

Thinking small:

Why poor producers and small business owners may hold the key to a sustainable recovery

A CAFOD POLICY DISCUSSION PAPER

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1. Introduction

The economic crisis has highlighted the importance of a neglected part of the economy – small-scale producers and businesses. This report makes the case for greater investment and policy focus in these parts of the economy to achieve ‘quality growth’ – growth that increases wellbeing, is resilient and reduces poverty.

Small-holder farmers and small business owners in Zambia and Cambodia took part in workshops organised by CAFOD to assess their experience of the economic crisis, to explore the terms of their participation in markets, and to hear their views on the economic reforms that work for them. Relevant country officials, academics and civil society organisations were also interviewed to inform this discussion paper. Finally, an analysis of programmes supported by CAFOD and other livelihood programmes was carried out to look at what works in practice.

This discussion paper begins by drawing out lessons of the global economic crisis: how did the small-scale parts of the economy fare and what conclusions should policy-makers draw from this? It then makes the case for a central role for small-holder farmers and businesses in the post-crisis economic and private sector strategies of developing countries. It examines progress to date in efforts to “make markets work for the poor” before making a bottom-up analysis of what works in practice to support better market integration of poor farmers and small business owners.

WHO ARE WE TALKING ABOUT?

The small-scale sections of an economy are more easily described than defined.

They tend to be subdivided into two main groups:

- Small-holder farmers are those with fewer assets, but the amount of land or livestock they have can vary greatly, depending on the state of the local economy or agro-ecological conditions.
- Micro and small enterprises include petty traders, artisans and street vendors, although formal definitions owe more to

a desire to allow international comparisons than to disaggregate a distinctive category of businesses.¹

Putting aside problems of definition, these groups share various distinguishing characteristics: they are usually informal, unregistered and therefore frequently ignored parts of the economy; they have very limited capital resources and tend to rely on the labour of one individual or household; they are vulnerable – lacking safety nets, reserves and resources to withstand shocks.

Such characteristics mean they have very different needs in terms of support, and the same reforms can have very different impacts on them compared to larger, formal firms.

Most significantly, poor women and men tend to predominate in these sectors and their numbers are growing. According to the World Bank there are around 1.5 billion smallholder households, accounting for three quarters of the developing world's poor. The informal sector – which is largely made up of small businesses – accounts for 75 per cent of total employment in developing countries.²

This means the fate of these sectors is important for poverty reduction, as well as for ensuring that economic development and growth strategies work for poor men and women.

2. Poor producers and traders during the economic crisis

Initially, there was some relief that the majority of small-scale poor producers and businesses were not affected by the direct impacts of the economic crisis. *The Economist*³ reported that rural areas in Mexico were largely untouched by the crisis, thanks to their geographical and economic isolation from global markets, whereas export manufacturing firms in border regions that are more dependent on US demand were hit hard.

¹ See section 4.1 for a fuller discussion on definitions of small and medium-sized enterprises (SME) in developing countries.

² Chen M (2008) 'Addressing informality, reducing poverty' in *Poverty in Focus*, No 16, December 2008, pp6-8.

³ "Counting their blessings", *The Economist*, 30 December 2009

Similar trends were notable during CAFOD's own research in Cambodia and Zambia. In both countries, for example, the agricultural sector witnessed an increase in productivity during the period immediately following the crisis.

In Cambodia, the agricultural sector provided stability during the crisis when key industries such as tourism, garment manufacture and construction went into steep decline. Agricultural production increased, with exports continuing to rise during 2009. The agriculture sector grew five per cent in 2009, the only sector that did not fall into decline⁴. The increase in production was partly attributed to a return of labour to rural areas, as the agricultural sector is credited with absorbing laid off workers from affected industries, although evidence is anecdotal. Similarly, in Zambia many small-holder farmers were unaffected by the crisis and production levels were good compared to recent years, mostly due to favourable weather conditions⁵.

These sectors provide a source of stability for poor households. Setting up small businesses or raising income through farmers are both key to enabling poor households to cope with economic shocks of any kind, not just global economic crises. Smallholder farmers attending CAFOD workshops reported that farming in particular is seen as a source of income stability and food security, especially for groups that find it difficult to participate in labour markets, such as women, the elderly and uneducated/unskilled workers.

Unfortunately, not all poor business owners were isolated from the global crisis. Where they were integrated into global markets and supply chains, they were often hit first and hardest.

For example, in Cambodia many small businesses were hit by the downturn in tourism. Hotel occupancy in the main tourist destination of Siem Reap decreased by 40 per cent, according to local officials. Restaurateurs, souvenir sellers, transport and food stall sellers were severely affected⁶.

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A souvenir seller in Siem Reap reported that he was selling only 30 per cent of what he had sold a year ago. As a result, his household had reduced spending and borrowed money from relatives who did not charge him any interest.

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⁴ UNDP (November 2009), Global Economic Downturn: Opportunity or crisis?, UNDP Country team, Cambodia

⁵ Interview with official, Zambia Ministry of Agriculture, April 2010

⁶ UNDP *ibid*

In Zambia, small businesses in the tourism sector were also hit by a fall in visitor numbers. Lodge owners and small businesses from Livingstone reported being drastically affected by the downturn in 2008 and 2009. Laying off staff, taking on debts or using reserves, as well as cutting expenditures and diversifying economic activities, notably into agriculture and trading, were strategies employed to cope with the crises⁷.

Moreover, any benefits of initial isolation were limited by the vulnerability of these economic actors. Despite their isolation, these sectors and households have been hit hard by the second wave and indirect impacts of the crisis.

