

What have we learned about the use of markets and private sector providers for service provision in developing countries?

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This paper provides a number of examples where markets and private sector providers play a role in service provision. In this context, 'markets' is to some extent a code-word for all of the systems (socio-cultural, etc.) within which poor people live.

This Paper has four main parts:

- A. Measures that governments can and should take to allow markets to work for the poor;
- B. Evidence that markets are already working for the poor;
- C. Examples of interventions by development agencies to make markets work for the poor; and
- D. Examples of interventions by large companies serving the poor profitably.

The examples shown tend to question the common perceptions that:

- "The private sector provides for the rich, and the public sector for the poor"
- "The poor would prefer free or highly subsidised services; cheap, commercially-provided services are low in quality"
- "Services such as health, education are mainly financed by the public sector"

Market development requires a different way of operating; it is a much broader agenda than, for example, helping poor people to find markets for the goods and services that they can produce (although it would typically include that). It is about adopting new models that serve the poor within their current realities; in particular, it is about partnership and win-win situations, more than the use of public funds to reach pre-determined goals that are deemed to be desirable. It is necessarily about accepting that public funds can achieve far more, if they leverage commercial dynamics rather than displacing them.

A. Measures that governments can take to make markets work for the poor

Traditionally, governments have intervened in various ways to serve the poor, for example through the following mechanisms:

- Subsidised provision of a service or good through a parastatal or government agency
- Funding to others, including private companies, to provide the service or good
- Transfer to the poor the means to buy the service or good, for example through vouchers
- Obligation (or exertion of moral pressure) on existing providers to cross-subsidise the extension of the service / good
- Establishment of an industry-specific levy fund to subsidise expansion of access

where it is currently unviable

Most of these examples risk displacing market initiative, rather than building on it, or encouraging it. They have evolved partly as they can be implemented in the short term, and can generate substantial profile. They can also be targeted very precisely. However, they typically represent approaches adopted in wealthy countries, where value for money is not always the highest priority; this Paper considers the case of developing countries, where governments are often not well resourced. Given such resource constraints, what should government priorities be?

One part of the answer must relate to key elements of infrastructure, where government expenditure can address 'bottlenecks' and allow industries or sectors to develop in proper ways. However, there is general consensus now that governments in developing countries should place very high priority on streamlining the regulatory framework and 'rules of the game' -to make formalisation easier (or, in some cases, practicable) and more attractive, and so to promote participation in the formal market economy.

Hernando de Soto argues that the main reason that the poor remain poor -and that the informal sector remains informal -is that they cannot formalise their assets. The two essential elements in this diagnosis are heavy business regulation and weak property rights, which are particular problems in poorer countries.

The World Bank's *"Doing Business" report for 2005* finds that:

- Businesses in poor countries face much larger regulatory burdens than those in rich countries. They face 3 times the administrative costs, and nearly twice as many bureaucratic procedures and delays associated with them. And they have fewer than half the protections of property rights of rich countries.
- Heavy regulation and weak property rights exclude the poor from doing business. In poor countries 40% of the economy is informal. Women, young and low-skilled workers are hurt the most.
- The payoffs from reform appear large. A hypothetical improvement to the top quartile of countries on the ease of doing business is associated with up to 2 percentage points more annual economic growth.

Thus, it is not so much a question of what governments might need to do. But more a case of streamlining the regulatory environment for which the government is directly responsible. The 2005 report gives a long list of "simple solutions and where they have worked", although unfortunately, few of the poorest countries are listed there.

The most important aspect of market development in **urban property** is undoubtedly the cost of formalisation. De Soto cites the following examples:

- Registering a small garment workshop on the outskirts of Lima took 289 days and cost \$1,231; obtaining legal authorisation to build a house on state-owned land took six years and eleven months, requiring 207 administrative steps in 52 government offices; to obtain a legal title took 728 steps
- Authorisation to build a dwelling on urban land in the Philippines took 168 steps, involving 53 public and private agencies and taking 13 to 25 years
- Acquiring and legally registering a lot on state-owned desert land in Egypt required 77 bureaucratic procedures at 31 public and private agencies
- Obtaining a lease to settle on government land took 65 bureaucratic steps, requiring on average more than 2 years. To buy the land required another 111

bureaucratic hurdles, and 12 more years.

