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Pro-poor market development

**An approach and quick-scan screening tool
for pro-poor business propositions**

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1 Introduction

This working paper describes KIT's approach to pro-poor market development. The paper consists of two sections. The first section provides our conceptual framework for strategic thinking about pro-poor market development. The second section presents a practical working tool to guide decisions about investments in pro-poor business ventures.

In our view, pro-poor growth is more than a simple increase in employment or income levels. It should also include the empowerment of micro and small-scale entrepreneurs to defend themselves against the forces of competition. This concept of "chain empowerment" is explained in the first section of this paper.

The second section presents a quick-scan tool which can be used to screen pro-poor business proposals, by which we mean business projects that are commercially viable and at the same time contribute to poverty reduction.

We hope that our conceptual approach and the quick-scan screening tool may assist development practitioners in strategic and operational decision-making.

2 Approach to pro-poor market development

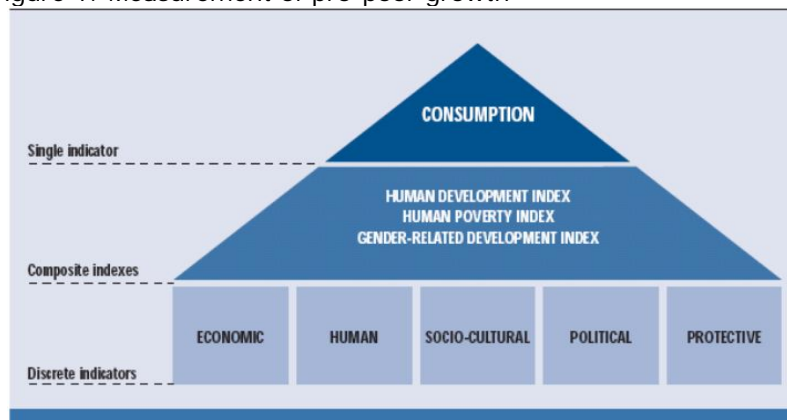
2.1 What is pro-poor growth?

There are two main approaches to defining pro-poor growth (DFID, 2004). The absolute definition of pro-poor growth considers the increase in the income of poor people. From this perspective, any growth is pro-poor as long as the incomes of the poor are rising. The relative definition of pro-poor growth compares the increase in the incomes of the poor with the increase in the incomes of other people. Here, growth is pro-poor only if the incomes of the poor grow faster than those of the population as a whole.

From our perspective, the absolute definition of pro-poor growth is not an adequate instrument for guiding development efforts. Studies show that any economic growth typically reduces poverty levels (e.g. Ravallion, 2004; World Bank, 2000). Hence the absolute definition of pro-poor growth would ultimately lead to the conclusion that poverty reduction can be left to the private sector and that additional efforts are unnecessary.

The relative concept of pro-poor growth also suffers from serious flaws. Focusing exclusively on income growth, it neglects the non-economic dimensions of poverty and omits the crux of poverty alleviation – namely to enhance the capacity of people to sustain their well-being. All in all, both the absolute and relative concepts of pro-poor growth only measure the ‘tip of the iceberg’ (Fig. 1).

Figure 1: Measurement of pro-poor growth



Source: OECD, 2001

Our concept of pro-poor market development responds to the flaws mentioned above. In our view, market development is pro-poor only when:

- 1 It has impacts beyond an increase in the income of the poor. It should also lead to more economic control by the poor, namely, a renewed power balance in the value chain.
- 2 It strengthens the economic, social and organizational capacities of the poor. This is, of course, a prerequisite to more economic control by the poor.

2.2 What is pro-poor chain development?

The increase of control and capacities in the value chain can be conceptualized with the term ‘economic rent’. Economic rent refers to the ability of producers to appropriate areas of value accretion and protect themselves from the competitive pressures that drive down their terms of trade (Kaplinsky and

Morris, 2001; Kaplinsky, 1998). In a context of liberalization and globalization, sustainable income growth in least developed countries can no longer be based on the efficient use of resources, because competitive forces continually drive down their terms of trade. Sustainable development critically depends on the capacity to identify and appropriate areas of value accretion.