In the CAFOD workshops, Zambian small-scale farmers from Livingstone and mining areas reported a drop in income, owing to reduced demand in local markets because of the direct impacts on workers in the mining and tourism sectors. Secondary impacts were also felt in Cambodia through a loss of internal remittances from garment workers to rural households. Before the crisis, these had averaged \$30-40 per month, but an estimated \$30-45 million was lost out of a total of \$150 million in remittances per year⁸. These temporary downturns can have long-term impacts for those concerned⁹.

While no integration might have been better than bad integration during this most recent crisis, a more constructive lesson is that the integration of poor economic actors into markets needs to be managed more effectively.

It is no cause for celebration that these small-scale producers and businesses were not hit by the downturn in global markets, mainly because they were not benefiting from them in the first place.

It is a cause for alarm that more integration into global markets can still mean long-term reversal in poverty reduction efforts when economic shocks inevitably happen again.

More needs to be done to make markets work well for poor farmers and small businesses, both to ensure that they benefit during the good times and to ensure that their vulnerability

⁷ CAFOD workshop April 2010

⁸ UNDP *ibid*

⁹ See section 5.1 for a fuller discussion of long-term consequences of vulnerability to economic shocks.

does not result in disproportionate and long-term consequences during the bad times.

As outlined in the next section, this focus on small-scale parts of the economy makes sense in most economies, but particularly in those with a large poor population.

3. Does it make sense to invest in the poor for a 'good recovery'?

Despite making up the vast majority of the economy, small-holder farmers and businesses are often neglected in economic development and growth strategies of developing countries.

There are three reasons for this approach:

1. Small-scale sections of the economy have been largely written off as backward, unproductive and stagnant. They will not be the source of a step-change in growth or structural transformation in developing country economies. Bigger returns are expected from foreign direct investment (FDI) and export sectors.
2. The preference for across-the-board reforms to avoid pandering to vested interests and the unintended consequences of poorly targeted government assistance.
3. It is generally assumed that the reforms that benefit larger firms will also benefit the smallest ones. In fact, the general orthodoxy is that they will gain more from 'investment climate' reforms as they suffer disproportionately from poor infrastructure, inappropriate regulation and bad governance.

CAFOD's research throws these assumptions into question and suggests that a greater focus on the sector is more likely to deliver 'quality' growth that is fair, resilient and sustainable.

First, the assumption that assisting these sections of the economy are not as important as FDI or larger firms for achieving economic development is not borne out by experience. Much advice to developing countries is still predicated on the perceived need to attract more FDI to achieve economic development and growth. Indeed, FDI can bring important benefits in terms of capital inflows, new technologies and activities and access to larger, more profitable markets.

However, it is true to say that the development impacts of this FDI have been disappointing, as noted by the G8¹⁰. For example, recent research suggests that developing countries, including low-income countries, in fact receive significant amounts of FDI in relation to the size of their economies. However, profits remitted by investors in sub-Saharan Africa between 2003 and 2007 frequently matched or exceeded FDI inflows¹¹.

CAFOD's analysis is that supporting the local small-scale sector is a crucial factor for a successful FDI strategy that has good development outcomes.

Benefits from FDI are not automatic. Foreign firms establishing a presence in a developing country are more rooted and provide more widespread benefits through spillover and linkages effects if they have a network of local suppliers and clients. Technology and learning is more likely to be disseminated if local small firms are not too far behind their foreign counterparts.

The need for complementary FDI and small-scale strategies is demonstrated by the case of the Mozal aluminium smelter in Mozambique (see box).

TRICKLE DOWN NEEDS TRICKLE UP: MAKING FDI WORK FOR DEVELOPMENT, THE CASE OF MOZAL

With an investment value of \$2.1 billion, the Mozal aluminium smelter in Mozambique is one of Africa's largest FDI recipients and a huge commercial success. It makes up 42 per cent of Mozambique's exports, a large part of its manufacturing output and earns 53 per cent of the foreign exchange entering the country.

However, Mozal's success has failed to benefit the majority of Mozambique's population, partly due to an incentives package that meant Mozal paid corporate tax on one per cent of its turnover and its capital intensive nature, that created only 800 permanent jobs in its first phase.

¹⁰ G8 Summit Declaration on Freedom of Investment, Investment Environment and Social Responsibility, Heiligendamm, Germany, June 2007

¹¹ Bindha and Martin (2010), Private Capital Flows to Low Income Countries: Dealing with boom and Bust, Development Finance International

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Technology and learning is more likely to be disseminated if local small firms are not too far behind their foreign counterparts.
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Mozal also underperformed in relation to expected benefits for local firms. Only 2,500 jobs were created indirectly via linkages between Mozal and local suppliers and contracts during the first phase of its development.

Strenuous efforts by the International Finance Corporation (IFC), Mozambique government and donors meant that multiple Small and Medium-sized Enterprise (SME) development programmes specifically supported local small firms to benefit from Mozal's presence by helping to improve their knowledge, developing their capacity to supply and training them in skills for winning contracts, for example. Mozal was also encouraged to unbundle its contracts so that smaller contractors were able to fulfil them.

These considerable efforts and resources to support small firms meant that, during its second phase of development, Mozal generated an estimated \$35 million for local companies¹².

It is also wrong to underestimate the contribution of the small-scale parts of the economy to economic development in their own right.

As demonstrated by the economic crisis, the small-scale parts of the economy can be important in coping with economic shocks. As was observed in Zambia and Cambodia, they provide an important safety net during tough economic times, providing a source of income for laid-off workers. The capacity of small business to respond quickly to new market conditions is recognised as an important feature for the economy in general¹³.

