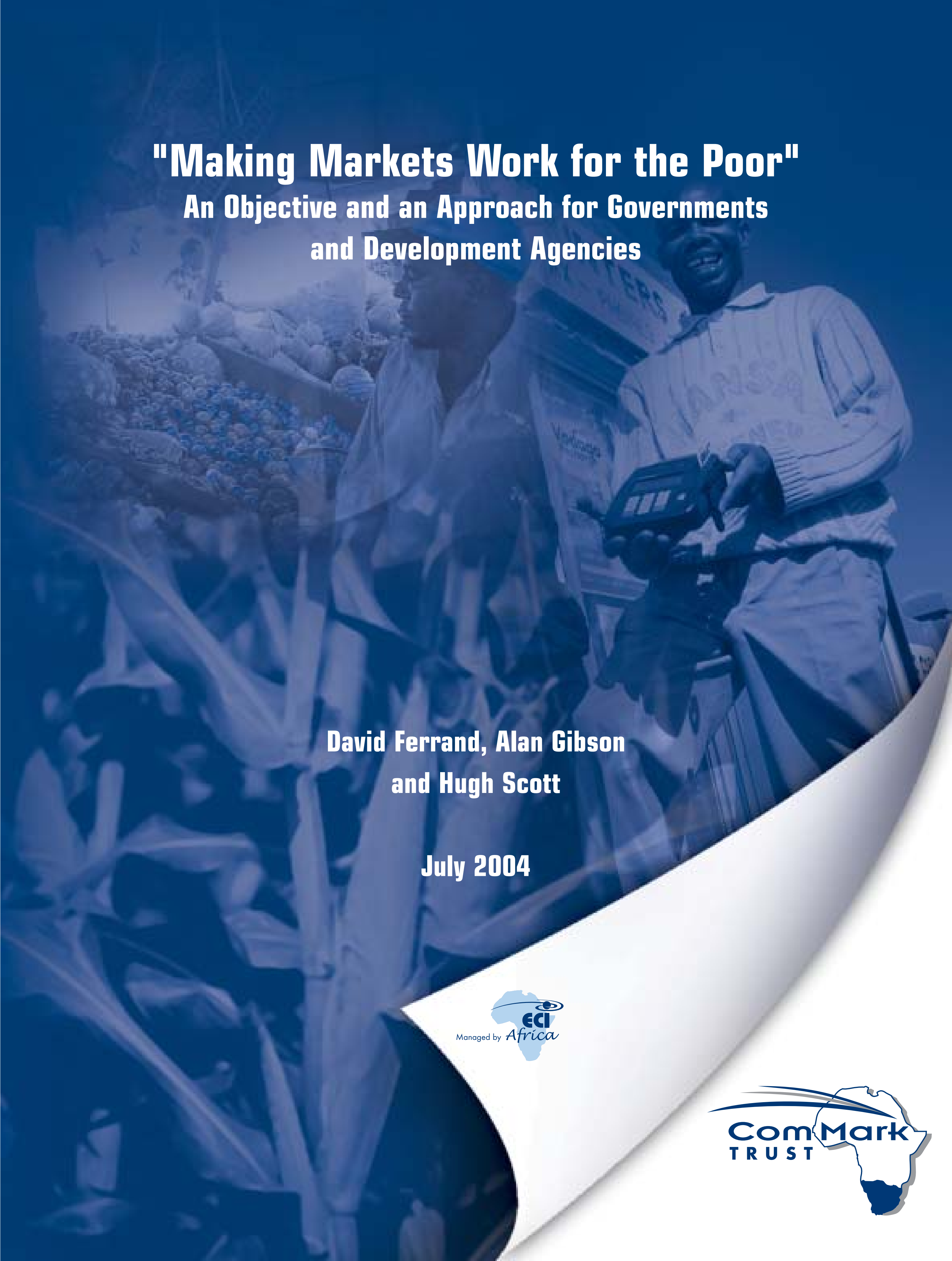

"Making Markets Work for the Poor"

An Objective and an Approach for Governments and Development Agencies

David Ferrand, Alan Gibson and Hugh Scott

July 2004

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PREFACE

Governments and development agencies' efforts at promoting economic growth and poverty reduction have achieved mixed results. Different approaches have been tried – some have aimed at major regulatory reform and others intervened to deliver products and services directly and "get things done" – with great achievements in some countries countered by obvious lack of success elsewhere.

What's worked and what hasn't? Why is it that poor people in some countries have experienced huge improvements in their lives and retain the realistic expectation of more to come while, in many others, the numbers of the poor have grown and their prospects, apparently, are bleak? What explains this difference and how can we learn the right lessons to allow more people to move away from poverty?

Answers to many of these questions lie in markets. Approaches to development that have tapped into and shaped the power of markets successfully have allowed poor people – as consumers, producers and workers – to contribute to and benefit from economic growth. But in other situations markets palpably do not offer this opportunity.

It is the promise of massive, positive impact that makes "making markets work for the poor" a fundamental challenge for governments and development agencies. This paper, drawing on the lessons of international experience, is about how these players should go about addressing this objective and about the essence of the approach they should use to realise the promise of markets.

1. INTRODUCTION

Poverty is reducing substantially for many millions of people and a critical reason for this achievement is improved functioning of markets. Countries that have been successful in reducing poverty have utilised and shaped markets to provide the right conditions – jobs, opportunities, services, information – to allow people to raise their incomes. In short, they have made the markets in which the poor exist – as consumers, producers and workers – work more effectively for them.

This good news for many is not shared by the grim reality for many millions of others for whom poverty persists and the pathway to progress offered by inclusive and functioning markets is denied. The great progress made in some countries is placed in a stark light by the weak performance of others.

The role of markets is critical to understanding and addressing poverty. Different types of market situation impinge on the lives of the poor on a daily basis, for example factor markets of labour, land and financial services, commodity and product markets (such as in agriculture), services markets (such as infrastructure and business services), and markets for services that are traditionally seen as more public in nature (such as water). While for some, markets are seen as the domain of the rich and market reform a process from which the poor must be *protected*, this paper argues that by *improving* the operations of such markets, the potential exists to raise incomes and reduce poverty on a massive scale.

The great progress made in some countries in reducing poverty is placed in a stark light by the weak performance of others.

This paper is about the promise and challenge of making markets work for the poor (MMW4P). Aimed at senior officials in government departments, development agencies and organisations of civil society (including business membership organisations and not-for-profit agencies), it is about MMW4P as an *objective* and as an *approach*.

MMW4P as an *objective* – setting out the rationale for why this should be a priority, building on hard evidence and new thinking that has accompanied this.

MMW4P as an *approach* – while not a precise formula, at its heart is a rigorous process and a market development framework to guide analysis and action that:

- is grounded in where the poor are in markets,
- understands the complexity of market systems,
- builds realistic plans for how markets can work more effectively in the future and
- sets out to address the key impediments to better functioning markets.

The paper is structured as follows: **Section 2** sets out the broad rationale for MMW4P in relation to wider benefits from developing markets. **Section 3** looks in more depth at how markets can work for the poor (and how they might not) and in doing so brings out the complex realities of market operations. A key reason for the often poor results of government and agency interventions is that they are not grounded in an understanding of this complexity, as indicated in **Section 4**. Given this, **Section 5** turns to what organisations should do in taking MMW4P into their work. Building on a model of a functioning market, it sets out the main questions that should always be considered. Finally, **Section 6** summarises key considerations for the way ahead and provides a listing of additional resources and reading.

The paper is not a "how to" manual; this isn't possible given the breadth and scale of the MMW4P challenge. It is a brief strategic guideline; an invitation to organisations to consider their role in the light of the great potential to act to bring about positive market change to improve the lives of the poor dramatically.

2. WHY MARKETS MATTER FOR POVERTY REDUCTION

Differing levels of economic growth is the key reason explaining the world's variable experience in reducing poverty. Where growth has been strong – as in China and much of South Asia – the average incomes of hundreds of millions of people have risen above poverty levels; where it has been weak, poverty has persisted and, in some cases, worsened (Table 1).

Table 1: The Links Between Growth and Income Poverty (1990-99)[1]

Region	Growth (annual per capital (%)	Overall reduction (%) in proportion of people living on less than $1 per day
East Asia and the Pacific	6.4	14.9
South Asia	3.3	8.4
Latin American and the Caribbean	1.6	–0.1
Sub-Saharan Africa	–0.4	–1.5
Central and eastern Europe and CIS	1.9	–3.5

Markets matter for the poor in the same way that they matter to everyone else; their effective functioning is good for all.

Markets are at the heart of successful economic growth. As a key "organising principle" of economic activity, providing the structure and processes to determine what is produced and consumed, their link with growth and with poverty – at one level – is clear. Markets matter for the poor in the same way that they matter to everyone else; their effective functioning is good for all.