Economic rents arise from the possession of scarce attributes that create barriers to entry. Each economic sector or sub-sector is marked by an average rate of profit defined by competitive forces. When an entrepreneur introduces innovations, he reaps a surplus – this is economic rent. Economic rent is the gain that an entrepreneur reaps from being ahead of his/her competitors. As others copy the innovation the economic rent whittles away and prices fall. This renews the search for a ‘new combination’, either by the same producer or another one, in the continual entrepreneurial pursuit of surplus. Hence, economic rents are dynamic: new rents will be added over time, and existing areas of rent will be eroded through the forces of competition (Kaplinsky and Morris, 2001; Kaplinsky, 1998).

There are a variety of forms of economic rent:

- 1 Resource rents – access to scarce natural resources and infrastructure
- 2 Technology rents – having command over scarce technologies
- 3 Financial rents – access to finance on better terms than competitors
- 4 Marketing rents – possessing better marketing capabilities and/or brands
- 5 Knowledge rents – possessing superior information systems
- 6 Human resource rents – having access to better skills than competitors
- 7 Organizational rents – possessing superior forms of internal organization
- 8 Relational rents – having superior quality relationships with suppliers and customers
- 9 Policy rents – operating in an environment of efficient government; policy barriers to the entry of competitors

Hence, in our view, market development is pro-poor only when it enhances the economic rent of poor farmers – that is, the capacity of poor farmers to upgrade their position in the value chain so that they appropriate a greater share of the returns accruing from the chain.

2.3 How can pro-poor chain development be conceptualized?

The economic rent of poor farmers in the value chain can be conceptualized by assessing changes in their position in the value chain. Two dimensions are key to assessing the position of farmers in the chain (Peppelenbos, 2005; KIT et al., 2006):

- 1 The types of activities that farmers undertake in the chain
- 2 The involvement of farmers in the management of the chain

Ad 1. Chain activities:

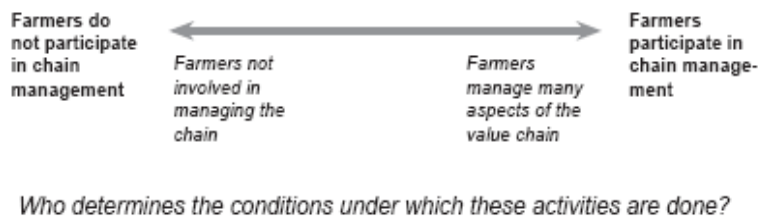
Farmers may concern themselves only with production; they prepare the land, grow the crop, and harvest the crop when it is mature. But they may also be involved in other chain activities, such as procuring inputs, drying their crop, sorting and grading, processing, transporting and trading. Being involved in various activities in the chain is known as vertical integration. We can plot farmers’ involvement in chain activities along a vertical axis as in Figure 2.

Figure 2: Farmers' involvement in value chain activities



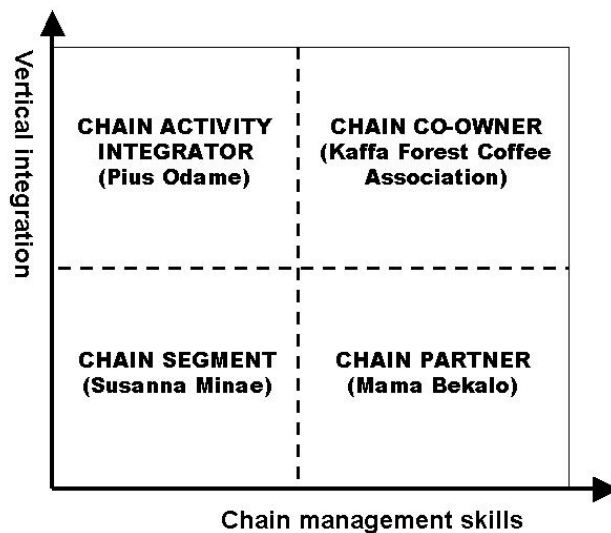
Ad 2. Chain management: Farmers may be excluded from any decision-making about management decisions that affect them, even over what crops they grow or what animals they raise. Someone else may make these decisions and then inform the farmers. On the other hand, farmers may have a high degree of control over management: they may be able to decide how much they sell, to whom, and at what price. They may control the definition of grades and standards, the targeting of consumers, the management of innovation and so on. We can think of these aspects as chain management and plot farmers' degree of involvement in managing the chain on a horizontal axis (Figure 3).