FDI is generally preferred as one of the most stable forms of capital inflows to poor countries, but the economic crisis demonstrated that this is not necessarily always the case. During the crisis, the International Monetary Fund (IMF) observed that FDI inflows to Africa fell by 0.5 per cent in 2008 and predicted that these would fall by a further 25 per cent in 2009. In both countries studied for this report, scaling back of

¹² Thomas, R. (2005), FDI and SME Linkages: The case of MOZAL I & II, SADC-Development Finance Resource Centre

¹³ See for example Liedholm and Mead (1999) Small Enterprises and Economic Development

FDI as a result of the crisis had a significant negative impact on the local economy. In Zambia, copper mining projects were scaled back, resulting in 19,239 job losses (over 30 per cent of the total workforce) by June 2008¹⁴. In Cambodia, an estimated 30 to 40 per cent of construction projects have been postponed or cancelled resulting in a significant number of job losses¹⁵.

The need to tackle vulnerability has been a key lesson of this crisis and should be an important feature of future policy as crises become the 'new normal' for developing countries¹⁶. Social protection schemes are an important way of preventing short-term shocks from dire, long-term impacts. However, during this most recent crisis, these did not often help the poorest, most marginalised people, or those in rural areas¹⁷. This has led some to point out the need to support existing coping strategies. Improving conditions for small-scale farming and businesses could be part of such a strategy.

Small-scale businesses can also help to reduce exposure to shocks by acting as part of diversification strategies, which are important to developing countries emerging from the crisis.

Both Zambia and Cambodia were made more vulnerable to the impacts of the economic crisis by their reliance on a few exports and even markets. Zambia is practically a one-product economy – copper accounts for 80 per cent of its exports. When the copper price fell by two thirds during the early phase of the crisis, nearly one third of jobs in the sector were lost¹⁸. For Cambodia, garments and textiles account for 65 per cent of exports, 66 per cent of which go to the US market. Garment exports to the US dropped by 26.1 per cent during the first nine months of 2009 and dropped by 5.3 per cent to the EU. Nearly

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The need to tackle vulnerability has been a key lesson of the crisis.
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¹⁴ Chrispin Radoka Matenda (2010), The Impact of the Global Financial and Economic Crisis on Job Losses and Conditions of Work in the Mining Sector in Zambia, ILO Zambia

¹⁵ UNDP (2009), UNDP's Response to the Global Economic Crisis, UNDP Cambodia

¹⁶ Kanbur (2010), Protecting the Poor Against the Next Crisis, www.kanbur.aem.cornell.edu

¹⁷ Hossain, Eyben et al (2009), Accounts of the Crisis: Poor people's experience of the food, fuel and financial crises in five countries, Institute of Development Studies, Sussex

¹⁸ Green, D. (December 2009), A Copper-Bottomed Crisis, Oxfam Discussion Paper, Oxfam GB, Oxford

73,000 garment workers out of 351,340 lost their jobs and 50 factories closed as a result¹⁹.

Impressive double digit growth rates of both economies in the years prior to the crisis were revealed to be narrow-based and precarious. Both governments are now seeking to diversify their economies to make growth more broad-based and robust. Agriculture and tourism have been identified by both countries' governments as potential sources of diversification – sectors in which small-scale businesses dominate.

As well as sectoral diversification, fostering small-scale businesses can also help to diversify markets. It is notable that countries such as India, with significant domestic and regional markets, were in a better position to weather the storm. Supporting them can provide a boost to local markets and local demand and generate more multipliers. This is because small-scale businesses tend to focus on domestic markets, buying, selling and investing locally.

As well as providing more resilient growth, involving small-scale businesses can produce growth that reduces poverty and promotes wellbeing. The economic crisis highlighted the inadequacy of Gross Domestic Product (GDP) as a measure of progress. Growth had not necessarily reflected a real increase in economic activity, created jobs or increased the wellbeing of most people. The need to achieve such 'quality' growth has been heightened by the urgency to reduce poverty without threatening sustainability and the climate.

The International Labour Organization (ILO) Jobs Pact has been endorsed by the G20 as a cornerstone of its economic recovery plan. This was not only because of the destruction of jobs during the economic crisis (an estimated 200 million workers will be pushed into poverty as a result of the crisis, according to the ILO)²⁰, but also because of the recognition of the failure of a model of economic development that resulted in jobless growth. The World Bank²¹ recognised that growth in developing countries was accompanied by persistent high levels of unemployment, particularly among young people. This directly

¹⁹ Hang Chuon Naron (2009), *Cambodian Economy: Charting the course of a brighter future*, Supreme National Economic Council, Ministry of Economy and Finance, Phnom Penh, Cambodia

²⁰ Global Employment Trends report, 2009.

²¹ World Development Indicators 2008

implies an important role for the small-scale sector, which tends to be more labour intensive. In fact, the jobs pact calls for special support to small businesses.

As labour is one of the main assets for poor people and employment is one of the main channels through which they participate in growth, investing in the small-scale sector is important to ensuring that growth is more efficient in reducing poverty. While transnational corporations (TNCs) and large firms can provide high-quality jobs, these may be based on short-term contracts and may be dependent on frequently changing global sourcing decisions. It is unlikely that these will be created in sufficient number to replace small-scale parts of the economy in providing livelihoods to an estimated 70 per cent of the population in low-income countries. According to the World Bank, growth in the agriculture sector has twice the impact in terms of poverty reduction as growth in other sectors. A 2004 report²² by the United Nations Industrial Development Organization (UNIDO) concluded that large-scale firms do not have a reduced impact on poverty reduction because of fewer multipliers and employment impacts.