But for the poor, the operations of markets are *especially* important. Markets offer the primary means through which poor people can participate in economic activity. They can do so as producers (farmers, business owners), as employees (i.e. providers of labour) and as consumers (of goods and services). Markets operating in an inclusive manner serve the poor by offering them the things they need – jobs, opportunities, finance, products – to increase their incomes. Conversely, where markets are working exclusively, poor people have fewer chances to participate and benefit from economic growth. The condition of income poverty is therefore linked inextricably to the functioning of markets.

If people don't participate in economies through markets – if for example unemployment is high or if access to appropriate goods and services is limited – the only way in which growth benefits can trickle through to them is via tax or charity-funded services. While these are, of course, absolutely necessary, participation as welfare-recipients is less likely to provide a basis for lasting development. Countries that have been more successful in reducing poverty tend to have done better at getting people *into* markets effectively rather than relying on redistribution through transfers. And this matters not just because of poverty reduction *per se*. No matter the nature of their political processes, societies that largely exclude people from markets are nurturing alienation, dependency and division. There is a qualitative dimension to growth – not just *how much* but *how matters* – which can be explained substantially by the operation of markets.[a]

So, markets matter particularly for the poor because how they operate shapes the extent to which the poor are a part of and benefit from overall economic growth; or are excluded, with the potential for heightened inequality.

The vision underpinning MMW4P as an objective is of more effective and more inclusive markets – getting poor people successfully into markets – as a means of achieving growth and large-scale poverty reduction. Markets can help the poor but often don't, or don't do it as well as they should. As a process, the task in MMW4P is to understand why this is so – to recognise and address the barriers that currently prevent markets from working for the poor.

[a] For example, East Asia's relatively strong record in reducing poverty through growth stands in contrast to that of Latin America.

3. HOW DO MARKETS WORK FOR (AND AGAINST) THE POOR?

Markets are a part of poor people's daily reality. In buying what they need to survive, in earning money and in planning for the future, people live within markets. So, what do we do mean when we talk of markets working *for* – or indeed *against* – the poor? What does bringing people into markets mean when markets – like the weather – are just *there?* In short, beyond the immediate appeal of the slogan, what does a market working for the poor look like?

To understand this, let's consider "poor people" in different contexts. Around the world they total around 1.2 – 2.7bn in number[b]. Although they're probably unaware of their official designation ("the poor") they will know that their lives could be better. And they are very different. In different locations – urban and rural. With different cultures and diverse values. In different political systems. With different livelihoods, opportunities and expectations.

Markets are part of poor people's daily reality.

Different…but in other ways very much alike. Sharing, for example, the perception that their fundamental problem is lack of income. They are poor because they don't have enough money[c] (hardly a surprising revelation but sometimes lost in wider development verbiage!) And sharing another core truth; for the poor – wherever they are – to succeed, their immediate environment has to offer them a chance to access what they need to earn an income, build assets and take advantage of opportunities. And throughout the world this environment is shaped significantly by the – sometimes complex – ways in which markets function.

In rural areas generally, access to productive land is obviously critical for agricultural production. In China and Vietnam the rural poor face a seemingly formidable problem; unable to take title of land it might be expected that they lack the ownership and incentives necessary to invest. Yet, in each case, changing the rules governing the use of land has brought about large increases in investment and production. In China changes in government policy – allowing individuals to keep surplus output – were the trigger for rapid growth, while in Vietnam the introduction of land use certificates has conferred on households the right to rent, mortgage and inherit.[2 and 3]

The African equivalents of productive Vietnamese and Chinese peasants also need access to land but face a different set of problematic rules. Traditional ownership patterns and the social norms around these prevail and often act as a major disincentive to investment and risk-taking. In Kenya, women farmers are responsible for the cultivation of many small farms. However, their rights to the land they farm is traditionally weak and being eroded further as customary ownership changes to more formal systems of titling – existing gender biases having been amplified by the transition to a formal system. Weak property rights therefore reduce the ability and motivation to raise finance and to invest; as a result, productivity and output fall.

However, change *is* possible within these structures. Adaptations of customary institutions of communal land in South Africa allowed a previously moribund land rental market to grow from 4% of households to 25% in a 4-year period[d]. This resulted in improvements in farm efficiency (from reduced losses) and in equity – with those with land (and without the means to cultivate) renting to those without land (but with the resources and ability to farm).[4]

Financial services play a critical role in every economy. Differences in financial sector development have been shown to account for around 20% of variances in overall growth rates.[5] However, from many different contexts, compelling evidence attests to the special importance of financial markets for poor households. In Indonesia the clients of a micro-finance institution were able to increase their incomes by three times the rate of comparable non-clients. Poor households in Bangladesh have been able to reduce their vulnerability to natural disasters by using financial services to accumulate savings to use in time of need. Similar illustrations can be found across the world from Bolivia to Zimbabwe.

The main asset of the poor as a whole, however, is not financial services or land – it is their labour. Some countries allow them to use this asset more than others. Countries that have experienced significant investment in labour-intensive garment industries, taking advantage of favourable access to foreign markets; have appropriate labour conditions that are conducive to employment

[b] Depending on whether poverty is defined with respect to $1 or $2 per day

[c] The outcomes from many different Poverty Reduction Strategy Paper (PRSP) processes undertaken over the last few years confirm this shared view of priorities.

[d] Figures here are from a pilot project in KwaZulu-Natal that, although still on a small-scale, is now being replicated by government extension services more widely.

creation. Bangladesh's 1.5 million garment workers have few formal employment guarantees but wages are 2–3 times higher than in comparable jobs.[6 and 7] Lesotho's 55,000 new garment sector employees experience similar benefits.

Poor people in other countries are unlikely to benefit from this kind of opportunity. Clearly, labour is *not* simply another market, and appropriate measures – such as formal regulations and consumer pressures – are important to counter unethical behaviour. However, in countries such as South Africa and Croatia[8], labour market laws are slanted towards job incumbents (insiders) rather than the unemployed (outsiders), and a raft of regulation raises employment costs. The cost of protecting those in employment has undermined the rights of those without, contributing to their exclusion from the market.[9]

Whether in Bangladesh or Lesotho, "cheap labour" is unlikely to be a competitive advantage indefinitely and, like any industry moving from a commodity to a branded product, the garment industry will need to innovate to survive. For this to happen, its "offer" to customers needs to emphasise features such as quality and reliability, not just price. Developing these will, in turn, require greater use of specialised services related to productivity, design and human resources. Currently in Bangladesh, bought-in services account for around 20 – 25% of output,[10] a lower proportion than in more advanced industries. Ultimately, for employees to continue to benefit from the garment product market, the market for business services must also develop.

Markets can work for the poor, and there are often complex reasons why they don't. If we want to act to enhance markets, we need to understand this complexity.

For many poor farmers, the commodity market for which they produce is the most important. Getting a good deal for them is dependent critically on information – provided through a variety of means. In South Africa, small-scale wool-growers typically secure one-quarter of the returns per animal of large-scale farmers. The key reason for this difference lies in the access of large-scale farmers to production and marketing services that allow them to invest to enhance their productivity.[11]

Overcoming this "information constraint" to make markets work more effectively for the poor is a function of many issues. Physical proximity helps and is dependent on infrastructure services. Increasingly also, however, access to information depends on the performance of other markets. In India, large-scale agricultural input companies are providing a range of IT-based services to rural areas – seeing value in the resulting improved relationships with their farmers – and allowing them to access information on prices, methods and other trends. Improvements in the information content of *input* markets therefore improves the performance of *output* markets and helps farmers position themselves better within these.[12] In Uganda, there are a few similar innovations but, with the liberalisation of radio markets, new radio stations are keen to meet audience demands and programming content is 70% agriculture-focused.[13]

And finally poor people that live in countries where mobile phone networks have expanded quickly find that their ability to source relevant information has grown. Although this is a triumph of technology, the real story is one of a changed government role; from inefficient monopoly provider of a public service to regulator of competitive private companies offering a private service. This change has allowed the market to work. In Africa in particular, the impact of this change has been dramatic with 11 million new subscribers per annum.[14 and 15]

These examples show how markets can work for the poor – and the often complex reasons why they don't. If we want to act to enhance markets, we need to understand this complexity. They also illustrate three specific, interdependent principles.

(i) While markets work in a variety of ways, ultimately they benefit the poor by being accessible and appropriate.

- Accessibility may be as simple as physical proximity but often it relates to more complex factors including *know-how* and *know-who*. In financial markets lack of understanding of how to open a bank account or providing references from existing account holders may present even greater constraints than physical distance from banks.