Poor people pay much more to occupy and keep hold of urban property, than do their more wealthy compatriots; simply put, it is expensive to be poor, as it is much more difficult to establish and defend any legal rights to property. This means that many additional costs are incurred. Several initiatives are therefore under way to address this from the regulatory point of view; few, however, have yet demonstrated great impact. In many cases, the legal processes take several years of continuous work, and practically speaking are out of the reach of anyone who does not have either reserves or good connections.

Another way in which Governments interact with markets is as customer. In Dar es Salaam, Tanzania, for example, the contracting out of solid waste collection and street sweeping by the **Municipality** to small enterprises and CBOs rapidly created more than 1,500 jobs. Coverage of waste collection increased from a 5% to more than 40%, with a much higher level of service reaching the poor.

B. Evidence that markets are already working for the poor

Education is highly valued by poor people, and governments have therefore placed high priority on achieving wide outreach with free or subsidised education. In practice, though, it has been difficult for governments in developing countries to meet the aspirations of their citizens for universal education of adequate quality. As a result, there is often extensive provision of education on a commercial basis. There are many ways in which the private sector can and does play active roles in the provision of education; the potential roles are also quite different, as Table 1 below makes clear :

Table 1: Key Roles for the Respective Sectors in Education

Public Sector	Private Sector
<i>Overcoming market failures</i> Where needs are likely to go unmet because of market failure or where social benefits or services exceed the private benefits	<i>Improving quality</i> In needing to maintain and develop their businesses, they tend to innovate and transmit best practice
<i>Providing for the poor, rural and under-served</i> Provision of a safety net for citizens that cannot pay market prices, either through providing services directly or by creating incentives for the private sector to undertake the task	<i>Improve customer service</i> Better customer focus – an assertion supported by the number of poor parents that send their child to a private school even when a public school is available at lower cost
<i>Implementing appropriate regulations to ensure quality</i> Setting, monitoring and accrediting standards, disseminating information to guide choice	<i>Improve management standards</i> Businesses can act as a partner in transferring important management skills
<i>Controlling costs</i> Arguably a necessary task where there is little competition, no parallel public provision, or where consumers are poorly informed	<i>Developing new services</i> An essential role where demand is expanding or the patterns of demand are changing

There are some indications that poor people may at times prefer to pay for private education, than access the cheaper government provision. This may be because private education providers are often operating in a highly competitive market, and they are therefore under great pressure to provide a quality service. Similarly, commercial

providers are often very decentralised in their management and operations, leading to a high level of flexibility and innovation. Private providers may be more dispersed than government schools, and therefore more accessible to poor people.

Training, like education, has for a long time been considered a duty of government to provide, or at least to subsidise. Again, though, it has often been difficult for governments in developing countries to fund the recurring costs of vocational training in particular, to an adequate standard. And again, there is some indication that poor people would prefer to access training from commercial providers; reasons given include:

- the trainer is often known to the trainee, so giving some assurance of quality and post-training support
- the training is in the local language
- the training is available in formats that work for the trainee (e.g. evening classes, short segments)
- commercial training providers often have closer links with potential employers post-training; for example, some Vietnamese training providers report that they can assure their trainees of employment on successful completion of their course
- commercial providers are under some competitive pressure, so are more likely to offer a flexible and innovative training product of quality

In **telecommunications**, and specifically in mobile telephony, there is abundant evidence that commercial providers can and do serve very large numbers of relatively poor people, given the right regulatory environment. Technology has been driving telecommunications in recent years, but the policy framework provided by the national government must be supportive if beneficial changes can be realised. In particular, governments must resist the temptation to shield unduly the established telecoms provider (which is often state-owned) but to allow sufficient competition between established and new providers. This applies particularly to mobile telephones, where commercial providers have shown themselves very willing to invest, given the right signals from government.

Specifically, the technology of second generation (2G) mobile telephones offers many attractions to people in very small enterprises:

- Pay-as-you-go requires little up-front investment and no credit history; the owner can limit the liability if the phone is lent to others, and calls can be received at no charge
- No fixed place of business, literacy or particular language ability are required
- If there is competition between providers, they tend to adopt low-margin, high-volume business models; the technology itself is very low-cost

The opportunity to leapfrog protected landline providers, and to reach rural areas that are currently not served at all has motivated many mobile providers to invest heavily, even in environments that look very unpromising (e.g. post-conflict). The technology of secure payment by SIM card is opening up many exciting possibilities

Similarly, examples exist in **municipal affairs**, and specifically in water supply, where commercial providers are often serving poor people who are not being served at all by public providers. The government's stance is either actively hostile, or discriminates by default against commercial providers; despite this, the achievements in Latin America especially are impressive.