Figure 3: Farmers' involvement in value chain management



If we combine these two diagrams we get a matrix (Figure 4). Farmers can be located anywhere on this matrix.

Figure 4: Four forms of farmers' participation in value chains



Source: KIT et al., 2006; adapted from Peppelenbos, 2005

Here are some examples:

Susanna Minae keeps a herd of goats in northern Kenya. Every few months, she sells a few goats to a trader who visits her village. The trader dictates the price he pays, and she has no choice but to accept. We call her a chain actor, because she engages only in farming and has no influence over the management of the chain. Farmers in conventional contract farming schemes are chain actors.

Pius Odame grows maize on his small farm in western Kenya. He harvests and dries his grain, then mills it into flour before selling it to a trader who visits his village after harvest. We call Pius a chain activity integrator because he has moved from farming into other activities in the chain, although without gaining influence on the management of the chain. Chain activity integrators may be organized into groups, such as marketing cooperatives, to buy inputs, process or market produce, but they have no managerial control over the chain because they are not involved in quality management, consumer targeting, or proactive innovation.

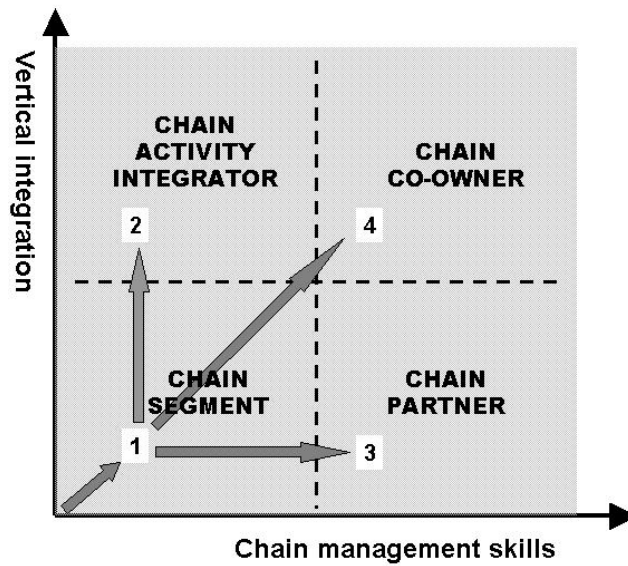
Mama Bekalo grows pineapples in Tanzania. She sells her fruit to the farmer association but does not do any processing or grading. Through the association, she has negotiated a contract to supply hotels in Zanzibar. We call Mama Bekalo a chain partner, because she specializes in farming and – through the association – exerts influence over the management of the chain. Chain partners have a long-term partnership with traders, processors or retailers. They may be organized for technological innovation and institutional dialogue in the chain, but they are involved only in production, not in further processing their produce.

The Kaffa Forest Coffee Association harvests coffee, removes the pulp, dries the beans and packages them for export from Ethiopia to Germany. It has negotiated contracts to supply several importers with high-quality beans, and has created its own brand that fetches premium prices on the German market. We call this association a chain co-owner, because it has moved upstream in the chain, increasing both its activities and its influence. Chain co-owners are organized in business cooperatives that develop new products and reach the end-consumer.

2.4 How can pro-poor chain development be monitored?

To monitor changes in the position of the farmer in the value chain, we can think of the matrix as a continuum (Figure 5). A farmer may start off at the bottom left corner of the rectangle. He begins grading his product. Doing so moves him a little upwards in the rectangle, increasing his vertical integration as he adds an activity. He also moves a little to the right, reflecting greater chain management because he has improved quality management. But he remains within the chain actor quadrant 1. If the same farmer later starts processing his product, he may move into the activity integrator quadrant 2. Or he and his neighbours may organize as a group and negotiate deals with traders, and may start working with the local research institute to test new technologies. This would move them into the chain partner quadrant 3. A combination of these vertical movements (more activities) and horizontal movements (more management) would bring the farmers into the chain co-ownership quadrant 4.

