Policy Note on the Business Environment for Inclusive Business Models

International Finance Corporation
World Bank Group

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Executive Summary

The G20 Challenge on Inclusive Business Innovation sought to recognize businesses with innovative, scalable, replicable and commercially viable ways of reaching low-income people in developing countries (box 1). The 15 winners of the G20 Challenge show how the private sector contributes to development through inclusive business models.

By integrating the base of the pyramid in the value chain, inclusive business models help underserved populations become market players and give them access to basic goods and services and livelihood opportunities. Inclusive business models respond to market demand. They are driven by profits and financially sustainable. Companies with inclusive business models make no tradeoffs between integrating the base of the pyramid in the value chain and making profits.

Until recently the literature on inclusive business has focused on social entrepreneurs, which tend to run smaller companies and are often startups. But the focus is shifting to more established companies with inclusive business because they provide innovative solutions that sustainably reach many people at the base of the pyramid. Showcasing these homegrown businesses—generally in medium-size and large domestic companies—was the goal of the G20 Challenge.

This note first analyzes survey answers from the G20 Challenge applicants on the regulatory obstacles they face in their businesses. It then summarizes how public policy can support business models that include people at the base of the pyramid as producers or suppliers (focusing on agriculture) and as customers (focusing on affordable housing, health, education and basic financial services). These sectors were chosen because most applicants from the G20 Challenge operate in one of them. Finally, the note offers recommendations on how governments, development finance institutions and donors can support companies with inclusive business models.

Government can support inclusive business models and the policy environment for them by:

- Supporting public goods and investments in basic infrastructure such as roads, telecommunications and electricity. In some cases more active support is needed, such as for early market entrants. This support should be targeted and minimize market distortions.
- Improving the business environment by reforming regulation, reducing bureaucracy and engaging in public-private dialogue. Such efforts might require rethinking policies that are well intended but stifle innovation.
- Reviewing sector-specific hurdles to inclusive business models and learning from other countries.
- Collecting and disseminating reliable data. Government can help identify research on base of the pyramid markets that can lead to more companies reaching the base or expanding opportunities for companies working in these markets.
- Increasing access to finance throughout the value chain—identified as a priority in responses from G20 Challenge applicants.

BOX 1: G20 CHALLENGE ON INCLUSIVE BUSINESS INNOVATION

The G20 Challenge on Inclusive Business Innovation was a global competition seeking to recognize businesses with innovative, scalable, replicable and commercially viable ways of reaching low-income people in developing countries. The competition was launched during the G20 Summit in Cannes, France, in November 2011.

Between November 2011 and February 2012, 167 applications were received from businesses in 72 countries. Judges chose 15 winners, announced during the G20 Summit in Los Cabos, Mexico, in June 2012. Winners were selected based on their financial sustainability, development results, innovation, potential for growth and social and environmental sustainability.

Source: http://www.g20challenge.com.

BOP – The base of the pyramid are people living on less than $8 a day in purchasing power parity (PPP) terms or who lack access to basic goods and services.

Development finance institutions and donors can support inclusive business models and the policy environment for them by:

- Using global or regional knowledge to facilitate knowledge transfers and share best practices.
- Helping governments create and implement policies conducive to inclusive business, based on policies in other countries that can be adapted to different contexts.
- Bringing together private, public and nongovernmental partners to foster value chain development for inclusive business models.
- Building capacity to ensure that inclusive business models are commercially viable, environmentally and socially sustainable, and replicable. Donors can build capacity through technical assistance or funding, including matching grants.
- Providing financing for pilot initiatives in companies with inclusive business models, enabling donors to help companies better understand the base of the pyramid.
- Financing companies with inclusive business models with loans or equity from development finance institutions.

WHY THIS NOTE?

This policy note has 2 goals. First, to assess whether inclusive business models face specific regulatory hurdles. Second, to recommend policies that create a business environment conducive to inclusive business.

Little research has been conducted on the first goal. This note analyzes survey answers from companies that applied to the G20 Challenge. These companies were asked to rank regulatory obstacles and explain whether these obstacles created significant hurdles to their ability to serve the base of the pyramid. On the second goal, this note highlights policy recommendations for governments, development finance institutions and donors. It also includes policy measures specific to countries and contexts. Some policy measures address regulatory hurdles for inclusive business models. Others support inclusive business models by providing incentives when needed.

The first section analyzes survey answers from the 167 applicants for the G20 Challenge. The starting point was to listen to businesses—a logical place to begin when seeking to improve the business environment.

The second section describes policy measures for business models that include the base of the pyramid as producers or suppliers, focusing on agriculture. Businesses that source from small farmers have inclusive business models because they integrate farmers in their value chains. Small farmers are often considered base of the pyramid if their income is low or they lack basic goods or services.

The third section describes policy measures for business models that include the base of the pyramid as customers—particularly models that provide affordable housing, health, education and basic financial services. In many countries basic services are still mainly provided by the public sector or recently privatized companies—and more stringent regulations often apply. This section describes regulations and policies that affect inclusive business models in these sectors.

The fourth section describes roles for governments, development finance institutions and donors in supporting inclusive business models. The business environment is important because companies that do business with the base of the pyramid need to understand new markets, understand the market behavior of base of the pyramid customers, apprise new risks and develop new systems, business processes and training. Companies with inclusive business models also face perceptions from investors and lending institutions that the base of the pyramid is riskier than other markets.

