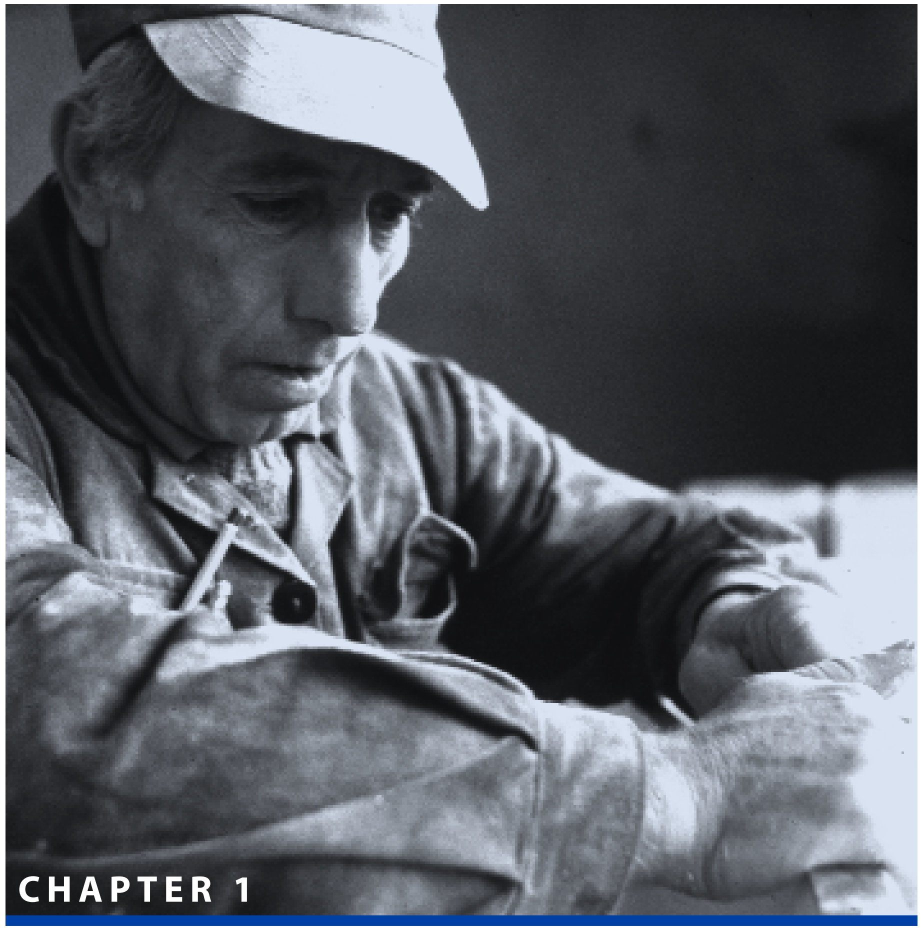
Photo: Boris Missirkov



CHAPTER 1

WHY THE PRIVATE SECTOR IS SO IMPORTANT IN ALLEVIATING POVERTY

This report is about walking into the poorest village on market day and seeing entrepreneurs at work. It is about realizing that the poor entrepreneur is as important a part of the private sector as the multinational corporation. It is about acknowledging that the private sector is already central to the lives of the poor and has the power to make those lives better. It is about using the managerial, organizational and technological innovation that resides in the private sector to improve the lives of the poor. It is about unleashing the power of local entrepreneurs to reduce poverty in their communities and nations.

The Millennium Development Goals, ambitious in scale and scope, can be achieved only through committed application of best knowledge and practice. The problem is huge, with a fifth of the planet's people living on less than $1 a day. But some encouraging examples show how private enterprise can alleviate poverty. Consider garment exports in Bangladesh, information technology in Costa Rica and cut flowers in Kenya—new industries creating jobs, boosting incomes, lifting hopes. And consider the following successes, ranging from modern multinationals to domestic entrepreneurs, demonstrating the potential of private return to boost development.

- Cemex, the Mexican cement firm, has become one of the world's leading producers and innovators in the industry, employing thousands.
- Casas Bahia in Brazil has developed a unique business model providing efficient retail services aimed at poorer customers.
- Infosys, an Indian information technology services firm, grew from less than $10 million in sales in the early 1990s to become a leading global player with almost $800 million in sales today. Along the way, it has also been setting international standards for corporate governance and creating a new partnership for development with local and central government.
- ICICI Bank, also in India, is applying technology and a comprehensive approach to the full range of its client base—particularly in rural markets and to small and medium enterprises and microentrepreneurs.
- In Cambodia hundreds of small private providers offer services ranging from battery recharging to fully metered electricity provision for entire communities. These providers now serve an estimated 115,000 customers—more than one-third of electricity customers nationwide.
- Fierce competition between private locally owned mobile phone companies in Somalia has driven costs on international phone calls to less than $1 a minute, about a sixth that in many other African countries. This, in a country where there is no official banking or postal system and where many do not have regular running water or electricity.
- In Guatemala the Confederation of Agricultural Cooperatives formed a joint venture with a Canadian firm. The enterprise now exports vegetables worth more than $3 million a year to Canada, providing steady income for 100 indigenous women and supporting more than 1,000 farmers.
- In Mozambique a farmer bought an oilseed press on credit. Now as the owner of four presses, he has organized nine other press operators into a small cooperative association, bargaining with local banks and customers as a group.
- In India small-scale soybean farmers use a village Internet kiosk to check spot prices for their products on the Chicago Board of Trade's website, bypassing local intermediaries and getting better prices.