- Appropriateness relates to the characteristics of what is dealt with in the market – notably in terms of prices and conditions. Do regulations allow employers to offer suitable jobs for the poor? Does a business service make sense to the way in which a small-scale trader operates her business? Will banks accept a deposit of the size which a poor person can afford to start saving?

Access, price and conditions together comprise "the deal" offered to poor people by markets. MMW4P is about enhancing the nature of this deal.

Access, price and conditions together comprise "the deal" offered to poor people by markets. *MMW4P is about enhancing the nature of "the deal".*

(ii) The extent to which markets work/don't work is dependent on a number of factors. These are complex and differ with market and location but (generalising) we can see markets as being comprised of three related dimensions – sets of functions within which key market players (the private sector, government and wider civil society), can play a role.

- The core market: the supply/demand essence of any market, sellers and buyers, providers and consumers, that constitute the central transaction process,
- Institutions: the rules of the game, formal and informal, and the enforcement of these, that shape how markets operate,
- Services and infrastructure that lubricate markets, providing the means through which they can change and improve (and which themselves may constitute markets).

MMW4P means improving markets in relation to some or all of these elements.

(iii) Markets are inter-connected. Effective land markets can provide the collateral basis to stimulate financial services markets; specialised business services markets impact on manufacturing competitiveness; relevant information provided through a functioning media feeds into many markets; improved telecommunication offers previously unconnected farmers the means to access up-to-date price information. Markets are inextricably linked. The performance of one, whether good or bad, impinges on another. The real cause of one market's weak performance may lie in a related market. *MMW4P requires that inter-connectedness is recognised when identifying causes of under-performance.*

4. WHY ARE OUR ACTIONS OFTEN UNSUCCESSFUL?

The importance and complexity of markets is not a new phenomenon, even if our re-discovery of them may sometimes imply this is so. The policies and resources of development agencies and governments have always impacted on markets' development. In this light, looking back over the last decade or two, what has been the experience in making markets work for the poor and what can be learned that might help guide actions in the future?

Although the world of "development" is blessed with many different schools of thought, two dominant strands of relevant thinking and practice stand out. If markets can be likened to an (unruly) orchestra comprised of different players with the overall rules provided by a conductor (government) – whose role is to create a conducive environment for successful performance – each of these strands represents different approaches to assist the orchestra to produce agreeable music.

4.1 THE REMOTE REFORMERS

This has been the dominant group in development circles over many years. The key tenets of this "market-friendly" approach are relatively straight-forward: fiscal discipline, low marginal taxes and a broader tax base, competent delivery of basic services, openness to trade and investment, liberalising microeconomic reform and privatisation of state enterprises. And while there has never been unanimity on every aspect of this, the so-called Washington Consensus has been at the heart of the policy prescription advocated by most agencies and pursued by many governments.

While the conductor may know the melody he wants, the orchestra can't play much of it and, in any case, think it's not right for them!

The essence of this approach is that getting "prices right" in an economy will provide an overarching framework conducive to development – and this is the key priority for governments. While not a fixed blueprint, the "right" policy prescription hasn't varied much from one country to another. Driven by sometimes distant economists, this is based on a view of what economies should be – rather than what they are. By tweaking the *fundamentals*, the supply-side of economies, poised and willing, would be unleashed and market development and growth would follow.

After many years, the experience of this approach is best described as mixed. Some countries have succeeded in achieving strong growth and others, palpably, have not. Especially in Africa, the development experience has been one of substantial failure.

Why has this happened? Various reasons are cited. Corruption, sometimes on a grand scale, has derailed privatisation reform – such as in Russia. Poor infrastructure has prevented African farmers from taking advantage of newly-created opportunities. Weak prudential regulation undermined financial sector reform in Asia. Weak government capacity has hindered attempts at regulatory reform.

What cannot be said is that the set of principles and policy prescriptions espoused by the Washington Consensus are wrong – they still embody the main thrust of mainstream development approaches. However, clearly this has not been enough. In particular, three critical weaknesses have undermined the reformers' efforts:

1. A failure to recognise the importance of institutions and the complexity of institutional change processes (Box 1). Achieving changes in laws (*de jure*) and regulations is of little use if enforcement practices are not also changed (*de facto*). Developing countries often have no shortage of splendid laws arising from noble motivations that have no positive meaning in practice and, indeed, when usurped by vested interests in officialdom, can be entirely negative. Changing the formal rules of the game is usually one, but perhaps a small, part of wider change processes yet many in development agencies cling to a misplaced faith in their ability to "decree" change.

Box 1: MMW4P and New Institutional Economics

A key influence on thinking and practice in MMW4P is new institutional economics (NIE). At the heart of institutional thinking is recognition of the central economic role played by the institutions which structure human interaction. NIE asserts that costs in an economy are composed of both transformation costs – related to production – and transaction costs – the costs of doing business in markets. Institutions play a critical role in reducing the costs of transacting by providing the structure which supports co-ordination and co-operation within markets. In essence the efficiency of a market can be measured in terms of transaction costs.

Institutions impact on co-ordination by conveying reliable information to market participants. For example, the institutions of weights and measures allow buyers in a market to rapidly assess key characteristics of a potential transaction. Underpinning the effectiveness of institutions as rules is the question of how rules are enforced. Where there is little incentive to deviate from a rule then there is little need for enforcement. However there may be significant benefits to say breaking a contractual undertaking and the cost of enforcement is a key contributor to the transactions cost. Tackled on an individual basis it is frequently too high – the transaction simply becomes unviable. Credible and reliable enforcement of institutions by a third party offers the potential for dramatically reducing transaction costs. In modern market economies the enforcement of critical institutions – such as property rights, contract law and standards – is *the* core economic role of the state. State and increasingly supranational agencies (WTO, ISO etc) have the potential for credible, low cost enforcement across markets encompassing huge numbers of participants. Just as new production technologies offer advances in reducing transformation costs through improved productivity, effective institutions offer huge economies of scale in reducing transaction costs in markets.

Despite the potential economic efficiency of effective modern formal institutions the development of such structures is by no means an inevitable evolution. The incentives for individual players within an economy are not necessarily aligned with those of the economy as a whole. An elite may find itself well served by a corrupt commercial justice system. Informal institutions at the village level may establish major gender inequities relating to rights over economic assets. It is the poor who are most often vulnerable to such distortions in the institutional framework either directly undermining their ability to transact in markets or indirectly through the impediments to broad-based economic growth. Influencing the development of formal institutions which allow markets to work for the poor requires a deep understanding of the context. It is not sufficient to understand simply how envisaged changes might impact on poor people in theory, but also to assess the incentives for change among others – especially the rich and powerful – and the potential for mis-enforcement. Unless a system of business standards can credibly act in an impartial, inclusive and efficient way, it may act against the interests of the poor and deregulation might be more beneficial.

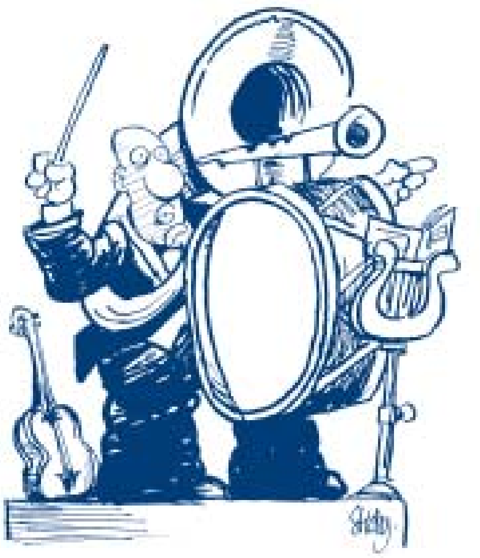
2. A failure to recognise that formal institutions are embedded within a wider framework of informal institutions, culture and power structures. Since institutions do matter, actions cannot be divorced from process; economic development has to be driven and owned by countries and people in those countries. Change therefore has to be based on an understanding of the political economy of countries, especially the incentives of different groups in change processes.

3. A failure to recognise other "constraints" to development that hinder businesses and their ability to respond to macro signals such as weak business practices, networks, sources of information, infrastructure and levels of skill and knowledge. In their way, these are as systemic and fundamental as formal rules (Box 2).

Overall, remote reformers have set about the task of development with a clear sense of vision, of what should be there. Unfortunately, while the conductor may know the melody he wants, this has been created without any input from the orchestra, who don't know it, can't play much of it and, in any case, think it's not right for them!

4.1 THE IMPULSIVE INTERVENERS

Parallel to the travails of the reformers, this second strand of development practice has been concerned with intervening directly with businesses to "get things done". While acknowledging the need for the right macro framework, the essence of the approach is that, if the market isn't delivering well, we should replace it and provide finance, advice, materials and expertise directly. We should do it ourselves or "instruct" the private sector to do it.



Impulsive interveners have become players in the orchestra – and the wider conducting task has been neglected.