The G20 Challenge on Inclusive Business Innovation

WHAT ARE INCLUSIVE BUSINESS MODELS?

The G20 Challenge defined inclusive business as a private sector approach to providing goods, services, and livelihoods on a commercially viable basis, either at scale or scalable, to people at the base of the pyramid by making them part of the value chain of companies' core business as suppliers, distributors, retailers, or customers.[1]

Companies that do inclusive business have developed different business models to integrate the base of the pyramid in the value chain and to turn underserved populations into market players. Inclusive business models can expand access to goods, services and livelihood opportunities to the 4 billion people at the base of the pyramid.[2] Given their importance for development, inclusive business models are becoming an area a focus for governments, development finance institutions and donors.

Inclusive business models are part of established, commercially viable companies, typically in developing countries. Inclusive business models are not limited to a type or size of business. Small and medium-size enterprises (SMEs), domestic companies of all sizes and even multinational corporations operating in developing countries can have inclusive business models.

They are profit driven and financially sustainable. Companies with inclusive business models make no tradeoffs between integrating the base of the pyramid in the value chain and making profits. This differentiates inclusive business models from social entrepreneurs and is what makes these companies innovative.

WINNERS OF THE G20 CHALLENGE

The G20 Challenge sought to recognize inclusive business models that stand out for their financial sustainability, development results, innovation, potential for growth and social and environment sustainability.

The most innovative models are the result of creativity and business discipline that enabled the integration of the base of the pyramid in their value chains. The 4 main features of innovation are building the capacity of the base of the pyramid, financing the base of the pyramid, adapting products for the base of the pyramid and distributing goods and services to the base of the pyramid (box 2). The 15 winners of the G20 Challenge combine these innovation features.

The G20 Challenge winners are homegrown and financially sustainable companies in various sectors, including agriculture, affordable housing, health, education, water utilities, supply chain finance and retail. The 15 winning companies provide basic goods and services to the base of the pyramid, source from small farmers or distribute their goods through poor people without active government support.

BOX 2: COMMON INNOVATION FEATURES IN INCLUSIVE BUSINESS MODELS

Building the capacity of producers, suppliers, distributors, retailers or customers at the base of the pyramid. For example, by teaching small farmers how to increase productivity, educating potential customers about the value of basic products and providing tools to enable distributors and retailers to better meet the needs of such customers.

Financing producers, suppliers, distributors, retailers and customers at the base of the pyramid. For example, by allowing small farmers or customers to pay in installments, giving small farmers inputs such as seeds, giving in-kind credit to small farmers and customers, providing retailers with credit for business improvements, working with financial institutions to make loans and making products more affordable.

Adapting or creating products for the base of the pyramid. For example, by adapting product sizes, mixes and delivery schedules to meet the needs of retailers with capital and capacity constraints and designing products for the base of the pyramid that maximize access and value (such as curriculums that emphasize developing employable skills and provide flexible hours to working students).

Using distribution approaches to reach the base of the pyramid. For example, by strengthening networks of small retailers that already reach the base of the pyramid to distribute products and services, using technology to offer education or financial services in remote areas.

Source: IFC. 2011. "Accelerating Inclusive Business Opportunities, Business Models that Make a Difference." Washington, DC.

1 http://www.g20challenge.com

2 WRI (World Resource Institute) and IFC (International Finance Corporation). 2008. "The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid." Washington, DC.

BOX 3: QUESTIONS FROM THE G20 CHALLENGE APPLICATION FORM

QUESTION 1: Please order the obstacles below that create a hurdle to your business, using a 1-8 scale based on how much of a hurdle the obstacle represents to your business. "1" represents the biggest hurdle to your business, while "8" represents a less serious constraint. Please feel free to add and order obstacle(s) in the spaces provided:

- ☐ Tariffs and taxes (VAT or equivalent, corporate income tax, other taxes)
- ☐ Obtaining required permits
- ☐ Labor regulations
- ☐ Access to finance
- ☐ Debt recovery through courts (judicial action)
- ☐ Intellectual property protection
- ☐ Other:
- ☐ Other:

QUESTION 2: Do any of these obstacles create a significant hurdle to your ability to include the BOP in your value chain, either as suppliers, distributors, retailers, or customers?

☐ Yes ☐ No

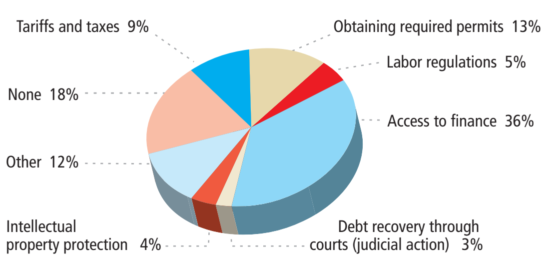
If you answered yes, please explain how these obstacles are specific to your inclusive business model:

QUESTION 3: Is there a government program or are there special government incentives (e.g., tax breaks, subsidies to your business or to your customers such as low rate mortgages to low-income people, low interest loans for agricultural improvements, low energy tariffs for low-income people, etc.) that support your inclusive business model?

☐ Yes ☐ No

If you answered yes, please briefly describe the program or the incentives and their importance to your inclusive business model.