These examples are not just success stories—they are stories about the successes of the domestic private sector. They are what this report is about. But moving from example to broad achievement requires thinking freshly about development, unconstrained by ideology, unhinged from tired debate.

DEEP POVERTY REMAINS INTRACTABLE

Despite great progress in some countries and regions, deep poverty remains a stubborn and intractable problem across much of the world. Substantial gains in some countries have been accompanied by deep losses in others, and far too many people still earn less than $1 a day, suffer from hunger and lack access to water, sanitation and energy. The latest *Human Development Report* of the United Nations Development Programme reports that the proportion of people in extreme poverty fell to 23.2% in 1999 from 29.6% in 1990. But the number of people living on $1 a day slipped only to 1.17 billion from 1.29 billion a decade earlier. Moreover, if the dramatic improvement in China's poverty indicators is excluded, the number of people living in absolute poverty actually increased.

In recent years poverty alleviation has moved to the centre of the global dialogue as the primary overriding objective of development—not a derived outcome. The Millennium Declaration was an unprecedented expression of solidarity and determination to rid the world of poverty, committing countries, rich and poor, to eradicate poverty, promote human dignity and equality and achieve peace and environmental sustainability. It led to agreement on the Millennium Development Goals (box 1.1).

Yet progress is more than possible—and it occurs with regularity under the right conditions. Economic growth has lifted hundreds of millions of people out of subsistence agriculture into manufacturing and service employment, increasing wealth and reducing poverty. Witness the

BOX 1.1 THE MILLENNIUM DEVELOPMENT GOALS

1. Eradicate extreme poverty and hunger: reduce by half the proportion of people living on less than $1 a day; reduce by half the proportion of people who suffer from hunger.

2. Achieve universal primary education: ensure that all boys and girls complete a full course of primary schooling.

3. Promote gender equality and empower women: eliminate gender disparity in primary and secondary education by 2005, and at all levels of education by 2015.

4. Reduce child mortality: reduce by two-thirds the mortality rate for children under five.

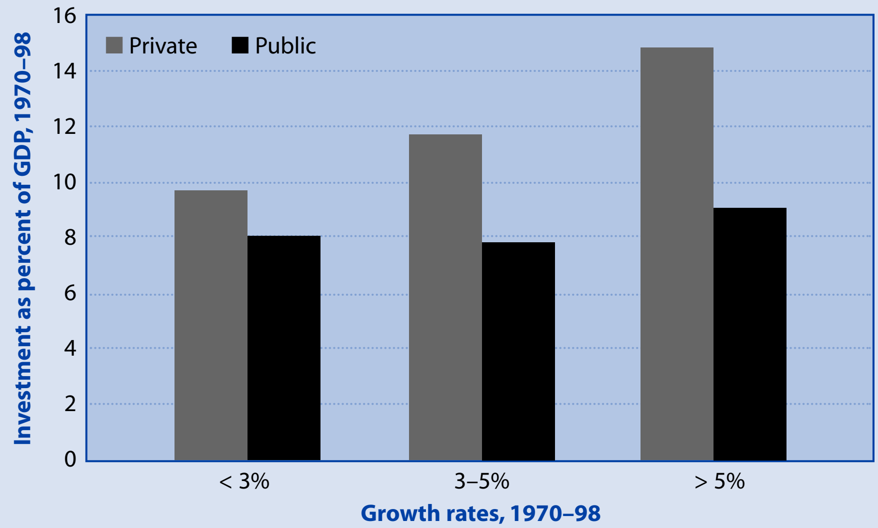
5. Improve maternal health: reduce by three-quarters the maternal mortality ratio.

6. Combat HIV/AIDS, malaria and other diseases: halt and begin to reverse the spread of HIV/AIDS; halt and begin to reverse the incidence of malaria and other major diseases.

7. Ensure environmental sustainability: integrate the principles of sustainable development into country policies and programmes; reverse the loss of environmental resources; reduce by half the proportion of people without sustainable access to safe drinking water and basic sanitation; achieve significant improvement in the lives of at least 100 million slum dwellers by 2020.