Although paradoxically often from within the same organisations as reformers (and working concurrently with them!) interveners emphasise their *on-the-ground, in-the-field, hands-on* business ethos. Impatient with fine words, in contrast with their more academic colleagues, they see their approach as immediate and tangible. Working with appropriate agencies (government or not-for-profit organisations) and using a variety of forms to deliver directed, subsidised "support", their view of the future was one that envisaged partner organisations carrying on this same practical task. After many years, with some exceptions, it is clear that this experience has not been hugely positive. Major reviews of international experience indicate that results of these interventions have been characterised by limited:

- *outreach*, with typically a minute proportion of businesses being served;
- *sustainability*, with the whole apparatus of business "support" being so heavily subsidised as to need continuous infusions of external resources;
- *impact,* with only patchy signs of real business improvement and little evidence that directed support stimulates wider development

Indeed, especially in smaller and weaker economies where donor influence has more sway, some have argued that such is the distortion to business practice and incentives created by these interventions that their overall impact has been negative.

Why has this happened? At one level, performance here confirms a wider truth; that the best deliverers of services to business tend to be close to and have a business-like, transactional relationship with them. Governments and not-for-profit agencies are unlikely to have these characteristics. More generally, even when businesses have benefited from direct provision and this is cited as an example of success, questions remain over *what* is being demonstrated. "How to run a business well or how beating a path to donor or government largesse can be a profitable strategy"?

Overall, the interveners' experience has been undermined by two essential flaws. First, a failure to place businesses in a market context. The interveners' instinct has been to ask the question "What problems do businesses have and how can I solve them?" and *not* to ask the more relevant, bigger systemic questions: "What problems do businesses have? Why isn't the market environment providing solutions to these? and How can I address these factors?" Improving the functioning of markets does not feature on interveners' list of priorities and the underlying market causes shaping business behaviour are therefore not addressed. Logically, if the right questions are not asked, the right approaches are unlikely to emerge.

Remote reformers and impulsive interveners are united by a failure to ground what they do in market realities.

Second, a failure to recognise the appropriate roles of key players. Services are primarily private – best delivered and paid for through market mechanisms – rather than public goods. In encouraging direct "solutions" governments have commonly drifted into roles which are inappropriate and unsustainable.

The interveners' experience – representing a vast swathe of development practice – illustrates a real desire to have a direct impact and to lead by example. However, to pursue the orchestra analogy, in becoming direct market actors they become players in the orchestra; the wider conducting task is neglected and the overall impact reduced to a rather ineffectual collection of individual efforts (a fractious din!)

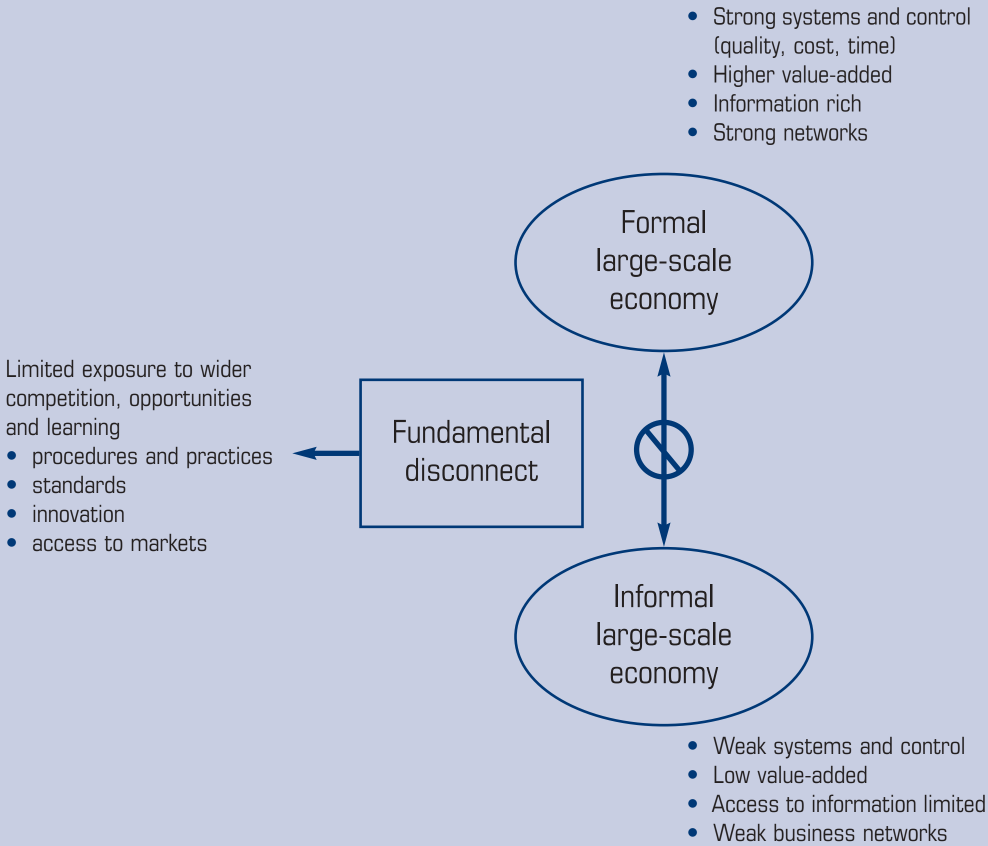
Remote reformers and impulsive interveners – both (slight) caricatures – are obviously different; the strengths of one being the weaknesses of the other. While one focuses on a distant framework that is disconnected from institutional realities the other springs from a desire to bring about final *ends* that neglects the importance of market *means*. They are united by a common problem; namely a failure to ground what they do in market realities, in the way that market systems work and a clear vision of how they can work better.

More positively, however, they are connected by a conviction that the lessons from these experiences need to be and are being learned.[16 and 17] And from both in recent years has come a clear recognition of the potential to effect large-scale change and how this can be done. MMW4P is the result of this hard learning.

Box 2: The Discontinuity of African Economies

Approaches to business development in Africa have often floundered because of a failure to address the *discontinuity* that characterises its' economies. On the one hand informal sector businesses employ vast numbers of people. They typically offer low value-added products, have loose procedures and limited networks. They are generally ill-served by formal organisations – for example, poor producers cannot afford to go to a court to recover a debt and the debtor knows that.

In contrast, large formal businesses operate in information-rich environments, with formal procedures, higher-value added products and linkages. They are generally better served by formal organisations – for example, a bank can and will pursue a debtor and the debtor knows that. The rules (formal and informal) governing each of these worlds are very different; generally they act to exclude poor people from the formal economy.



Effective development – making markets work for both formal and informal economies – needs to address this fundamental "disconnect". But often this doesn't happen. Reforming approaches fail because they don't address the complex nature of the relevant "rules of the game". Interveners often fail because they focus on informal businesses in isolation from the larger business system *or* try to "do the deals" for businesses (making themselves part of the market) *or*, by instructing businesses to interact, distort incentives and reinforce differences.

Approaches to business development in Africa have often floundered because of a failure to address the discontinuity that characterises its' economies.

5. MAKING MARKETS WORK: THE APPROACH

A number of points are clear. Functioning markets are critical for poverty reduction but often markets do not work effectively for the poor. Often the actions of governments and development agencies have been inconsistent with MMW4P as an objective. There are identifiable reasons for this situation that stem from a failure to ground actions in a detailed understanding of market realities.

Given this, what can be done about it? How can government and development agency resources be used to tap into the potential of markets to enhance the lives of the poor? How can the approach of MMW4P be made consistent with the objective of MMW4P? How can the market "orchestra" be assisted to perform well?

Functioning markets are critical for poverty reduction. How can the market "orchestra" be assisted to perform well?

This section outlines three steps that are the foundation of the MMW4P approach, highlights the critical questions and principles within these and applies these in relation to one example – the financial services market of South Africa.

5.1 understanding markets, focusing on factors that inhibit their improved performance and opportunities for their development;

5.2 developing a vision of the future, a picture of how markets can work more effectively; and

5.3 acting to build markets, addressing the core issues that will allow markets to become more effective and inclusive (i.e. to move from 5.1 to 5.2).

In doing so it is clear that MMW4P is not a precise methodology competing with other market analysis and planning tools. This rather is a framework within which a plethora of tools (listed at the end of the paper) can be used; key considerations that should always be borne in mind in turning MMW4P into reality. This, therefore, is a logical process to guide thinking and action, to shape the *mindset* of MMW4P. Its value lies in the discipline and clarity it imposes, not the line-by-line instruction offered. Nor is it a linear flow that "ends" in action; markets change and our understanding of them needs to be continually re-assessed in the light of actions – the flow is circular and continuous.

