

Strategies for Poverty Alleviation

Recommendations to the Heron Foundation

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Note on Author

Dr. Aneel Karnani has been a professor at the business school of the University of Michigan since receiving his Doctorate from Harvard Business School in 1980. Dr. Karnani's professional career in academia and consulting has focused on strategic management, the structure of industries, and sources of sustainable competitive advantage. More recently, Dr. Karnani's interest in global competition and in the ways that local companies and multinational companies compete has informed his critique of both his colleague C.K. Prahalad's 2004 book, The Fortune at the Bottom of the Pyramid and of micro-enterprise as the presumptive alternative development strategy for emerging economies. Dr. Karnani's views have appeared recently in the Stanford Social Innovation Review, the California Management Review, the Financial Times, and Worth magazine, among others. Foundation staff asked Dr. Karnani for his perspective on opportunities for the Heron Foundation to reduce poverty in the developing world and connections between the Foundation's strategies in the United States and abroad.

Executive Summary

The only way to alleviate poverty and to “help people help themselves” is to increase the income of the poor. In order to do this, the Foundation should pursue a strategy that emphasizes three elements:

1. Generate jobs
2. Make people employable and increase their productivity
3. Reduce friction in the labor markets

In addition, the Foundation should emphasize strategies that treat the poor as producers, particularly in strategies that go beyond micro-enterprise by re-organizing inefficient markets to capture more value for producers.

The Foundation should begin its international initiatives in one country in order to understand its market better, develop effective relationships, and realize economies of scale in investment.

Introduction

Give a man a fish, you feed him for a day; teach him how to fish, and he will not be hungry for life. That is an old cliché, and like all clichés, has an element of wisdom. But, it does not go far enough. A fisherman with a simple rod and a canoe will not be hungry, but he will still be poor. For him to rise above poverty, he needs steady employment at reasonable wages in a commercial fishing company. Now, his daughter might go on to become an engineer and move up the development ladder.

Widespread poverty is an urgent challenge for the world. The starting point for addressing this challenge is the simple and obvious observation that the primary problem of the poor is that they have a low income. The only way to alleviate poverty is to increase the income of the poor; to do that we need to view the poor as producers, and emphasize buying from them, not selling to them. Many of the current approaches to poverty alleviation miss this simple point and hence are not very effective. The advocates of foreign aid often see the poor as passive recipients of charity.¹ The advocates of market liberalization see the poor as automatic beneficiaries of a ‘trickle down’ effect.² The ‘bottom of the pyramid’ proposition, popularized by CK Prahalad, views the poor primarily as consumers, as an attractive market for multinational companies.³ None of these approaches emphasize directly increasing the productive capacity of the poor.⁴

There are essentially two ways for a person to be a productive member of the labor force: as an employee or self-employed. The microcredit movement aims to help the poor become self-employed. However, most studies suggest that microcredit is beneficial but only to a limited extent. The reality is less attractive than the promise.⁵ Creating

opportunities for steady employment at reasonable wages is the best way to take people out of poverty.

The International Labour Organization states that “nothing is more fundamental to poverty reduction than employment.” This strategy for poverty alleviation requires three elements:

1. Generate jobs
2. Increase employability and increase labor productivity
3. Reduce friction in the labor markets

There are also opportunities in some instances to organize the poor as producers, particularly in strategies that not only build stand-alone micro-enterprises, but also connect them to broader market structures that capture more value for producers. The sections that follow explore each of these strategies in more depth and in each case provide one concrete example of local implementation in the developing world.

Generate Jobs

Free market advocates argue that the best antidote to poverty is economic growth. There is much evidence linking poverty reduction to economic growth – the so called ‘trickle down’ effect. It is assumed that economic growth will automatically lead to job creation which in turn will lead to poverty reduction. But, it is possible that markets do not create enough jobs or do not create the right sort of jobs. While it is the responsibility of the government primarily to facilitate private sector job creation, philanthropic organizations and NGOs can play a useful role.

Poverty alleviation in developing countries requires low skill job creation on a large scale in labor intensive sectors of the economy such as agricultural commodities, light assembly (e.g. toys, shoes, garments), and textiles. Many of these sectors have low capital intensity and low entry barriers. This emphasis on large scale, low skill job creation in developing countries is distinct from the needs that Foundation has experienced in the United States, where the need may be for more skilled and higher paying jobs, particularly in areas of economic dislocation (e.g. the automobile industry in Michigan).

Small and medium sized enterprises (SMEs) play a large role in job creation in these sectors in developing countries. Yet, SMEs often find it nearly impossible to tap financial capital markets. NGOs can step in to help overcome these market ‘failures’ and philanthropy can play a role in bridging this gap in “access to capital.” Initial progress has been made in microfinance, but a substantial credit gap persists for SMEs; perhaps lessons from U.S. capital access programs could be applied to this sector in developing countries.

One excellent example of how to alleviate poverty by focusing on job creation is TechnoServe, a mid-size NGO based in California and active in many countries around the world (especially in Africa). TechnoServe begins its work with an analysis of the national and international market potential in a country and identifies high-potential but

underperforming economic sub-sectors. TechnoServe then seeks to resolve the identified market failures that constrain development; TechnoServe works in agriculture to:

- Support the organization and skill-building of farmer groups – to reduce transaction costs, facilitate information flows and build trust in market institutions to help them participate in formal economic sectors.
- Help break through barriers in financial intermediation, to mobilize capital and enable it to flow where it is needed. Address other critical factor issues, such as technologies, labor and environmental health.
- Develop local entrepreneurial, managerial and technical skills.
- Help policy makers understand the importance and implications of their decisions, and help local stakeholders advocate for their needs.