Obstacles creating biggest hurdle to inclusive business



These companies show what the private sector can do to provide economic opportunities for poor people and help provide basic goods and services that have not been addressed by the public sector. These 15 winners serve more than 40 million people at the base of the pyramid in more than 10 countries. In addition, a number of other applicants demonstrated promising inclusive business models. Together these inclusive businesses highlight the importance of creativity and business skills in coping with the difficult business environment at the base of the pyramid. They also indicate that many more people at the base of the pyramid could be reached through inclusive business models if more models were replicated and if the business environment improved.

THE BUSINESS ENVIRONMENT FROM THE PERSPECTIVE OF G20 CHALLENGE APPLICANTS

Methodology

The G20 Challenge asked applicants 3 policy questions (box 3). The first asked businesses to rank regulatory obstacles. Six obstacles on the application covered tariffs and taxes, permits, labor regulations, access to finance, debt recovery through courts and intellectual property protection. Applicants could add 2 other obstacles. The second question asked whether these obstacles represented hurdles to their ability to include the base of the pyramid in their value chains to assess whether the obstacles the applicants had identified were perceived as being specific to inclusive businesses. The third question was about government programs and incentives that support applicants' businesses.

Obstacles for companies with inclusive business models

About 90% of the 167 applicants said that access to finance was one of the main obstacles to their businesses. It was considered the biggest obstacle by 36% of the firms surveyed.[3] About half added other obstacles and ranked them as significant. Among the most common were poor infrastructure and lack of qualified labor.

3 Followed by obtaining permits (listed by 13% of applicants as the biggest hurdle) and tariffs and taxes (9%). Intellectual property protection, labor regulations and debt recovery were listed as constraints, but were usually ranked as less significant constraints.

Are the obstacles specific to inclusive business models?

Just under half of the applicants indicated that the obstacles they selected or added undermine their ability to include the base of the pyramid in their value chains. Slightly more than half indicated that the obstacles might be significant but do not represent hurdles to their ability to include the base of the pyramid in their value chains.

Among the 78 businesses that said regulatory obstacles affect their ability to include the base of the pyramid in their value chains, half operate in agriculture and half in the other sectors surveyed, including retail, housing, health and education. Of the latter, 32 said that access to finance has the biggest effect on their ability to break even, achieve scale and reach more individuals at the base of the pyramid.

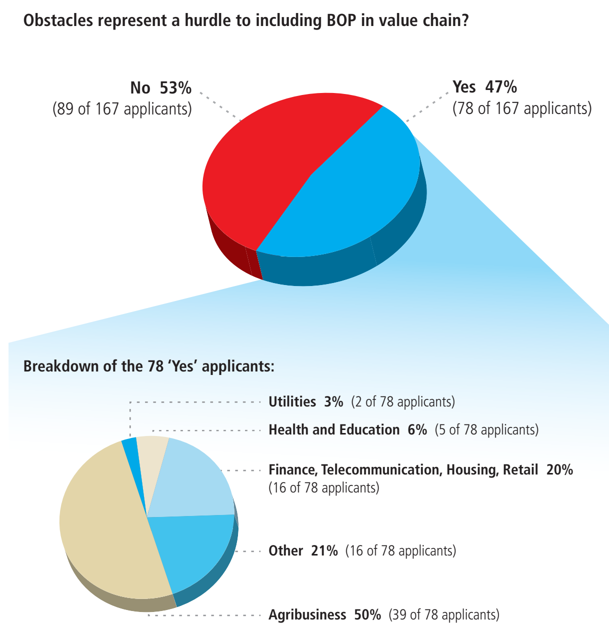
Some survey answers on access to finance were sector specific and mentioned regulation. For agriculture, restrictions on long-term loans do not always match the needs of farming production. Most responses did not explain whether access to finance is an issue because banks systematically exclude them or the businesses are not sustainable to qualify for commercial financing. But several applicants said that high interest rates and collateral requirements make it difficult to increase profits, sell to the base of the pyramid and provide credit.

Some applicants referred to the need to increase access to finance for customers at the base of the pyramid—for example, by making microfinance more widely available or by not being stuck in the "missing middle" between small loans provided by microfinance institutions and larger loans provided by more formal financial institutions. One respondent refers to banks as perceiving the base of the pyramid market as being more risky.

Although most G20 Challenge applicants had received commercial financing, their responses suggest that access to finance is a priority area for inclusive business models because:

- Lenders lack sufficient information on borrower creditworthiness.
- Lenders consider inclusive businesses riskier.
- The business case of some borrowers with an inclusive business model is not strong enough to qualify for commercial financing.

The following sections describe measures that can help address these factors.



Policies to Support Inclusive Business Models that Integrate Producers or Suppliers at the Base of the Pyramid

Companies that source from producers at the base of the pyramid integrate them into their value chains. This section focuses on agriculture because 38% of the G20 Challenge applicants are active in it. Agribusinesses in developing countries often source from small farmers considered at the base of the pyramid if their incomes are low or they lack access to basic goods or services in rural areas.

