DCED

The Donor Committee for Enterprise Development

Private Sector Development Synthesis Note

Current Debates on Inclusive Business Models

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Key take-aways:

- There is broad agreement that inclusive businesses integrate the poor in their value chain, but definitions vary in how exactly inclusive businesses, benefits for the poor or 'inclusiveness' are defined - with possible implications for how support is designed and targeted.
- While low-income populations offer sizable commercial opportunities, businesses often cannot rely exclusively on very poor clients or suppliers for profitability. Alternatively, they may need to engage with people who are not the poorest.
- While technical and financial support to individual businesses has helped achieve direct impacts on poor people in their value chains, practitioners increasingly seek more systemic solutions, e.g. by promoting an enabling environment or helping to scale up and replicate successful models.

Since its conceptual development in the mid 2000s, inclusive business has increasingly been proposed as central to addressing development needs (see for example G20 Inclusive Business Framework, 2015). Inclusive business models are seen as delivering long-term benefits at scale – something that many direct development interventions have been unable to achieve (Wach, 2012). This Note explores the concept and associated debates in more detail, and points to further key resources.

>> 1. What is an inclusive business?

Inclusive business models expand opportunities for the poor by integrating them as producers, suppliers, workers, distributors, or consumers (Practitioner Hub for Inclusive Business). There is, however, a range of definitions in use, that vary in their emphasis. This can have implications for how donor support is designed and targeted, for example (see DCED, 2016 for more details):

- **The institutional nature and mission of inclusive business**: According to the predominant view, inclusive business refers to a profitable core business activity of a private company, with the commercial motivation being fundamental 'to ensure that business involvement in enabling sustainable livelihoods is both scalable and replicable' (WBCSD website). Others, however, note that the institutional background 'is insignificant for the approach per se' (UNDP, 2010), which can develop at the initiative of for-profit, non-profit or even public actors.
- **Centrality of inclusive business line(s) to the company:** The G20 Framework, for example, distinguishes between inclusive business models, which integrate the poor across core operations and typically expect market rates of return; inclusive business activities, which also include poor people into a company's value chains, but are not central to commercial viability; and social enterprises, which focus on improvements for the poor and reinvesting profits into the business.
- **Dividing lines between 'inclusive' and 'non-inclusive':** While "virtually any business ... can help a country develop, whether through taxes, employment, market expansion or technology transfer, inclusive business is generally considered to "go further"(Business Innovation Facility, 2010). However, differentiating between inclusive and regular businesses can be challenging in practice

(Wach (2012). For instance, do businesses have to reach a certain number of poor people or is inclusiveness about the proportion of poor people among those reached? Do they have to have only an immediate or systemic impact on poor people's living conditions (Bauer, 2016)? There is also disagreement on whether inclusion of the poor needs to be a conscious of the business, or whether only the end result of increased opportunities for the poor matters. For some, inclusive business also need to have positive environmental impact (Endeva, 2010) while others note tensions, such as increased waste from products sold in affordable small packages (Kramer and Herrndorf, 2012).

>> 2. What is the business opportunity and can the poorest be reached?

According to Ernst and Young (2015), developing countries account for 37% of global trade, but they will account for an estimated 57% of global GDP by 2030. This means that doing business with low-income populations offers a large market, a rapid growth potential, a less competitive environment than in many more advanced economies, and opportunities for innovation (DI, 2007). Prahalad (2005) estimates the global consumer market of over 4 billion people with annual incomes below $1,500 at $13 trillion annually, while Hammond et al (2007), with a $3,000 income line, value it at $5 trillion.

However, Karnari (2009) argues that the market size has been overestimated. He states that the $3,000 poverty line used by Hammond et al (2007) is above those commonly used, and calculates a market size of $1.2 trillion with a $1,000 line. He also argues that some of the businesses that involve the poor are only profitable as they also sell to the middle class. A review of 20 inclusive business case studies by Deloitte (2017) finds that some have been able to sell to those living on less than $2.50 a day and in some cases $1.25 a day; however, most enterprises received some subsidized capital. Selling profitably to the poor is made more likely if companies focus on asset light products (e.g. a mobile phone app rather than a manufactured product) and if they serve customers across a broad range of incomes. This is similar to the finding of Jenkins et al (2011), who noted that successful business models tend to take a 'whole pyramid' approach, where the poor are segments within a broader market.

For agri-businesses including the poor as suppliers, it has similarly been noted that it may not be possible to involve the poorest of the poor if businesses are to receive an adequate return on their investment. Instead, the bulk of beneficiaries are likely to be emergent small-scale commercial farmers (Jacobs, 2017 and FAO 2017). BIF (2013) also found that while some firms supported by the programme were reaching the poorest billion, the typical beneficiary is in the 'next billion up'. Baumüller et al (2013) summarise that though social enterprises may focus more on the poorest, inclusive businesses tend to target producers and consumers above absolute poverty lines with daily incomes of $3–4, who possess capital and assets but have limited market access.