As an example, TechnoServe has helped revitalize the cashew nut industry in Mozambique.

Increase Employability

The central issue in employability is education. Again it is the primary responsibility of the government to help increase the employability and productivity of the poor, but NGOs and foundations can play a useful role here. Poor people often do not have the appropriate educational qualifications to get a job due to a variety of reasons: lack of money, geographic location, lack of time (opportunity cost), family responsibilities, lack of information, and lack of motivation (and role models). Various initiatives from scholarships to training programs can be used to help the poor.

Another problem is that the educational system sometimes graduates students without the skills required by the employers. There is a mismatch between the curricula adopted by the schools and the requirements of the marketplace. A useful approach is to design short vocational training programs targeted at specific types of jobs. Some of the experience in the United States with community colleges and public/private partnerships may prove relevant in developing nations.

Employment Generation & Marketing Mission (EGMM) is a public-private partnership in the Andhra Pradesh state of India that has successfully trained rural poor youth for jobs in the private sector. Rapid economic growth in India is creating many low-level jobs in areas such as retail, construction, and security services. A problem is that the educational system often graduates students without the skills required in the marketplace. EGGM has set up a range of no-frills academies to train the rural youth with a 10th grade education in soft skills (such as communication) and vocational skills. With such focused training programs of less than two months duration, EGGM has placed 30,000 youth in jobs in the organized private sector in 2005-07; their target for 2007-09 is 150,000 jobs. Impact studies show that providing one job in the organized sector to one youth takes the entire family out of poverty in a sustained manner.

Reduce Friction

There is often much friction in labor markets. Companies have job openings and there are people with (almost) the right qualifications who need jobs, and yet the jobs and people do not get linked together. The poor and the jobs may be not only physically

separated, but also separated by gaps in information, gaps in preparation, perhaps even gaps in aspiration. It could be the poor person's first job. It could be a job in a geographically, socially and culturally unfamiliar place. A poor person may even not be motivated to look for a job because they feel isolated from hope and, even if motivated, they may not know where and how to search for a job. The private sector, government and civil society can help to reduce the friction in labor markets by providing information, motivation by peers, transportation, and even transitional benefits; some of these techniques have been tested in the United States and can be adapted in the developing world. These efforts should lead to fuller employment.

To return to the example from Andhra Pradesh, EGGM has a promising strategy to reduce this friction in the labor market among unemployed rural youth. They have created and trained a cadre from among the rural communities called the 'job resource persons' who have built up a database of unemployed youth. EGGM relies upon credible local recruiters to address local youth groups--such as employed youth who have benefited from EGGM training and mothers whose family's lives have already been improved by wages sent home to the village. For young people relocating from villages to cities, EGGM helps with the transition in various ways: from providing a social support network to identifying budget accommodations to providing short-term loans.

Poor as Producers

Another significant way that philanthropy can support poverty alleviation among the poor is to support efforts to organize the poor as producers, particularly in strategies that not

only build stand-alone micro-enterprises, but also connect them to broader market structures that capture more value for producers. As in the example of TechnoServe and Mozambican cashew farmers, the poor often sell their products and services into inefficient markets and do not capture the full value of their output. Any attempt to improve the efficiency of these markets will raise the income of the poor.

Another excellent example of the poor as producers is Amul, a large dairy cooperative in India. Amul collects milk from over 2 million farmers twice a day from 100,000 villages. It started by selling milk, but has since forward integrated into more value added products such as butter, milk powder, cheese, ice cream, and pizza. It has even entered direct retailing through franchising parlors. Amul is owned by the poor (it is a cooperative) so it is a wealth creation vehicle for the poor. Amul buys from the poor (the farmers, who are its members), but its customers are mostly from the middle and upper income groups, and export markets, so it works as a mechanism to transfer income (and wealth) downward. There may be other instances where philanthropy grants or investments can support the creation or expansion of producer cooperatives in developing nations, particularly in agriculture.

Conclusion - Opportunities Abroad

The bulk of the efforts of the Heron Foundation are focused in the United States. There is a strong argument why the Foundation should devote some of its resources to alleviate poverty abroad. There are over 2 billion people in the world living on less than \$3 per day. Through the United Nation's Millennium Development Goals, the world has

promised to significantly reduce poverty by 2015. Given the depth and extent of poverty in Africa, South Asia and East Asia, the Foundation can achieve significant results with fairly limited resources – a bigger bang for its bucks.

This would not require the Foundation to radically change its resource allocation. It would be advisable for the Foundation to start its international initiatives by focusing on one country or at most a few countries in a region. In business terms, this would enable the Foundation to capture more “economies of scale” because its information on markets would be stronger, its relationships with NGOs, government, and other philanthropies would be richer, and the size of its grants and investments relative to the overall need in the civil society would be more significant.

¹ See *The End of Poverty*, J. Sachs, 2005. For a critique of this approach, see *The White Man’s Burden*, W. Easterly, 2006, and *Despite Good Intentions*, T.W. Dichter, 2003,

² See *The World is Flat*, Thomas Friedman, 2005. For a critique of this view, see *Globalization and its Discontents*, George Stiglitz, 2002.

³ See *The Fortune at the Bottom of the Pyramid*, C.K. Prahalad, 2004. For a critique of this approach, see Karnani, A. ‘Mirage of Marketing to the Bottom of the Pyramid,’ *California Management Review*, Summer 2007.

⁴ See *Development as Freedom*, Amartya Sen, 2000.

⁵ Karnani, A. “Microfinance Misses its Mark,” *Stanford Social Innovation Review*, Summer 2007.