household appliances, and in the generation of savings. Of the 60 guides who were part of the SNV/IDB-MIF project, 30 are employed in Rainforest Expeditions' programs.

### *Other results*

The main idea behind the initiatives developed by Rainforest Expeditions is the conservation of the Amazon rainforest. The influx of tourists generated by the company requires that measures be implemented to secure the protection of the area and the sustainability of the operations. Rainforest's success in doing so is evident from the fauna observation registry they maintain for the area, which suggests that several species have increased in number over the past 10 years. Also, deforestation in the area is periodically analyzed, and the studies show that the reserve area is practically intact. The area occupied by the community, however, shows signs of deforestation. Community members occupy larger areas for crops, investing the money they earn in the business. Additionally, growing numbers of external investors are hiring community land for fruit production. For the community, this is such an attractive business that it is difficult to refuse.

## **ODEBRECHT AND SKILLED LABOR TRAINING FOR THE SANTO ANTÔNIO HYDROELECTRIC DAM**

- Improved skills and employment for low-income area residents who are hired by Odebrecht

The following case shows how low-income local communities can benefit from a business initiative by being trained to become employees of the company, thus forming a local workforce. For Odebrecht, hiring local people as employees for a large construction project in a remote area in Brazil reduced their costs and facilitated a good relationship with the surrounding communities.

### *Background*

Odebrecht, a Brazilian conglomerate working in the fields of engineering, construction, chemicals, and petrochemicals, was founded in 1944 by Noberto Odebrecht and is currently present in South America, Central America, North America, the Caribbean, Africa, Europe, and the Middle East. The company employs 120,000 people in 20 countries, of whom more than half work in Brazil.

The company traditionally sources most of its construction workers from Brazil's largest cities. However, the infrastructure projects in most cases are located in the northeast and Amazon regions of Brazil,



which are several hours' flight from São Paulo and Rio de Janeiro. The economic implications for Odebrecht are substantial, as the company pays for the workers' flights, accommodation, and other daily living expenses. Further, this model of sourcing employees from distant cities creates negative social impacts, as the majority of the workers are men who stay for many weeks in remote towns, working on construction sites away from their families. This situation often results in an increase in prostitution, drinking, and other social ills in these towns.

Porto Velho, in the state of Rondônia, where in 2008 Odebrecht Energia's hydroelectric dam was to be built, had experienced similar problems in the past due to mining in the region. These problems contrast strongly with Odebrecht's values and mission, which include creating social development in the communities where it operates. In early 2008, research by the CPPT Cuniã NGO in Porto Velho found that the city had a skilled workforce to meet only 30 percent of Odebrecht's needs, which would require the company to fly in the other 70 percent from other cities to Rondônia.

### *Opportunity*

To construct the Santo Antônio Hydroelectric Power Plant, located in Porto Velho on the Madeira River and with 3,150 MW of installed power—enough to supply energy to 40 million people—Odebrecht Energia needed a huge workforce of at least 12,000 workers to start. The company's original model of flying in workers for weeks at a time to construction sites from economic hubs such as São Paulo, Rio de Janeiro, and Belo Horizonte would have been prohibitively costly and would have had serious negative social impacts. Additionally, bringing in skilled workers from other areas would have fueled resentment within local communities that hoped the projects would create local jobs.

While the company was interested in hiring from local communities, the region of Porto Velho struggles with low literacy rates, a lack of skilled workers, and poor infrastructure, the legacy of previous economic cycles of mining and other extractive activities. Odebrecht Energia was very interested in not further exacerbating boom-bust cycles, but instead contributing positively to the economic development of the region. After numerous conversations with local community members and visits in the Porto Velho area, the company determined that training area residents as skilled workers would be the best solution for creating shared value.

### *Development*

Odebrecht's response was to create the Believe Program.<sup>68</sup> The Believe Program runs a technical training school, operated in partnership with national and local entities, for participants to develop the specific skills needed for Odebrecht's construction work. Interested adults can apply to the program and study for free. If they pass the course, they are eligible to apply to Odebrecht and are well prepared to be hired.

The Believe Junior Program, which Odebrecht introduced in August 2009, is designed for the children of employees at the Santo Antônio hydroelectric dam aged between 14 and 18 years who have completed

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<sup>68</sup>. In Spanish, the program is known as the Acreditar Program.

at least Grade 6. The Believe Junior Program is aligned with the Brazilian Youth Apprenticeship law and seeks to give young people dignity, a sense of citizenship, and self-esteem.

The Believe and Believe Junior Programs were the brainchild of Antonio Cardilli, Administrative and Financial Manager at the Santo Antônio hydroelectric dam. He first developed the idea in 2006 after making many pre-feasibility trips and studies around the Porto Velho region. There he spoke with local, mainly indigenous, communities, which helped him better understand the communities' beliefs and ways of seeing the world, as well as the region's social and economic dynamics.

The inclusive business model was designed to train and recruit up to 70 percent of the Santo Antônio hydroelectric dam workers locally to help reduce costs and contribute to long-term local development. The Believe Program began in February 2008 with the goal of training professionals in 15 areas.<sup>69</sup> The target participants are men and women over 18 years of age who are literate and have no outstanding electoral or military obligations.

A key characteristic in the development of the IB was forming partnerships with NGOs and with government and academic institutions. The main partners include: Serviço Nacional de Aprendizagem Industrial (National Service for Industrial Education) (SENAI), Governo do Estado de Rondônia (Rondônia state government), Prefeitura de Porto Velho (Porto Velho municipal government), Faculdade Interamericana de Porto Velho (the Inter-American University of Porto Velho) (UNIRON), and Ministério do Desenvolvimento Social (the Ministry of Social Development) (MDS).

An agreement was developed between the state government and Odebrecht for the government to provide the company with access to a database of local residents who receive the Bolsa Família.<sup>70</sup> Odebrecht then was able to contact the people on the list to determine whether they were interested in participating in the course. In return, the Believe Program received financial support from the government for educating the adult recipients of the Bolsa Família. UNIRON provided physical space for the classes and the practical training area.

Critical success factors include Odebrecht's, and in particular Antonio Cardilli's vision, conviction, and dedication to generating shared value for the company and the local community, and to learning from past mistakes of doing business in remote areas of Brazil. Partnering with local governmental, nongovernmental, and academic institutions was also an important factor in successfully implementing the program.

## *Investments*

Odebrecht Energia has invested approximately US\$14 million over the past four years in the Believe Program on a national scale, of which US\$8.5 million have been dedicated to the Santo Antônio project. This investment was seen as a core investment for doing business and being able to operate in this

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<sup>69</sup>. The program consists of basic and technical modules. The basic module covers health, safety, environment, quality, and work psychology. The technical module covers 15 different job functions, including mechanical, electrical, and machine operation positions.

<sup>70</sup>. Bolsa Família, or Family Benefits, is a social program introduced under President Lula that provides a modest monthly payment for families living below the poverty line.

region. Part of this investment included hiring a small team at each operation site to manage the Believe Program. UNIRON also provided its classrooms during the day for Believe Program classes.

### *Company results*

Although it has not been possible to quantify the exact amounts, Odebrecht Energia has saved substantial amounts of financial resources and time by hiring workers from the local community for the Santo Antônio project. So far, in the past four years, Odebrecht has hired over 32,000 workers from over 110,000 participants overall from its Believe Programs across Brazil. For the Santo Antônio hydroelectric dam specifically, Odebrecht Energia has hired over 28,000 workers out of 70,000 participants in the Believe course. This figure represents over 70 percent of the company's required labor. Currently, 90 percent of the construction workers at the Santo Antônio hydroelectric dam were trained in the Believe program. Furthermore, Odebrecht Energia has strengthened its reputation as a responsible company, concerned about the local community's welfare and future development. The company is also pleased with the positive impact the program has on employee morale and motivation.

The model developed at the Santo Antônio project has been replicated throughout Brazil in 20 projects with Odebrecht Energia, Odebrecht Industrial Engineering, and Odebrecht Infrastructure, and in eight countries where Odebrecht operates.

### *Impacts on the community*

Compared to other areas of Brazil, the Porto Velho area is very low-income, and a significant portion of the population is comprised of indigenous or Amazonian communities living along the rivers. Given that Porto Velho and its surrounding areas have long been dominated by mining, rubber plantations, and other extractive activities in boom-bust economic cycles, with skilled workers being brought in from other regions, local capacity previously had not been developed, and local communities are understandably skeptical of large projects.

The Believe Program, in contrast, offers a different approach for working with local residents and provides skilled labor training that equips participants to obtain employment with either Odebrecht or other companies in the area. The courses include between 32 and 200 hours of classes at the local university. In a city of 400,000 people like Porto Velho, 120,000 (30 percent of the local population) have either passed the Believe Program or have a close relative who has done so.

The Believe Program acts as a gateway to formal and stable employment, either directly with Odebrecht or with other companies, and improved income for the local population. Starting pay for Believe graduates was usually around 40 percent more than the minimum wage (around US\$315 per month, compared to the minimum monthly wage of US\$225). Considering that many people in the area were not previously formally employed, the increase in their income was significant and had a direct and considerable impact on their quality of life.

Participants also have an opportunity for professional and social mobility within Odebrecht, a situation that is impossible or very difficult in informal employment situations. Stable and increased income as a result of employment with Odebrecht also enables low-income communities to make investments for themselves and their families, such as in cars, university studies, house and neighborhood improvements, and access to bank accounts and credit.

It is also worth noting less tangible impacts on the community, including the positive relationship with Odebrecht. Also, by hiring locally, the company has limited the number of workers it brings from outside the region, thereby helping to avoid increasing social problems related to prostitution and excessive drinking. Further, through receiving training and obtaining stable jobs, many people have been able to leave the Bolsa Familia program and have an increased sense of pride and self-esteem in being able to provide for themselves and their families.

## **ACOPAGRO: COCOA PRODUCTION FOR SPECIALTY MARKETS**

- Increased quantity and quality of cocoa production for organic and fair-trade markets brings stable family income for Peruvian producers.

This case shows how an anchor company can be formed by the community itself, which then guides the company's activities for local development.

### *Background*

ACOPAGRO is a cooperative in the San Martin region of Peru, dedicated to the production and commercialization of cocoa. It started out with 27 members in 1997, supported by a USAID program for alternative development and reduction of coca production. By 2007 it had over 900 members, and its production had grown from 27 to 1,100 tons, the majority of which (over 90 percent) was exported to specialty (organic and fair-trade) markets in Spain, Italy, Belgium, and Switzerland. Production growth was based on a combination of increased area of production (more members and cultivated land) and increased productivity per hectare (because of the use of clones and technological improvements).

The Cooperative provides technical assistance to its own members as well as to other organizations, with a staff of professionals specialized in the production process, from planting, plantation management and harvesting to post-harvest treatment and storing. It also directly provides microfinance solutions to its members at low interest rates. Furthermore and on the basis of income from Fair Trade sales; it implements social projects around health care, small cattle, and vegetable gardens.

## Opportunity

Cocoa production in the San Martin region has been increasing, especially from 2005 onwards, as a consequence of the policy to reduce existing illegal coca plantations in favor of cocoa and because of favorable market conditions for cocoa. This has led to accelerated growth for ACOPAGRO in terms of membership and production volume, which in turn has caused inequalities among the members because the cooperative's staff did not have the capacity to cover all members' technical assistance needs.

In 2008, only 50 percent of ACOPAGRO's 1,000 members (mostly smallholders) were certified for organic production. On top of that, only 20 percent of producers applied adequate harvest and post-harvest management practices for the crop. For ACOPAGRO and its members to continue serving the growing market and taking advantage of the position it had developed, the cooperative needed to invest in increasing quantity and quality of its production, which at the same time would lead to increased income for its smallholder producers.

## Development

ACOPAGRO's inclusive business initiative was implemented in 2009 and 2010 as a project of the SNV/IDB-MIF IB program and focused on increasing the productivity of smallholder cocoa plantations as well as improving the quality of their production. The project aimed to strengthen ACOPAGRO's technical team to provide better services to producers, and included a training and technical assistance program for producers, on cocoa production as well as on the harvest and post-harvest processes.

ACOPAGRO implemented this project through its own technical team, with support from an SNV consultant. The activities focused on 2,000 farmers: improving services to the existing 1,000 members and including another 1,000 in the process. The producers targeted had between one and five hectares of cocoa in production and received an income of under US\$3,200 each per year. Of their total income, at least 60 percent was from cocoa. The project included the following activities:

- 1. Strengthening the capacities of ACOPAGRO's technical team and of representatives of ACOPAGRO's intermediate organizations in charge of providing technical assistance to the members.** Training modules were implemented that included improved organic production and enterprise development.
- 2. Training and technical assistance on plantation management for 2,000 smallholder producers.** This responds to the requirements of the specialty markets in which ACOPAGRO sells its production and that allow for differentiated prices. This program was facilitated by the technical team and built on a participatory model of farmer-to-farmer training (*escuelas de campo*), which allowed for: (1) extending its coverage to geographic areas that formerly were underserved, (2) building on existing knowledge and experience, and (3) involving farmers as trainers, which enhances the sustainability of the results.
- 3. Training and technical assistance in harvest and post-harvest management, focused on**

**guaranteeing the quality of the cocoa to be exported.** EThis program was designed with the support of a consulting firm specialized in processing and also included the empirical knowledge of senior members of ACOPAGRO. It was offered to 120 ACOPAGRO members in charge of the collection centers, where the farmers deliver their harvest and where the fermentation and drying processes occur. ACOPAGRO's technical team was in charge of training additional members over time to keep up with the growing volume of production.

The farmers' associations have been crucial in the implementation of the activities, as intermediary organizations (forming part of the cooperative structure) between ACOPAGRO's technical team and the famers. The associations' representatives were approached by the technical team and secured the involvement of the farmers in the IB initiative.

### *Investments*

The project required a total investment of US\$221,537 and was funded between IDB-MIF (58 percent) and ACOPAGRO (42 percent). The investment was used to strengthening the technical team, implementing training and technical assistance programs, and hiring a consultant who worked on quality improvements in cocoa processing.

### *Company results*

ACOPAGRO was able to increase its volume of organic cocoa for export from 1,560 tons in 2008 to 2,510 in 2010 (an increase of 61 percent). This happened on the basis of an increase in the number of providers from 1,300 to 2,030 over the same period. These providers also increased the productivity of their plantations from an average of 500 kg/ha to almost 1,000 kg/ha. The investments made in the production, harvest, and post-harvest processes allowed suppliers to comply with the quality requirements of the market served by ACOPAGRO. Apart from that, ACOPAGRO has been able to generate stability in its supplies: in spite of the fact that its members (as well as its additional suppliers) are free to sell to other buyers, most of them sell their production—as far as it meets the quality requirements—to ACOPAGRO. Farmers indicate that their interest in having ACOPAGRO buy from them is directly related to the benefits they receive from the training programs and as members of the cooperative.