Three-quarters of the world's poor people live in rural areas—and more than four-fifths of them depend on agriculture for their livelihoods.[4] Connecting small farmers as suppliers to the value chains of companies can create economic opportunities for the farmers and companies. But it also creates challenges, such as providing financing and building capacity for farmers that makes them more productive and reliable. Financing can also raise farm incomes because globally, farmers operate at only 40% productivity.[5]

Some agribusinesses provide financing and capacity building—such as extension services—to farmers. Others partner with other stakeholders, including nongovernmental organizations (NGOs) or public agencies. To support inclusive agribusinesses, governments can implement regulations that make agricultural markets more efficient. Governments can also help small farmers organize into associations and cooperatives, enabling them to strengthen their market positions, access inputs, training or financing, and work better with larger agribusinesses.

CREATING REGULATIONS FOR INCLUSIVE AGRIBUSINESSES

Developing policies to support inclusive agribusinesses

Some governments have explicit policies supporting inclusive agribusiness. In 2010 Ecuador launched a 4-year Program for Rural Inclusive Business (PRONERI). It encourages small producers and inclusive agribusinesses by improving market access, financial services, technology transfer, irrigation and organizations (particularly rural associations and cooperatives).[6]

Other countries have policies that support small farmers, though they are not called inclusive agribusiness. One is Brazil's social and agricultural policies, which since 2006 have aimed to support 4 million "family farmers." These are defined as people who conduct their businesses in rural areas, derive income mainly from their businesses, manage their businesses with help from family members and do not own an area larger than set out in the law.[7]

Governments should implement regulations that make it easy for small farmers to obtain licenses and undergo inspections, land titling and land transfer regulations, and deal with input markets and food security. Regulations related to land titling are crucial. In countries where small farmers can own, pledge and sell land, they invest more in the land and enter into different forms of cooperation. In Thailand since 2004 the Department of Land—with support from the World Bank and the Australian aid agency—has provided millions of land deeds to farmers, produced cadastral maps for all rural and urban areas and made land administration more effective. Previously only 12% of agricultural land was covered by land deeds, but they have been issued to eligible landholders throughout the country. As a result, farmers invest more, have switched to higher-value crops and obtained better credit terms, raising their incomes and land values.[8]

Providing information and communication technology for inclusive agribusiness

Agribusinesses need basic infrastructure including rural roads, storage facilities, irrigation and information and communication technology (ICT). This is a government responsibility.

ICT services in rural areas enable farmers to access information about market prices, weather conditions and extension services, empowering them to make better decisions and linking them to buyers. In Mongolia private telecommunications providers were unwilling to expand ICT infrastructure to rural areas. So the government established a universal access policy to pay providers to run ICT infrastructure

4 IFC. 2011. "Scaling up Access to Finance for Agricultural: SME Policy Review and Recommendations. Washington, DC.

5 Okray, Jenn. 2010. "Local Non-profit Develops Successful Crop Insurance to Fight Hunger." Medill Reports, Chicago.

6 Programa Nacional de Negocios Rurales Inclusivos. http://www.snvla.org/mm/file/IB%20Moz-Zim%20Learning%20Journey%20Article.pdf

7 Junker, Franziska, and Kai Schuetz. 2010. "Agricultural Policies in Brazil: Market Integration, Poverty Reduction, and the GTZ's (German Agency for International Development) Contribution to Implementation." GIZ.

8 Chakriya, Bowman. 2004. "Reducing Poverty, Sustaining Growth—What Works, What Doesn't and Why." Thailand Land Titling Project, AusAid.

in areas, including rural communities.[9] In Ghana ICT made the production of cashews more productive through "virtual cooperatives." During a pilot in 2011, about 400 small farmers used the software to access market information and sell their products. More than 100 tons of raw cashews have been traded through the system.[10]

Removing obstacles for inclusive agribusinesses

Governments can remove regulation that limits the ability of small farmers to earn more. One example is Kenya's Coffee Act, which only allows contracts between farmers and buyers to last a year.[11] As a result, banks and traders are reticent to extend financing terms for more than a year because they cannot manage the risks.

Another example is regulation requiring farmers to sell produce at wholesale markets at particular times and conditions. Morocco's Ministry of Agriculture and Maritime Fisheries is lifting monopolies among municipalities in running wholesale fruit and vegetable markets. Such monopolies lead to high consumer prices and low producer incomes, and encourage farmers to use informal channels.[12] This change gives farmers more flexibility and enables them to work directly with private investors, traders and entrepreneurs—benefiting the farmers and the inclusive agribusiness companies that source from them.

SUPPORT TO SMALL FARMERS

Building the capacity of small farmers

Governments and private initiatives can help establish standards so that small farmers can produce goods of quality acceptable to domestic and international markets. As market demands for standards increase, monitoring mechanisms—such as certification programs—need to comply with them.

Peru provides an example of high-quality standards and monitoring. The National Coffee Board established a quality assurance system for coffee nurseries and certified coffee plants in 2011. Growers are evaluated under standards set by the National Coffee Association (Junta Nacional del Café) and Environmental Management for Agriculture.[13]

Inclusive agribusinesses often also deliver technical assistance to small farmers. In other cases governments play a more active role in developing the capacity of farmers, providing agricultural schools and extension services. Governments can provide the enabling environment and regulation to develop cooperatives and other farmer organizations.