8. Develop a global partnership for development.

FIGURE 1.1 MORE INVESTMENT—MORE GROWTH



Source: Bouton and Sumilinski (2000)

dramatic improvement in the living standards in East Asian countries, including Indonesia, The Republic of Korea, Malaysia and Thailand, and the sizable reduction in the number of people in poverty in China.

The impact of economic growth, overall, on poverty depends on a range of factors that influence the nature of this growth, but the empirical evidence is compelling. In East Asia and the Pacific, the region with the strongest growth in the 1990s, annual per capita GDP growth of 6.4% resulted in a 15% decline in the rate of poverty (using the $2 a day criterion), and in South Asia 3.3% annual growth led to an 8.4% decline. In contrast, the slow growth of 1.6% in Latin America and the Caribbean and 1.0% in the Middle East and North Africa caused a marginal deterioration in poverty rates. More dramatically, negative growth rates increased poverty rates by 1.6% in Sub-Saharan Africa and 13.5% in Europe and Central Asia.

The message is clear: sustained economic growth reduces poverty. The link is equally clear between economic growth and strong private investment. A study of 50 developing countries from 1970 to 1998 examined the relationship between private and public investment and growth and incomes. Countries with higher growth featured higher private investment (figure 1.1).

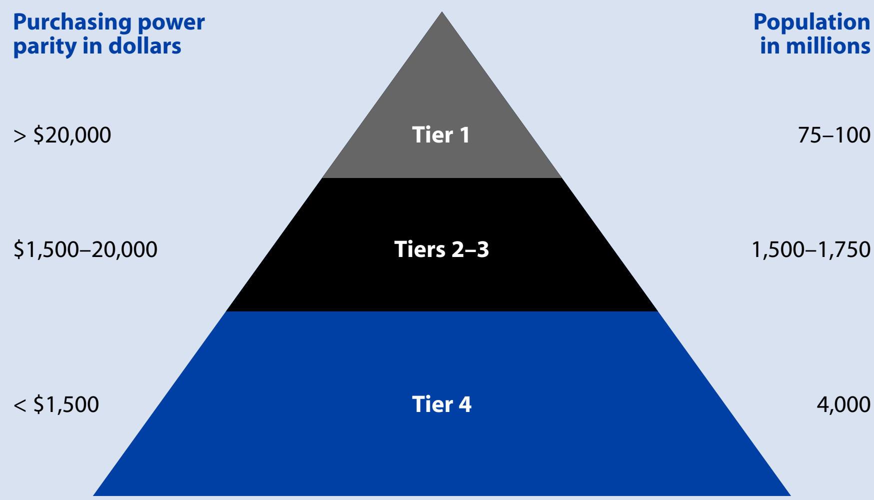
But for output growth to contribute to poverty alleviation, it must translate into incomes of the poor. For wage labourers and salaried workers, the quantity of employment and the rate of pay are crucial. For the self-employed, productivity and returns are important, influenced by technology, inputs and prices. Employment is thus the key link between output growth and poverty alleviation.

THE PRIVATE SECTOR IS IMPORTANT FOR THE POOR—AND OFTEN IS THE POOR

The private sector is central to the lives of the poor. First, all poor people are consumers. Across the world the story is the same—poor consumers pay more than rich consumers for basic services. In Mumbai, slum-dwellers in Dharavi pay 1.2 times more for rice, 10 times more for medicine and 3.5 times more for water than do middle class people living at the other end of the city on Bhulabhai Desai Road.

Fully 4 billion people in the world—those who earn less than $1,500 a year—make up the "bottom of the pyramid" markets (figure 1.2).

FIGURE 1.2 **FOUR BILLION PEOPLE AT THE BOTTOM OF THE PYRAMID**



Source: Prahalad and Hammond (2002)

The quality of goods that poor people purchase—whether food, water or financial services—is almost always substandard. Often, an informal private sector fills the gaps with goods of higher prices and varying quality. It serves an important need, for informal economies sustain the majority of poor families in many countries. Yet the advantages of economies of scale and scope are missing from the lives of people at the bottom of the pyramid. Some of the barriers are poor marketing and poor distribution.

The private sector is already meeting the needs of poor people in places governments do not reach. In some countries, for example, the government has little impact on the poor. In the slums there are no health services, no public education and no infrastructure. This story repeats itself across the developing world. In many cases, where services exist, they are provided by private sources. Anywhere from 15% to 90% of primary education is provided in private schools. Some 63% of health care expenditures in the poorest countries are private, almost twice the 33% in high income countries that belong to the Organisation for Economic Co-operation and Development.

With the right attention and regulatory requirements, privately provided services can help meet the needs of poor people. Recent data on the distribution of new water connections by income quintile from three countries in Latin America show that 25–30% of the network expansion was targeted at the lowest fifth of the income profile.