### *Impacts on the community*

All farmer families studied for this research have increased their yearly income by 50 percent or more. That increase is related to a combination of factors: greater volumes of cocoa produced (through increased productivity as well as expansion of the planted area); larger commercial value of production, because of the improved quality and premiums in the case of organic and Fair Trade products; and the share of the members in the utilities of the cooperative. The families' total income share from cocoa production increased from 58 percent to 77 percent over the project execution period (implying a decrease in the share of income from off-farm employment and from other crops).

Farmers furthermore indicated the importance of the stability in income. Through ACOPAGRO they have secured a market, and the cooperative supports their growth in terms of volume and quality of production. This allows them to make reinvestments in their business in terms of expanding planted areas. Some also reinvest in additional economic activities, such as providing taxi services and production of cocoa side-products, such as liquor or marmalade. Furthermore, spending on housing improvement, household appliances, means of transportation, and education has increased.<sup>71</sup>

## **Conclusions on IB with partners/employees**

### *Motivation*

An inclusive business initiative between a company and low-income people as partners or employees in effect integrates low-income partners within the company structure. In the cases described, the companies had a particular business interest in hiring or working closely with the low-income communities because they represented a competitive advantage or potential. The communities had a distinctive potential as a workforce because of the specific geographic location of a company's project, and because they allowed the company to develop a constructive relationship with the communities that surrounded their business (Odebrecht) or that were a crucial part of its success (Rainforest). In the case of a cooperative enterprise like ACOPAGRO, the whole business model is built on the participation and representation of its (mostly low-income) members. Their development and growth is practically synonymous with the development and growth of the cooperative as a whole.

### *Investment*

The IB cases researched that involve employees or partners all started out as business models without initial capital investment for the purpose of inclusion being provided by an external donor. They grew around a company interest that was closely and clearly linked to the interests and potential of the communities surrounding them—the communities being an integral part of the companies' operations from the beginning. The companies for that reason see the low-income communities not as a group that might be involved through extra capital investment, but as an intrinsic part of their business model and they have invested in them as such.

### *Results*

The results of an IB with employees or partners to a certain extent are similar to those of the model with suppliers: the low-income communities deliver a service or product and receive an income and/or other benefits that allow them to improve their standard of living. Apart from that, the companies in the cases described invest in developing their employees' capacity, which serves them beyond the relationship with the company. An additional value generated, especially through IB with partners, is the fact that the low-income partners share the utilities of the company.

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<sup>71</sup> Education refers specifically to the possibility of having children study beyond secondary school and learn a profession.

## Risks

In the cases described, investments have been made by both the companies and the communities in terms of capacity development in technical and entrepreneurial skills. Sharing the risks and profits of an enterprise, however, does not necessarily mean that the interests and priorities of both parties always coincide or that trust relationships automatically emerge. The companies indicated that large time investments were necessary to construct those relationships and flag the risk of conflict in situations where business interests do not necessarily coincide with community interests and priorities.

## Mutual agreements

In the IB employee/partner model, the interdependence between company and community goes a step further than in the IB supplier model, since the communities, apart from delivering the service or product, have become part of the company structure itself and to a certain extent have a say in its functioning (in IBs with partners, this is taken a step further than in IBs with employees). This takes the matter of loyalty to a different level: the company is no longer an external party to be negotiated with, but rather an entity that the low-income people have a stake in or form part of. The two parties cannot simply withdraw from each other if they don't meet each other's expectations. At best, this generates a commitment, beyond loyalty, to generate mutual results.

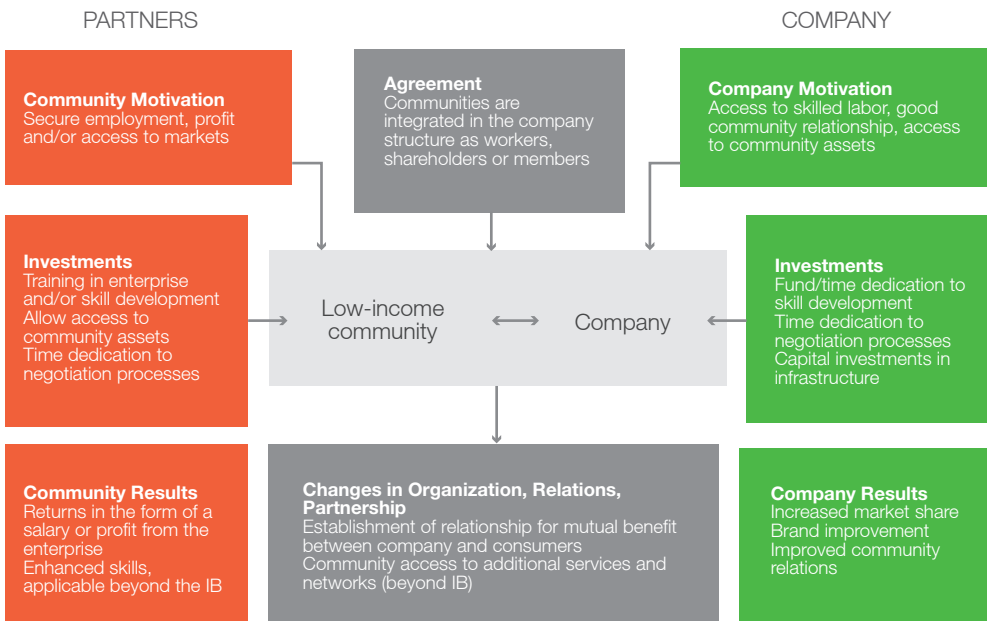


Figure 9: Overview of General Motivations, Investments and Results of IB Initiatives with Partners/Employees



## *Environmental impact*

In two of the three IB employee/partner cases studied, environmental sustainability was included in, or inherent to, the initiative, because it was an important aspect of the business model. In the case of ACOFAGRO, certification for organic cocoa was applied with, or transferred to, groups of small-scale producers. The IB initiative made certification accessible for small-scale producers and by doing so allowed both company and small-scale producers to contribute to environmental sustainability and generate value—not only for the two parties but also for the broader society in which they operate. The case of Rainforest is entirely built around protection of the nature reserve area in the Peruvian Amazon; part of the motivation to involve the local community is to provide them with economic activities that are alternatives to the exploitation of the forest.



CHAPTER 3

THE ROLE OF PUBLIC  
POLICY IN INCLUSIVE  
BUSINESS RESULTS



# THE ROLE OF PUBLIC POLICY IN INCLUSIVE BUSINESS RESULTS

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### 3.1 Purpose of public-policy research

Central to this IB research project is the question of whether IB can be considered a viable development solution, capable of considerably improving the living conditions of the poor while also providing businesses with the incentives to scale up—to a size commensurate with the problems of poverty and exclusion that emerging economies face. Hence, apart from looking into the business case for IB models and the way they reflect “inclusiveness,” it was necessary to assess the conditions for achieving, sustaining, and scaling IB results.

Some of these conditions are inherent to the relationship between a company and the communities involved in an IB initiative. Other factors that influence the success and sustainability of IB results are related to the broader environment in which the IB initiative is created. The existence of support mechanisms for companies and communities, such as funding, infrastructure, technical assistance, and policy incentives, is to a certain extent influenced by public-policy conditions. This chapter therefore presents and analyzes public-policy mechanisms to provide insight into the role that public sector stakeholders can play in creating an enabling environment for IB initiatives. Public-sector roles are analyzed within the framework of the larger system in which IB initiatives take place, also referred to as the IB ecosystem.

Specifically, policy contexts were studied in more detail for three South American countries: Ecuador, Colombia, and Peru. The following sections describe the role of public policy and the way public policies may contribute to more inclusive economic development. This description includes the social and political contexts in which the policies were implemented, the implementation process and participating institutions, and the policies’ results and impact. The chapter also includes key lessons learned from the selected cases, as well as from the IB cases described in Chapter 2.

### 3.2 The inclusive business ecosystem and the role of public policy

#### *Inclusive business in society: complementarity and interdependence*

Ever since the publication of C.K. Prahalad’s *The Fortune at the Bottom of the Pyramid*, the need for “building an ecosystem for wealth creation and social development” at the BoP<sup>72</sup> has been part of the debate around market initiatives with low-income communities. Prahalad described this ecosystem as a framework that allows private sector and social actors to work together and create wealth in a symbiotic

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72. Prahalad, 2006.

relationship. These “horizontal arrangements in which all parties share responsibility for performance outcomes, without any party exercising authority or control over others,”<sup>73</sup> were later analyzed by Ezequiel Reficco and Alfred Vernis within a framework of “business ecosystems” applied to a setting of doing business with the low-income segment.<sup>74</sup>

Reficco and Vernis identify a set of characteristics that can be found in business ecosystems and that allow for the generation of value for the different parties involved in them. These characteristics include the presence of “business platforms” formed around a key (or “anchor”) player that helps align the visions and decisions of the ecosystem members. Such a platform allows for learning and for sharing risks, while it can help organize and strengthen the activities of the individual participants on the basis of well-defined standards and practices. According to Reficco and Vernis, the anchor organization (which may be a company but can also be, for example, a community-based organization or cooperative) is to guarantee that proposals are generated that allow for the creation of value for all involved—and as such, to make sure that the participants are committed to the initiative. The platform then should be used for the clarification of roles, commitments, and expectations, and thereby potentially reduce the perceived risk of the IB initiative. At the same time, the platform allows for connections between the stakeholders involved, which may help in reducing transaction costs. The collaboration that takes place in the framework of the platform allows its members to achieve together objectives that would not have been attainable individually.

In *Tackling Barriers to Scale: From Inclusive Business Models to Inclusive Business Ecosystems*<sup>75</sup> Christina Gradl and Beth Jenkins also identify structures that anchor companies may use to strengthen the ecosystem in which they operate. They are complementary, can be applied in combination, and include the following: (1) private initiatives (a company in direct relation with its suppliers or customers); (2) project-based alliances (wherein one or more other organizations are employed, in case a company relies on the resources or capabilities of other players); and (3) platforms (established for a common purpose, to organize collective action to overcome weakest links or create public goods, such as research or shared infrastructure. According to Gradl and Jenkins, these structures are used to harness the resources and capabilities necessary to execute strategies aimed at strengthening the ecosystem around the IB model. Such strategies include: awareness raising and capacity building at the BoP; research; information sharing; public-policy dialogue; and creating new organizations.

### *Roles and mechanisms in an IB ecosystem*

Building on the concept of the IB ecosystem, and going beyond the bilateral relationship between companies and low-income communities involved in IB initiatives, there are typically (any of) four other types of roles to be played in the IB ecosystem. One is the role of **investor or funder** that provides seed or risk capital for IB initiatives, for the company and/or for low-income stakeholders. This role may be played by, for example, investment funds or donor agencies. Second, the role of **regulator**, which

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73. Reficco and Márquez 2009.

74. Márquez, Reficco, and Berger 2010.

75. Gradl and Jenkins 2011.

helps create the rules of the game, is often played by government bodies, trade unions, or consumer organizations. The role of **facilitator**, also sometimes called “neutral broker” or “ethical agent”<sup>76</sup> helps bridge gaps and facilitates relationships between a company and low-income communities. It can be played by, for example, NGOs or government entities, but sometimes also by a dedicated unit within an anchor company. The facilitator can provide support in terms of information, relationships with other actors, and capacity development, as well as building trust and negotiating for necessary resources. The final role is that of **knowledge developer**, which can be played by universities, research centers, and networks that support understanding and innovation through analysis of IB models, measurement of results, and recommendations for scaling.

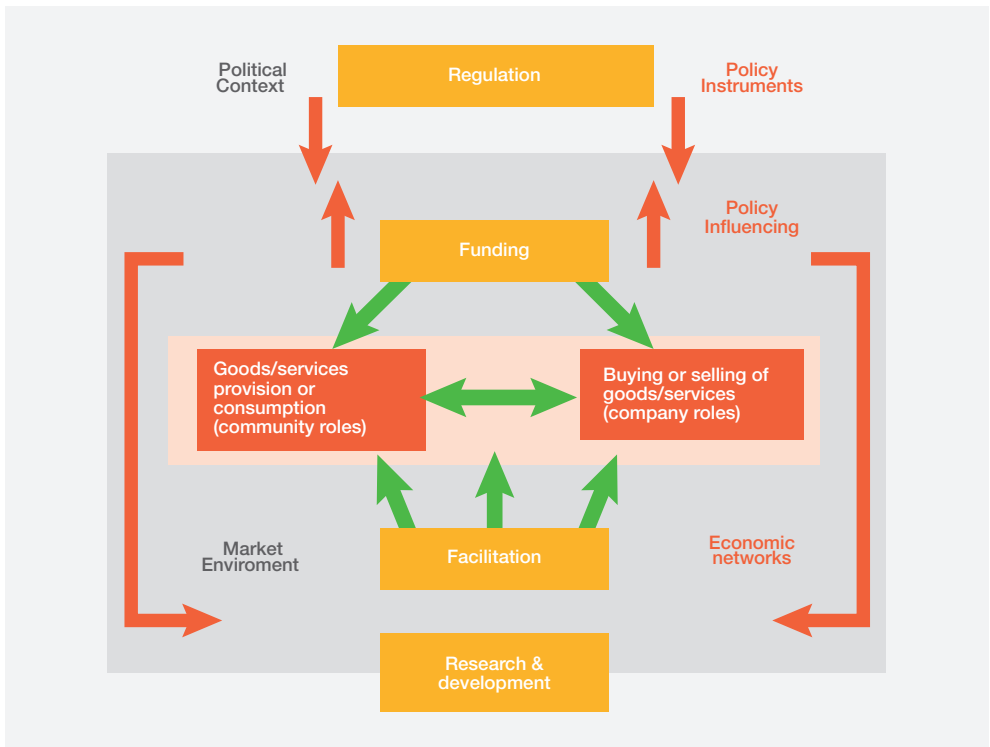


Figure 10: Common Roles and Mechanisms in the IB Ecosystem

Figure 10 shows, in general terms, the relationships between the stakeholders in an IB ecosystem. The ecosystem metaphor refers to the interdependence and complementarity between entities, and it suggests underlying change and adaptation dynamics in order for the system as a whole to survive. Individual participants and organizations will prosper only if the system allows for it.