"At present, the role of the [large-scale] garment industry as a source of new employment and income generation is becoming more crucial. However, the paid employment in the manufacturing sector could not fully compensate the inadequate employment absorption in agriculture. More robust agricultural development can revive the role of agriculture as a significant contributor to employment and income generation."

H.E. Dr. Hang Chuon Naron

Secretary of State, Economy and Finance, Royal Government of Cambodia²³

Particularly when considering aspects of poverty beyond income, focusing on poor entrepreneurship pays dividends, as it can improve social and even political standing, as well as boosting feelings of self-esteem. In fact, these considerations featured as prominently as income in terms of benefits of economic activity by small businesses consulted for this study.



.. paid employment in the manufacturing sector could not fully compensate the inadequate employment absorption in agriculture.

H.E. Dr. Hang Chuon Naron
Secretary of State, Economy and Finance, Royal Government of Cambodia



²² UNIDO (2004), Industrial Development Report 2004

²³ Hang Chuon Naron (2009), Cambodian Economy: Charting the course of a brighter future, Supreme National Economic Council, Ministry of Economy and Finance, Phnom Penh, Cambodia

Being small is not of itself a virtue; it can be a symptom of failure and many small businesses are set up out of desperation as survival strategies. Not all small businesses will be viable. Even in Organisation for Economic Co-operation and Development (OECD) countries, start-up failure rates are high. However, the small-scale sector can be a source of growth, diversification and innovation. In Cambodia, for example, small information technology (IT) service providers have sprung up to provide internet and other services to poor men and women in urban and peri-urban areas. This is a dynamic and growing part of the economy.

The importance of small businesses to economies, including in developed countries, is recognised in the European Union (EU)'s Lisbon and Europe 2020 strategies. Their importance for growth, employment, innovation and flexibility is highlighted. Small and micro businesses make up 98.7 per cent of firms in the EU, 50.4 per cent of employment and 39.9 per cent of value added in the economy. Even though small firms systematically have lower productivity than larger ones, the EU's Small Business Act sets out a comprehensive framework of support, as well as guidelines on taking their needs into account in regulatory and policy decisions.²⁴

Even when business are survivalist and stay small, they remain important in fighting poverty and increasing wellbeing. They provide some security and opportunities to earn income to the majority of poor men and women in developing countries, in the absence of any real alternative.

Far from being an economic basket case, investing in the small-scale sector should be part of a good recovery. The following section highlights what needs to change to put this into practice to put small-holder farmers and small businesses at the heart of a good recovery strategy.

²⁴ European Commission (2009) *SME performance review: annual report on SMEs*.

4. Do we need new strategies?

The focus of governments and donors is on across-the-board reforms intended to benefit all businesses, rather than on delivering an investment climate and economic development strategy that works for the poorest majority of small businesses.

While it is difficult to argue against common advice to simplify procedures or improve ports, there is little evidence that a sweeping approach to reforms has worked well for poor, small-scale producers and businesses. In fact, their needs are very specific and there are real policy choices and spending trade-offs to be made, depending on whether their needs are prioritised or not.

Interviews with officials and workshops with small-holder farmers and small business owners in Zambia and Cambodia have led CAFOD to these initial conclusions. To make economic development work for poor producers and small businesses, three things need to change:

- The spending bias needs to be corrected
- The policy blind spot needs to be addressed
- There needs to be more representation and voice for poor producers and small businesses.

These three areas are examined in more detail in the following sections.

4.1 CORRECTING THE SPENDING BIAS

Supporting small businesses tends to be resource intensive. For example, in Ireland and Singapore, countries whose SME schemes are frequently held up as exemplary, the cost of this support is approximately \$10 per head of the population per year.

Developing country government budgets are severely constrained. Officials at the agriculture and trade/industry ministries interviewed for this study observed that the majority of resources were still directed at larger firms and attracting



One of the main issues in the fight against poverty is targeting the groups bypassed in the development process by addressing the specific needs of these groups.

H.E. Dr. Hang Chuon Naron
Secretary of State, Economy and Finance, Royal Government of Cambodia



foreign investment. Budgets for the new SME strategy in Zambia, for example, or for setting up cooperatives for smallholder farmers in Cambodia still represented only a small fraction of these budgets, although they were slowly increasing.

In Zambia, although the government was set to launch its first SME strategy, spending on this part of the economy was still small and probably inadequate to put the schemes into practice²⁵. Local non-government organisations (NGOs) and small business owners interviewed for this study felt that support for small businesses compared poorly to costs of the dominant mining sector in terms of fiscal incentives, subsidised power costs and maintenance to roads.

In Cambodia, while the government had recognised the need to invest in rural development and small-scale agriculture after the crisis, a key plank of this strategy – to set up and support farmers’ cooperatives – accounted for a negligible share of budget and was not expected to rise significantly²⁶. In contrast, local NGOs complained of the cost of Economic Land Concessions being sold cheaply to encourage foreign investment in large-scale agriculture.

Donors demonstrate a similar bias against significant investment in small-scale sectors. The Fair Trade Advocacy Organisation and the Dutch church development agency, ICCO found that, in EU and member state funding on aid for trade, there were only few, small and sporadic commitments and projects specifically targeted at small producers.²⁷

The branch of the International Finance Corporation (IFC) that lends to SMEs has a broad definition of SMEs. It divides firms according to the loans size:

- micro firms are those receiving loans of less than \$10,000
- small firm have loans of less than \$100,000, and
- medium firms have loans of less that \$1 million or \$2 million.

²⁵ Interview with official, Ministry of Trade, April 2010

²⁶ Interview with official, Ministry of Agriculture, June 2010

²⁷ Report at:

http://www.wfto.com/index.php?option=com_content&task=view&id=1030&Itemid=293



In Zambia, although the government was set to launch its first SME strategy, spending on this part of the economy was still small.



