



MAKING MARKETS WORK FOR THE POOR

EXECUTIVE SUMMARY

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The Third Wave

AN INTRODUCTION TO MAKING MARKETS WORK FOR THE POOR

International development programs in the last six decades can be understood as rolling out in two distinct waves, each with its own advantages and limitations. The first consisted of individual charitable contributions from people whose compassion for those in the developing world inspired a personal response. This first wave resulted in a multitude of successful small-scale projects, and fostered a sense of personal involvement in donors. Yet despite growing numbers of voluntary donations, resources mustered in the first wave of development were inadequate to address the multitude and magnitude of problems faced by communities in developing countries.

The second wave of development worked to boost the effectiveness of aid programs by involving state and multilateral institutions channelling tax resources from the developed world into large-scale poverty-reduction initiatives in developing countries. While this wave launched a number of programs with significant macroeconomic impact, it proved susceptible to shifting political priorities, and was often restricted to programs that favoured tied aid—a politically defensible but notoriously ineffective constraint obliging aid agencies to spend their funds in ways to benefit the donor state first.

The third wave of international development—now upon us—stems from the success of innovative projects that propelled the transition of micro-credit banks from development institutions into regulated organizations in the private sector. This wave seeks to harness latent entrepreneurship in the developing world, and to do so addresses the two structural problems that plague developing economies—the informal sector and the missing middle.

STRENGTHENING THE INFORMAL SECTOR

In many countries, the cost of doing business is prohibitively high, reflected in a punitive regulatory environment which saps the initiative of even the most industrious of local entrepreneurs. As a result, informal enterprises—often quietly employing family and friends—tend to operate under the radar of local legislation. Then, lacking official recognition, they are unable to access traditional, formal sources of financing,

or to sell equipment and property, or even seek investment partners when they are ready to grow.

This reality has far-reaching consequences; when the informal sector in a country is large, national tax revenues are reduced and government capacity is diminished. As a corollary, the informal sector in developing countries is also characterized by a missing middle—the relative absence of small- and medium-sized enterprises as opposed to individual entrepreneurs or family farms. This scarcity has considerable impact; small- and medium-sized enterprises tend to be more innovative and labour intensive than their larger competitors, and consequently play a crucial role in any national economy. They provide employment, and are the well-known engine of local development, ensuring both the stability and international competitiveness of domestic industry. In the developed world, small- and medium-sized enterprises receive government assistance: this is seldom the case in developing countries.

A RADICAL NEW APPROACH

Building on extensive experience gained working with the poor, CARE has been planning and implementing a third-wave approach for several years, and has already witnessed encouraging successes: in Kenya, farmers organized into small companies have successfully entered the export market and seen incomes climb; in Honduras, small-scale coffee producers now export their beans through a Canadian coffee company and practice socially responsible trade; in Bosnia, businesspeople given access to start-up capital have rebuilt their businesses and their lives after war in a way which leads to financial integration.

From these lessons CARE has developed an understanding of the barriers to entrepreneurship prevalent in the developing world. Simply put, lack of access to capital, inhibiting regulatory environments and negative market conditions encourage entrepreneurs to operate informally and at the same time prevent their businesses from growing.

This paper presents three strategies that target these underlying constraints and provide alternative approaches that introduce and integrate the poor into efficient, functioning markets. By working with portal companies, incubating pro-poor enterprises and pursuing bottom-of-the-pyramid opportunities, CARE will help ensure that private-sector investment produces beneficial social outcomes for the very poor.

These three projects complement CIDA's current priorities as outlined in *Expanding Opportunities through Private Sector Development*. In particular, the proposed pilot projects represent innovative strategies to increase incomes of the very poor, improve productive capacities, support sustainable enterprise expansion, build public/private sector partnerships and expand the role played by developing countries in international and regional markets.

These strategies also respond directly to the recent report of the United Nations Development Programme titled *Unleashing Entrepreneurship: Making Business Work for the Poor*. That report urged NGOs, governments and private enterprises to set free local businesses in developing countries as a way to eradicate poverty. *Making Markets Work for the Poor* is our innovative strategy for pursuing private-sector development—the long-awaited third wave of international development.



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