76. Shell Foundation 2010.

The dynamics generated within an IB ecosystem ideally help to create and sustain value for both the company and the low-income segment. An agreement between stakeholders as to this overarching goal will help determine the different roles that the actors involved in the system might play—assuming that they agree, implicitly or explicitly, to contribute to what Porter refers to as “shared value creation.”<sup>77</sup> Shared value is about “expanding the total pool of economic and social value,” as opposed to redistributing existing wealth. Although Porter applies the concept of shared value creation to the role of business in society in general, it is also applicable to IB initiatives and the value IB generates for companies and low-income communities alike.

To that end, an IB ecosystem should include mechanisms that help guarantee the generation of shared value in a sustainable manner. Such mechanisms include ones that sustain the economic networks around the companies and communities involved in the IB initiative,<sup>78</sup> as well as mechanisms of policy development and policy influence. These support systems and policy tools should be geared towards overcoming market failures—especially those that lead to the exclusion of the poor—and towards generating the capacity, capital, and support required for the generation of sustainable and shared value.

Rather than describing an “ideal” context for IB development, the IB ecosystem is used in this research as an analytical framework to assess the roles and functionality of the system in different contexts. In the next section, it is applied to policy initiatives developed in Ecuador, Peru, and Colombia, each of which in its own way was geared towards achieving inclusive results for low-income producers.

### 3.3 Concrete examples of public sector roles and mechanisms

The cases in Chapter 2 show that an IB initiative between a company and a low-income community is not developed in isolation. As mentioned earlier, in certain situations an IB project is initiated or facilitated by a third party, such as a development organization or a corporate foundation. In cases where capital investment is required, often a financial institution or development bank is involved; and government entities—intentionally or not—can stimulate IB development through existing policies or specifically developed incentives. The following examples describe different situations in which inclusion of low-income suppliers was enhanced through policy development, in some cases specifically involving IB development. They illustrate that the roles that each actor typically plays in an IB ecosystem can be interchangeable between the different parties and are often influenced by political preferences, institutional contexts, and market conditions.

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77. Porter, 2011.

78. Among them, service providers, community organizations, trade organizations, and business networks.



## RURAL INCLUSIVE BUSINESS DEVELOPMENT IN ECUADOR: THE PRONERI PROGRAM

- Access to markets, income and improved livelihoods for smallholder producers through an initiative with increased government participation.

### *Social Inclusive Business Program 2007: public–private partnership for IB development*

In Ecuador, the national government started promoting IB development in 2007, under the then newly elected President Rafael Correa, through a Social Inclusive Business Program. This initiative focused on including small-scale farmers in the value chains of medium to large companies in a way that provided the farmers with access to new markets while creating added value for both. The program started with the signing of a memorandum of understanding, facilitated by SNV, between different government institutions, six medium and large national and multinational companies (Amanco, Nobis, Floralp, Supermaxi, Pronaca, and Toni), and a national public–private entity for export promotion (Corporación de Promoción de Exportaciones e Inversiones [CORPEI]).

Each participating entity stated what it would contribute to the program's design and implementation. The Ministry for Social Development was the government entity charged with responsibility for the program's implementation. The program's main objectives included: income generation for excluded and poor communities; strengthening farmers' associations; access to local, national and international markets; increased productivity; and improved capacity for innovation and commercialization among producers and associations. The program identified smallholder producers' needs for training, technical assistance, and technological innovation in corn, cocoa, dairy, and vegetable production, among other agricultural value chains. It supported the design and implementation of several inclusive business initiatives, providing tools and expertise as well as access to finance for both companies and communities (through the National Development Bank and the National Finance Corporation). By 2008, the program had benefitted nearly 1,000 smallholder families, increasing their incomes by up to 100 percent.

### *National Development Plan 2009–2013: prioritizing small-scale farming*

In 2008, a new constitution was established, based on principles of social and economic inclusion as well as on food security and sovereignty, with a focus on enhancing production by small- and medium-scale farmers. In its fundamental principles, the constitution indicates the state as the main protagonist in defining topics such as national development planning, poverty eradication, sustainable development, and equitable redistribution of resources. The National Development Plan for 2009–2013, or "National Plan for Good Living," outlines specific change strategies focused on the reconstitution of forms of

wealth accumulation and redistribution. Among others, those strategies include: the democratization of the means of production; selective import substitution; increased productivity; and diversification of export goods, channels, and destinations. The plan prioritizes small-scale production and supports it with technical assistance, credit, training, and education, with a focus on the development of short production chains, avoiding intermediaries.

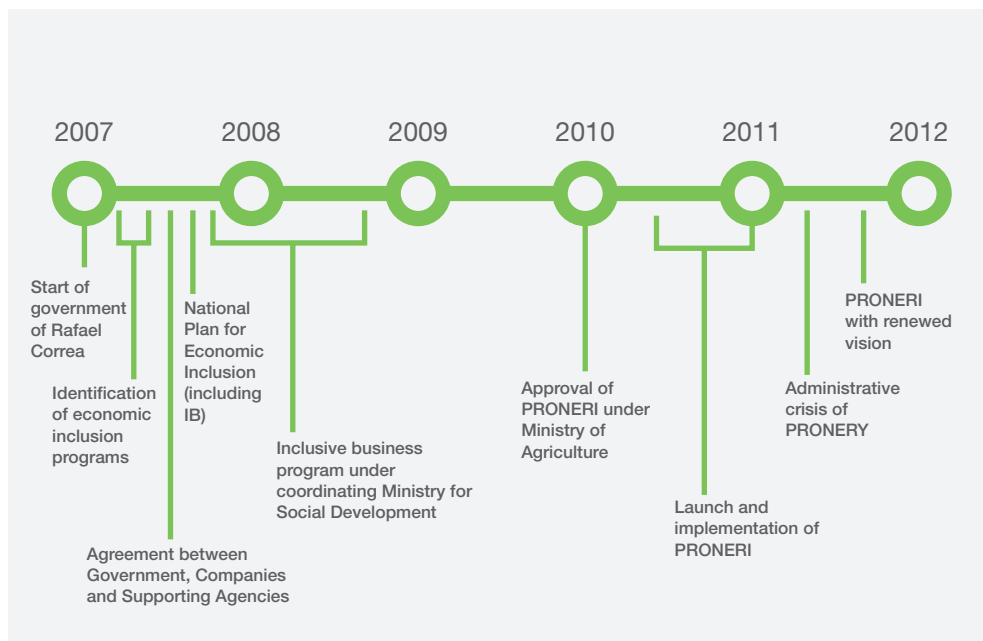


Figure 11: Timeline of the Development of the Ecuadorian Government's Inclusive Business Initiatives

### *Rural Inclusive Business Program (PRONERI, Programa Nacional de Negocios Rurales Inclusivos) 2010: market access for smallholder farmers*

In the context of these policies, in 2010, a new IB program was developed and approved, this time under the authority of the Ministry of Agriculture. Its objective was to promote commercial agricultural initiatives between smallholder producers and agro-industrial companies that contribute to “good living.” The program sought to forge partnerships that benefit both smallholder farmers and private companies and that help guarantee equitable market access, transfer of technology, access to credit, and access to irrigation, as well as strengthening of farmers’ associations’ production and negotiation capacity. The program required an investment of US\$761 million, of which US\$126 million would be provided by the Ministry of Agriculture and the other US\$635 million by the National Development Bank (Banco Nacional de Fomento) and National Finance Corporation (Corporación Nacional Financiera).

This Rural Inclusive Business Program (or PRONERI, using its Spanish abbreviation) started in January 2010 and included the following components:

- 1. Strengthening farmers' associations.** Facilitating training, assistance, and funding for management capacity, business development, and organizational development; the program funds assistance to and training of farmers' organizations, supporting them in the development of business plans and preparing them for meeting IB requirements.
- 2. Supplier development programs.** Facilitating the relationship between suppliers and companies, providing access to and adoption of technologies, and improving providers' competitiveness; the companies are in charge of the transfer of knowledge, in the framework of an IB plan approved by PRONERI and a contract between company and suppliers, as well as an agreement between PRONERI and the company that establishes the rights and obligations of the parties in the implementation of the program. The companies are to co-fund a minimum of 50 percent of technical assistance.
- 3. Commercial agreements.** Generating, strengthening and formalizing commercial relationships between suppliers and companies; the program facilitates commercial agreements that are transparent, equitable, and sustainable. It provides mechanisms for mediation and the minimization of differences between the parties.
- 4. Irrigation technology.** Increasing crop productivity through the application of irrigation technology; the program co-finances irrigation infrastructure (up to 70 percent, with farmers contributing 30 percent). This component seeks to generate farmers' capacities in the use and maintenance of the technology, while ensuring an efficient use of water resources.
- 5. Finance mechanisms.** Facilitating access to finance for the producers, accompanied by agricultural insurance instruments; the program involves the National Development Bank and the National Finance Corporation for access to credit for agricultural activities, infrastructure, and post-harvest treatment. The idea is for the companies to act as guarantee for the credit provided to the producers.

In four years, this program was to benefit 42,000 families in 12 production chains, working with 120 companies who would benefit through increased competitiveness and therefore would be able to grow and generate additional employment.

### *Policy changes: more emphasis on smallholder production and less participation of private companies*

At the end of 2010 and in early 2011, due to political and structural changes in the Ministry of Agriculture, new priorities arose in its activities. Its new vision was to support the production of smallholder families, strengthening initiatives that lead to food sovereignty. This led to changes in PRONERI's components and in the eligibility criteria for the actors and processes involved:

- Increased emphasis on strengthening associations, with a focus on generating added value in rural production;
- Less emphasis on irrigation, partially due to the overlap of functions between the Ministry of Agriculture and the National Secretariat for Water;

- Less emphasis on business plan development and a decreased focus on commercial agreements between producers and companies;
- In terms of commercialization, the program shifted its focus from a relation between the producers and the market as such to relations between associations' enterprises and the producers;
- Whereas formerly the emphasis was on medium to large agro-industrial companies, the program in 2011 started to involve a wider range of enterprises, including rural associations' enterprises, small enterprises, companies where (part of) the shares are held by producers, and public companies;
- Large companies contribute 50 percent of the co-funding for technical assistance and training for producers, while associative enterprises contribute 15 percent (the remainder being funded through the program).

Overall, these changes implied a general shift from a focus on IB with private companies to a focus on directly strengthening smallholders' production and their relations with and within associative enterprises. This shift was related to the government's interest in improving local production by smallholder farmers, linked to a food sovereignty strategy that implied import substitution of crops such as corn, rice, potatoes, beans, and vegetables. Where companies were involved in the program, it was mainly to provide technological packages for farmers and because they were required to buy national production before being allowed import quotas. The Ministry of Agriculture indicates that through this strategy, over 2011 and 2012, in the corn sector alone 10,000 smallholder farmers increased their production per hectare by 60 percent. The Ministry has established a trust fund through which enterprises and smallholder producers can access credit for inputs and technical assistance, to be provided through the enterprises involved. The producers have a preferential interest rate (17 percent), and the enterprise deducts the credit payment from the amount owing to the producers. The producers also make sure to sign a future exchange contract with the enterprise to purchase the production as part of the credit. It is important to mention that the Government of Ecuador sets a price for corn, which does not fluctuate over time.

### *Application of the IB ecosystem analytical framework*

The Social Inclusive Business Program as designed in 2007 acknowledged a potential role for private companies in obtaining the inclusive development results the government was striving to achieve. Roles were clearly defined: the different government entities involved would be in charge of coordinating the program, facilitating public-private dialogue, supporting capacity development of low-income communities, and guaranteeing financing, while the private sector organizations would support the development and implementation of IB plans. Furthermore, the companies would support and co-finance training and technical assistance for the communities involved.

When the National Development Plan was launched in 2009, there was an increasing focus on improving

the living conditions of smallholder producers, and on their contribution to Ecuador’s food sovereignty. If and where private sector actors could support that, they would be part of the strategy. At the same time, the government increasingly emphasized the role of producers’ associations and the public sector. The Ministry of Agriculture’s Rural Inclusive Business Program (2010) reflects that changed focus in that it clearly supports the strengthening of farmers’ organizations and their capacities, preparing them to enter equitably into commercial agreements. The private companies that were to participate in the program would co-fund the technical assistance to the producers, while benefiting from the program through increased and improved supplies.

In 2010 and 2011, political changes and shifts in emphasis led the government to not implement the program as it was conceived, but rather to focus on strengthening the smallholder suppliers and supporting and facilitating their direct relationships with markets. Making use of its regulatory power, the government created conditions that led the companies to substitute for the import of raw materials, through which the market for local production was expanded. Private sector relations with the smallholder producers in that sense were conditioned by the government and not necessarily only based on voluntary agreements.

In this ecosystem, the emphasis has shifted over time from facilitating business–community relationships for inclusive development, to achieving community development and poverty reduction—with private sector involvement as part of a playing field coordinated and dominated by the government. At the same time, the public actors involved were frequently occupied with processes and changes related to political priorities, which has influenced and delayed the implementation of the IB-related programs. These political priorities in the end have also had their effect on the focus of the program itself, moving away from creating linkages with large companies toward facilitating community enterprise development.

## **COFFEE POLICY DEVELOPMENT IN COLOMBIA, AND THE NATIONAL FEDERATION OF COFFEE GROWERS (FNC)**

- Representation of small producers’ interests through the FNC and policy development on the basis of private sector participation and proposals.

### *Creation of the FNC*

The coffee sector in Colombia has been an important driver for the country’s economy for over a century. In 2013, coffee represented four percent of Colombia’s GDP and had a 10.3 percent share of the world market, with Colombia being the world’s third largest coffee producer after Brazil and Vietnam. Of the coffee growers, 95 percent are smallholder families (around 563,000 in total) with fewer than two hectares of coffee per family.

In the early 20th century, coffee in Colombia was mainly traded as a commodity, with little differentiation of quality and little attention to processing and added value. Consequently, individual farmers and the sector as a whole were very exposed to price fluctuations on the international market. In 1927, the National Federation of Coffee Growers (FNC by its Spanish abbreviation) was formed to allow coffee farmers to jointly manage risks and to develop strategies to face market challenges. The Federation in its initial phase focused on improving and guaranteeing quality standards, providing technical assistance and technology transfer to farmers.

### *Coffee sector development with public funding through the FNC*

In 1940, the FNC created the National Coffee Fund as a commercial instrument to comply with trade agreements in a global market that was affected by the Second World War. The fund received its resources from tax revenues through the national government and was used for several decades to maintain price stability for the coffee growers. Over time, the Federation used the Fund to create other economic organizations linked to the coffee sector, such as the Agricultural Insurance Company (1952) and the Coffee Growers Bank (1953). Farmers' cooperatives were set up for internal coffee trading, and, in turn, they created their own export agency (called Expocafé). An important principle maintained by the FNC is the "guarantee to buy," to ensure farmers' income. This principle was developed as a means to compensate for the asymmetries in the negotiation capacity of the coffee farmers. Related to this, in 1965, the FNC created Almacafé SA: a company that facilitates coffee storing, processing, and packaging, as well as quality control of the final exported product.