Even with these expansive definitions, over 70 per cent of its \$97.1 billion loan portfolio goes to medium-sized enterprises²⁸.

Where SME-specific projects do exist, the problem of poor targeting due to definitions can undermine their usefulness to the poorest economic actors, who are inevitably harder to reach.

There is no standard definition of a small business, but to allow international comparisons, most countries use thresholds similar to that of the OECD. Most governments distinguish Small and Medium-sized Enterprises (SMEs) when designing policies and targeting spending programmes. These definitions are often inappropriate to developing country markets, where some of the largest firms and local entities of foreign multinationals can qualify as SMEs. The main criterion for defining small businesses is the number of employees. The EU, Zambia and Cambodia all define micro businesses as those with fewer than 10 employees and small businesses as those with less than 50 employees, despite very different relative importance or characteristics of such firms across these varied economies. The African Development Bank recommends using 50 employees as the cut-off for SMEs. For the World Bank, SME activities can apply to firms with up to 300 employees, whilst the United Nations Development Programme (UNDP) cut-off is 250. Targeting SMEs is clearly not consistent with targeting the poorest.

Small business representatives in Zambia praised the government's Citizen's Economic Empowerment Programme, which is intended to support marginalised economic actors and the small business sector. However, they complained that the local entity of a large multinational company was able to benefit because of broad SME definitions, while they frequently failed to secure support because of onerous application procedures. Many small businesses are ineligible for such schemes as they are not formally registered. Instead, they rely on NGO programmes²⁹.



Where SME-specific projects do exist, the problem of poor targeting can undermine their usefulness.



²⁸ By value. For figures see IFC (2010) IFC Financing to MSMEs around the World, IFC Factsheet

²⁹ CAFOD Workshop, April 2010

MAKING THE POOR WORK FOR MARKETS OR MAKING MARKETS WORK FOR THE POOR?

The aim of successfully integrating small-scale producers and businesses into markets as a route out of poverty is not new. Useful lessons can be learned from many existing initiatives.

Micro loans have helped many poor women in particular to set up small businesses and generate income for their families. These initiatives have improved their participation in markets, by tackling their practical and economic constraints, but also by focusing on increasing the skills of recipients and tackling the social and political barriers they face. However, the microfinance industry has grown quickly and become increasingly competitive and focused on profit. Broader objectives of empowerment, increased wellbeing and improving the mechanisms of participation of poor men and women in markets have become diluted or even lost, with the result that many poor men and women have become exploited by a tool originally designed to empower them in markets.

Other initiatives involve increasing participation of small-scale producers and businesses in global supply chains. The experience of small-holder farmers in supplying supermarkets is too easily one of exploitation, or even exclusion from agricultural retail markets in the face of unequal competition. However, some initiatives have successfully improved the participation of poor men and women in these markets, where they have striven to improve their bargaining position, to reinforce their rights to land and water, for example, or to tackle social and political exclusion and not simply to increase their participation in markets.

CAFOD partner COMAL³⁰ has taken a truly progressive approach to making markets work for the poor in Honduras. Rather than focusing on increasing participation in conventional markets (on whatever terms), COMAL has created local market systems designed around the needs of poor communities. Local producer organisations grow food crops for guaranteed prices that are sold through a network of community stores, which allow poor families to buy on credit as well as to pay in kind. There is even a special local 'solidarity' currency to encourage spending on

³⁰ In full: Red de Comercialización Comunitaria Alternativa

local produce. COMAL also provides training and low-interest loans, as well as supporting people to become aware of issues affecting them and to become politically active. The COMAL experience does not focus on increasing the profitability of local businesses. These economies of solidarity have indeed increased their income, but they have been driven by the need to provide food security while supporting the social cohesion and political standing of these communities.

Far from being an exception, COMAL's success demonstrates a broader lesson that is also evident in the successes and failures of other initiatives. Making markets work for the poor is about much more than increasing their participation in markets. The quality of that participation is critical. Conventional market institutions and relationships will be exploitative unless these are modified. Profit objectives are not necessarily the best drivers of pro-poor approaches, and interventions must be comprehensive, not simply economic.

4.2 CORRECTING THE POLICY BLIND SPOT

When it comes to policy reforms, the World Bank's private sector development approach serves very much as a blueprint for interventions in developing countries and donor activities. Key tools include the investment climate analyses and doing business rankings (DBRs).

These rankings score countries according to a checklist of reforms, published annually worldwide as an indicator of the attractiveness of countries as a destination for investors.

Evidence from this study indicates that these rankings do influence the policy choices and priorities of national governments.

"Zambia moved from 100 to number 90 in the World Bank report... We are now working towards improving our ranking to 50 in the 2011 report."

Dr Nsemukila, Permanent Secretary, Commerce Trade and Industry.³¹

³¹ Cited in *ZDA Spotlight*, Zambian Development Agency, Issue 10, March 2010.

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Zambia moved from 100 to number 90 in the World Bank report... We are now working towards improving our ranking to 50 in the 2011 report.

Dr Nsemukila, Permanent Secretary, Commerce Trade and Industry

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This can skew the priorities of governments that are hard pressed for financial and human resources. For example, they encourage the establishment of strong intellectual property regimes, which are costly to implement and enforce but will not benefit the majority of smaller firms. Other “doing business” reforms work against smaller businesses. For example, they advocate investor protection. These regimes tend to preclude conditions to use local suppliers, a tool that was used successfully by governments in the past to encourage linkages and more widespread benefits from the presence of foreign firms. World Bank promotion of land reforms and taxes to improve the investment climate may also work against local poor producers and businesses, depending on the local system and conditions. Other elements of importance to poorer economic actors – for example, accessible and affordable healthcare – were highlighted as key during CAFOD’s small business workshops, but are not prioritised in the DBRs.

