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Making Market Systems Work Better for the Poor (M4P)
An introduction to the concept

Discussion paper prepared for the ADB-DFID 'learning event'
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February 2005

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Making Market Systems Work Better for the Poor (M4P) is an approach that aims to accelerate pro-poor growth by improving outcomes that matter to the poor in their roles as entrepreneurs, employees or consumers of markets. M4P focuses on changing the structure and characteristics of markets to increase participation by the poor on terms that are of benefit to them. It addresses the behaviour of the private sector and therefore reinforces the strengths of market systems, rather than undermining these systems. In this way, M4P is based on recent thinking about how to use market systems to meet the needs of the poor and how to support the private sector through market mechanisms that bring about sustainable change.

LIST OF ACRONYMS

ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
CGAP	Consultative Group to Assist the Poor
DFID	United Kingdom Department for International Development
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
ILO	International Labor Organization
M4P	Making Market Systems Work Better for the Poor
NGOs	Non-Governmental Organisations
NIE	New Institutional Economics
PRSC	Poverty Reduction Strategy Credit
PPP	Public-Private Partnerships
PPG	Pro-poor Growth
SME	Small and Medium Enterprise
SL	Sustainable Livelihoods
TSP	Training Service Providers

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Preamble

With only a decade left to achieve the Millennium Development Goal of halving the number of people living under one dollar a day, increasing attention must be paid to the rate of growth of the incomes of the poor. The effective operation of markets plays an important growth-enhancing role by creating incentives for investment and trade, and by allocating resources within the economy. But cross-country evidence also shows tremendous variations in the extent to which incomes of the poor increase as a result of growth. In other words, the pattern of growth is important for poverty reduction too. The participation of the poor in markets and the terms of their participation are critical determinants of whether growth is pro-poor. A better understanding of the role of markets in generating pro-poor growth will help formulate more effective policies and programmes to reduce poverty.

Traditionally, when market outcomes have not been pro-poor, the response has been for governments – on their own or supported by donors – to provide goods and services themselves. Often, the result of this intervention is to distort markets and 'crowd out' the private sector. And because Government and donor resources are limited, these direct interventions have either failed to meet the needs of the poor, or have generated temporary and unsustainable supply. In the worst-case scenarios, the supply of the good or service becomes a form of patronage.

This paper provides an introduction to an emerging framework[1] for ***Making Market Systems Work Better For The Poor (M4P[2]).*** The framework builds on recent approaches to providing goods and services for the poor through market systems, and summarises much of the recent thinking on how to provide assistance to the private sector. M4P can be understood in three ways: (1) as a development objective; (2) as a framework for analysis and understanding; and (3) as a practical framework for action. Part One of this paper explains why M4P matters. Part Two elaborates the M4P concept, and Part Three describes the practical application of the M4P framework using combinations of poverty analysis, market analysis, and political economy and change analysis. Experience with the M4P framework is presented in boxed text, as well as in Annex 1. Annex 2 is a comprehensive 'jargon buster', to assist the reader with terminology used in the paper. Some theoretical material is elaborated in Annex 3.

The targeted users of the paper are:

- donors involved with the design, implementation and review of country strategies and programmes; and

[1] Alan Johnson has derived the content of this paper from a series of written and verbal contributions from Sunil Sinha (Emerging Market Economics), Stephen Jones (Oxford Policy Management), Rob Hitchins (the Springfield Centre), Andrew Dorward (Imperial College London) and David Porteous (FinMark Trust) and from Cerstin Sander, Kevin Quinlan, Richard Boulter, Tony Polatajko, Max Everest-Phillips, Hugh Scott, Mavis Owusu-Gyamfi and Anna Morris (DFID).

[2] To avoid the creation of an unwieldy and unpronounceable acronym (MMSWB4P), M4P will stand as a shorthand version of the full acronym. Also commonly used is MMW4P – Making Markets Work for the Poor.

- national governments involved with the design, implementation and review of policies for economic growth and poverty reduction, including sectoral and private sector development plans.