5.1 UNDERSTANDING MARKETS

The starting point in MMW4P is to understand the current situation of, and the causes of underdevelopment in, a market, in terms of its key *dimensions* (Figure 1)[e]:

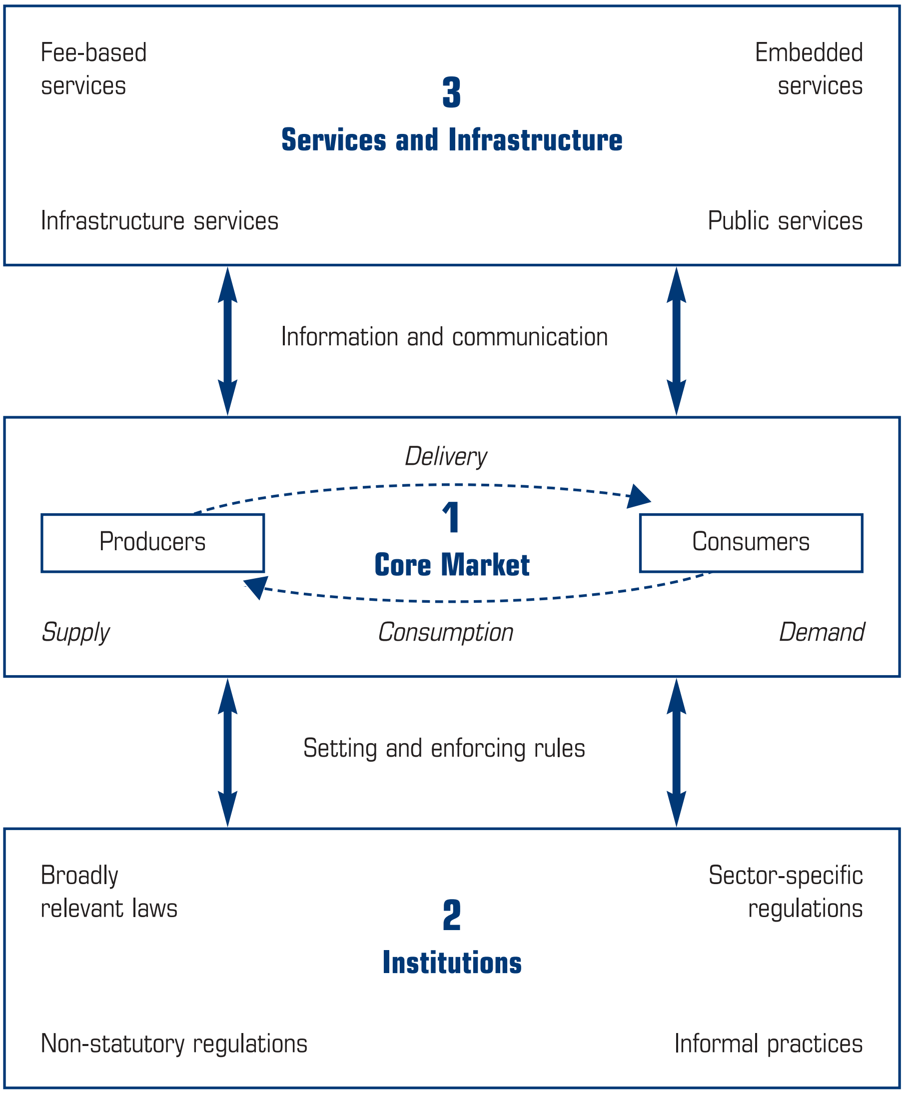
- The Core Market – the central supply-demand set of transactions
- Institutions – the rules of the game framework.
- Services and Infrastructure

In any market, the central function is the provision of goods or services to paying customers. When markets work well transaction costs for the poor are reduced. How well markets work is shaped by their immediate environment: by institutions – rules, regulations and standards and their enforcement through various mechanisms – and by services and infrastructure that serve primarily – through information and communication – to lubricate the core market. Institutions and services and infrastructure constitute the key elements in the environment that enables core markets to operate (and the main focus of MMW4P is to improve that environment).

Three other factors impinge on markets. First, by their nature, the influence of *factor markets* is all-pervasive and is felt in every market situation. Even if they are not the core market for analysis, their influence is important. Second, market functions are always undertaken by *key players* – the formal or informal creators and enforcers of rules, the providers of services and infrastructure as well as in the core market. Market players are either from the private sector, from government or from wider civil society, particularly business membership organisations (BMOs) and not-for-profit organisations[f]. Arrangements between these three sets of players create a market. Third, all three dimensions of markets can be seen in an *international, national and local* context.

Institutions and services and infrastructure constitute the key elements in the environment that enables core markets to operate.

Figure 1: Key Market Dimensions



[e] Each dimension constitutes a set of functions –
(1) delivery and consumption,
(2) and enforcing rules and
(3) information and communication
– that take place within any market

[f] Consumer groups might also be considered as important players within civil society.

The Core Market

The focus here is on gaining an accurate picture of the overall market – of performance, trends, players, structures and issues – and, importantly, of where the poor "fit in". The core market constitutes not just a single set of producers and consumers but, especially in commodity markets, entire systems of value-added where material is purchased, processed and sold (and where, inevitably, the market is more complicated). So there are two critical questions:

What are the wider influences on and prospects for the market?

For commodity and service markets in particular, the wider set of influences on their prospects and the main drivers of growth need to be understood – even if they may seem rather distant from the poor. For major industries, this will include overall market structure – identifying and assessing the performance of key players and the main channels of value-added; relevant market, trade and consumer trends; and relevant production and technology-related developments. Any analysis should therefore emerge with a clear and informed view of the "big issues" impinging on a market. For example:

- For commodities, the wider issue of industrialised nation import barriers and agriculture subsidies affect farmers as a whole,
- For manufacturing sectors, the competitive challenge posed by other countries or industries in relation to price, quality and reliability,
- For service markets, emerging trends in service delivery,
- For export-focused industries, underlying end-consumer trends and fashions.

The poor participate in a market as consumers, producers and employees either directly or indirectly.

Where the poor are in markets: what is the current level of market participation?

The poor participate in a market as consumers, producers or employees either directly or indirectly.

- As consumers, goods and services such as finance, water, electricity and food are important and, in rural areas, agricultural inputs. For these, the key indications of market engagement are use and consumption (are they consuming and, if so, how much?) and their perception of these (satisfaction and image).
- As producers, for example as small-scale farmers, participation is shown in their number, market share and in the prices or margins they achieve.
- As employees, numbers and wages (and other conditions) are key indicators. For general labour market analysis, of course, a key indicator of market development is non-participation (i.e. unemployment).

If the poor's participation in markets is not direct, the route through which markets can affect them needs to be identified. This might be solely on the basis of growth benefits – increased spending and transfers from government. Or, it may be on the basis of more direct linkages – for example, more secure employment or better services from improved business competitiveness. Different groups of the poor may also have conflicting interests: the poor as consumers may welcome the arrival of cheaper prices from large-scale food retailers in a liberalised market; small food retailers less so.

Responses to these questions set out the context of the big issues underpinning the development of markets and the poor within them. Addressing these usually requires examination of the wider environment of institutions and services and infrastructure.

Institutions

The focus here is on the sets of rules and the enforcement mechanisms, both formal and informal, that impinge upon markets. In general, governments are the main formal players in the institutional framework, setting and enforcing rules. However, the private sector through membership associations may be more effective at developing industry-specific regulations where ownership rests firmly with the industry.

In understanding the institutional framework, the priority is not to exhaustively list all the rules that exist but to identify those that impact most on market development and, importantly, how they impact on markets. There are three sets of questions.

What are the most important formal rules impinging on the market and the poor? How do they impact on the market?
These include:

- ❑ Generally applicable rules such as contract, property, consumer protection, weights and measures, health and safety, competition and tax laws. These are not market-specific but may be most important in shaping markets.
- ❑ Sector-specific rules such as banking law, electricity and telecommunications acts and land use and ownership laws.
- ❑ Non-statutory regulations such as industry codes of good conduct, quality standards and registers.

The balance of relative importance between these institutional types varies but it is increasingly recognised that *general* institutions are fundamental to creating a conducive market environment. It is the lowest income countries that have the most regulation, the least market-friendly environments and the highest costs of doing business (Box 3).

Box 3: The Importance of Appropriate General Regulation for Business

Current work by the World Bank[18] has highlighted the significance of regulation in relation to market development and overall business performance. Regulation was assessed with respect to five sets of critical business tasks:

- starting a business (for example, registration processes and capital requirements)
- hiring and firing workers* (limits on contracts, working hours and wages)
- enforcing a contract (systems for tracking cases, complexity of procedures and attorney representation)
- getting credit* (creditor protection, restriction on assets as collateral, credit information procedures)and
- closing a business (extent of court powers and bankruptcy procedures).