While headline needs (as highlighted by the rankings) of large and small businesses may well be the same (credit, infrastructure, efficient regulation, good governance) – in reality very different actions, policies and priorities might be needed. For example, in Cambodia the government is investing in railroad and port infrastructure, which would earn a higher DBR, but is likely to benefit larger, exporting firms disproportionately. Rural infrastructure – transport, energy and communications – would be a more pro-poor investment, but would be more difficult to achieve, with little result in the rankings.

The views of poor producers and business are unlikely to be reflected in the rankings. The World Bank recognises one of the limitations of DBRs is that the surveys contributing to them include only the views of formalised, medium-sized and urban firms.

4.3 IMPROVING VOICE AND REPRESENTATION

Independent evaluators found that the potential distorting effects of DBRs was mitigated by their role in kick-starting

discussions with business and other groups, rather than guiding policy in a vacuum³².

CAFOD's findings point to this optimism being misplaced, at least as far as correcting policy bias against poor, small-scale economic actors. These groups are largely absent from such discussions.

Across-the-board reforms intended to guard against policies working for particular interest groups are not necessarily grounded in the political reality of most countries, where lobbying and political influence is more likely to come from larger firms, including those from overseas.

Where small business organisations do exist, they tend to exclude the poorest, either by requiring membership fees or by specifically barring informal enterprises from their membership.

NGO projects that include an element of increasing the voices and representation of small businesses and farmers have been among the most effective. For example, Caritas Cambodia works with rural communities to help farmers in direct, practical ways with inputs and skills training, but also by setting up farmers' groups for joint decision-making. These groups not only promote good working practices (contributing to the economic viability of the project) and to social cohesion, they have provided a platform for representatives to take issues to local government, for example, informing them when assistance with particular vaccines for livestock is needed.

Developing priorities and choices for reform from the perspective of poor producers and business owners is therefore possible and can look very different.

The next section explores in more detail the lessons learned from programmes targeted at these groups, as well as from consultations with them. Such analysis begins to point to the direction of reforms needed to make markets work for poor farmers and business owners.

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Where small business organisations do exist, they tend to exclude the poorest, either by requiring membership fees or by specifically barring informal enterprises from their membership.

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³² Independent Evaluation Group (2004), *Doing Business: An independent evaluation of the World Bank/IFC doing business indicators*

5. What would trickle up reforms look like? What do we know about supporting poor economic actors in markets?

In order to make markets work for poor producers and traders, it is not enough to assume that standard reforms will work. It is necessary to understand their characteristics as economic actors, their experiences of markets, their objectives and constraints in relation to them.

The following section highlights key features of these aspects, drawn from research commissioned by CAFOD from the Institute for Development Studies (IDS) on how poor men and women experience markets, analysis of CAFOD partners' and other civil society organisations' livelihoods programmes – learning lessons about what works in practice – and consultations with smallholder farmers and small business owners in Cambodia and Zambia.

5.1 PRIORITISE RISK AND VULNERABILITY

After the economic crisis, much more attention is being paid to reducing risk and to improving the prospects of the most vulnerable – both nations and households – to cope with apparently inevitable shocks. Such aims are now (almost) on a par with achieving impressive growth rates, which is, after all, the dominant objective of most economic policy.

The economic crisis has been just the latest illustration of the need to tackle risk and vulnerability to make poor livelihoods work and poor businesses viable.

To cope with risk, households often adopt strategies that have negative impacts over the longer term.

In Cambodia, 70 per cent of rural households surveyed by the Cambodia Economic Association reported incurring new loans between January and June 2009. These loans were for consumption rather than investment, affecting the long-term financial sustainability of the household. The majority reported

worries about repayments. Households also reported reduced consumption, with 63 per cent eating only two meals a day³³.

In Zambia, key informants taking part in surveys for the Jesuit Centre for Theological Reflection (JCTR)'s social research in peri-urban areas also reported evidence of households' changing eating habits, as well as cutting back on health spending³⁴.

Temporary set-backs can have long-term, dire consequences for individuals, as well as negative impacts for the businesses that they run – either farms or informal firms. For example, for most small businesses, personal and business finances are not separate. Private consumption loans will therefore affect the viability of their business. As their businesses tend to rely on the labour of household members, changes in health and food expenditure will also have an impact.

For the poor farmers and small-scale entrepreneurs interviewed by CAFOD as part of this study, risk and vulnerability have been long-standing, overriding concerns guiding their economic activities.

As part of the workshops undertaken for this study, small-scale farmers and small business owners took part in an exercise to determine whether the level or stability of prices mattered most to them. For the vast majority of participants, stability of prices mattered more than the level of prices. Respondents were prepared to accept slightly higher prices, if these were more stable. Reasons given were that this helped to manage expenditure and aid planning. With respect to income, results were more mixed. Some participants preferred a stable income, but a small majority either accepted unstable incomes as an inevitability (this corresponded particularly to small-holder farmers, whose income fluctuated according to harvests) or they welcomed it as a spur to do better and to seek new opportunities (predominantly the small business owners).

Two qualifications to this acceptance of fluctuating incomes should be made. All respondents felt there needed to be a minimum average income, so that savings from peak times

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Temporary set-backs can have long-term, direct consequences for individuals, as well as negative impacts for the businesses that they run.