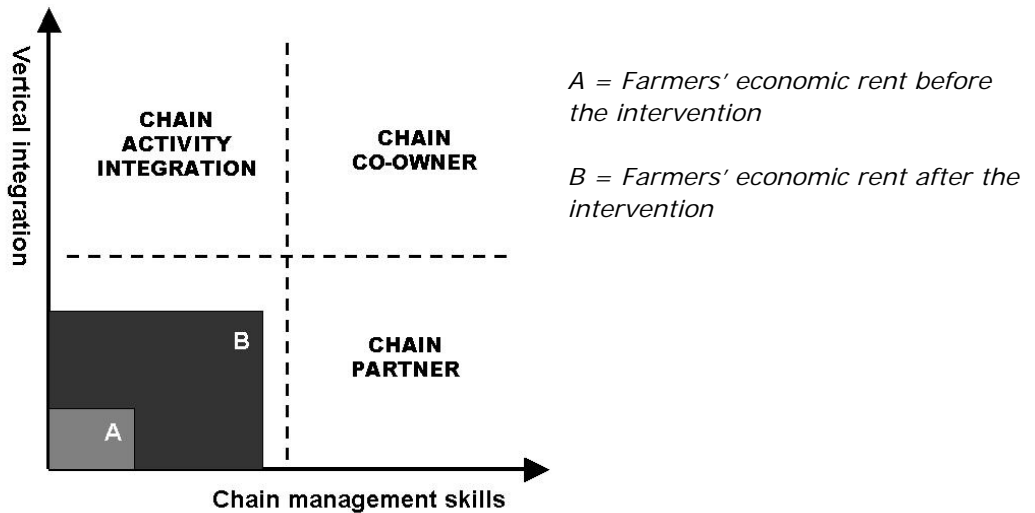
Figure 5: Monitoring farmers' positions in the value chain



As farmers take on new chain activities and enhance their chain management skills, they gain more control over the value chain, increase their economic rent, and appropriate a greater share of the returns accruing from the value chain. In other words, pro-poor value chain development can be visualized as a movement to the right and/or upwards in the matrix.

In Figure 6, 'Area B' minus 'Area A' represents the pro-poor impacts of an intervention in the value chain. Accordingly, we propose to monitor the impacts of pro-poor value chain development in terms of changes in farmers' involvement in chain activities and chain management.

Figure 6: Monitoring pro-poor impacts of value chain development



3 Quick-scan screening tool for pro-poor business propositions

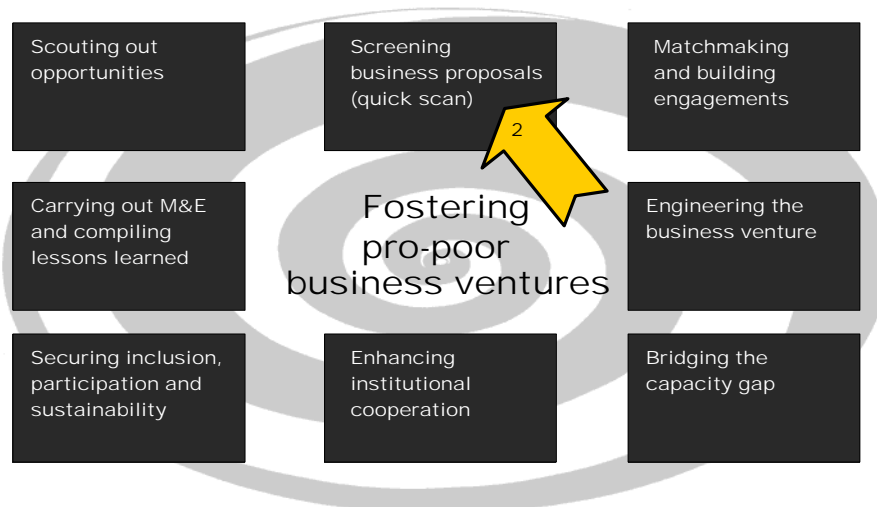
3.1 What are pro-poor business ventures?