The overall conclusions from this analysis are clear: cumbersome regulation is associated with lower productivity, informality and corruption. And while there are considerable differences between countries, there are recurrent "best practice" lessons in how to regulate to stimulate markets generally. For example, reducing the number of steps for business registration, simplifying procedures, reducing capital requirements and making the process administrative rather than judicial fosters business formalisation.

But the process of regulatory reform is not static. Regulation has to be reviewed and reformed on a regular basis – in this way reflecting the dynamic, changing nature of the market environment it should be seeking to shape positively.

* Both are related to factor markets rather than general regulations but have a pervasive influence.

Regulation has to be reviewed and reformed on a regular basis, reflecting the dynamic, changing nature of the market environment.

What (and who) are the most important formal mechanisms for enforcement of rules? How do they impact on the market?
This includes, for example, commercial justice institutions, government systems of regulation, inspection and licensing, inland revenue authorities, company and land registries, industry regulators, local government tax offices, and self-regulation mechanisms in business associations.

What are the most important informal institutions impinging on the market? How do they impact on the market?
The actual way in which rules are interpreted and applied is often shaped more by social norms and practices as much as the letter of the law. Where formal rules and their application are weak, the business environment is governed by the informal. For example, the general impracticality of commercial and contract law often means that business transactions become focused within established networks. In Africa, it is recognised widely

that existing networks and trust – arising from particular conditions – is a key hindrance to trading and to collaborative business arrangements. While in Asia many networks of small business have developed – to permit flexible production specialisation – in Africa this is less common. Overall, when the formal rules surrounding markets are weak *and* informal institutions are not supportive of business transactions, the environment for markets is significantly dysfunctional.

■ **Services and Infrastructure**

In considering services and infrastructure, the final dimension of any market, two key questions should be asked.

What are the main services offered currently in a market, how are they offered and by whom? What has been the experience of the key market players in consuming these services?

Service and infrastructure are the "loosest" dimension within this view of markets. Moreover their apparent intangibility leads some to ask a basic question: where are the services in any particular market? In practice, services can take a number of different forms:

- ❑ Fee-based business services such as business consulting, accountancy, training, design, advertising, network brokering, computer services, security, accountancy, legal, market research, technical information and equipment maintenance.

- ❑ "Embedded" business services where no separate fee is paid but which are included within the commercial transaction – for example, market designs as part of a retailer-producer relationship or livestock advice from input supplier to farmer

- ❑ Infrastructure: this includes electricity, telephones, roads and water. While these are conventionally seen as *hard*, physical facilities, at the point of consumption they are (soft) services.

- ❑ Public services – although not a fixed category and often allied to regulatory roles, there are clearly some services that are aimed at a wider public purpose, including business statistics, public health and information on regulations.

A valid analysis must identify the causes of market weakness. If this analysis is wrong nothing else can be right.

Three important facts about services and infrastructure are noteworthy. First, a complicating fact of life is highlighted; markets are interdependent and where one ends and another begins is not always clear. The means through which many services are provided is often also a market. Is information on product design passed within the supply chain an inherent part of a "core market" or an external service market? One might argue it could be either but in this framework we identify it as a separate service in order that it is not subsumed (and therefore hidden) beneath other headings. The important point here is to identify the importance of different functions within a market; services and infrastructure are a key function.

Second, the importance of services and infrastructure is growing quickly. Information and knowledge are increasingly central to business competitiveness, allowing firms to specialise, reduce costs and innovate. Although traditionally regarded as a third leg of economies – the tertiary services sector now accounts for 60 – 70% of most industrialised economies. Fee-based business services alone account for typically 25 – 30%[9] and this figure is growing. Moreover, as trade and connectedness become more important for peripheral regions so the importance of transport and communications service grows.

Third, the service content in products is becoming an increasingly important way of providing a competitive advantage. For example, agriculture input suppliers increasingly compete on the basis of the information they can offer along with seeds, fertilisers etc.

[9] The conventional basis for categorising economic activity – the Standard Industrial Classification (SIC) – is not especially helpful in disaggregating services, so figures here are not exact.

Understanding the Performance of Markets

Emerging from an analysis of these three dimensions should be a clear view of the current reality of markets. In particular, this should provide a clear answer to three linked questions:

What are the underlying causes of the market's overall performance?
What are the core reasons why the poor's participation is currently weak?
What are the important strategic challenges to further build their participation?

Answers to these will differ from one situation to another. However, in all cases, a worthwhile, valid analysis must identify the causes, not merely the symptoms, of market weakness. This is more than semantics; the MMW4P approach is led by analysis. Identifying underlying causes is the necessary starting point for actions that can lead to major change and impact. If this analysis is wrong nothing else can be right! Distinguishing between symptoms and causes – and between layers of causes – is therefore important since it is causes that should be the focus of action.

Distinguishing between symptoms and causes is important as causes should be the focus of action.

Addressing these is the key focus of actions

Table 2: Distinguishing Between Causes and Symptoms

Outcome	Sympton	Underlying Cause
High rates of unemployment in the formal economy in South Africa	Lack of suitable additional jobs generated by businesses in the economy – jobless growth	Weak supply-side from lack of investment in basic education and skills. Formal labour laws provide many disincentives to potential employers to employing people other than on a casual basis
Poor access to land for small-scale farmers in Ethiopia[19]	Existing ownership and allocation of use excludes many of the willing and productive poor	Regulations restricting rental and sale of land to protect the poor (in practice repeal generated a major increase in output and equity)
Low levels of investment by SMEs in Kenya	SMEs report access and cost of credit as key constraint (adding weight to moves to re-establish interest rate controls)	Heavy government borrowing to finance the budget deficit resulted in a period of high interest rates which combined with weak creditor rights significantly reduced incentives for commercial banks to lend, especially to SMEs where transaction costs are relatively high. Interest rate controls would have further disincentivised lending to the SME sector. A recent reduction in market interest rates on government instruments has resulted in banks looking to expand lending to new markets (including SMEs).
Low prices and struggling sales in the Ghanaian export craft industry	Poor product differentiation, productivity and professionalism among exporting companies	Weak provision and low use of specialised management consulting, design and communication services (in turn a result of demand-side hesitancy and supply-side capacity weakness)
Low prices and returns for farmers producing basic commodities in Bangladesh	Poor productivity and decision-making by producers	Weak information flow through the supply chain on use of inputs and price trends (in turn a result of lack of innovation among key supply-chain players or weakness in local media players)

5.2 DEVELOPING A VISION OF THE FUTURE

Using the same framework as above, having considered where a market is currently, the next step is to consider how a market could work more effectively and sustainably in the future. This is the move from what *is* to what *could* be – and is where different market players are challenged to spell out their vision of the future and to justify this.

Building on our understanding of markets, the key question here is "How will the core causes of market weakness be overcome now and in the future?" More specifically, answers to the following questions are necessary:

How will appropriate rules be developed and enforced?
How will services and infrastructure be offered?
Who will undertake (who does?) and pay for (who pays?) each of these sets of functions?

The importance of this stage may seem obvious (after all this is the essence of planning) but is worth reiterating. Meaningful development is about more than a one-off hit, more than a short-term treatment of symptoms that provides a transient feel-good glow. It's about making a lasting and sustainable difference. And it is about impacting positively on more than one or two organisations.

Development is about more than a one-off hit. It s about making a lasting and substantial difference.

Yet it is common for this critical strategic step to be neglected. Interventions – and this is the norm – have been implemented with no clear picture of *market* sustainability, with no vision of how a market can work better more effectively in the future and of who will pay for and undertake key functions. Without this vision, inevitably, efforts become stuck with limited organisational change and the wider potential of systemic market-level change is unrealised. This distinction between organisational sustainability and the sustainability of markets is central to the MMW4P approach.

In general, questions of who does what and why – of where organisations should fit into a market map (Figure 1) – revolve around considerations of core competence and capacity:

- Core competence: what it is the distinctive advantage of particular players? What is it they can do better than others or that only they can do? For example, Business Membership Organisations, (BMOs), may be uniquely positioned to play an advocacy role because of their collective, representative nature. However, they are less likely to be able to deliver financial or consulting services directly because it conflicts with their obligation to represent members' common interest.

- Capacity: organisations' view of the role they play has to be informed by a realistic assessment of their capacity. A common problem for many developing countries has been "models" of government action from well-resourced high-income economies imported into their low capacity contexts which has often deflected resources from more important roles. Strategic decisions must also take cognisance of operational realities.

Questions of competence and capacity are important for every player in MMW4P but especially for government. A myth persists that being pro-market is somehow anti-government. MMW4P frequently *does* mean that governments should stop service delivery functions and regulate better. But, in whatever role, governments are of central importance in determining how markets should function. The key question is what role they should play? Governments have options; in any market situation government can choose between different roles such as direct provision and regulation and how it plays these roles.