In Nigeria the state of Kwara and the U.S. Agency for International Development facilitated a partnership with a private agricultural trade company. The Kwara State Agricultural Development Program trains farmers to sell high-quality rice for processing. Farmer yields rose from 1.55 tons per hectare in 2007 to 5.55 in 2009.[14]

In Latin America rural productive alliances are economic agreements between farmers and buyers. The first alliance was formed in Colombia in 2005. The World Bank supports more than 2,200 such alliances in Latin America, benefiting 110,000 rural households. Alliances submit proposals to ministries of agriculture, which determine who will receive managerial advice, capital and basic infrastructure.[15] Governments work with local buyers to determine what supplies they need. Based on those needs, they offer extension services.

Financing to small farmers

Small farmers face significant limitations in accessing finance. For example, nearly a third of small farmers in India do not have credit accounts with formal financial institutions.[16] In Africa agriculture accounts for an average of 30% of economies but only 5% of bank lending.[17] Globally, production

9 IFC. 2012. "Herders Call Home: GPOBA Pilot Connects Mongolia's Farmers." Handshake 5: IFC Quarterly Journal on Public-Private Partnerships. Washington, DC.

10 GIZ. 2011. "Development Partnership with the Private Sector—Virtual Cooperatives: ICT for African Cashew Farmers." Eschborn.

11 http://www.aec.msu.edu/fs2/kenya/o_papers/coffee_study_sc.pdf

12 World Bank. 2011. "Program Information Document: First Development Policy Loan in Support of the Plan Maroc Vert." Washington, DC.

13 http://www.esfim.org/collaborative-research/peru

14 http://www.vanguardngr.com/2009/11/olam-disburses-n309m-loan-to-rice-farmers-in-kwara

15 Collion, Marie Hélène. 2012. "Productive Alliances, Productive Results." Handshake 5: IFC Quarterly Journal on Public-Private Partnerships. Washington, DC. http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22660571~pagePK:64257043~piPK:437376~theSitePK:4607,00.html

16 http://www.agrifinfacility.org/afsf/node/116

17 Isaac, Chris. 2012. "Catalytic Capital, Powering Africa's Agricultural Potential." Handshake 5: IFC Quarterly Journal on Public-Private Partnerships. Washington, DC.

finance can significantly affect farm incomes—farms operate at just 40% productivity.[18]

Private commercial banks (which have been replacing state-owned agricultural banks) are often hesitant to lend to small farmers because they consider them and agricultural companies working with them risky. Institutions that provide financing to small farmers do not always have the expertise to tailor instruments to their needs.[19] Inclusive agribusinesses often provide financing to small farmers so that farmers can invest in irrigation, fertilizer, higher-quality seeds, processing equipment and replanting supplies.

Governments can improve access to finance for small farmers. Warehouse financing is a lending technique that provides access to financing secured by supplies in a warehouse. Farmers can deposit their products at licensed warehouses and receive receipts that can be used as collateral for bank loans.[20]

Risk-sharing facilities and partial credit guarantees can stimulate loans to small farmers, especially when accompanied by capacity building for small farmers taking loans. Partial credit guarantees should require that a portion of guarantees remain with financial institutions to avoid adverse selection—and ensure that the guarantees are phased out to ensure financial sustainability.[21] Risk-sharing facilities and partial guarantees only address the perception of risks, not the risks inherent to agriculture.

Finally, agricultural insurance is important for farmers susceptible to conditions such as weather, pests or disease outbreaks. If private insurance is not available, the public sector can create insurance mechanisms. Mexico's Insurance Funds (Fondos de Aseguramiento), a program run by state-owned Agroasemex, provides farmers with crop and livestock insurance. Catastrophe insurance is provided by federal and state governments.[22]

Research and development to support small farmers

Governments have invested heavily in agricultural research. They increasingly play a convening role in establishing networks for research and development (R&D) on agricultural technologies to make small farmers more productive—such as with seeds, irrigation and fertilizer. This often involves collaboration among public and private stakeholders. When the private sector is unwilling or unable to invest, governments can step in.

Bangladesh has a long history of government efforts to develop crop varieties and disseminate inputs to small farmers. For more than 30 years the International Rice Research Institute has worked with the Bangladesh Rice Research Institute to develop high-yield and stress-resistant rice varieties. The Bangladesh Institute of Nuclear Agriculture and Bangladeshi universities also developed several varieties.[23] As a result of the new rice varieties and extension services from the Department of Agricultural Extension, domestic rice production has increased significantly.

India's National Agricultural Innovation Project works with public organizations, farmers, the private sector and others to develop and disseminate new technologies that ease poverty for farmers in disadvantaged regions.

International research has great potential to support small farmers. An example is the Consultative Group on International Agricultural Research (CGIAR), a partnership funded by developing and industrial country governments, organizations and foundations to support research to develop agricultural technologies.[24]

18 Okray, Jenn. 2010. "Local Non-profit Develops Successful Crop Insurance to Fight Hunger." Medill Reports, Chicago.

19 IFC. 2011. "Scaling Up Access to Finance for Agricultural SMEs," provides recommendations on how to build the capacity of financial institutions by strengthening their value chains for finance.

20 Through its Global Warehouse Finance Program, IFC is working in several countries to adapt legal environments for warehouse receipt financing. Toyoda, Makiko. 2011. "Receipts That Pay: Warehouse Receipts as Collateral." Handshake 5: IFC Quarterly Journal on Public-Private Partnerships. Washington, DC.