The FNC also set up its own training institute, the Manuel Mejía Foundation. Apart from providing training to coffee producers and their families and communities, the Foundation has also played an important role in training the Federation's technical staff. Over time, the Foundation has become a leading institute in innovative education alternatives, including virtual ones.

Thus, during the second half of the 20th century, the Federation consolidated a business model that sought to maximize and stabilize individual farmers' income, while at the same time it offered the sector as a whole the more public benefits of technical assistance, scientific investigation, guaranteed buying, promotion, and publicity.

### *Structural changes in the global market, and the FNC's changing position*

The 1990s brought structural changes and adjustments to the commercial models in the coffee sector. These years marked the end of the international agreement on quotas, saw the entry of Vietnam into the international coffee market, and witnessed an increasing consumer interest in specialty coffees. The FNC's response was to create, in 1995, the Specialty Coffees from Colombia Program, which focuses on generating added value and differentiation of Colombian coffee, identifying and selecting coffees with exceptional characteristics due to their origin and/or the technology applied in the production process,

and making use of the successful Juan Valdez brand.<sup>79</sup> Over this last period of changes, the FNC drastically reduced its size in terms of staff and investments. Whereas formerly it had practically replaced the government in coffee-producing areas, providing social services and investments, it now sought a model of co-funding together with governmental and nongovernmental entities.

### *The FNC model and its relation with the government*

The FNC's institutional model is based on a participatory structure with democratic principles that guarantee coffee producers have a voice in decision making. Together with a positive impact on coffee growers' incomes, this participatory model has contributed to the overall legitimacy of the Federation. The FNC's structure incorporates committees at the municipal (364) and departmental (15) levels, which in turn are represented on a Steering Committee (Comité Directivo) at the national level. The Steering Committee, together with four government representatives (from the Ministries of Finance, Agriculture, Planning, and Trade), make up the National Coffee Grower Committee, the entity where coffee-related policies are agreed upon between the government and the FNC. Over the years, the FNC has collaborated with the government in preparing and implementing coffee sector policies that have allowed for both the individual coffee growers and the Federation as a whole to generate additional value on the basis of coffee production.

### *Application of the IB ecosystem analytical framework*

Assessing this case within the framework of the IB ecosystem, it becomes clear that the FNC has played several roles at the same time. It has been the principal buyer of its members' coffee production, and as such, has played the role of the "anchor company" that enables the smallholder coffee growers to gain access to markets and market intelligence. At the same time, it has facilitated access to funding and technical assistance, on the basis of which the producers have been able to improve productivity and quality. Over time, the FNC has developed initiatives along the entire coffee value chain, from cultivating the coffee to marketing the product to the end consumer. The Federation's decisions and strategies have always been based on a thorough understanding of market dynamics and on a belief in its capacity to influence those markets for the benefit of smallholder coffee growers. This vision has strengthened the organization's legitimacy.

The FNC furthermore represents smallholder coffee growers' interests related to social development and negotiates conditions for development with the government. In the coffee-producing regions of Colombia, over a certain period of time and until the end of the 20th century, the Federation even took over some of the government's role in terms of investments in public services such as education, health, and infrastructure. At the same time, the government has played an important role in legitimizing the

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<sup>79</sup> In order to better position Colombian coffee in an increasingly competitive market, the FNC in 1959 had created the Juan Valdez brand and developed an extremely successful marketing strategy around it. The brand represents the small-scale, hardworking coffee farmer with a mule, developing an emotional link between the consumer and the authentic Colombian coffee grower. Over time, the Juan Valdez brand shifted its emphasis from the quality of the coffee to a focus on Colombia as its place of origin, and, lately, specialty coffee for niche markets. In 2002, The Juan Valdez brand was extended to include the development of Juan Valdez coffee shops, first only inside Colombia, then from 2005 internationally, through a franchise model. Over time, the Juan Valdez brand has proven crucial in the FNC's mission to secure increased income for the Colombian coffee producers.

Federation through creating the Coffee Fund and collaboratively developing policies. This combination of roles and the influential position that the FNC has established as a result of its work has enabled it to play a central part in developing and implementing coffee policies in Colombia. These coffee sector policies have benefited half a million smallholder coffee growers in terms of social and economic development.

The government's support of the Federation, among many other factors, is strongly related to the great importance of coffee production for the national economy. It is difficult to imagine that within a more diversified economy, an organization representing one sector could reach the position that the FNC has been able to obtain. At the same time, in spite of its close relationship with the government, the FNC has always been an independent organization with institutional autonomy. It also has an explicitly apolitical character: throughout its history, the FNC has not participated in political organizations. This not only has strengthened its legitimacy but also has allowed for continuity, since it is less affected by political changes in the government.

Apart from being well connected to the public sector, the FNC has also developed private–private alliances with companies that either help commercialize the Juan Valdez brand or connect the producers to other brands—such as Nestlé Nespresso SA, part of the Nestlé Group, which involves 36,000 FNC-related producers in a program for sustainable coffee production.

Partnerships with development organizations and universities have allowed for research and development in favor of sustainable coffee production, biodiversity, certification processes, waste-water treatment, and a range of other measures and techniques that allow for innovations and increased efficiency and sustainability in coffee production.

The predominant role in this system is the FNC's—as buying company, manager of market relations, representative to the producers, facilitator, technical-assistance and financial-service provider, and supporter of research and development. The government plays its role of regulating and facilitating sector development in close relationship with the FNC, which appears to have enhanced the effectiveness of both.

Although it has received much praise, the FNC model has also been the subject of criticism. Some consider it not entirely sustainable, since the FNC could not have succeeded without public funding. Others have pointed out that it requires too high a contribution from the coffee producers, while the benefits from exporting do not always come back to them. Furthermore, the FNC's participation in defining the policy that regulates coffee export has led critics to fault the Federation for being judge and jury at the same time. Also, the price-guarantee system supported by the FNC has been questioned, and social conflict has arisen around the debate.

Such criticism goes to show that an IB initiative, like any other business, has to evolve and adjust constantly—especially since it seeks to combine competitiveness with complex social demands.



## **POLICY DEVELOPMENT FOR INCLUSIVE AND SUSTAINABLE BIOFUEL PRODUCTION IN THE SAN MARTIN REGION OF PERU**

- Regional policy development for biofuels market development with a focus on smallholder producer inclusion.

### *National policy framework on biofuels*

Since 2001, the Peruvian government has been promoting, mainly through legislation, the production and use of liquid biofuels such as bioethanol and biodiesel. The government's focus has been on reducing contamination and the use of fossil fuels, promoting profitable alternatives for agricultural production, and responding to the need to attract new investments for employment generation in Peru. In 2003, the Promotion of the Market for Biofuels law was approved. In the framework of this law, the government's policies on biofuels are based on free-market principles of competition and market access, and they seek to establish a critical mass to develop and sustain the scientific and technological structure required for investigation and innovation in this sector. The law also seeks to diversify the biofuels market, facilitate greater participation of the private sector in the chain, and promote agricultural and agribusiness development. At the same time it intends to enhance the development of alternative crops as raw material for biofuels as part of the National Anti-Drug Strategy, especially in the Peruvian rainforest. To enact this policy framework, the government in the same year created the Program for the Promotion of the Use of Biofuels (PROBIOCOM), under the authority of the Agency for Private Investment Promotion. A public-private multisector commission was tasked with developing a proposal on percentages and timelines for mixing conventional diesel with biodiesel, and gasoline with bioethanol.

In 2005, the Regulation for the Law on Promotion of the Market for Biofuels was passed, which indicates the specific mechanisms to promote investment in biofuel projects. They include incentives for clean development mechanisms in the framework of the Kyoto Protocol, facilities to contribute to the substitution of illicit crops with alternative crops for biofuel production, and the development of technology for the production, commercialization, and distribution of biofuels. Two years later, in 2007, the Regulation for Commercialization of Biofuels was approved. It outlines the obligatory requirements for producing and commercializing biofuel and the required percentages when mixing with regular fuels like diesel and gasoline.

### *Policy development for biofuels in the San Martin region: sustainability and inclusion*

The San Martin Region, located in the north-east of Peru, between 1950 and 1970 experienced a large influx of peasant farmers from the highlands and coast of the country. In the seventies, coca bush cultivation was introduced and expanded in the area, driven by drug-trafficking organizations. With 30,000 hectares occupied by coca plantations, the San Martin region had the highest coca production

in the country. Eradication of coca began in that same decade, through the introduction of so-called “alternative development initiatives.” They gained force in the nineties, with support from international cooperation, government, and the private sector. The focus was mainly on coffee, cocoa, oil palm, and palm heart. Cooperatives were formed around these products, and in the early 21st century, small farmers’ associations achieved improvement in the quality and quantity of production, added value, and competitiveness. The regional government of San Martin showed itself strongly committed to the alternative development strategy and acquired efficiency and leadership around it. San Martin became the region with the most significant poverty reduction in Peru (from 70 to 30 percent between 2001 and 2010), with the agricultural sector generating 46 percent of employment and yielding 79 percent of the national oil palm production and 33 percent of the cocoa.<sup>80</sup>

Regional governments in Peru represent an intermediate level of government between the national and the municipal layer. They have the autonomy to formulate and approve regional development plans, which involve input and participation from the municipalities and civil society, and they regulate activities and services in the areas of production, economic development, and basic services. They also have the constitutional right to present legislative initiatives to congress and can institute regional ordinances that are legally binding. Yet despite the emerging national legal-institutional framework, regional governments between 2003 and 2007 had not developed many actions around structuring policy frameworks on biofuels at the regional level.

Capitalizing on the existence of the national framework, and taking advantage of the region’s recent progress and its proven potential for biofuel production, in 2008, the Regional Government of San Martin (GORESAM) decided to create, through a regional ordinance, the Biofuel Program of the San Martin Region (PROBIOSAM). The following were motivating factors for this decision:

- Compliance with GORESAM’s role as a promoter of sustainable development of the agro-energy market in the San Martin Region, reducing the use of fossil fuels and generating the region’s energy independence;
- Creation of conditions in the region to take advantage of the carbon credit market;
- Generation of a favorable environment for public and private investment in biofuel production in the region;
- The obligatory use of bio-ethanol and bio-diesel (as of 2009 and 2010, respectively) for cars in Peru, as per the national Law on Promotion of the Biofuel Market;
- Compliance with international agreements signed by the national government in the framework of the Kyoto Protocol.

PROBIOSAM includes nine guidelines for the design of regional policies and strategies for the sustainable development of the agro-energy market in San Martin:

- Design biofuels production systems that guarantee social, economic, and environmental sustainability.

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<sup>80</sup>. UNODC, n.d.

- Implement production systems that generate raw material for biofuels, in line with the capacity and ecological zoning of the territory, avoiding competition with food production and prioritizing the use of deforested and degraded land.
- Enhance the conversion of farmland with traditional crops into profitable biofuels projects, organizing smallholder farmers and providing them with access to training, finance, and markets.
- Support private investment in agro-energy, with a focus on IB initiatives.
- Propose regional policies and regulations for inclusive and sustainable biofuel development, within the existing legal framework
- Develop institutional and professional capacity for the development of profitable renewable energy alternatives in the region.
- Develop the biofuels market, reducing the use of fossil fuels to generate energy independence in the region and contribute to reduced environmental contamination.
- Enhance clean development mechanisms (carbon credits) as an income opportunity.
- Promote research and technological development in energy crops and biofuels in general, in collaboration with international research centers.

These guidelines are translated by PROBIOSAM into concrete projects through three mechanisms:

- 1. Design of policies, mechanisms, and actions** by the Biofuels Roundtable, with the participation of private and public stakeholders that are responsible for and interested in the development of the agro-energy market.
- 2. Coordination of the activities of all organizations working in biofuels in the region**, through the Regional Directorate for Economic Development, which to that end works through a team of professionals dedicated to developing projects that guarantee the sustainability of the program, as well as to supporting the implementation of biofuels investment projects.
- 3. Implementation of agreed activities** through the Regional Agricultural Directorate.

### *Implementation of activities*

Over 2007 and 2008, before PROBIOSAM was formed, GORESAM had already initiated several activities related to biofuel development. They focused on the exploitation and/or establishment of energy-crop plantations (sugar cane, palm oil, and jatropha curcas) and biofuel production plants, as well as on related research and development. Funding sources included the National Public Investment System, the German bilateral development cooperation GIZ, and the National Finance Corporation for Development. Also, several private companies signed agreements with the San Martin Regional Government on investments in jatropha plantations and oil-extracting factories.

On the basis of these initiatives and in the framework of PROBIOSAM, the Regional Directorate for Economic Development continued to promote and accompany the establishment of jatropha plantations on degraded and deforested land, with a specific focus on the benefits for smallholder farmers and on avoiding competition between energy crops and food production. GORESAM found, however, that public policy development in the region was hampered by limitations in terms of staff capacity, credibility in the eyes of the community with regard to its role in promoting regional development, and integration between the Regional Directorate for Economic Development and GORESAM's other directorates and special projects.

In this context, in 2008, GORESAM developed an agreement with SNV to (i) strengthen its capacities for policy design and development, (ii) facilitate public–private collaboration and the creation of conditions for including low-income groups in economic development, and (iii) enhance coordination between GORESAM and other public and private entities. Within this logic, specific attention was given to IB development as well as inclusive policy development for the biofuel, coffee, cocoa, and tourism sectors.

The Biofuels Roundtable was to be the entity through which biofuel sector development would be achieved. It was set up as an inter-institutional body for dialogue and collaboration that incorporates public and private sector stakeholders with an interest in and/or responsibility for the development of the biofuel market. The Roundtable includes four private companies, five producers' associations, three regional government institutions,<sup>81</sup> two research and education institutes, and two NGOs.

From 2010 onwards, and with support from the Regional Directorate for Economic Development, inclusive business models were developed and implemented between smallholder producers and five processing companies (Verdal RSM Perú SAC, Agrobiofuels SAC, CAA Andahuasi, VWP Latinoamérica SAC, Francisco Tello Perú) and a farmers' cooperative (COOPALP). An example of one such inclusive business is the one between Verdal RSM Perú SAC and several communities in the Picota province of San Martín. In this model, company and smallholder producers signed an agreement through which the smallholders would allow the company to plant jatropha on their degraded lands, currently not in use for agricultural production. The company took responsibility for managing the plantations while generating employment for the smallholder families. At the same time, the smallholders received part of the profit from jatropha sales. The company committed to buying all jatropha production from the plantations. The agreement was signed for a 20-year period. At the end of 2012, a total area of 750 hectares had been planted with jatropha in the San Martín Region, mainly on degraded lands formerly used for coca and corn.