Shaping the Institutional Environment

Setting and enforcing the rules of the game is always a core role for governments and can be critically important in stimulating markets. Commercial banking provides a potentially highly efficient system for intermediation in an economy, but these gains can only be obtained through effective regulation. Banks are principally lending other peoples' money rather than their own. Credible bank regulation controls the moral hazard this creates giving savers the confidence that their deposits are safe, a *sina qua non* of an effective banking system. However, regulation is more than a simple administrative task. It requires in-depth understanding of how an industry and market works to allow knowledgeable engagement with private sector players. It requires a clear vision of how the market can work and the role of different players within it. Two points are clear from a variety of experiences. First, there is a multiplicity of models of public-private interface and creativity is required in developing appropriate models for different situations (Table 3). Second, to develop the most appropriate approaches, governments need knowledge of markets and this remains a key capacity challenge.

Table 3: Alternatives to Legislation for Government [20]

The UK Government's Department of Trade and Industry lists 18 alternatives to formal legislation.	
• Do nothing	• Recommendation schemes
• Self-regulation	• Working with representative bodies
• Co-regulation	• Pre-market assessment schemes
• Information and education campaigns	• Post-market exclusion measures
• Financial (tax) incentives	• Service charters
• Tradable permit schemes	• Codes of practice
• Guarantee arrangements	• Standards (voluntary and regulatory)
• Mediation services	• Mandatory audits
• Quality marks	• Ombudsmen

A myth persists that being pro-market is somehow anti-government. Governments are of central importance in determining how markets should function.

■ **Government as a Direct Service Provider: Being Clear Why**

Governments have traditionally played a leading role in the provision of particular services, usually on the basis that there is a wider "public good" character to these that mean the poor in particular will be excluded if government doesn't provide directly. However, in considering direct provision roles, governments need to be aware of three trends:

❑ Direct provision is often "captured" by those who are better off and better connected – and in this process the poor, being neither, miss out.

❑ Services such as water, electricity, telecom which have all been seen to be the domain of the state, in many countries, are now successfully delivered by the private sector within a framework set by government. Moreover, by regulating and supervising appropriately, incentives can be set to reach the poor. In Latin America, this type of reform of water and electricity services has resulted in improvements in quality and access for all but especially for the poorest.[21]

❑ In other spheres such as business services and agriculture advice for farmers, it is clear that functioning markets can offer these through a range of formal and informal sources, as separate services or embedded within other products.

Even in other areas where governments will always be closely involved – public health and primary education – and the rationale for government provision is much stronger, the same general reasons that often lie behind poor government delivery elsewhere (the efficiency of public sector organisation) are relevant. In these cases, the potential of private sector delivery paid for and monitored by government has not been explored extensively.

■ **And the Role of Donors?**

If, for governments and civil society organisations, the strategic question of what role to play is essentially about where they fit in a market, for development agencies the answer to the same question is clear: nowhere. MMW4P as an approach takes development assistance at its word and envisages that its role is a temporary *facilitator*, a provider of finite and focused assistance to build markets successfully. Donors have no legitimate long-term role within a market. Any future vision that places them there will tend to build an acceptance of development assistance as a permanent, normal fixture within economies and encourage debilitating dependency. Donors' role is to facilitate others to do things; not do it themselves.

5.3 ACTING TO BUILD MARKETS

Given a clear understanding of a market and a clear view of the future, the focus of MMW4P actions is to build the market – to address the big systemic issues that will allow a market to function more effectively. Self-evidently, this will depend on the nature of the market and the constraints identified in looking to the future. Of course, an "it depends" response is vaguely unsatisfying. Even if it is clear that off-the-shelf blueprint "solutions" are of limited value, in disingenuous or incompetent hands, "it depends" may be a conveniently elastic justification for close to anything. However, there is no reason for defensiveness about this step in the MMW4P approach. Building an approach around market realities is a virtue – not a flaw. Preceding steps on understanding markets and building a view of the future are not academic exercises; they are actions at the heart of the approach and precisely the point where previous approaches have failed.

Notwithstanding these concerns, a number of overarching principles are applicable in guiding our actions – many of which have particular implications for key players in markets – governments, BMOs and civil society as well as development agencies who engage with them.

The same underlying test for actions always applies: is this action contributing to the development of the market?

- **Observing the Final "Developing the Market" Test**
  While there are comparatively few hard and fast "do-and-don't" rules in MMW4P, the same underlying test for actions always applies: is this action contributing to the development of the market? Or the converse is it distorting the market? Is this activity consistent with our vision of how this market can work more effectively and sustainably for the poor in the future? Can we identify a credible path to a functioning market without on-going developmental intervention or subsidy? Is this intervention addressing the underlying causes of ineffective, non-inclusive market performance? This is MMW4P's acid test, against which everything has to be justified. And although broad, this test can be broken down into more specific indicators.

- **Building Ownership for MMW4P Analysis and Actions**
  MMW4P analysis and actions cannot be undertaken in isolation. Markets are multi-dimensional and multi-player in nature. The essence of facilitation is working with these market players to create a "better" market system; MMW4P can't be done by one party alone! The implication of this is clear. More than the normal lip service of "stakeholder discussion", MMW4P can only be successful when market understanding, a vision of the future and consequent actions are owned by key players.

  Investing in understanding markets is a starting point for building ownership and developing a consensus on how they can work better in the future. It is a role which both governments and development agencies are well suited to playing. Cynics, of course, may carp that more studies is the last thing needed. However, the relevance of many past studies has been questionable. MMW4P depends on market understanding within an appropriate framework. This might not necessitate large studies – but it does mean analysis.

  And it means substantial buy-in from donors. Especially in weaker economies, donor self-indulgence, to casually pursue their "own thing", will result in market-distorting interventions that will undermine the approach.

- **Building Organisations in Valid Roles**
  Inherent within any valid view of the future of course is recognition of appropriate roles for key players. Engaging with different organisations is only a worthwhile strategy if a possibility exists to exert genuine influence to guide them into better delivery of valid – and away from unjustified – roles.

  For governments, a number of implications are clear:

  - Recognise that there are options…in any market situation there are a range of possible roles that government can play, from doing nothing to direct provision. Conventional approaches have tended to confine government to traditional activities despite the evidence that new roles (for example in telecom and water) can be so successful. Opening eyes to new possibilities is a pre-requisite for change.

- ... but regulation is always a priority! How governments set and enforce rules is a critical factor in determining how markets work. Increasingly, tools such as regulatory impact assessments (RIAs) allow the implications of different approaches to regulation to be understood and create the potential for better, more market-enhancing regulation.

- Less of some roles but more of others: what governments do is frequently not a result of rational analysis but of historical circumstances. Many traditional roles in direct delivery – of finance, business advice, property, materials etc. – look invalid in the light of objective scrutiny. For example, most countries have parastatal "small business development" agencies that have soaked up vast resources to deliver finance, industrial property and other services and with little positive result. A legitimate role for them is narrower and confined to public functions.

  Conversely, poorly-delivered (but valid) government roles – for example, in land registration, financial regulation, information provision and standards setting – show where a stronger and more dynamic influence is required.

- Invest in appropriate capacity: choices on roles to be played have inevitable (and sometimes difficult) operational implications. More specialised staff, knowledgeable of markets and the private sector will be required and will need to be invested in. There are likely to be fewer requirements for capacity related to direct delivery.

Conventional approaches have tended to confine government to traditional activities despite the evidence that new roles can be so successful. Opening eyes to new possibilities is a pre-requisite for change.

Organisations in civil society – especially BMOs and NGOs – need to understand where they fit within any market. Although there are country variations, BMOs' core roles usually revolve around advocacy, information, networking and self-regulation. Attempts (or inducements) to step outside this invariably fail. NGOs, who have often drifted into a "provider" role of some kind, need to consider whether they are in the market (in which case what should their role be) or outside as facilitators of others.

Understanding roles provides a basis for engagement and development. Rather than being all-things-to-all-funders, BMOs and NGOs are challenged to justify a narrower view of their role and explain why this offers more possibilities of success.

- **Developing Business-Like Relationships**
  Facilitating market development has to be done with someone and often with direct for-profit market players. For example, seeking to build the product development capacity of the financial services sector may well involve direct engagement with banks and specialised organisations and consultants. In working with these market players, the most productive relationships are transactional where, in return for "assistance", *quid pro quo* commitment is required and is given.

  In this context, for development agencies, their inherent organisational limitations need to be understood and innovative mechanisms for facilitation developed. Facilitators need to be flexible, knowledgeable, close to market players and a bridge between different perspectives. While there is no fixed view of their organisational format, facilitators need to have these characteristics. Most donor agency staff can't play this role directly; they need to invest in the right entities that can.