C. Interventions by development agencies to make markets work for the poor

There are few examples of successful interventions to up-grade the **education and training** markets as a whole. Development Banks in particular have implemented training voucher schemes in Latin America and elsewhere, increasingly with the rationale of up-grading the whole training market on a sustainable basis. In practice, however, it is difficult to pick up market development outcomes, often for the following reasons:

- Voucher schemes are generally popular with both voters and funders, so have often continued for many years; their effects on the market will only become clear once funding has stopped
- Voucher values have often been high (up to 90% of the cost of the training course) and as a result, their market development effects have probably been reduced
- In some cases, lack of transparency and bureaucratic delays have reduced market outcomes substantially
- In markets which were initially very thin, much of the voucher value may have been absorbed in increased prices for training services

There is a trend to use donor funding to analyse whole market systems, and to select the most appropriate interventions, whatever those might be. One example given is the strengthening of commercial radio stations in Uganda in their ability to reach and serve people in the **informal sector** with information and advice; the stations are also acting as a forum for discussion about issues of concern to informal sector operators. All programming is supported by commercial sponsorship, and has an estimated 7 million regular listeners.

However, this rigorous approach to market development has not yet been rolled out in many cases, except where it was achieved under a different banner in the past. The Appropriate Technology approach, for example, had many well-publicised failures, but a few spectacular successes -which invariably built on market dynamics to reach millions of people in sustainable ways. Most of these successes were related to agriculture.

****Editor's note:** The example of the market based provision of **rural sanitation services** by IDE is featured in the paper and was the subject of a specific case study during M4P week and is featured as a separate paper in these proceedings rather than part of this summary.

One of the most famous success stories for development in recent years has been in **micro-finance (MF)**; many new micro-finance organisations have been built on indigenous systems for ensuring debt repayment. In the process, these MFIs have reached millions of poor people with credit facilities. While delivering some impressive numbers, this approach existed alongside the existing market for financial services, and only interacted with the financial system at the national level when it was forced to do so. The traditional micro-finance approach was, strictly speaking, therefore not sufficiently comprehensive or systemic to be termed a MMW4P approach.

More recently, however, the MF 'industry' has realised that access to credit is not sufficient, and that a full range of financial services is required; for some, access to

savings facilities, for example, is more important than access to credit. This has led to growing interest in insurance, transaction banking (especially remittances) and other financial products. Now, there is a further shift emerging, led partly by CGAP, towards looking at entire financial systems, or markets -a MMW4P approach. There is relatively little documented on this approach yet, however.

D. Examples of interventions by large companies serving the poor profitably

Apart from what public funds might achieve, another option is for private companies to identify profitable opportunities to serve the poor, that no-one had previously noticed. This may require innovative business models that are radically different from current operating practices. Some of the examples presented here, therefore, are the work of commercial enterprises, that have found profitable ways to serve the poor.

This approach is currently being championed by C.K. Prahalad, WRI and others, on behalf of very large companies; meanwhile many smaller companies have been doing this for many years. Prahalad's book cites many case studies, and two are summarised in this Paper. One example, in urban property, involves a Mexican cement manufacturer, which has dramatically expanded its sales by facilitating savings clubs among poor people; the savings are used to build house extensions, for which the company provides technical advice and a full range of building materials.

A well known example is **GrameenPhone**, a joint-venture telecom company set up in Bangladesh by Grameen Bank –with capital from the Norwegian company Telenor and loans from donors – to provide mobile telephony to its subscribers. It provides a wide range of products in line with this mandate, many of which are benefiting poor people. In particular, it has launched a “Village Phone Programme”, which since 1997 has provided some 45,000 telephones to 39,000 villages in Bangladesh, bringing access to the telephone networks to some 70 million people.

The formula is simple: a subscriber – usually a woman, hence the label “Village Phone lady” – borrows around \$350 from Grameen Bank and repays the loan by selling phone services to her fellow villagers who, usually for the first time, can enjoy the economic and social benefits of telecommunication contact with the outside world.