### *The challenges of inclusive biofuel development*

The regional biofuel program PROBIOSAM has been a platform for dialogue between investors, producers, NGOs, and government entities, and it has enabled GORESAM to manifest its political will to attract investments in biofuel development. However, the platform did not have its own budget, and its decisions were not binding. In order for its proposals and ambitions to materialize and to attract investments, it seems necessary that either (i) a national entity design and enact a policy framework to promote biofuels development in a consistent manner at all levels or (ii) additional incentives be in place to achieve changes at the regional level.

<sup>81</sup> Agriculture, Energy and Mining, Transport and Communication.

Different actors involved in this case acknowledge GORESAM's support for creating conditions for smallholder farmers to benefit from the development of the biofuel sector (in matters related to technical assistance, land titles, and infrastructure). Furthermore, the role of the National Institute for Agricultural Innovation in developing the technological package for jatropha is widely acclaimed. The intention, however, to support the development of IB initiatives had not fully materialized when this case study research was conducted. Although farmers' associations were strengthened, this had not yet led either to significant changes in the relationship with the companies to which they sold their production, or to business models that fully integrate smallholder farmers on the basis of the added value that they offer the companies. According to some of the private parties involved, this had to do with the fact that no capital investments so far had been made in developing such models.

At the end of 2012, the PROBIOSAM program, according to the stakeholders involved, had come to a halt. The private companies were dissatisfied with the results, pointing out that the program did not include possibilities for funding IB models, which according to them was a requirement for making it work. At the same time, the situation around the use and ownership of land with the potential for growing jatropha was not clear.

### *Application of the IB ecosystem analytical framework*

It was the national government that initiated the creation of conditions for biofuels production in Peru, developing a national legal and policy framework that would allow for the development of the country's biofuel market. GORESAM, wanting to take advantage of its territory's potential for palm oil and jatropha production, built on this national framework and created a platform that would allow for public-private collaboration to generate investments and coordinate the implementation of initiatives, emphasizing the inclusion of smallholder farmers in the process. However, there was not enough clarity on how the IB models would be funded, nor were there any guidelines on the inclusiveness of the models to be applied by the companies interested in biofuel production in the San Martin region. Consequently, there is no clear focus on the mutual value that might be generated through biofuel production, for companies and smallholder producers alike.

The roles filled in this system are the "regulator" (national and regional government bodies), the "buyer" (companies, and in some cases GORESAM, on the basis of agreements with development organizations) and "producer" (smallholder biofuel producers). For the facilitation and funding roles, the situation was less well defined. Given this lack of clarity, many different shapes and types of business models emerged, with no clear standards on value generation for the producers. At the same time, the companies have indicated the need for capital investment in such models, and that the lack of access to such capital has hampered the development of these initiatives.

It is important to note that these limited results from an effort to promote inclusive biofuel production occur in a context where the inclusion of smallholders and cooperatives in other production chains (cocoa, coffee) has been much more successful—in the framework of programs around alternative

development initiatives that involved private and public stakeholders and that managed to favor inclusive local economic development. The success of the “San Martin Model” on former occasions has been explained as a confluence of a set of variables that includes the following: (1) strategies and actions of productive development; (2) local population’s and institutions’ will to change; (3) direct promotion of small farmers through association; (4) productive investments to give greater added value to agricultural products; (5) social and economic infrastructure investments; (6) favorable behavior of global markets for the important products in the region (coffee, cocoa, oil palm, palm heart); and (7) social capital that generated the necessary trust to reach the alignment and consensus of almost all the economic and social factors involved.<sup>82</sup>

In the case of inclusive biofuel production in the San Martin Region, not all these variables seem to have coincided. Although strategies were in place, and local actors did develop coordinated efforts, the required investments did not take place in an aligned and focused manner. The social capital that has been generated in the framework of the alternative development initiatives has somehow not fully been put to work by the local actors for the purpose of the inclusive development of the biofuel chain. Potentially, this is related to the fact that the market for biofuels in Peru is not as fully developed as any of the others on which the region’s agricultural production has focused so far and that have shown increases in demand and prices.

### 3.4 Conclusions on the workings of the IB ecosystem

#### *Roles in the ecosystem*

The cases studied reflect how in an IB ecosystem, the roles of regulator, facilitator, and funder may evolve around the core IB relationship between the buyers (companies) and the suppliers (smallholder producers) of a product. They show how different roles can be played in distinct manners, how the actors influence results, how they work together, and what instruments they use. In some cases, the inclusive relationships between buyers and producers were from the beginning at the heart of the policy initiative; in others, a policy framework was developed to facilitate such relationships.

In the IB cases described in Chapter 2, it became clear that in the core relationship between company and low-income community, the company, in a best-case scenario, does a combination of the following: creates excellent opportunities to increase sales, competitiveness, and market share; reduces costs; buys supplies under conditions favorable for the communities; provides suppliers with information on market requirements; strengthens farmers and their associations through training and technical assistance; and supports farmers’ access to financial resources. The role of the suppliers basically is to guarantee the volume and quality of supplies, under the conditions negotiated between suppliers and their associations on the one hand, and the company on the other. The public policy examples described above show how additional actors—government, NGOs, and financial institutions—organize around or according to inclusive models that involve companies and supplier communities, and decide their role on the basis of specific interests and objectives. Sometimes these will respond to government priorities and political context; at other times they will support development goals or take advantage of a market opportunity.

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<sup>82</sup>. UNODC, n.d.

The cases show that the role of **regulator** is not exclusive to the government: the Colombia coffee case shows the power of the FNC to initiate and influence the content of coffee policies, in close collaboration with the public sector and to the benefit of both. In Ecuador, the government's PRONERI program not only reflected government policy with regard to the roles of the private sector and smallholder farmer communities, it also directly facilitated relationships between the companies and communities and guaranteed access to public funding sources. In the San Martin biofuels development case, although a national regulating framework was in place, at the regional level it was complicated to enact this framework because the regional government did not have all the necessary legal competencies for this subject matter (such as those related to land use or environmental protection). Further, mechanisms for territorial coordination and cohesion between sectorial institutions were lacking.

Whereas in the individual IB cases (as described in Chapter 2), financial capital was often provided by either the company or a development fund, the role of **funder or investor** in the public-policy cases in this chapter was assumed in part by the government: the PRONERI program was largely government funded, and the FNC's operations in Colombia were partially government funded. In the case of Peru, one of the limiting factors mentioned was precisely the fact that the regional government did not have the budget to implement its proposals. The question remains: provided that an IB initiative represents a return for both companies and low-income communities, to what extent, under what conditions, for what purpose, and for what period of time should the public sector provide funding? Capital investment in IB has been seen as necessary, as initial or risk capital for the company as well as for the creation of conditions at the community level; however, IB as a value-generating initiative is supposed to be about an investment that will produce returns in the medium to long term. If that is not the case, no basis exists for continued investment in scale and sustainability. For that reason, any public sector (or other stakeholder) funding, rather than a subsidy, should be based on—and stimulate—the logic of recovering the initial investment.

The role of **facilitator** or broker of the relationship between company and community is often seen as being played by a neutral party that is able to generate or enhance understanding and trust between two entities that would not naturally work together in a mutually beneficial agreement. Such a neutral broker plays a role in circumstances where the company–community relationship does not yet exist and/or where either or both of the parties need support in building a relationship that creates mutual value. In the IB cases described in Chapter 2, this role was often played by an NGO or a development organization. Sometimes the company played this role directly, through staff dedicated to the inclusive business. The public-policy cases show how the government can assume this role, such as in the case of PRONERI in Ecuador. In the case of Colombia, where the FNC is both the farmers' representation and the purchasing company, brokering the relationship with the farmers is part of the FNC's core purpose.

Roles related to **research, development, and dissemination** around IB models take a variety of forms. The public-policy cases examined for this study incorporated research into their setup to a certain extent. In some instances, research was carried out to develop technological packages that would contribute to generating added value for smallholder farmers (by government entities, in the case of jatropha production in Peru), or to designing methodologies for capacity development and organizational strengthening (by the FNC-related Manuel Mejía Foundation in Colombia). Research was also used for reflection on and analysis of the types of business models that would create results for communities (as

was part of the role of the PRONERI team in Ecuador). The knowledge developed from these particular cases may lead to innovation within particular projects and programs, but it needs broader platforms if it is to be disseminated to larger audiences and support mainstreaming IB as a common practice. The latter takes place through partnering with research centers and knowledge institutions in the analysis and assessment of experiences, and through knowledge platforms and networks.

### *Results in creating mutual value for communities and companies*

An essential factor for an IB initiative to be successful and contribute to poverty reduction is the generation of additional or new value, which enables the business model to go beyond the redistribution of existing wealth and can help transform relationships between companies and communities. The IB ecosystems described in this chapter show that certain roles played in the system can indeed support this process of “increasing the pie” and therefore can contribute to potential new value for low-income communities. What is the role of different entities involved in the IB system, in terms of increasing total value and enhancing the distribution of wealth in a way that benefits low-income communities? How do the investments generate returns, and for whom?

**Public sector actors**, in the cases described, have developed policies that enhance economic inclusion and contribute to strengthening low-income communities’ access to markets and relationships with the private sector. In some cases, public entities have directed public investment specifically to communities in order to contribute to these groups’ empowerment and productivity; in others, the government has stimulated specific IB initiatives or supported the inclusive development of a sector as a whole. In all cases examined, these investments have the potential to create conditions that allow for the generation of additional value for the communities (e.g. through capacities for increased or improved production), which ideally in turn creates new value for the companies they supply. On that basis, the company can then sustain the generation and distribution of value in a way that benefits the communities.

**Development agencies** in the IB ecosystem often not only play a role in facilitating company–community relations but can help establish public–private partnerships that contribute to the generation of new value. In both cases, their role focuses on making common interests explicit and supporting the development of initiatives that build on that interest—through brokering relationships, developing capacities, and providing access to capital investment. In doing so, they can help bring initiatives to scale and support systemic change and impact.

**Local providers of technical and financial services** are important in the system in that they often contribute strongly to increasing the volume and/or quality of the local communities’ production. As the cases show, this role can be played by independent parties (financial institutions or NGOs) or by the anchor company involved in the IB.

In the cases analyzed in this chapter, no additional **capital investors** were present—apart from the companies themselves who co-invested in the initiatives (Ecuador and Colombia), and by the groups of actors mentioned above. In the inclusive development of the biofuel sector in San Martín, Peru, the companies viewed the lack of investment capital as limiting the initiative’s success. In other programs,



however, such as the Ecuador IB program, a financial contribution from the companies is required, especially since the IB project is designed to generate additional value for the company.

In summary, the creation of mutual value by a company and a community often not only depends on the company–community relationship but requires incentives, regulations, support, and investments from third parties—often leveraging public resources to attract private support and investment.

### *Limitations and imperfections*

Ideally, the mechanisms and roles in the IB ecosystem represent “a framework that allows private sector and social actors to act together and create wealth in a symbiotic relationship.” Such a framework suggests a common objective among the actors involved, which indeed enables them to act together and focus their interventions on a common goal. In the cases described, however, the public, private, and social actors did not necessarily have a common objective: although they opted for inclusive models, they may have been driven by different motivations and interests—and on top of that, these may have changed over time and not consistently reinforced each other.

The Ecuador case shows how government interest in improving the living conditions of the poor initially explicitly included a role for large companies, but over time, the focus shifted to include associative enterprises and direct export of smallholder production rather than just working with or through companies. The Peru case focused on government support for inclusive development of the biofuels sector and did not explicitly define a role for the private sector; the private sector, in turn, did not feel supported in its role to promote IB models and ended up waiting for the government to guarantee investment in such models. That the market for biofuels is still in the process of development has probably influenced the behavior of the actors involved. Apart from this, the relevant policies and related decisions in both countries have been changing over time, and with those changes, resources often have not been allocated, thereby paralyzing programs. The Colombia case shows how a private organization like the FNC—if it is clear about its objectives and mission—can guarantee the continuity of initiatives that include smallholder farmers, especially if it is not involved in politics. On the basis of such clarity and concurrence about objectives, the public sector can then participate and bring in initial capital investments and mechanisms for funding, with a specific focus on the needs of the underprivileged communities and territories.



CHAPTER 4

CONCLUSIONS ON IB  
FOR COMPANY COMPETITIVENESS  
AND POVERTY REDUCTION



# CONCLUSIONS ON IB FOR COMPANY COMPETITIVENESS AND POVERTY REDUCTION

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The central question of this research project was whether inclusive business can be considered a viable development solution that can substantially contribute to improving the lives of the poor, while also generating for companies a sustainable economic return from business opportunities with low-income communities—in a way that allows IB to scale to a size commensurate with the problems of poverty and exclusion that emerging economies face.

To address this overall question, it was necessary to analyze the answers to the following:

- (1) Is there a business case for having different IB models—for the company and the community involved—that reflect the value generated for both parties?
- (2) What does “inclusiveness” in such models look like, and how can it be assessed?
- (3) What conditions need to be in place to achieve IB results, and how can they be sustained and taken to scale?

This chapter aims to summarize the findings of the case studies on IB and public-policy initiatives and to shed some light on the responses to the questions above.

### 4.1 The business case for IB initiatives

The business case for IB refers to the reasons for the involved parties to undertake the initiative, and to how these reasons are tied to their bottom line. In other words, how will the initiative help both low-income participants and companies achieve their underlying goals? Only if such a business case exists will the parties involved be able and willing to justify the expenditure of resources and capital and decide to take action.

As argued in Chapter 1, the concept of “business case” implies that both companies and low-income participants make a conscious decision based on perceived benefits before entering into an IB initiative. In this sense, IB clearly differs from philanthropy and from working with low-income communities as beneficiaries in general. The low-income segment in IB does not passively receive benefits but actively co-creates them.

The business case for an IB initiative, then, is linked to the return on the investment for both parties, and



- increased attention from investors and funders, in funding business initiatives that create social, environmental, and economic value and/or reduce poverty;
- increased pressure from consumers globally for products that are developed under socially just and/or environmentally sustainable conditions.

Within the relationship between company and community, the following factors were found to help generate greater shared value:

- Technical assistance provided by the company directly to smallholder producers allows for transfer of the knowledge and skills necessary to meet the market demands that the company faces.
- The interest in meeting market demands is shared by the company and the smallholder producers, which contributes to building and maintaining a positive relationship, to the benefit of both.