The Royal Tropical Institute (KIT) engages with the private sector to address poverty in low-income countries. This cooperation aims at developing pro-poor business ventures: mediated business partnerships between companies in Europe and small enterprises or farmer organizations in developing countries, which are commercially viable yet support poverty alleviation.

3.2 Identifying viable business propositions

KIT has developed an eight-step approach to the development of pro-poor business ventures (Figure 1). The process starts with identifying and screening new business propositions - entrepreneurial ideas that later may be elaborated into bankable business proposals through partnership development and a feasibility study. Not every business proposition merits a detailed feasibility study: in view of costs and the need for efficiency, it is crucial to have a simple, quick and low-cost tool for identifying promising business propositions. KIT has developed a quick scan screening tool for this purpose. It can be found at the end of this document.

Figure 1: KIT's eight-step approach to pro-poor business ventures



3.3 Screening pro-poor business propositions

Pro-poor business ventures must satisfy two key criteria:

1. SUSTAINABILITY

Proposed business ventures are assessed in terms of their:

- Commercial viability and risk incurrence
- Contribution to poverty alleviation
- Impact on the environment

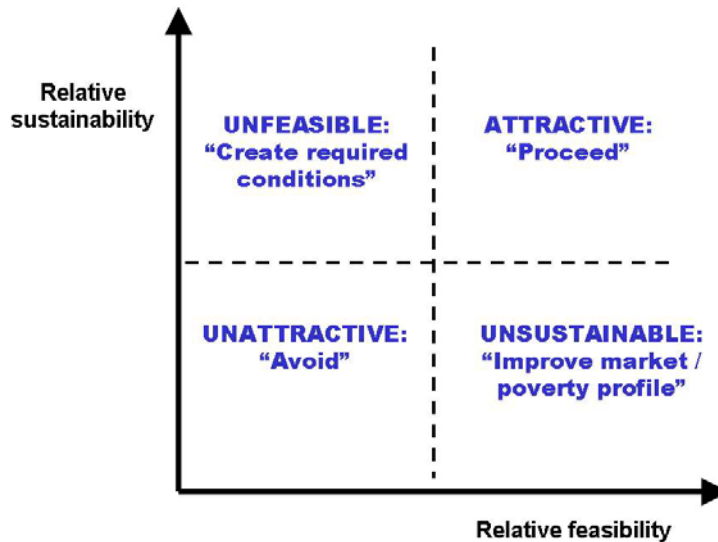
2. FEASIBILITY

Proposed business ventures are assessed in terms of:

- Available partnerships
- Available local capacities
- Available options for financing

These two factors, sustainability and feasibility, determine the overall attractiveness of a business proposition and form the basis for KIT's quick scan (Figure 2).

Figure 2: Quick scan for pro-poor business propositions



Four assessments are possible:

- 1 **ATTRACTIVE VENTURES:** These ventures combine high feasibility (good local conditions) with high sustainability (commercial viability and high development relevance). These proposals can be followed up with a more in-depth feasibility study, partnership development and business plan engineering.
- 2 **UNATTRACTIVE VENTURES:** These ventures score low on both scales and should be avoided.
- 3 **UNSUSTAINABLE VENTURES:** These ventures have high feasibility (good local conditions) but score low on sustainability (commercial viability or development relevance). They need to reformulate their target market or improve their way of reaching the poor in order to qualify for an in-depth feasibility study.
- 4 **UNFEASIBLE VENTURES:** These ventures have high market potential and development relevance, but they lack feasibility. To take the business proposition further, it is necessary to improve the local conditions by identifying a local service provider, seeking financing or building local capacity.

3.4 Quick-scan screening tool

To quickly assess the overall attractiveness of a pro-poor business proposition, KIT has developed a quick-scan screening tool. This tool consists of a questionnaire with 22 questions on the six key aspects of pro-poor business ventures (Box 1). Qualitative judgments and quantitative scores are attributed to each key aspect in the questionnaire, which is presented in Table 1 at the end of this document.