Put simply, an innovative private sector can find ways to deliver low-cost (even sophisticated) goods and services to demanding consumers across all income ranges. It can sell to the urban distressed area as well as the poor rural village or town. It can develop distribution links to the consumer in the village and so be better able to harness knowledge about the actual needs of this segment of the market. It can keep costs low through outsourcing, for greater flexibility.

The private sector can thus alleviate poverty by:

- Contributing to economic growth.
- Empowering poor people by providing them with services and consumer products, increasing choices and reducing prices.

The first creates employment and income growth. The second improves the quality of life for the poor. And the greater interaction between those at the base of the pyramid and the private sector creates opportunities for direct involvement in the market economy.

WHO ARE ALL THE ENTREPRENEURS?

The Commission takes an expansive view of the private sector. Large companies are a vital part of the private economy, but the poor are an equally important part. They are often entrepreneurs themselves—frequently of necessity, operating informally, trapped in subscale enterprises. We endorse the view that market-oriented business ecosystems comprise many forms of private enterprise coexisting in a symbiotic relationship. The ecosystem generally includes multinational corporations, large domestic companies, cooperatives, small and medium enterprises and microenterprises, with formal and informal players. It thus encompasses the farmer in the field as much as the multinational company.

Agriculture is of particular interest because 75% of the people living on less than $1 a day are in rural areas, with livelihoods dependent on mostly subsistence production. In Africa agriculture supports more than 70% of the population, contributing an average of 30% of GDP. Providing inputs to the agricultural sector and the value added processing and marketing of agricultural goods are important parts of private sector development. The critical importance of agriculture in alleviating poverty reinforces the need for urgent progress on eliminating subsidies for producers in developed markets, and on trade reform.

In many developing countries, women constitute the majority of microentrepreneurs in the informal economy and a significant percentage of the formal sector. Many of them are illiterate and live in poor rural communities. And setting up their own enterprises—generally microenterprises—is usually the only possibility for them to be employed and earn an income on their own. In Latin America and the Caribbean between 25% and 35% of formal sector micro-enterprises and small and medium enterprises are owned and operated by women. In the Philippines women own 44% of the microenterprises, more than 80% in rural areas. In Zimbabwe women run the majority of microenterprises and small enterprises (67%), while enterprises run by men tend to provide proportionally more of the household income and have more employees.

Entrepreneurship exists in large companies, where individual executives take the initiative to innovate and expand the business. This report highlights many instances of large companies that have targeted bottom-of-the-pyramid markets and developed products and processes to serve the poor profitably or to operate sustainably in very challenging environments. Entrepreneurship by individual engineers and executives is often at the root of such moves by big corporations, which can have a major positive impact on development.

Entrepreneurship also drives many civil society organizations, and it exists in government and public administrations. Individuals in these organizations have the drive to innovate and pursue opportunities with the passion and dedication of an entrepreneur, albeit with little if any pecuniary reward.

Entrepreneurship flourishes perhaps most in small and medium firms with significant potential to grow and innovate. This dynamic segment is typically the hotbed of entrepreneurship and innovation. It can drive economic growth, create jobs and foster competition, innovation and productivity.

A FOCUS ON THE DOMESTIC PRIVATE SECTOR

We focus here on the domestic private sector—for three main reasons. First, domestic resources are much larger than actual or potential external resources. Domestic private investment averaged 10–12% of GDP in the 1990s, compared with 7% for domestic public investment and 2–5% for foreign direct investment (FDI). Second, when informal resources are examined, such as the potential value of land, the domestic assets that can be tapped are significantly larger than the cumulative FDI or private portfolio flows. Third, unleashing the domestic resources in an economy—both financial and entrepreneurial—is likely to create a more stable and sustainable pattern of growth.

Estimates of the informal assets in developing countries range as high as $9.4 trillion, many multiples of cumulative portfolio flows or of FDI flows to developing countries over the past 15 years. These comparisons are illustrative only, comparing flows and stocks of assets.

Converting informal assets into financial resources will require a broad programme of reform that will enable these assets to be used as collateral in the banking system. But keep in mind the size of these assets. Recent work in Egypt, for example, concludes that the country has a large and vibrant extra-legal economy that employs over 8 million people (about 40% of the workforce) and has assets of almost $250 billion, 30 times the market value of all companies registered on the Cairo Stock Exchange.

This focus on the domestic private sector does not diminish the importance of FDI. Beyond the financial resources that FDI brings, its infusion of a corporate culture can change the way business is done, bring managerial know-how and best practices, provide access to international markets, transfer technology and innovation, introduce competitive pressures in previously closed markets and be the principal driver for the growth of local business. In these situations, FDI can improve the overall investment climate.