21 IFC. 2011. "Scaling up Access to Finance for Agricultural SMEs." Washington, DC.

22 IFC. 2012. "Preparing for Disaster." Handshake 5: IFC Quarterly Journal on Public-Private Partnerships. Washington, DC.

23 Ferrer, Paula Bianca. "IRRI In Bangladesh." *Rice Today* 11 (1).

24 CGIAR (Consultative Group on Agricultural Research). 2011. "CGIAR at 40 and Beyond: Impacts that Matter for the Poor and the Planet." Washington, DC.

Policies that Support Inclusive Business Models that Provide Basic Goods and Services to the Base of the Pyramid

In many countries basic services such as health, education and housing are mainly provided by public sector or recently privatized companies. For example, for most of the 20th century, public utilities had exclusive rights to serve some areas. So new business entrants—often companies with inclusive business models—often face regulatory obstacles in accessing markets. More stringent regulations apply to basic services.

Companies with inclusive business models provide the base of the pyramid with access to basic goods and services, as well as those often considered public goods and services. Given the importance of these goods and services, regulations and stakeholders in many countries require that they be extended to the base of the pyramid.

People who cannot afford basic goods and services and those able and willing to pay but living in remote areas often lack them. More companies are entering markets for people able and willing to pay. For those who cannot afford them, government subsidies might be warranted. Some companies with inclusive business models have reached low-income markets by leveraging subsidies.

This section shows how government policies have facilitated open markets in low-income housing, health, education and basic financial services using mobile payments. These areas were selected because they represent more than a quarter of applicants for the G20 Challenge.

AFFORDABLE HOUSING

Buying a house is a large investment—especially for people at the base of the pyramid. By 2030 the number of slum dwellers in the developing world will double to 2 billion people. According to an estimate accepted by India's National Housing Bank, the country needs nearly 25 million units of urban housing: potentially a $250 billion opportunity.

Governments should adopt regulations that promote affordable housing. Land titling and regulations should make it easy to transfer property and allow developers to sell land and houses. Other regulations supporting affordable housing allow collecting loans through payroll withholdings.

Many large emerging markets have or are developing mortgage programs for low-income homebuyers. A growing number of developers in those countries are serving the gap between private mortgages (available only to those who can afford them) and public subsidies (targeting low-income families). Some have leveraged government subsidy programs to access low-income markets.

A study on low-income housing in India describes the approaches that China, Singapore, South Africa, the United Kingdom and the United States have used to deliver affordable housing.[25] Governments need to make the economics work through mandates, incentives, subsidies and contributions by the people receiving the housing.

Mexico, Brazil and South Africa adopted targets for housing to the base of the pyramid by 2012, 2014 and 2015:

- Mexico has a target of 6 million mortgage credits under its 2007–12 housing program.[26] Most of this plan focuses on families earning less than $920 a month. The program provides subsidies to poor families.[27]
- Brazil's affordable housing program started in 2009 and aims to provide affordable housing to 3 million low- and middle-income families by 2014.[28] Households earning less than $1,000 a month pay no more than 10% of their income for 10 years to live in government housing. Households earning between $1,000 and $3,400 per month can apply for low-interest loans.
- South Africa aspires to provide housing for all, achieve access to land tenure and eliminate slums by 2015. Since 1994 the government has implemented measures to provide adequate housing, including subsidies. Since 1994, 2.3 million housing opportunities have been provided. In 2009, 71% of South Africans lived in formal dwellings. South Africa created 7 institutions to assist with housing, particularly for people who do not qualify under the Housing Subsidy Scheme and are excluded from private financing—about 30% of the population. In 2009 the Housing Development Agency was established to double housing delivery to more than 500,000 units a year.

25 Global McKinsey Institute. 2010. "India's Urban Awakening: Building Inclusive Cities." Delhi.

26 http://www.conavi.gob.mx. CONAVI promotes and coordinates the National Housing Program.

27 Ibid.

28 Samad, Taimur. 2012. "PPPs for Low-income Housing." Handshake 4. International Finance Corporation. Washington, DC.

EDUCATION AND HEALTH MARKETS

Fielden and LaRoque (2009) highlight the regulatory barriers to private education. Some regulations do not specify the private sector's role in education, impose unclear registration criteria for private schools, prohibit foreign-owned private education institutions and limit the ability of private schools to set tuitions at market rates and operate for profit.[29] In the past 10 years the regulatory environment in many countries has become more conducive to private education, including for low-income populations.

In the mid-1990s Brazil's Ministry of Education began accrediting private providers of postsecondary education. Today about three-quarters of postsecondary students in Brazil attend private schools. Much of this growth has occurred in lower-income schools.[30]

Over the past 10 years Sub-Saharan Africa has been recognizing the significant contribution that private education can bring. In Ghana, Kenya, Nigeria, Senegal and Uganda private school enrolment has jumped from 15% to more than 40%.[31] Several governments are encouraging private sector growth.

Similarly, countries have started encouraging private health care for low-income populations. Policies have created opportunities to serve low-income patients by, for example, adopting national health policies that encourage private care or health insurance for the base of the pyramid.