Box 1: Questions for the screening of pro-poor business ventures

- SUSTAINABILITY:**
- 1 Commercial viability: How viable is the business venture in terms of product attractiveness, market potential, customer demand, and competitive forces?
 - 2 Poverty relevance: What is the number of small and medium-size enterprises (SMEs) that can be reached? What changes can be expected in their situation thanks to this venture? What impact on social inclusion and gender equality is expected to result from this venture?
 - 3 Environmental impact: What are the expected impacts on the environment?
- FEASIBILITY:**
- 1 Local partnerships: What are the existing partnerships? What evidence of commitment is there?
 - 2 Local resources/capacities: Which local resources and capacities currently exist and which are lacking? What is the strategy to bridge the capacity gap?
 - 3 Funding arrangements: What investments are needed to set up the business venture (including capacity building)? Which public-private financing arrangements are available?

For each of the six key aspects, there is a maximum possible score of 40 points. These scores are transferred to the hexagon in Figure 3. An example of an assessed business proposition is shown in Figure 4 (fictitious scores). The hexagon clearly shows the areas where the business proposition needs further improvement. To reach a final assessment, the scores are tallied and imported into the matrix (Figures 5 and 6).

Figure 3: Scoring pro-poor business propositions (hexagon)

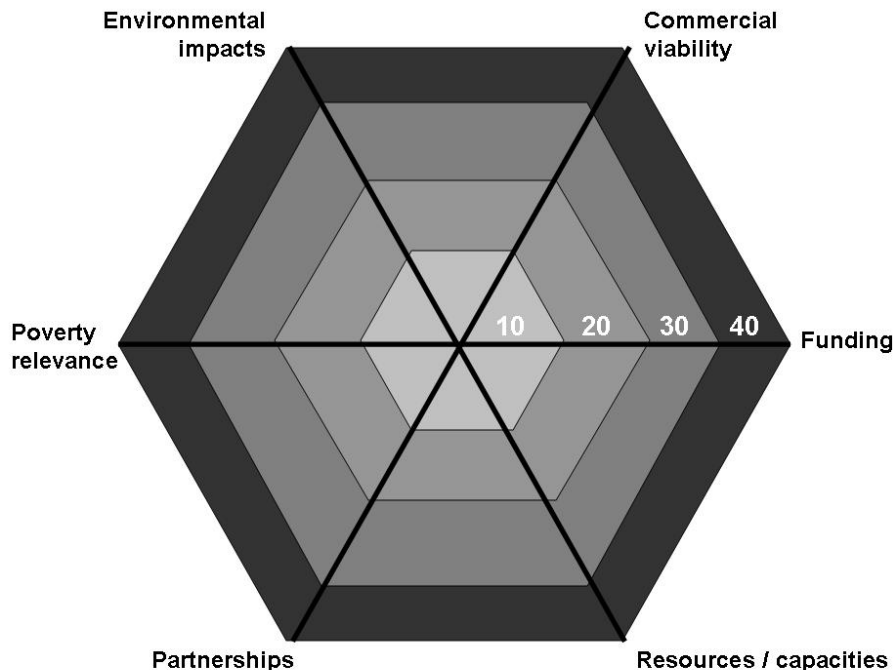


Figure 4: An example of an assessed business proposition (hexagon)

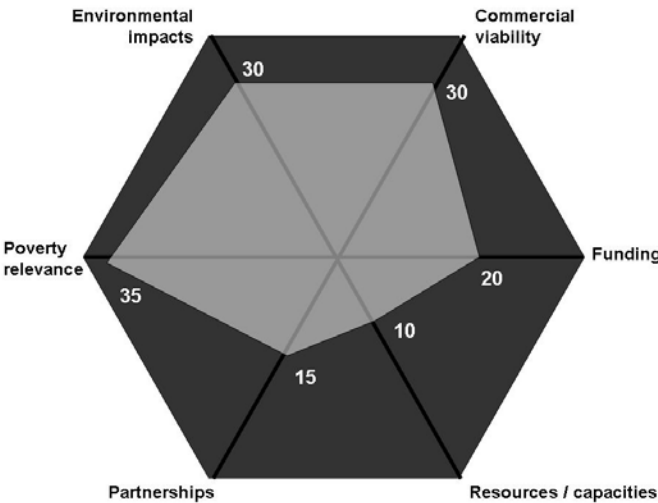


Figure 5: Scoring pro-poor business propositions (matrix)