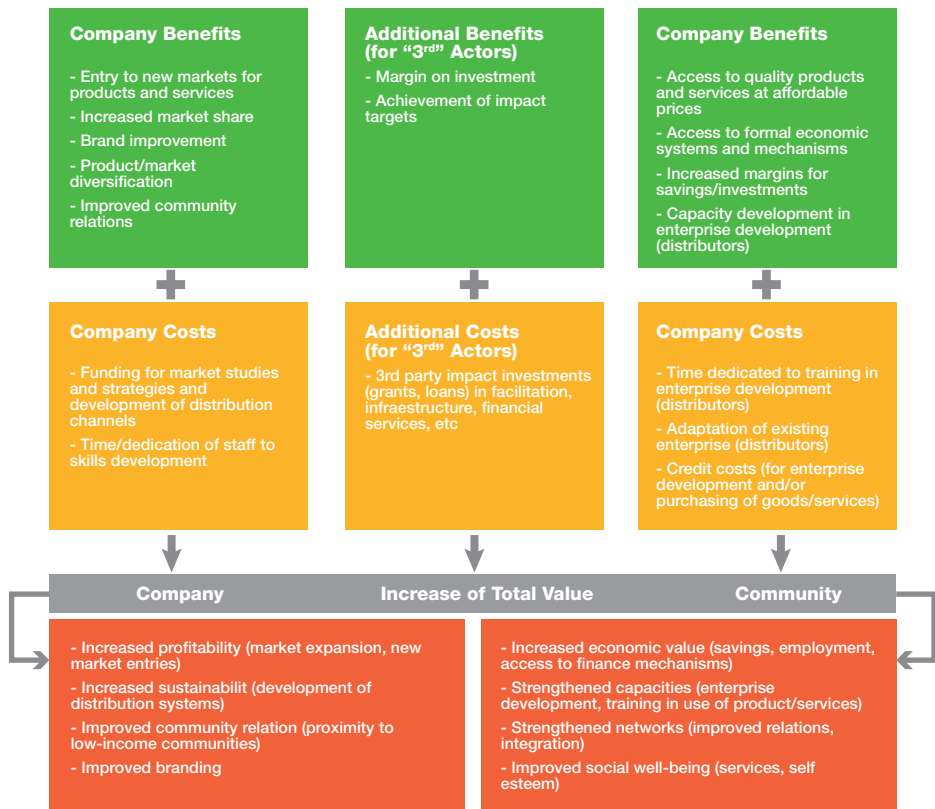


Figure 13: IB with Consumers

The potential to increase the overall value in the case of IB with consumers (and distributors) is determined by market size and the relevance of goods and services for the communities. To achieve success, this type of IB model usually requires the company to go through a process of innovation to work with low-income communities, involving learning and capacity development to understand and produce for the low-income market.

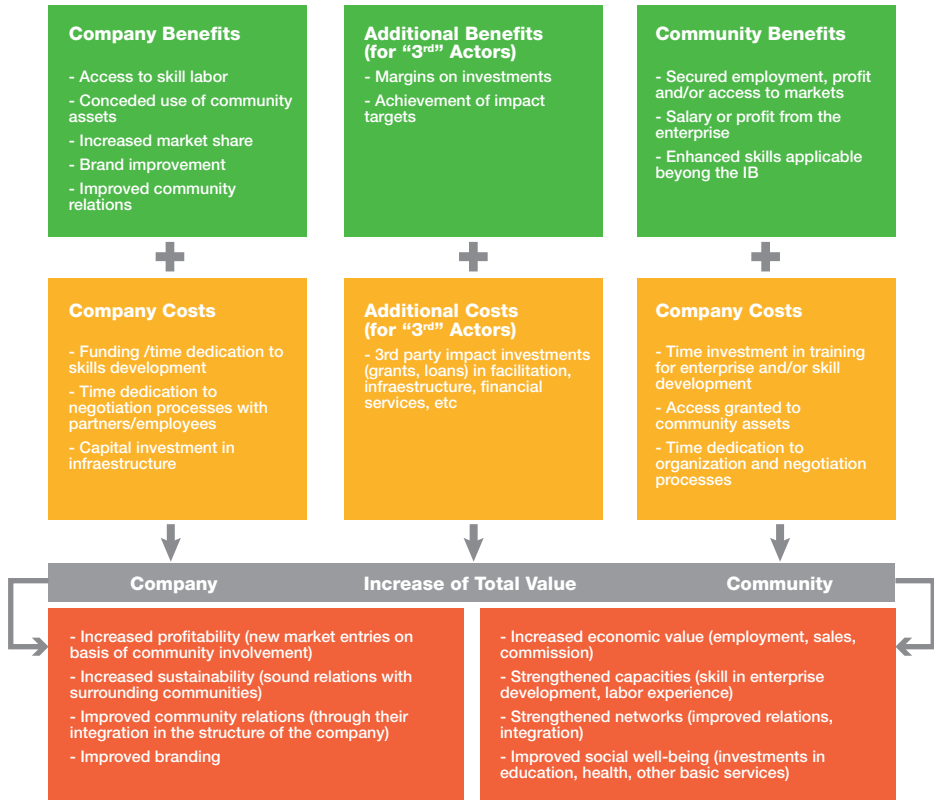


Figure 14: IB with Partners or Employees

In IB initiatives with low-income communities participating as the company's partners or employees, the communities become part of the company structure as paid workers or shareholders. This generates a direct relation between company stability and/or growth and community benefits.

Across the cases studied, for all three IB models, a business case has been found to exist for both parties if and when the IB initiative is part of the company's core business from the beginning: the company



sees a potential return on investment from working with the community, and the community responds out of an economic or social need or interest that will be attained through working with the company. Once a business case exists, the IB initiative is often sustained after initial external funding, through continued investments made by the company and/or the community.

This illustrates that although the development of an IB initiative may be motivated by values and social responsibility, the initiative is likely to be sustainable if its profitability is clear to both parties involved.

## 4.2 Inclusiveness

In the models described in this study, “inclusiveness” refers to the community’s share in the benefits or value that is created, and the mechanisms applied to guarantee and sustain the generation of value by and for the community. In some of the cases, low-income groups gained new roles and greater participation in the value chain; in other IBs, low-income groups were already engaged with the company but gained participation under better conditions. The “inclusiveness” of the communities in the cases studied for this research is expressed in (i) their relationship with the company, (ii) their integration in social and economic networks and in the formal economy, and (iii) the lasting economic and social impact on the communities, which is achieved through and beyond the initial IB initiative and allows for increased social mobility.

### *Transformed relationships*

In the different IB models that were studied, the relationship that developed between the company and the participating low-income communities was decisive for achieving impact in the communities. In many cases, the dynamics of these relationships were transformed through the IB. For the IBs that contributed to creating concrete economic and social benefits and that improved capacities on both sides, the mutual understanding and trust relationships that developed turn out to have been vital in achieving those results.

The potential for inclusion of each IB initiative depends on the particular circumstances and conditions in which it takes place, including the role of the low-income communities in the value chain, and the external drivers and conditions, such as the political context in each country. For example, when organizational strengthening takes place, communities are more likely to improve their negotiating position with the company. Stronger community-level organizations also contribute to greater value creation—for example, through lower transaction costs, increased productivity, and access to certification. Also, in situations where the company engages directly with the communities through its own staff (rather than outsourcing the process to service providers), stronger relationships develop, which both sides perceive as beneficial.

However, even with favorable conditions, companies and communities often do not come together naturally. This is when the role of an intermediary agent, facilitator, or “trusted broker” becomes particularly critical. This entity can help establish the initial relationship between the two parties, based on a role as either a funder or a designer and facilitator of the initiative.

Some of the cases show how through an IB initiative the company and community can move away from a benefactor–beneficiary relationship to a more horizontal relationship, wherein the two sides become interdependent and establish a partnership based on mutual interest and benefits.

### *Entering the formal economy*

In IB cases with suppliers, frequently an IB agreement enables small-scale producers to enter the formal economy. In the cases that were researched, suppliers ended up selling their products in formal markets and gained access to financial services through the formal system. Initially, this entry often happened with some type of backing or guarantee provided by the company. Further, it was found that in some cases, small-scale farmers or suppliers moved up in the value chain, taking on value-added activities, such as packaging or production quality control. Moreover, several projects illustrate how families went from subsistence to being able to reinvest their profits and reach income levels that enabled them to save. This occurs particularly in situations where the initiative is not only about increasing income but also about achieving price stability.

IB initiatives with consumers also directly influence individuals' and small enterprises' capacity to enter formal economic processes. In the cases studied, this is particularly clear for the distributors involved but in some instances is also true for consumers. Such is the case for Edyficar, whose model is based on supporting low-income customers' entry into the formal financial system. In the case of Eletropaulo, the formalization of the electricity infrastructure was accompanied by an urbanization process that provided people not only with regularized electricity services, but also with a formal address. The formal address on the electricity bill provides participants with an official document that facilitates their ability to conduct business and transactions that require proof of address.

In the IB cases with partners and employees, the low-income parties in the IB initiatives gained access to employment, finance, and/or formal markets through participating in the business. The cases also illustrate that the low-income families reinvested in their businesses and savings, not only to solve emergency situations but also to gain access to better and larger loans that were then invested in growing the business or improving their housing conditions.

### *Inclusiveness embedded beyond the original IB initiative*

In some of the cases studied, the participating company and community have been able to expand the initial IB results to include additional dimensions that contributed to further economic development and growth.

Such was the case with the producers' associations involved in the IB initiative with Dole in Peru. They took advantage of their strengthened position as producers in the value chain and took on additional economic activities related to transporting the bananas. The case of Eletropaulo in Brazil shows how a service or product, if it is developed in response to a well-understood demand from a low-income market segment, can help generate additional benefits. Access to a safe and stable energy supply from Eletropaulo enabled low-income households to benefit from additional services thanks to the formal registration of their addresses.

### 4.3 Sustainability and scale

For IB initiatives to have a significant impact on low-income communities, results need to reach a scale that responds to the magnitude of the problems of poverty and inequality, and to be sustainable. At different levels, however, barriers to scale occur: within the company and its relationship with the community, within the broader value chain, in terms of public goods and infrastructure, and in terms of the public policy conditions generated by governments.<sup>83</sup> To get inclusive business results to scale, and expand from building “inclusive companies” to building “inclusive industries,” such barriers need to be lifted.

This section examines the studied cases to identify specific ways in which these barriers may be addressed. Given the relatively short implementation period that had elapsed at the time of this research, any remarks regarding these examples’ sustainability and scalability should not be considered conclusive. However, it is possible to identify factors that appear to influence the development of the results over time and the potential for scaling up. Scaling up ranges from replicating initial results to creating the conditions for results to be multiplied and sustained.

#### *Replication*

The IB cases with suppliers reflect repeated patterns across cases, such as:

- effective and timely technical assistance to increase productivity and improve production quality;
- the role of the company in enhancing access to finance (either directly or through involving finance institutions) for small-scale suppliers that were otherwise not eligible for credit;
- the organization of small producers being strengthened to allow for joint management of the resources, services, and relationships involved in the IB.

Expansion of the IB initiative usually takes place through replicating one or more of these components—tailored to the particular circumstances and opportunities of each case.

The cases of IB with employees or partners documented in this study are already at a stage in which the results are being replicated (ACOPAGRO, Odebrecht) or expanded to include additional initiatives (Rainforest). ACOPAGRO and Odebrecht are replicating the IB approach through a relatively straightforward repetition or expansion to include more individuals under a similar framework. Rainforest’s replication activities are taking place on a smaller scale, and each addition requires careful preparation and implementation to ensure community commitment and environmental results. Several cases of IB with consumers (e.g., Edyficar in Peru and Eletropaulo in Brazil) show how the provision of a service or product can be expanded to include additional communities.

Replication is a way for companies to build on their own or others’ IB experience. It enables businesses and communities to develop initiatives based on lessons learned, adjusting general models and

<sup>83</sup> Koh, Hegde, and Karamchandani, 2014.

components to their specific context and opportunities. This type of scaling up focuses mainly on eliminating barriers to inclusion at the company level (related to knowledge, capital, leadership, business model) and in the value chain (supply channels, distribution channels, linking small producers with end demand, financing, service providers). The following section concentrates on factors that influence the potential for scaling up beyond the individual company or IB initiative.

### *Growing markets*

For IB initiatives to be attractive for the participating company, it is necessary to work in a market with enough size to generate sufficient financial returns on the investment while also producing the desired social impact. Such initiatives often concern growing sectors of the economy and markets where added value can indeed be generated on the basis of the increased participation of low-income people. Only if such conditions exist can margins be created that enable the IB to grow and include additional community members through expanding production and/or creating new jobs.

The IB cases with suppliers that show a large potential for scale are those developed in markets where global consumers demand enhanced inclusion and greater social and environmental benefits. Mechanisms and principles such as certification for good agricultural practices, organic production, fair trade, and others are common approaches for creating this type of shared value. These conditions, if accompanied by technical assistance and capital investment, help enable smallholder farmers to not only increase but also stabilize their income, and gain access to additional services such as credit and technical assistance, introducing additional opportunities and improving their quality of life.

Consumer markets in individual Latin American countries may not always represent sufficient volume to make the investment attractive (with the obvious exception of countries such as Mexico and Brazil, and other emerging economies, such as Peru). In such cases, mechanisms need to be developed that allow for economies of scale, such as involving multiple countries or identifying opportunities that can be taken advantage of on a smaller scale.

Making markets work in favor of inclusion, as a way to take inclusive results to scale, will require that barriers be addressed related to awareness—among customers and producers—of market-based inclusive solutions, market information and company know-how (e.g., intelligence on and insight into low-income customer markets, appropriate business models).

### *The workings of the IB ecosystem*

The public policy cases described in this research show how, around the IB core relationship between a company and a community, additional stakeholders play complementary roles as part of a broader system. In particular, the regulator, facilitator, and funder roles are important for the development and sustainability of IB results. The cases also indicate how different public, private, and civil-society entities, according to market circumstances and political contexts, can take on different roles (or a combination of roles). Therefore, no overriding conclusions can be drawn about the absolute importance of any given type of stakeholder within the system. The cases studied do show that, within each particular

context, different public, private, and civil-society or NGO stakeholders contribute to achieving and sustaining results.

Ideally, the mechanisms and roles that occur in the IB ecosystem represent a framework in which public, private, and civil society stakeholders work together in creating value. In the cases analyzed for this research, however—both specific IB and public-policy cases—such a framework, with common objectives among the actors involved, was rarely made explicit; where it existed, many complications ensued with its implementation.

In spite of these challenges, the cases do show that specific policy mechanisms and instruments have proven to be successful in enhancing inclusion and generating added value, such as: government regulations on limiting import in favor of domestic; small-scale production and establishing direct market relationships (Ecuador); representation of and lobbying for smallholder needs through trade organizations (coffee in Colombia); and the creation of conditions and market linkages for smallholder production in special areas (cocoa in Peru).