Sri Lanka's health policy for 2007–16 encourages the development of the private sector and seeks partnerships to buy services delivered by private providers. Private hospitals played a minimal role in providing inpatient care until the early 1980s, but today the private sector provides half of ambulatory care.[32]

In 2008 India introduced a national health insurance program for poor people. Each beneficiary pays a 30 rupee (less than $0.70) registration fee, while the central government pays three-quarters of the premium. The rest is paid by state governments. Information technology is used on a large scale. Every beneficiary family is issued a biometric-enabled smart card containing their fingerprints and photographs.[33]

BASIC FINANCIAL SERVICES THROUGH MOBILE BANKING

Mobile phone penetration is soaring around the world, with subscriptions more than quadrupling since 2002 to more than 4 billion in 2009. More than half of these users—2.5 billion people—are unbanked, representing a huge potential for expanding financial access at a lower cost than through bank branches.[34]

Mobile banking, mobile payments and branchless banking refer to basic financial services from cash transfers and deposits, retail purchases, bill payments and welfare payments—through the use of mobile phones—without visiting bank branches. Extending credit is generally not considered a service.

In 2008 the Alliance for Financial Inclusion brought together partners, central banks and other financial regulatory institutions from more than 70 developing countries. The alliance is an online network for peer learning on policy measures for financial inclusion. No country or institution has all the answers.

Policymakers and regulators around the world are drafting regulations for mobile banking and adapting bank regulation to mobile banking. Mobile banking can be disaggregated: money exchange, storage, transfer, investment, policymaking and regulation allowing such unbundling.[35] When services are unbundled and no longer part of the traditional banking system, the question arises of which organization should regulate them and what type or regulation is appropriate for each.

Until recently few governments tackled regulation of telecommunications and financial services.[36] But that is changing. India, Kenya, Mexico and the Philippines are

29 Fielden, John, and Norman LaRoque. 2009. *The Evolving Regulatory Context for Private Education in Developing Countries*. Washington, DC: World Bank.

30 Ibid.

31 Nyagah, Nelly. 2009. "Attracting Private Investment in African Education." http://tradeinvestAfrica.com

32 Ibid.

33 http://www.rsby.gov.in/about_rsby.aspx

34 http//www.afi-global.org

35 Klein, Michael, and Colin Mayer. 2011. "Mobile Banking and Financial Inclusion: The Regulatory Lessons." Policy Research Working Paper 5664. World Bank, Washington, DC.

36 WEF. 2012. "Galvanizing Support: The Role of Government in Advancing Adoption of Mobile Financial Services." Geneva.

adjusting regulations to the presence of mobile operators that provide basic financial services.

In Kenya M-PESA's approach to financial regulation was one of engagement from the start. The regulator was willing to explore new ideas and listen to potential market entrants. The team engaged with other regulators, such as the U.K. Financial Services Authority.[37]

In Mexico since February 2010 regulations have allowed mobile network operators to set up agent networks and manage mobile accounts on behalf of banks. Banks and retailers can open mobile banking accounts for their customers because agent networks are considered key to financial inclusion, given the scarcity of financial development in rural and semi-urban areas.[38] The new regulations have paved the way for a variety of branchless banking services.[39]

In the Philippines the Central Bank has devised 2 arrangements with 2 mobile operators: Smart and Globe. Banks are permitted to outsource a range of services to Smart through prepaid accounts. A subsidiary of Globe, Smart offers virtual value accounts that enable mobile phone customers to make payments and money transfers. Arrangements for Smart and Globe have been successful largely due to a flexible and creative approach by the Central Bank.[40]

The Reserve Bank of India has kept large commercial banks at the heart of the financial system, and regulation has been slow to allow roles for nonbanks—including mobile network operators.[41] But changes in September 2010 have opened the door for mobile network operators to act as "business correspondents" for banks.

37 Makin, Paul. 2009. "Regulatory Issues around Branchless Banking." OECD, Paris.

38 Ibid.

39 CGAP. 2011. " Technology Program Country Note: Mexico." Washington, DC.

40 CGAP. 2008. "Notes on Regulation of Branchless Banking in the Philippines." Washington, DC.

41 Only banks licensed and supervised in India and with a physical presence there can offer mobile banking.

How Governments, Development Finance Institutions and Donors Can Support Inclusive Business Models

BOX 4: WHEN DOES PRIVATE INVESTMENT MERIT GOVERNMENT SUPPORT?

Market failures provide the main rationale for government to support private investments. Private investors might be reluctant to enter markets because they are not convinced of the business case or perceive high costs or risks. Support to early market entrants from government can induce investment. Often a subsidy, this support is often limited to early movers and should be no greater than necessary. It should also be targeted and limited to reduce concerns about market distortions, financial sustainability and long-term development.

Best practices focus on moving subsidies as close as possible to intended beneficiaries, as with conditional cash transfers or differentiated user tariffs. When subsidies cannot be delivered directly to intended beneficiaries or it is too costly to do so, they can be provided through intermediaries. In such cases the subsidy is often tied to delivery of the service.

Source: IFC staff.

Despite the recognition of business opportunities at the base of the pyramid, some companies are hesitant due to perceived risks or barriers or lack of understanding. Governments, development finance institutions and donors each play a distinct role in encouraging companies to enable them to do what they do best: identifying and implementing innovative business models. This section describes how—through coordinated efforts—these entities can support inclusive business models.