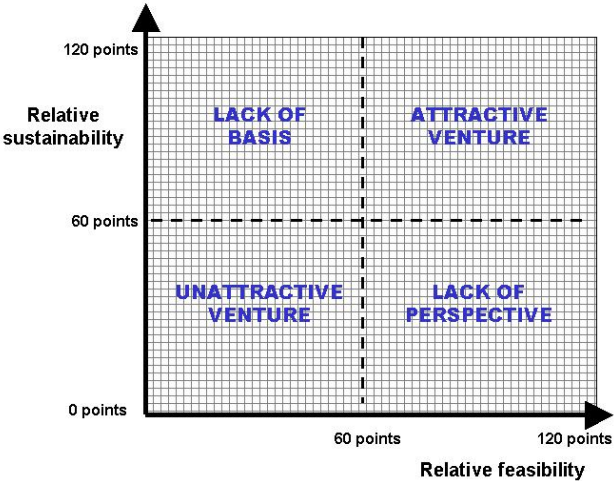
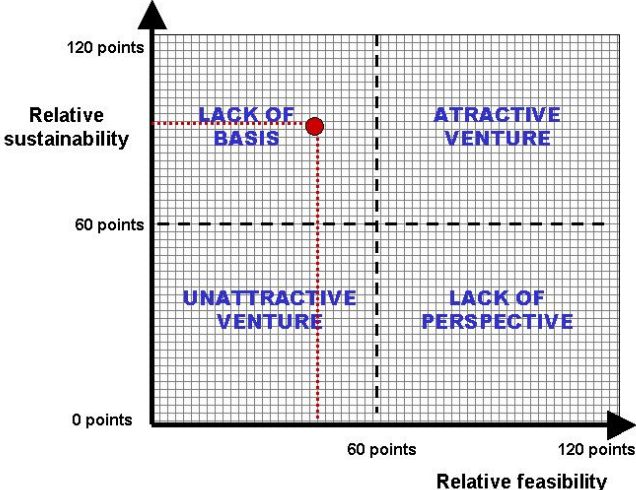


Figure 6: An example of an assessed business proposition (matrix)



Quick-scan screening tool for pro-poor business propositions

Criteria	Assessment			Total score
	Poor 0	Fair 5	Good 10	
SUSTAINABILITY (max. 120 points)				
Commercial viability (max. 40 points)				
The price-quality profile of the product is better than existing products / the product has unique selling points.				
The target market offers prospects for sustained growth, and there is an articulated market demand.				
Competitors have been identified and there is a strategy for dealing with them.				
In the event of failure, the business venture will not jeopardize the survival of the SMEs involved.				
Impact on poverty alleviation (max. 40 points)				
The outreach of the business is high: many farmers/SMEs will be involved and there is a potential for up-scaling.				
The farmers/SMEs will gain co-ownership of the business.				
There is a strategy for building the entrepreneurial capacities of farmers/SMEs.				
There is a strategy for sharing benefits with women, vulnerable groups, and the wider community.				
Impact on the environment (max. 40 points)				
The business will not negatively affect natural resources (e.g. land encroachment, loss of biodiversity, excess water use).				
The business will not interfere with ecological services (e.g. water catchment systems, erosion control)				
The business will be non-polluting (e.g. fertilizer, pesticides).				
The business will reduce the use of fossil fuels by reducing transportation requirements.				
FEASIBILITY (max. 120 points)				
Available partnerships (max. 40 points)				
Market agents have shown interest in a purchase agreement.				
Local service providers have shown interest in supporting the business proposition.				
Local financial agencies have shown interest in supporting the business proposition.				
The business proposition complies with local and national policies and laws.				
Available resources (max. 40 points)				
There is a plan to empower the farmers/SMEs as business partners.				
The skills and capacities of the business partners are described.				
There is a plan for bridging the capacity gap of farmers/SMEs and other business partners.				
The natural resources and infrastructure required for the business proposition are available.				
Funding arrangements (max. 40 points)				
The size of the required investment is described.				
The business partners are willing to invest.				
There is a mechanism for monitoring the use of the investments.				
Public agencies have shown interest in financing project assistance and the investment share of farmers/SMEs.				

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