### *Mainstreaming IB*

In some of the cases studied, the inclusion of low-income communities in a company's value chain, rather than being a separate project with its own goals and investments, was or became a matter of business as usual. Examples include Floralp in Ecuador, Eletropaulo in Brazil, and Edyficar in Peru. These experiences and the results to date suggest that mainstreaming inclusion in business practices is one way of achieving sustainable results at scale. The aforementioned companies acknowledge the relevance of and importance to their business model of low-income groups, either as suppliers or as consumers and/or distributors. The companies indicate that their prime motivation is a business interest, since without returns on their investments in the low-income groups they would not be able to sustain the initiative. Still, they have chosen to design (part of) their business to include low-income groups, with a focus on creating mutually beneficial results beyond their own profit.

Capital investment in inclusion in such cases becomes part of the business model and is reflected in the bottom line, rather than being seen as separate funding for a corporate social responsibility project, or a subsidy required to achieve social goals. Some of the IB cases studied show companies that began the process viewing IB as a social investment, and through initial external capital investment and technical assistance became convinced of the financial viability of inclusion. This realization, in turn, led these companies to make investments from their own resources to expand and continue the initial IB model, as was the case with Novacero in Ecuador and Dole in Peru.



CHAPTER 5

# THE ROAD AHEAD





## CHAPTER 5

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The cases studied show how inclusive business models can represent a business case for both the company and the community involved. They also provide an overview of the different ways in which inclusion of the low-income segment may take place, and how this inclusion can be supported and sustained by players in the IB ecosystem beyond the company.

Even though in many of the examples analyzed a business case for inclusion exists, this does not mean that the practice of IB is easily scaled or mainstreamed within a particular industry or sector. The cases teach us that no one formula exists for IB initiatives. General models and recurring components can be identified and can serve as useful starting points, but flexibility in their application is required. Each initiative needs to be considered with its own particularities and in its own context to find the right set of interventions and incentives. Therefore, rather than being a straightforward replication of a predetermined approach, transforming business relationships between companies and communities is a matter of carefully assessing the opportunity for inclusion, designing the model based on the common components and mechanisms that can be drawn from practice, and adjusting the model during implementation, on the basis of intermediate results.

The debate and the process of learning about IB and other market-based solutions for reducing poverty and for increasing social and economic inclusion continues along many paths—among companies, practitioners, researchers, public entities, and trade and community organizations. This chapter builds on the ongoing discussion about what is required to increasingly mainstream and scale inclusive business. It looks into what the research contributes to defining the road ahead: to take IB results to a scale that is commensurate with poverty rates and that is significant to the inclusion of large groups of poor people. To that end, it looks at challenges and opportunities for further development and scaling of IB at three levels:

- the “core” of an IB Initiative: company and community involved;
- the broader value chain within which the IB initiative takes place;
- the IB ecosystem as a whole.

### **5.1 Challenges and opportunities within the “core”: company and community**

From the IB cases studied it becomes apparent that the main challenges and opportunities for companies and communities are related to:

- **Company intelligence on the low-income segment** as a consumer market or as a supplier of goods and services: perceptions and myths persist of what low-income communities need and are capable of, and these can hamper the establishment of a profitable, constructive, and inclusive relationship.
- **Company management of the IB initiative.** Working with low-income communities as part of the core business—as suppliers, partners, employees, or consumers—and not just as a social responsibility to fulfill; this requires the adjustment of existing business units or the creation of new ones.
- **Community organization and strengthening.** Particularly in the case of IB with suppliers, but also in other IB models, results are more significant and better sustained if, within the community, strengthening takes place in terms of leadership, financial/administrative skills, and negotiation capacities. Organization of the community can also help reduce transaction costs and lead to economies of scale.
- **Company–community relations.** Establishing a good relationship between company and community, as the cases show, goes beyond business analysis and has a great deal to do with the softer skills of adjusting the preconceptions that each side has of the other, building trust, negotiating, and seeking solutions that are beneficial for all.
- **Company and community investments.** Since initial investments by company and community need to be made before the business case is clear to the parties involved, this outlay may be perceived as a risk. Once the business case becomes clear, both parties show more willingness to sustain the investments and to commit their own resources or make loans.

## 5.2 Challenges and opportunities along the value chain

Along the broader value chain, beyond company and community, the following challenges and opportunities have been identified for further IB development:

- **Financing for inclusive business initiatives.** Initially, access to additional external (risk) capital beyond the parties' own investments is often required—e.g., for IB model development, technical assistance and/or credit facilities for communities, company coaching, infrastructure, market research, and facilitation. Once the business case for IB is proven and returns are generated, this type of funding can be used for scaling or be substituted with the returns generated by the IB.
- **Support services for IB development.** Development and implementation of IB plans often involve, beyond the initial facilitators, other service providers—e.g., for market information and research, technology development and implementation, product development, or accompaniment of the certification process. Scaling of IB, and the development of inclusive industries beyond individual IB cases, requires the development of a market for such support services.
- **Use of market influences for inclusion.** Consumer markets in the Global North are becoming more demanding about the social and environmental conditions under which products in the South

are developed. Mechanisms like fair trade and certification schemes can be applied with smallholder suppliers to enhance their inclusion in such markets, and they often allow for increased productivity and improved production quality.

### 5.3 Challenges and opportunities within the wider IB ecosystem

The IB ecosystem within which IB initiatives take place also poses challenges and presents opportunities for scaling and sustaining IB results:

- **Legal frameworks.** Laws, regulations, and procedures may inhibit sectors that show a potential for inclusion within their value chain. In such cases, joint analysis and action are required from the public, private, and social players involved in the sector, to generate a more enabling environment for inclusion.
- **Specific policy measures.** Targeted initiatives such as taxes or subsidies can be used by local and national authorities to allow the inclusion of the low-income segment in certain sectors or territories.
- **Investments in public goods and services.** Awareness still needs to be raised of how market-based solutions may imply benefits for low-income producers, distributors, entrepreneurs, and consumers, to enhance the development of a favorable environment for inclusion. If such a debate takes place within a specific sector or territory, it can influence decision making on public investment in hard infrastructure (roads, bridges, markets, collection centers) and in public services, creating the conditions for inclusion of the low-income segment in business development.

### 5.4 Recommendations

To further IB development in line with the opportunities mentioned above, a set of possible mechanisms and actions to be undertaken by different types of players in the field of IB development is presented below:

- **Coaching mechanisms and facilities that allow for companies and communities to be accompanied by expert facilitators in the process of IB implementation.** Such mechanisms and facilities could be coordinated by private sector organizations like chambers of commerce, industry chambers, and other member organizations. Consulting firms and development organizations dedicated to IB development could play the IB facilitator role.
- **Funding streams or facilities to cover the necessary initial investments in technical assistance, facilitation, capacity development, and capital investment related to IB initiatives.** Such mechanisms exist for pilot projects and for larger-scale projects with a proven business case, but to a lesser extent for the phase between pilot and scale—let alone for moving from individual IB initiatives to the development of inclusive industries. This would involve development banks, impact investors, and other funders with an interest in combining financial and social returns.

• **Platforms for ongoing learning through the exchange of experience and knowledge, among companies and communities as well as public sector entities, practitioners, facilitators, researchers, and funders.** This would allow for the acceleration of lessons learned and the adoption of best practices and would generate inputs for policy development, investments, and innovation. Such platforms could work within as well as across industries and may be facilitated by knowledge/research institutes or practitioners.

• **Policy environments in which synergies are facilitated that explicitly promote IB development in a coherent manner, enhancing the sustainability of its results.** This requires analysis of legal frameworks on the one hand and understanding of private sector and community needs and opportunities on the other, so that appropriate incentives and policy measures can be identified and implemented. It involves public sector entities, private sector organizations, and research/knowledge institutes.

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# LITERATURE REVIEW

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Ashley, Caroline. 2009, February. Harnessing Core Business for Development Impact. London, UK: Overseas Development Institute. <http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/3566.pdf>.

This article summarizes how IB has reached where it is today, including motivations, models, and issues. It concludes that IB has major and multiple impacts on developing economies and people, that there are different ways to adapt the business model, and that delivering greater development benefits builds shareholder value. The article also states that at this point, the evidence is broad-brush and anecdotal, which doesn't allow for the analysis of IB's strengths and weaknesses.

Clay, Jason. 2005. Exploring the Links Between International Business and Poverty Reduction: A Case Study of Unilever in Indonesia. Oxford, UK: Oxfam. <http://policy-practice.oxfam.org.uk/publications/exploring-the-links-between-international-business-and-poverty-reduction-a-case-112492>.

This publication summarizes the IB model that Unilever implemented in Indonesia. While analyzing the impacts on poverty, the author explains that for a deeper understanding of the impacts, a more direct analysis of Unilever's operations and its relationships with employees, suppliers, distributors, retailers, and consumers is necessary. The author also states that the local multiplier impact of the distribution chain is little understood. One big question in the summary is whether Unilever is creating rather than meeting needs—i.e., is Unilever turning luxuries into necessities? The report suggests areas for further research:

- The general findings of this research for the generation of employment and revenue along the value chain were surprising. Do they hold for other companies in the FMCG (fast-moving consumer goods) industry? What does this mean for the design of pro-poor development strategies?
- This research suggests that there are likely to be differences of opinion over what are reasonable performance expectations within different sectors. Additional research that would allow side-by-side comparisons of the performance of oil and gas companies, mining companies, export-led manufacturers, and banks might suggest the types of tradeoff that occur when governments encourage one type of foreign direct investment over others.
- It is clear from this work that multinational corporations like Unilever can have impacts on local economies by sharing good-practice standards. What are the best ways for a company

to extend its policies and practices through the value chain?

- This work focused almost exclusively on the private sector. What can and should government be encouraged to do to promote an enabling environment for private sector investment that supports pro-poor development?
- The data available for this study were insufficient to allow us to draw strong conclusions about the gender-differentiated impacts of the changing systems of labor use on the supply and retail sides of the value chain.
- Pursuing research from a people-centered perspective—where people living in poverty are the starting point and their views are fully reflected—is an obvious priority for a follow-up research project.
- Finally, the discussions about the impact of advertising and marketing practices on poverty are particularly challenging. This is a key issue from the perspectives of both poverty and business viability. It would be good to understand these relationships better.

Davidson, Kirk. 2009. "Ethical Concerns at the Bottom of the Pyramid: where CSR meets BoP" *Journal of International Business Ethics* 2 (1): 22–32.  
[http://americanscholarspress.com/content/BusEth\\_Abstract/v2n109-art2.pdf](http://americanscholarspress.com/content/BusEth_Abstract/v2n109-art2.pdf)

This paper describes the ethical problems associated with IB initiatives, including appropriateness of products, fair pricing, advertising and promotion, distribution concerns, branding, packaging, repatriation of the "fortune," and the BoP as a "vulnerable" market. The author explains that just the right amount of social responsibility needs to be aligned with the company's economic goals. With too little CSR in the BoP market, the company is viewed as manipulative, and with too much, it is perceived as dispensing charity. The article doesn't give much room for BoP consumers/producers to analyze for themselves.

Gradl, Christina, and Claudia Knobloch. 2010, December. *Inclusive Business Guide: How to Develop Business and Fight Poverty*. Berlin, Germany: endeva.  
[http://www.endeva.org/fileadmin/user\\_upload/publications/IBG\\_final.pdf](http://www.endeva.org/fileadmin/user_upload/publications/IBG_final.pdf)

This easy-to-read guide gives a summary of IB initiatives, explaining what they are, how they are done, and where. It takes the reader through three phases of business development (development, implementation, and growth), each one divided into four steps, for the correct implementation of an IB initiative. It concludes with an analysis of six countries (Brazil, China, India, Mexico, Russia, and South Africa) and seven sectors (energy, financial services, food and agriculture, health, housing and construction, information and communications technology, and water) where there are various opportunities and potential solutions for IB initiatives. The publication is organized with explanations and short case studies to explain each section. The guide doesn't go into very much detail, but its layout and references are useful.

Hammond, Allen. 2011. "BoP Venture Formation for Scale." In *Next Generation Business Strategies for*

the Base of the Pyramid: New Approaches for Building Mutual Value, edited by Ted London and Stuart L. Hart, 193–216. New York, NY: Pearson Education.

This chapter describes how to scale an IB initiative. It starts off by describing structural flaws that cause failure in achieving scale: (1) a purely top-down approach without deep local connections, and (2) a completely bottom-up approach wherein it is difficult to overcome all the barriers to reaching significant scale. Successful BoP enterprises are built from the bottom up. Three sets of challenges to scale are described: (1) a lack of knowledge about the basic tools of business, (2) creating markets where there are none, taking into consideration challenging geography, missing infrastructure, and unsupportive government, and (3) difficulties for local social entrepreneurs in identifying and recruiting strategic partners globally. The two described approaches to achieve scale are: (1) from the beginning, construct ventures whose structure is both local and global as well as bottom-up and top-down and (2) build the entire ecosystem to support scale rather than a standalone venture. One area of missing research is on hybrid IB models: partnerships between businesses and NGOs or other social organizations. Within hybrid models, there are five preliminary types of partnerships: (1) sourcing, (2) distribution or marketing, (3) product co-development, (4) franchising, and (5) financing. The success criteria for hybrid partnerships are: (1) importance of profit: partnerships that incorporate an NGO into a business ecosystem rather than the reverse, (2) strong personal relationships and trust between key leaders in the business and the NGO, and (3) a strong sense of co-dependence. These criteria, models, and challenges are important in analyzing scalability in the case studies.

Hart, Stuart. 2011. "Taking the Green Leap to the Base of the Pyramid." In *Next Generation Business Strategies for the Base of the Pyramid: New Approaches for Building Mutual Value*, edited by Ted London and Stuart L. Hart, 79–102. New York, NY: Pearson Education.

This chapter discusses the environmental impact of BoP ventures and the opportunity to develop products and services that have a smaller environmental footprint. The author suggests actions and incentives to accelerate the green-leap revolution: create protected "white space," exploit "shelf technology," innovate from the bottom up, build regional ecosystems, remove the bias against distributed solutions, and create green-leap seed funds.

Jenkins, Beth, and Eriko Ishikawa. 2010, April. *Scaling Up Inclusive Business: Advancing the Knowledge and Action Agenda*. Washington, DC: International Finance Corporation and Harvard Kennedy School. [http://www.ifc.org/wps/wcm/connect/dbebe6004cc75ca394aab59ec86113d5/Pub\\_004\\_BOP\\_Scaling\\_Up\\_Inclusive\\_Business.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/dbebe6004cc75ca394aab59ec86113d5/Pub_004_BOP_Scaling_Up_Inclusive_Business.pdf?MOD=AJPERES).