The Village Phone Programme produces fair returns on GrameenPhone's investment: although Village Phone operators account for only 3.5% of the company's total subscriber base (of over 1.3 million) they provide 15% of its total gross revenues. With 700 base stations GrameenPhone already offers coverage to 49 of the 64 districts which make up Bangladesh. The company proposes to expand the number of base stations to 800 so that it can offer coverage to the entire country.

In 2002 GrameenPhone was the largest source of FDI in Bangladesh; as of May 2003 the company had invested over US\$ 230 million in the Bangladeshi economy. GrameenPhone is the second largest corporate taxpayer in Bangladesh, having paid US\$ 284 million in taxes between its inception in 1997 and May 2003.

Another example is of an Indian commodity trader which has installed internet terminals in 11,000 villages so that farmers can sell directly to them, bypassing the previous government monopoly and ensuring better prices for them. Both examples, however, involve individual companies which have been willing to adopt new business models, and are reaping the benefits while improving the lives of the poor. These companies have not addressed the market as a whole, but are included here since they point to future potential on an even larger scale, if other companies are willing to follow their example.

Conclusions

This topic remains emotive, as many people involved in development feel that, in the long term, basic services ought to be provided by government, essentially without charge for the poorest of the poor. Meanwhile, however, most governments of developing countries do not have the resources to meet these expectations in the foreseeable future, and the market has stepped in to fill the gaps. Sometimes this provision is of course of low quality, or even provided in ways that are fraudulent.

Overall, though, there is evidence that poor people actually prefer provision by the private sector, where that is possible, for a range of reasons. In addition, there is much evidence that the private sector could do a better job in some countries and sectors if the policy and regulatory environment was more conducive. There are therefore very persuasive arguments for looking at MMW4P more rigorously than before, to bridge the gap between what ought to be, and current reality. Markets probably offer the only realistic option in the near future to reach millions of people with essential services.

In this perspective, governments have a crucial role to play in providing an enabling environment -ensuring fair competition, setting the rules of the game and enforcing them effectively. This should be an easier role to play than some of the interventionist strategies that governments currently implement; such strategies have been highly effective in reconstruction scenarios, following disasters and wars. In more stable situations of steady growth, however, they probably do not provide adequate value for money; governments would be better able to achieve their goals by enabling whole markets to develop.

The examples here show that, in some disciplines (such as telecommunications), the expertise in developing service markets is already much in evidence. Regulation has succeeded in attracting investment, incorporating social development goals and ultimately supporting open competition, thus bringing prices down to low levels. However, in other disciplines (such as vocational training), the task of market development has only recently started. There is clear potential for more training courses, advice and exchange of knowledge on service market development between disciplines and countries, particularly for government staff charged with policy-making and regulation.

Controversially, it has been noted that countries with robust democracies have not necessarily achieved greater poverty alleviation than countries that are not democratic³². It is argued that democratically-elected governments are forced to take a short-term view, and are therefore often obliged to offer subsidised assistance to strategically-important sub-groups of voters (which may not include the poor). The longer-term and more systemic perspective, for example around the development of markets, can be lost in this context.

Until now, it has been more difficult for development agencies to see the opportunities inherent in market development. They are, by nature, government-supported administrations with short time horizons, looking for predictable and measurable results. Their strategies are only gradually shifting, for example from rolling out methodologies that have been 'proven' elsewhere, to more entrepreneurial and creative strategies. Typically, interventions now start with a wide range of pilot activities, only a few of which are expected to bear fruit; staff learn by doing. Over time, the promising interventions are fine-tuned and expanded, while those that are not working are stopped.

One area worthy of much more exploration is that of profitable opportunities for the private sector, and how development agencies can facilitate their exploration. Some are experimenting, for example, with shared investment in the risk for a limited period of time (typically 18 months). After that time, the intellectual property generated by the experience becomes public, and the private-sector partner has to innovate on its own in order to stay ahead.

Ultimately, it is not a question of advocating 'trickle-down' or other charged concepts, but rather of reaching the maximum number of people, given the resources available. Many entrepreneurs are keen to play their part in their local society, and the image of unbridled, and even exploitative capitalism is not generally appropriate. More importantly, giving poor people choices as consumers also enhances their dignity, in a way that handouts and charity never can. Those working in the various disciplines touched on in this Paper are discovering common ground, in their work to enhance and expand existing service provision by the private sector, already in evidence in many developing countries

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