Some organisations have also criticised firms that include the poor in their business models for other potentially adverse development impacts. Oxfam's Behind the Brand campaign, for instance, highlights issues like a lack of community consent to land investments. A wider debate has focused on taxes paid. Though Oxfam America et al (2011) find that from 2006 – 2010, SAB Miller paid over $50 million in tax in both El Salvador and Zambia, ActionAid (2012) highlights how the firm avoided paying £20 million in tax annually in southern Africa and India and that most tax paid is consumer-borne excise duties. On the other hand, tax benefits can encourage prospective inclusive businesses investment (UNDP, 2012).

>> 3. What types of support work best to promote inclusive business?

Different analyses emphasise different challenges for inclusive business models. WBCSD (2013), for example, highlights high opportunity costs, as other business investments may have higher and more dependable rates of return; and that company capabilities and experience may be insufficient. Koh et al.

(2014), who surveyed 37 businesses serving the poor in Asia, Africa and Latin America, found that at least half of them felt constrained by the following three business environment issues: Inhibitory laws, regulations and procedures (65%); absent/ ineffective standards (63%); and inhibitory taxes and subsidies (49 %). In response to such challenges, the G20 Inclusive Business Framework (2015) points to four pillars of inclusive business support: (1) Establishing conducive rules and regulations; (2); Enhancing access to financial resources and providing financial incentives; (3) Providing information and raising awareness; and (4) Strengthening the capacity of the BOP and of inclusive businesses.

In practice, many donor programmes have focused on pillars two to four – by providing finance and technical assistance to inclusive businesses through challenge funds and public-private partnerships (see also the DCED's mapping of donor facilities for partnering with business and the Inclusive Business Hub's database of organisations providing support to inclusive business); or by stimulating knowledge sharing through multi-stakeholder platforms (see for example DCED, 2017a), advocacy initiatives and awards. USAID (2017) summarises the current landscape of advisory support to inclusive business and how donors can add the most value (e.g. by focusing on market segments without commercial service providers and supporting the development of sustainable ecosystems for advisory support).

A common criticism is that few inclusive business models have gone beyond the pilot stage and reached scale or systemic change. For example, Thorpe (2014), based on a review of case studies, concluded that many partnerships between a company and a development agent lacked a systemic approach, with direct impacts limited to actors within the company's value chain. A growing amount of research and guidelines have therefore focused on how to scale up and replicate inclusive business models (e.g. GIZ, 2016; Monitor Inclusive Markets, 2014), and enable inclusive markets or ecosystems more broadly (e.g. FSG, 2017).

The DCED (2016a) itself has explored emerging evidence on how donors can help create an enabling environment for inclusive business. The findings suggest that traditional business environment reform (e.g. regarding business registration and licensing) is also relevant for inclusive business. For example, they may benefit particularly from due attention to inappropriate or missing quality standards or licensing regimes, which can represent binding constraints to introducing or scaling inclusive technologies or services. Specific legislation may also be needed to enable inclusive business to access relevant forms of finance (e.g. impact investment), or to act as providers of finance to the poor (e.g. mobile and agent banking regulation). Many lessons also exist from fields such as industrial policy on how to manage targeted support to inclusive businesses, for example by establishing a clear economic rationale for intervening, and making support time-bound and conditional on performance.

A particular area of debate is whether donors should promote the introduction of special legal forms for inclusive business. Evidence is still lacking on the effectiveness of this policy tool and views vary on whether special statutory forms can make it any easier to defend inclusive business activities internally or to shareholders; or whether they make it easier to attract government, donor or investor support, compared to alternative policy options (see also DCED, 2016b).

>> 4. Can the effects of inclusive business models on the poor be measured?

Several frameworks have been developed in order to help businesses measure their impact on the poor. Wach (2012) provides an overview of six of these, including BCtA's Results Reporting Framework and the INSEAD Economic Footprint. WBCSD (2013) has published a guide for businesses in measuring socio-economic impact, which outlines ten tools. In order to make measurement manageable, GRI (2013) recommends that firms focus on their significant economic, environmental and social impacts. Wach (2012) suggests thinking through the business model's causal chain to identify appropriate indicators, similarly recommended by the DCED Standard for results measurement.

While most businesses gather some relevant data from general operations, they often lack incentives to measure their development impact. Measuring the results for suppliers in remote areas raises further challenges. The DCED's (2013) guidance for challenge funds highlights how agencies can support the collection of development impact data, while firms focus on indicators they would anyway collect. In the context of impact investment, DCED (2017b) analysed what types of data impact investee businesses collect and value for their business decisions. It finds that most investees rely on their own, rather than standardised metrics, and focus on output and outcome, rather than impact-level data.

There are also efforts by external observers to assess and compare the inclusivity of different businesses – for example, the G20 Challenge on Inclusive Businesses and Oxfam's Behind the Brand Campaign. The former involved the selection of 15 winning businesses based on five criteria: innovation, development results, potential for growth, financial sustainability, and environmental and social sustainability. The latter uses seven criteria to assess and rank agricultural sourcing practices by the 10 largest food and beverage companies, such as treatment of workers in the supply chain. The Business Call to Action (2017) has published a 'maturity diagnostic' to help businesses understand their current performance and next steps to achieving a sustainable, SDG-relevant inclusive business.

Find out more on the DCED's Inclusive Business Knowledge Page: https://www.enterprise-development.org/implementing-psd/inclusive-business/