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³³ NGO Sothath (2010), Impacts of the Economic Downturn on Households and Communities in Cambodia, Cambodia Economic Association

³⁴ Interviews, April 2010

were adequate to compensate for troughs. In addition, respondents explained that they diversified economic activities, so that one might peak while another was dipping. This could especially impact on competitiveness of small businesses, which are often sole traders. While the flexibility of a diverse livelihood can be positive in rural areas where seasonality is an issue, the need to cope and manage risk can also undermine the ability of poor men and women to make their businesses efficient and competitive. The small businesses interviewed for this study cited the lack of skilled labour as a major constraint to the success of their enterprises. Many ran their businesses as sole enterprises. Having to run several businesses to keep a stable income, while performing many or all of the business functions themselves, means that these entrepreneurs are at a severe disadvantage when developing their businesses.

The importance of social safety nets and maintaining spending on public services is an old lesson from previous crises that is now widely accepted. However, many poor households and businesses still fall through the cracks. Research by IDS demonstrates that these schemes can reach only a fraction of affected households and tend to disadvantage those that are hardest to reach – the poorest, most marginalised and rural households. The importance of supporting widespread, existing informal safety nets such as those provided by farming incomes and small businesses is especially important in such a context.

Policies at a macro-level that minimise risk should also be given priority. For example, the importance of price stability for the workshop participants suggests that calls for the G20 to prioritise commodity market fluctuations and speculation are well placed. Fluctuations in exchange rates and inflation rates can also adversely affect price stability – and were highlighted as problems by small business owners interviewed by CAFOD. G20 policies to strengthen and stabilise the international monetary system are also therefore high priorities from the perspective of poor owners of small businesses. Similarly, there is an urgent need for World Trade Organization (WTO) and regional trade talks to include mechanisms to mitigate the impacts of price drops and import surges on poor households caused by integration into global markets.

5.2 MAKE LOCAL MARKETS WORK

The second aspect of markets highlighted by those interviewed, was the lack of real demand for the products and services that they produced or traded in.

"We grow many kinds [of crops] now but there is still a problem that sometimes we go to the market and there is no one there to buy it."

The focus on demand is also sometimes absent in NGO projects. Some beneficiaries of a bee-keeping scheme, for example, were concerned that too many households copied successful activities so that there was a risk of insufficient customers. Factoring in demand is a feature of those that are most successful. For example, a group of mushroom growers managed supply in the market by distributing equipment only to authorised growers and traders and were thereby able to ensure that the livelihoods remained economically viable.

Many efforts in finding markets for poor producers and entrepreneurs have focused on finding new, usually external, markets for their products.

This strategy can and does work but should not be adopted at the expense of making local markets work by stimulating local demand.

The lack of attention to demand and to local and domestic markets in economic development strategies has been notable in recent decades.

However, the success of cash transfer schemes is provoking renewed interest in these issues. These can be beneficial, not only because they can stimulate and support the local economy during difficult times, but also because of their significant multiplier effects. A study in Malawi found that, for every \$1 transferred, at least \$2 extra was generated. The study found that small businesses and smallholder farmers benefited in particular from the boost to demand from such schemes, as these inject money into local markets in a way that it is more

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We grow many kinds [of crops] now but there is still a problem that sometimes we go to the market and there is no one there to buy it.

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likely to stay in the local economy and provide widespread benefits – through buying local goods and services³⁵.

Boosting local markets is likely to be of particular help to poor enterprises, as they provide goods and services that are locally appropriate and infrastructure becomes less of a barrier. While coaching some enterprises to be able to produce at a standard to satisfy international standards and demand can be useful, providing opportunities in local markets can bring benefits across the board.

Failing to develop local markets can have the opposite effect, stifling innovation and enterprise development before they have got off the ground. So-called neighbourhood effects mean that it is harder for economic activities to get off the ground and begin to build wealth when the vast majority of local inhabitants (and therefore potential clients) are poor.

Boosting domestic markets would involve other more innovative strategies that have dominated advice to date: for example, supporting countries to use public procurement to provide a source of demand for small businesses and farmers, and shifting from export to local and regional focus in trade strategies and infrastructure spending.

5.3 FOCUS ON THE SOCIAL AND THE POLITICAL

The most successful livelihoods projects are those that address power relations and social exclusion, not just economic deprivation. Social and political considerations were also important to interviewees for this study.

Most business transactions demanded an understanding of local norms and customs, and most deals depended on relations and customs rather than formal contracts.

Furthermore, poor business men and women operate from a position of weakness that directly impacts on their business. For example, in Zambia small businesses often found that they had to do business on poor terms because they needed customers and had limited options. They were also in a precarious position when things went wrong, as they lacked resources and



Successful pro-poor economic policy must also take account of social and political considerations.



³⁵ Simon Davies and James Davey (2008), A Regional Approach to Estimating the Importance of Cash Transfers on the market: the case of CTs in Malawi, Development Policy Review, 26(1) 91-111

expertise when agreements were broken. In Cambodia, small-scale farmers knew that they were not always paid the best price by middlemen coming to villages to buy produce. Nevertheless, they were forced to sell on unfavourable terms, even if they had information to challenge the prices, because of the need for an immediate sale and their weak bargaining position.

Successful NGO projects tackle social and political exclusion. Forming cooperatives was effective, as this increased bargaining power. Groups were encouraged to prioritise the poorest and most marginalised in their activities to strengthen community cohesion rather than reinforce inequities and power imbalances. These groups often succeeded in securing a voice in local decision-making bodies, having a direct say in decision-making by local government.