- **Interacting With Many and Indirectly**
  When faced with how to build a market, facilitating organisations have choices over how to use their resources to stimulate private sector players. As a general rule, the risks of distortion are reduced if organisations are *not* subsidised directly in the delivery of a service or a product, but are supported through assistance, for example, to develop capacity, new products, new business linkages or collaborative working arrangements. Direct transaction subsidies – "invading" the heart of market processes – run the risk of distorting prices and incentives more than less direct routes. Ideally also, actions should work with a number of players so that unfair competitive advantage does not accrue to one player at the expense of the market system as a whole. The "end game" of interventions is not therefore better performance (improved services, higher profits) from one firm *per se*, but more robust, contested markets.

How governments set and enforce rules is a critical factor in determining how markets work.

- **Demonstrating with Caution and Leverage**
  Conventional approaches to intervention often focus on subsidising transactions directly (for example, some matching grant schemes) or on working with (even setting up) an industry model. In each case, the rationale is the same: relatively intensive support to a small number of players will – somehow – stimulate wider market change. Notwithstanding the inherent risks of distortion here and the mixed record of such interventions, demonstration potentially can lead to wider impact. In such cases, initial direct subsidy has been limited and the path through which wider market change can be leveraged is clear – for example, through conscious engagement with other players and sharing of learning.

APPLYING THE MMW4P APPROACH: FINANCIAL SERVICES MARKETS IN SOUTH AFRICA

Current developments in the financial services market in South Africa offer an insight into the MMW4P approach in practice. Since financial services have been a common area for interventions over many years, this also shows how the approach differs and has evolved from previous experiences.

Understanding the Market

The industry has been characterised by tight margins in recent years. High-end customer numbers are static although bank competition – from the small number of big players in the market – and new product development is focused on this group. The most likely source of growth in the industry is from new customers, especially the significant number of so-called "emerging consumers" who are being brought "on grid" into the formal economy with improved infrastructure. Expectations of improved services among this group, including financial services, are growing.

Poor people participate in the market as consumers. Although numbers vary from one service to another, only approximately 50% of South African adults use financial services. This "unbanked" group amounts to around 13 million people. Clearly, the vast majority of poor people do not participate in the market.

Legal regulation is provided by government and, through the industry's own bodies various performance standards are also set. In banking, the Banking Council also represents the industry to government (and others) and co-ordinates with them on its future path. This has included agreement on a Financial Services Charter committing the industry to greater outreach and access.

A number of core reasons underpin the low level of coverage achieved among low-income groups. Banks see this as a high-risk group with very little of the certainty offered by higher-income customers. They don't know them well – and related systems of information and standards are weak. Outside certain areas of rapid development (such as consumer credit), product development aimed at low-end consumers has been largely unsuccessful to date. On the demand-side, many potential consumers, with limited exposure to financial services, lack an understanding of the "norms" of using financial services. Finally, prudential regulations add to the cost of service to low-end customers and limit the development and growth of more appropriate providers.

How different: *Traditional analyses of financial services markets for the poor would start from the same basis as in MMW4P – i.e. low outreach – and identify two sets of reasons for this situation. First, overall government systems of regulation and licensing (one part of the MMW4P analysis). Second, existing financial services organisations – their products, attitude to risk, orientation and focus. However, analyses would generally not extend further to explore the systemic reasons that explain organisational behaviour, the core supply and demand-side factors (weak information and services) that cause existing market performance.*

Commonly, therefore, only a partial assessment emerges from initial analyses that leave underlying causes largely unidentified and unexplored.

A Vision of the Future

A more inclusive banking industry offers the prospect of large-scale impact on the poor: extending coverage from 50% to 60% would reach an additional 3 million people. What would a market that can deliver this improved performance look like? A number of significant changes may be required. One possibility under consideration would involve the following. In order to address the core information problem at the heart of the market's poor performance, the banking industry collectively would develop an "account for life" standard, providing shared information on individual customers. This could then provide the basis for improved product development by banks – drawing on a central fund established by the industry with its own resources. More specialised services providing information on this "new" market and feeding into product development would be offered. New, more appropriate government regulations, including suitable licensing of new banking organisations, would support this supply-side strengthening. Government would also play an active role in supporting demand-side changes. In particular, a large-scale programme of public education for this new consumer group would address informal constraints and would be supported by a new consumer credit law.

How different: *as with initial analyses, future pictures of how an industry can work more effectively in the future are partial and not developed in any depth. Again, two pictures are implied. On the one hand, reforming regulation is seen as breaking down all the barriers preventing greater private sector engagement. On the other hand, existing providers with a pro-poor orientation – microfinance not-for-profit organisations especially – are envisaged as expanding their operations – and this is the key to greater coverage.*

Having essentially not identified systemic issues, traditionally there is no vision of how these will be addressed in the future.

Actions

The focus of actions by key players is how to overcome identified systemic problems and pursue this shared vision. Specific and complementary activities by the key players – government, the industry as a whole, and relevant service providers – are envisaged. Having already played a key role in facilitating ownership of a future vision, the role of development agencies is to catalyse action by key players as they pursue this vision, primarily through technical assistance and pump priming. Key priorities are likely to include:

- Improving market information services on consumer coverage, constraints and perceptions.
- Developing and implementing industry-wide arrangements for standardised information and a product development fund
- For government:
  - designing and implementing a substantial consumer information and education campaign
  - developing and implementing new, more relevant licensing and consumer credit regulations, and investing in government's capacity to enforce these properly.

How different: *Consistent with previous steps, actions fall into two familiar camps. Reformers pursue change aspects of the formal, regulatory environment and agencies provide technical assistance to this end. Interveners support "partner" organisations directly and intensively – usually with financial and technical support – to improve and expand their operations and create pockets of (continuously subsidised) impact.*

In the case of South Africa, a traditional approach would clearly not address the most critical of the wider issues underpinning poor performance – supply-side information, products, demand-side understanding – and therefore be unable to bring about large-scale impact.

6. THE WAY AHEAD

One response to MMW4P, of course, is likely to be a weary sigh. Another set of acronyms, another "model", another urgent listing of "to do" and "how to" recommendations, another fad.

Such scepticism is understandable. Development (an industry and an endeavour) has a history of imposition of prescriptive models – whose rationale and efficacy are entirely questionable! The Bolton "model" goes to Bratislava. Durham to Dar es Salaam. Frankfurt to Accra etc. Well-intentioned but flawed attempts at innovation have sometimes been little more than an indulgence of pet ideas.

In this context, "What's *different* about MMW4P" is a relevant question. Two distinctive saving graces stand out:

1. The origins of MMW4P, objective and approach, lie in re-thinking borne of experience from the real world, from experiences of great progress (and others of little or none). MMW4P emerges from learning and genuine reflection that covers a diversity of disciplines and organisations; this is not a narrowly-based quirk.

2. Markets not models: MMW4P is about an objective and overall approach that provides a framework for countries to pursue their own specific solutions (which of course may differ in detail from one place to another). It is a framework providing a shared basis for productive debate and action. Far from being an imposed "model", it allows countries to "reclaim" their own development.

While there are no easy formulae, there are clear priorities for organisations seeking to make sense of MMW4P in their work.

This paper is about what we can learn from experiences to date to turn the potential of MMW4P into tangible, positive changes. Of course, there are clearly many areas of debate. In what ways can rules be changed to bring the poor into markets effectively? What are the best means through which service markets to *lubricate* wider market performance can be stimulated? What are the options before key players in considering their role and what competencies do they need to play these? What *sort* of market and what sort of growth is particularly important in achieving poverty reduction? For these and other key questions – which have not been explored in depth in this paper – further learning from experience and investment in relevant research is required.

However, while there are no easy formulae, there are clear priorities for organisations seeking to make sense of MMW4P in their work.

- Recognise MMW4P as a key objective: put MMW4P explicitly at the heart of organisations' strategies and aims; this is the first step to operationalisation.

- Understand the key stages in MMW4P as an approach: build a thorough understanding of markets; develop a transparent (and shared) picture of how markets could work in the future; and ground interventions in these analyses is the essence of the MMW4P approach – in doing so, take cognisance of emerging principles of good practice.

- Internalise MMW4P: take the broad objective and approach into organisations' realities. Using different tools (some of which are listed at the end of this paper), begin the process of aligning organisations' work with a credible view of market development.

- Engage with other players on this basis: MMW4P requires that different players in markets know their respective roles and commit themselves to undertaking these effectively. Markets cannot be built by one organisation alone.

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MMW4P AS AN OBJECTIVE: ADDITIONAL READING

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MMW4P AS AN APPROACH: POTENTIAL TOOLS

Within the key stages of the MMW4P approach, a range of tools/methodologies might be used, if adapted appropriately. Apart from market-specific methodologies, general tools include:

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