ROLES FOR GOVERNMENTS

Provide public goods and services and basic infrastructure

Government support for inclusive business models should focus on public goods and basic infrastructure such as roads, telecommunications and electricity. The private sector can provide "last mile infrastructure" bringing power or clean water to poor and often remote communities.[42] Government subsidies are sometimes needed to encourage early entrants, but they should be targeted and minimize market distortions (box 4).

Research priorities

Businesses in many countries lack market information on the base of the pyramid. By collecting and disseminating such household surveys, governments can provide valuable information to the public, including companies with inclusive business models.

Improve the business environment

Companies with inclusive business models are driven by profit—and do not make tradeoffs between profits and integrating the base of the pyramid in their value chains. This differentiates inclusive business models from those often referred to as social entrepreneurs. Because inclusive business models are commercial, government support should be framed as a business growth strategy that leverages market mechanisms rather than as a development strategy.

The business environment is important for companies that work with the base of the pyramid because they need to overcome additional challenges including understanding new markets and market behavior of base of the pyramid customers, apprising new risks and developing new systems or business processes. They often face perceptions by investors or lending institutions that doing business with the base of the pyramid is riskier compared to ordinary businesses. Governments should ensure a business environment conducive to doing business, especially for doing business with the base of the pyramid.

The business environment can be improved by reforming regulation, reducing bureaucracy and engaging in public-private dialogue. Governments can review sector-specific hurdles and learn from countries that have provided incentives for

42 Michael Kubzansky, Ansulie Cooper and Victoria Barbary, Monitor Group. 2011. "Promise and Progress: Market Based Solutions to Poverty in Africa." Cambridge.

inclusive business models. Improving the business environment may involve rethinking well-intended policies (such as to protect consumers) that might unintentionally stifle innovation in inclusive business models. Laws protecting intellectual property are especially important for encouraging innovation. Mechanisms and institutions should also register and enforce intellectual property rights.

When improving the business environment, special attention may be given to measures that can increase access to finance. Several G20 Challenge applicants indicated that access to finance is a problem because of collateral requirements. Policies can help banks assess the creditworthiness of potential borrowers (box 5).

ROLES FOR DEVELOPMENT FINANCE INSTITUTIONS AND DONORS

Development finance institutions and donors can support inclusive business models and policies in many ways. They can use their global or regional knowledge to facilitate knowledge transfer and share best practices. First, by sharing information on companies with inclusive business models and how they have overcome challenges. Second, they can help partner governments create and implement policies conducive to inclusive business based on policies in other countries.

Donor countries, looking to help improve the policy environment for inclusive business in partner countries, can bring together private, public and relevant nongovernmental partners to foster value chain development for inclusive business models. They can provide capacity building to inclusive business models through technical assistance or grant funding, including matching grants. In addition, donors can provide financial support for pilot initiatives to better understand base of the pyramid markets in companies with an inclusive business model.

Development finance institutions can provide financing through loans or equity and build capacity for companies with inclusive business models. They can also support companies with inclusive business models that provide capacity building by training base of the pyramid suppliers on technical issues or on governance, organization, business management or financial skills.

BOX 5. POLICY RECOMMENDATIONS FOR GOVERNMENTS LOOKING TO IMPROVE ACCESS TO FINANCE

Based on a cross-country comparison of regulations on access to finance, recommendations to improve it include setting up credit bureaus and collateral registries and updating laws on secured transactions. When tailored to country needs, some of these recommendations can be used to target businesses that integrate the base of the pyramid in the value chain.

Credit bureaus provide information on borrowers' credit histories—sometimes including information from nonfinancial institutions such as utilities and retailers. The information is not a substitute for risk analysis, but it can help banks better assess risk. As the base of the pyramid builds credit histories, banks may be more willing to lend to businesses with customers at the base of the pyramid.

Only 54 of 183 countries have credit bureaus that provide information from nonfinancial institutions. Credit bureaus that give information on payments to utilities and retailers help those without bank loans, credit cards or bank accounts build credit histories.

Access to finance can also be improved where laws allow and banks accept movable assets as collateral. Today 68 of 183 countries have centralized collateral registries for movable assets such as receivables, inventory or crops. Collateral registries provide information on whether assets are already subject to the security rights of other creditors.

Source: World Bank and IFC. 2011. *Doing Business 2012*. Washington, DC.

Conclusion

Domestic business models have shown how development results can be achieved by integrating the base of the pyramid in value chains in commercially viable and sustainable ways.

Recognizing the base of the pyramid's ability and willingness to pay for certain goods and services, an increasing number of companies with inclusive business models are making these goods and services available at affordable prices to the base of the pyramid and are integrating the base of the pyramid in their value chains. These new business entrants—inclusive businesses—can increase competition, lower prices and improve consumer choice, often bringing products and services previously unavailable or unaffordable.

This has been possible because in the past decade many countries have opened markets to private operators that used to be the domain of the public sector. Where markets opened, regulations have been adjusted.

Over the next decade, governments, development finance institutions and donors have important roles in continuing their support for inclusive business models. Adequate regulations and institutions that allow businesses to grow are important, especially for companies with inclusive business models. An area of further study is how to balance regulation so that well-intended policies do not unintentionally stifle the innovation of inclusive business models.

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