Successful pro-poor economic policy must also then take account of social and political considerations. This can include supporting collectives in the manner of NGO projects, but also include other policy measures. For example:

- government assistance to MSEs to negotiate terms with larger contractors, provide legal assistance and model contracts, and to allow for collective bids
- tackling power of supply chains, e.g. tackling vertical integration and anti-competitive behaviour of supermarkets
- increasing voice of small businesses (including informal) and small-scale farmers in policy-making and consultations
- assessing social and political impacts of economic reforms.

5.4 COMPREHENSIVE AND APPROPRIATE

Successful NGO projects did not focus on one improvement, but tackled all aspects affecting the viability of poor businesses – economic, social, political and human.

For example, CAFOD rural livelihoods projects not only identified market opportunities and supported viable economic activities, they also organised communities to build and maintain local roads (generating shared ownership, social capital and political voice, as well as essential local

infrastructure). They invested in health and education, both as a development outcome in its own right – but also as an investment in a key asset of the poor – their labour.

Successful projects also tended to start with an analysis of what assets – natural, cultural, social, human, economic – could be built upon locally, rather than helicoptering in new, unrelated activities.

"You cannot just expect them to start something new. They lack confidence. You must assess their assets, start with the skills they have, what they have and build from there. You cannot start from scratch."

Nay Vicheka, Project Manager, Caritas Cambodia

CAFOD supported a project in Timor Leste that observes these principles with some success (see box).

STARTING LOCAL: ONE VILLAGE, ONE PRODUCT MOVEMENT

The One Village One Product movement encourages communities to use local human, material and cultural resources to create value-added products/services for domestic and external markets. It has helped to improve productivity in some cases, changed the value chain structure in other cases, provided market access and reached many thousands of households. It does not only help to improve economic standing. When properly designed, it also improves social conditions. One of the underlying principles of these schemes is mobilisation of local knowledge and resources. It is therefore not surprising that these projects work best where local communities feel ownership of the schemes and where attention is paid, for example, to gender issues³⁶.

CAFOD partner CDC (Centro de Desenvolvimento Comunitario) works with groups in Timor Leste to develop small businesses that process local crops and sell them to local markets. In a country where 80 per cent of the population still relies on agriculture, and where nearly all the processed food consumed is imported, such projects truly make markets work for local people. They provide markets for local small-holder farmers

³⁶ Kurokawa, Tembo and te Velde (April 2010), Challenges for the One Village, One Product movement in sub-Saharan African: Insights from Malawi, Japan and Thailand, ODI/JICA

while also guaranteeing employment for group members. CDC has provided training on technical issues, such as chip making, as well as organisational issues such as good, sound financial management.

Natercia Matos da Costa Lemos is a member of one such group in Baucau – Timor Leste’s second largest city. Her group started with banana chips in early 2008. Just over one year later, they have diversified to include five different chip varieties – such as cassava and sweet potato. The group ensures employment for its 20 members, as well as a guaranteed buyer for local farmers. Natercia started by selling ten banana chip bags each week to the local gas station in Baucau and now sells more than 70 bags per week.

Each group has their own niche: chilli paste, tomato sauce, jams, chips, virgin coconut oil, tamarind candies etc. The jam group is very successful, more than doubling their sales from last year. In fact, one of their best buyers is the government, which purchases the jams to supply the local school feeding programme.

Different priorities and approaches are needed from the blueprint currently in favour. Governments need to intervene at a local level to identify and actively support economic opportunities that benefit poor men and women in whatever way necessary – investing in human capital, supporting community development or providing help with credit. Improving representation of small businesses and small-scale farmers is a key part of a pro-poor economic reform agenda.

Whilst the G20 may focus on economic development, this cannot be at the expense of aid pledges, investment in social sectors, such as health and education, and achievement of the Millennium Development Goals (MDGs).

6. Conclusions: What needs to change?

The economic crisis has highlighted the value and need for a new 'think small' approach to private sector development. Thinking small can deliver better 'quality' growth – growth that increases wellbeing, is more equitable and is resilient. It can do this by promoting the dignity and stable livelihoods of the most marginalised as well as the most numerous actors in the economy.

This is different from previous approaches to pro-poor growth. It means putting their needs at the heart of economic development and growth strategies, not simply inserting them into international supply chains or the existing blueprint. It does not mean simply increasing the number of SME projects or programmes.

This should not be seen as an anti-export, anti-growth or anti-foreign investment strategy. On the contrary, it is a necessary complement to making these goals viable. However, it is clear that the current conventional approach by itself is failing the poorest. Trickle up needs to improve for trickle down to work. If small-scale actors are better supported, they are better able to benefit from access to global markets or to capitalise on the presence of foreign investors.

While there are programmes and even policies that target small businesses, they are piecemeal and often not targeted at the right place. A first step is the need for tools for targeting: appropriate definitions, data and analysis of the sector in order to design appropriate schemes and policies. Another important component is organising representation of these groups and enabling them to take part effectively in policy and spending consultations.

This should pave the way to correcting a spending bias against the small-scale sector, evident in current aid for trade trends and other government, donor and multilateral spending.

There is also a need to correct policy assumptions and consequent bias against small businesses. We cannot assume

that generic investment climate reforms work for them. What is needed is specific analysis, based on a bottom-up understanding of their experiences of and interactions with markets, as well as direct consultation with them.

To make this shift in priorities work, this critical debate needs to take place at the G20 and World Bank, as well as with donors and developing country governments. While small businesses and farmers lack representation on most platforms, whilst low-income countries and civil society are absent from G20 debates and marginalised in other institutions, this will not happen.

CAFOD is the catholic agency for overseas development which works with communities in over 40 countries in Africa, Asia and Latin America, working to fight poverty and injustice. The agency works with all people regardless of race, gender, religion or nationality.

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