This report presents findings from 14 case studies of IB initiatives in different parts of the world. These studies had seven common themes: (1) growth was the primary driver for developing the IB initiative, (2) the most common business result was revenue growth, (3) the most common development outcome was expanded economic opportunity and access to goods and services for the poor, (4) networks and technology platforms were critical, (5) consumer, distributor, and supplier financing were part of the enabling context, (6) capacity building and skill building in low-income suppliers, distributors, and retailers was key to success, and (7) collaboration with other

organizations was also critical. The report presents the potential for scale coming from three areas: (1) whole-pyramid orientation (in which the poor are segments within a much broader overall market, supplier base, or distribution network), (2) cost-effective networks, and (3) collaboration and technology. The challenges for scale come from unrealistic expectations at the time of scale, lack of access to adequate financing, difficulty adapting business model to new geographies/scales, lack of appropriate partners in new geographies, and lack of buy-in within the company.

Karnani, Aneel. 2010a. "The Case Against Corporate Social Responsibility." *The Wall Street Journal*, August 23. <http://www.wsj.com/articles/SB10001424052748703338004575230112664504890>.

This article argues that companies will not participate in CSR on their own, and that government regulation is the solution. Companies, the author claims, are not willing to sacrifice profit for social welfare. This is useful to connect CSR and IB; if IB can offer companies the prospect of profit, then they will be interested in social welfare.

———. 2010b. "Doing Well by Doing Good: The Grand Illusion." Working Paper No. 1141, Ross School of Business Working Paper Series. [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1593009](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1593009).

This paper states the case against CSR, proposing that many of the examples of companies proclaiming to be socially responsible are in fact profit-maximizing actions that happen to coincide with increased public interest. This is a good starting point for explaining critiques against CSR and IB. The author believes that if markets are doing well, there is no need to appeal to companies to fulfill social responsibility, but if markets fail, then there is a tradeoff between private profits and public interest. In the latter, constraints need to be imposed on free markets—such as CSR, industry self-regulation, civil-society activism, and government regulation.

Kennedy, Robert, and Jacqueline Novogratz. 2011. "Innovation for the BoP: The Patient Capital Approach." In *Next Generation Business Strategies for the Base of the Pyramid: New Approaches for Building Mutual Value*, edited by Ted London and Stuart L. Hart, 48–78. New York, NY: Pearson Education.

This chapter covers the topic of patient capital; it describes this as an investment intended to return its principal plus interest—which may be at or below the risk-adjusted market rate—and that seeks to maximize social impact and combat poverty. The chapter describes BoP markets as having unaddressed needs, corruption, low purchasing power, and a lack of equity capital. Patient capital differs from traditional capital in at least four ways: a longer time horizon, a willingness to forego maximum financial returns in exchange for social or environmental impact, a greater tolerance for risk than traditional investors, and typically being bundled with intensive support for social entrepreneurs as they grow their enterprises. Organizations that offer patient capital currently are Acumen Fund, E+Co, New Ventures, Root Capital, and TechnoServe. Four key business model innovations are described that have been implemented by successful BoP ventures: making radical cost reductions, building a BoP-centric management team that balances social and traditional business skills, applying human-centric design thinking to products and services, and establishing trust with the BoP.



London, Ted. 2011. "Building Better Ventures with the Base of the Pyramid: A Roadmap." In *Next Generation Business Strategies for the Base of the Pyramid: New Approaches for Building Mutual Value*, edited by Ted London and Stuart L. Hart, 19–44. New York, NY: Pearson Education.

This chapter describes the seven key principles for creating a fortune with the BoP: (1) in the design phase, create market opportunities; (2) craft solutions with the BoP; (3) in the pilot phase, orchestrate effective experiments; (4) manage failures; (5) in the scaling phase, leverage and transfer social embeddedness; (6) generate co-mingled competitive advantage; and (7) throughout the entire process, enhance mutual value. For the success of IB initiatives, the business and donor communities must work together based on collaborative interdependence. The seven key principles could be used as a checklist for IB initiatives.

———. 2009. "Making Better Investments at the Base of the Pyramid." *Harvard Business Review* 87 (5): 106–13. <https://hbr.org/2009/05/making-better-investments-at-the-base-of-the-pyramid>.

London, Ted, and Ravi Anupindi. 2010. *Revisiting Value Chain Initiatives: Insights from the Base of the Pyramid Perspective*. Washington, DC: USAID. [http://pdf.usaid.gov/pdf\\_docs/PNADW442.pdf](http://pdf.usaid.gov/pdf_docs/PNADW442.pdf).

This report describes how collaborative interdependence between companies and donor organizations can improve IB initiatives. The authors describe BoP initiatives started separately by companies and by donor agencies, explaining their strengths and weaknesses. They then say that company-led and donor-led initiatives are complementary approaches. They give recommendations to donor agencies for facilitating interdependence: (1) ensure the team has a deep understanding of enterprise development and BoP markets; (2) develop and emphasize metrics valued by both partners; (3) support a flexible partnership model; (4) demonstrate commitment to co-creation; (5) support market creation that enables competitive advantage; and (6) ensure skills are transferred and not just leveraged. The authors suggest using the BoP Impact Assessment Framework, developed by Ted London, as a standardized approach. The authors also suggest that donor organizations offer a roadmap for venture success based on prior lessons and emerging best practices.

London, Ted, and Stuart L. Hart, eds. 2011. *Next Generation Business Strategies for the Base of the Pyramid: New Approaches for Building Mutual Value*. New York, NY: Pearson Education.

Rather than focusing on "finding a fortune at the base of the pyramid," the core message of the book—as summarized in its Summary, Introduction, and Conclusions chapters—is "creating a fortune with the base of the pyramid." Currently, critiques of IB include: that it is a form of corporate imperialism; that it spurs consumerism among the poor, adding to environmental destruction; and that it is questionable whether the resulting profit is compatible with sustainable development. This book describes the BoP as being heterogeneous, receiving the least amount of income, having local enterprises that are not integrated with the formal economy, inhabiting the informal economy, and comprising the majority of humanity. BoP businesses are described as revenue-generating enterprises that specifically target the BoP demographic—described as buyers, sellers, and entrepreneurs—with goods sold to or products sourced from the BoP. BoP

businesses tend to straddle the formal and informal economies, span sectors and sizes, and have the goal of becoming economically self-sustaining and scalable. The book primarily focuses on inclusive businesses with consumers, with little emphasis on suppliers.

London, Ted, Ravi Anupindi, and Sateen Sheth. 2009. "Creating Mutual Value: Lessons Learned from Ventures Serving the Base of the Pyramid Producers." *Elsevier Journal of Business Research* 63 (6): 582–94.

This paper reviews BoP literature focusing on the proposition of mutual value creation and producers at the BoP. The paper continues with a description of the study design, sample selection (64 case studies), and methodology. The results are divided into three categories: constraints faced by BoP producers, venture types, and venture strategies to address such constraints. It concludes by offering direction for future research that will further improve understanding of the opportunities for business ventures to create mutual value with BoP producers. The description of the study design, sample selection, and methodology are helpful for analyzing the case studies within our research.

Márquez, Patricia, Ezequiel Reficco, and Gabriel Berger. 2009. "Negocios Inclusivos en América Latina." *Harvard Business Review* 87 (5): 28–38.

This paper explains what IB is and its differences from CSR. It continues with a description of the attributes of IB initiatives and of areas where IB needs to develop. It goes on to ask whether IB is only for large multinational corporations or whether SMEs have a role to play as well. The article describes a lack of research on national companies, which is an important reason to look into cases of IB initiatives with these companies.

———. 2010. *Socially Inclusive Business: Engaging the Poor Through Market Initiatives in Iberoamerica*. Cambridge, MA: Harvard University Press.

This book covers 33 case studies and analyzes the actors involved in IB, sectors where IB has been implemented, and the extent to which value creation has been achieved. The cases are described briefly in different chapters, and each one is then summarized in the annex.

Monitor Institute. 2009. *Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry*. San Francisco, CA: Monitor Institute.  
[http://monitorinstitute.com/downloads/what-we-think/impact-investing/Impact\\_Investing.pdf](http://monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf).

This publications asks whether impact investing will remain a small, disorganized, underleveraged niche for years or even decades to come or whether leaders will join to fulfill the industry's clear promise, making this the new domain for addressing urgent social and environmental challenges.

Reficco, Ezequiel. 2010. "Negocios Inclusivos y Responsabilidad Social: Un matrimonio complejo." *Debates IESA* 15 (3): 14–17.

This article looks at the relationship between CSR and IB. It explains that IB is neither philanthropy nor CSR, and that CSR questions selling to the poor. Some publications look at IB as the next chapter in CSR but that idea is not shared by all. IB views low-income communities as potential business partners. There have been experiences of IB working with CSR, in that IB, like any new market, requires an investment of time and resources for it to develop. CSR initiatives with a strong focus on markets have been successful. The author concludes that IB needs its own space but that in some areas, CSR and IB can overlap.

Reficco, Ezequiel, and Patricia Marquez. 2007. "Socially Inclusive Networks for Building BoP Markets." University of San Diego - School of Business Administration Working Paper. doi:10.2139/ssrn.1112969.

This paper focuses on partnerships and collaborative arrangements in market initiatives with the BoP and covers three broad issues: alliance formation, alliance implementation, and performance outcome. These partnerships can also be called an ecosystem, socially inclusive networks, or hybrid value chains. The paper looks at socially inclusive markets—horizontal arrangements in which all parties share responsibility for performance outcomes, without any one party exercising authority or control over others. The section on alliance formation looks at why companies seek to build socially inclusive networks. It concludes that channeling information and resources, leveraging social capital, and becoming business "friends" are actions that improve conditions for sustained market transactions. The second section, on alliance implementation, looks at how socially inclusive networks connect BoP groups with value creation, through networks, the presence of a pivotal player, sound business practices (not charity), and governance structures. The analysis of alliance performance shows that risk taking, investment, competitive advantage, information exchange, joint learning through problem solving, and economies of time are characteristics of working in socially inclusive networks. The article concludes with questions for further research about (1) the conditions under which to relinquish control of a business chain and (2) the functions to be carried out in these networks, and what kinds of organizations are best suited for performing them.

Simanis, Erik. 2011. "Needs, Needs, Everywhere, But Not a BoP Market to Tap." In *Next Generation Business Strategies for the Base of the Pyramid: New Approaches for Building Mutual Value*, edited by Ted London and Stuart L. Hart, 103–28. New York, NY: Pearson Education.

The BoP has needs but is not a "market" in the traditional sense. A consumer market is a lifestyle built around a product, with two defining characteristics: (1) the idea and practice of paying money for a value proposition, and (2) the fact that its members have "embedded" a product and its value proposition into their lives. Markets with the BoP must be created with this concept in mind. Market creation is a different challenge from market entry. One must consider two key components in new business development: framing the value proposition and defining the strategic innovation process.

SNV. 2008. *A Firm-Level Approach to Majority Market Business: Private Sector Mapping Project*. Den Haag, Netherlands: SNV & IDB.

This report presents the results of surveys conducted in over 500 companies in LAC on involving majority markets within their value chain as producers or consumers. The report goes through the motives behind IB initiatives—the incentives, perceived benefits, and behavioral trends. It concludes with several findings, including: that IB initiatives give companies a competitive advantage, that the main incentives are market based, that there is still skepticism within the private sector about starting IB initiatives, that more effort needs to be directed towards cost reduction, that governments should try to put in place policies to spark involvement in IB, and that CSR should be leveraged as a reason to start an IB initiative.

SNV and WBCSD. 2010. *Inclusive Business: Creating Value in Latin America*. Den Haag, Netherlands: SNV & WBCSD.

This publication describes what IB is and the different models that have been implemented: with suppliers, distributors, platforms, and consumers. It describes 11 case studies of inclusive businesses, focusing on IB with suppliers but also giving examples of the other models. The publication concludes that IB has had a positive effect on low-income communities but that more research is needed on its level of impact. This work gives an idea of how much research has been done and to what extent case studies have been used to make the case for IB. These cases can be used as a jumping-off point for the case studies in our research.

Stok, Gustavo. 2010. "¿Quién ha aportado mi queso?" Inter-American Development Bank. <http://www.iadb.org/micamericas/section/detail.cfm?language=Spanish&id=8279&sectionID=mngr>.

This article describes the process that Floralp went through to start their inclusive business initiative. Seeking supplier stability and increased production, Floralp invested in a training and technology transfer program with small producers. Through this program, they have been able to increase milk production in small producers' farms and thereby increase income. In addition to being suppliers, the small producers are company shareholders. The Floralp model has been replicated in Peru.

Viswanathan, Madhu. 2011. "A Micro-Level Approach to Understanding BoP Markets." In *Next Generation Business Strategies for the Base of the Pyramid: New Approaches for Building Mutual Value*, edited by Ted London and Stuart L. Hart, 129–64. New York, NY: Pearson Education.

This chapter describes BoP markets from the bottom up. The chapter is divided into three sections: what, what this means, and how. The first section goes through the characteristics of BoP consumers, entrepreneurs, and marketplaces; the second section describes how to understand BoP marketplaces; and the third section explains how practitioners in the commercial and social realms can design solutions. The BoP marketplace is characterized more by relationships than by transactions. Two of the author's main points are that to understand BoP marketplaces, it is necessary to acknowledge our own weaknesses in understanding BoP contexts, and that those living at a subsistence level have significant experience in surviving it. A mindset of mutual learning is necessary for developing IB initiatives. This chapter is written from an anthropological point of view and can contribute to research on the BoP in the case studies. Most of the literature

written on IB does not come from this perspective.

Whitney, Patrick. 2011. "Reframing Design for the Base of the Pyramid." In *Next Generation Business Strategies for the Base of the Pyramid: New Approaches for Building Mutual Value*, edited by Ted London and Stuart L. Hart, 165–92. New York, NY: Pearson Education.

This chapter reviews the design phase for products and services for the BoP. The design process must reframe the problem. The process of strategic design starts by looking at the context and analyzing that. It goes on to reframe or redefine the problem by looking with a more abstract eye, then continues by creating options based on the reframed problem, and ends with a roadmap that maintains the integrity of the final solution. In reframing, the author suggests using the POEMS framework, which is a protocol that takes into account people, objects, environments, messages, and services. It identifies the people to be served and the things designers can change to make those people's lives better. This chapter highlights the importance of design in products and services for the BoP. Such an approach may provide insights into what went on in the design process in the case studies and how that impacted the results.



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