Other potential users include:

- national and international researchers (including NGOs) monitoring the poverty impact from strategies for economic growth and poverty reduction;
- academics setting-up and testing hypothesis related to the pro-poor functioning of markets;
- local and international NGOs, in the design and implementation of programmes for pro-poor growth, empowerment and poverty reduction; and
- representatives of private sector organisations interested in lobbying and advocacy.

Part 1 Why does Making Market Systems Work Better for the Poor (M4P) matter?

Markets, when they work, can be an efficient mechanism for the exchange, coordination and allocation of resources, goods and services in an economy. Well-functioning markets that support competition and lower the costs of doing business provide incentives for trade and investment, and hence growth and poverty reduction. Markets are the main 'transmission mechanisms' between growth in the wider economy and the lives of the poor. They are important for poor remote areas because of the linkages they offer between the local economy and the national and global economies. The way markets function will determine the rate and pattern of growth and, consequently, the speed and extent of poverty reduction.

But markets may also fail, and in particular fail the poor. In the specific context of poor rural areas, or in the development of new products or services, markets may be too 'thin'. The risks and costs of participating in markets may be too high. In other cases, social or economic barriers may mean that the poor, or specific groups, such as ethnic or religious minorities, are excluded from markets.

Governments have long recognised that market outcomes may not be pro-poor and have sought to intervene in markets. Unfortunately, traditional approaches to make markets work better frequently make things worse. This is because distortions are introduced that impair the efficiency of resource use and undermine growth. These distortions may reduce incentives for the private sector to grow and invest, and may not meet the needs of the poor. In the end, because of their costs, these interventions are not sustainable.

In recognition of this, the so-called 'Washington consensus' emerged in the 1980s and 1990s, based around macroeconomic stabilisation, liberalisation, deregulation and privatisation. This approach argues that the state should withdraw in order to allow markets to work efficiently and the private sector to grow: there is no need for interventionist action since market outcomes cannot be improved (and are indeed worsened) by state interventions. However, it is increasingly recognised that macroeconomic stabilisation, and greater reliance on liberalised and deregulated markets, is not sufficient to accelerate private sector-led growth, let alone enable the poor to participate in and benefit from such growth. The

Subsidized Fertilizer Nigeria

Convinced that the high price of fertilizer prevented poor farmers from increasing their incomes, government chooses to subsidize fertilizer. Subsidized fertilizer is diverted from the state and sold on the black market to large farmers. The drain on the exchequer has forced government to reduce the amount of fertilizer subsidised,> Who receives it depends on patronage from politicians. Fertilizer availability has fallen dramatically with the private sector reluctant to supply un-subsidized fertilizer for fear of competition from subsidized fertilizer. The poor are denied access to fertilizer from the state and the private sector..

The USAID DAIMINA project has worked to train private sector input distributors and increase their access to finance to strengthen the distribution system for unsubsidised fertilizer. It has built a constituency for reforming fertilizer policy amongst the private and public sectors and piloted a voucher scheme to show government how it can help the poor effectively without undermining the market for fertilizer. Private sector supply is now growing strongly. DFID's PrOpCom programme hopes to extend the distribution system to rural areas to ensure access for the poor.

experience of transition in Asia and Eastern Europe from central planning to a more market-based system shows that the rapid pursuit of liberalisation, privatisation and deregulation, without complementary state action supporting private sector and market development, can lead to dramatic falls in GDP and increased poverty (Hussain 2003). Structural adjustment in Africa and trade liberalisation in many parts of the world shows that there are always winners and losers. Unless the losers are helped to take advantage of new opportunities, they may be caught in poverty traps from which they cannot escape.

Based on this experience, many governments are looking to implement measures to stimulate pro-poor development outcomes through better functioning markets. The danger is that they will return to traditional and flawed policies based on direct intervention. What is needed is a new approach that learns from the well-known problems of both state and market failure.

M4P is such an approach. It aims to accelerate pro-poor growth by improving outcomes that matter to the poor in their roles as entrepreneurs, employees or consumers of markets. M4P focuses on changing the structure and characteristics of markets to increase participation by the poor on terms that are of benefit to them. It addresses the behaviour of the private sector and therefore reinforces the strengths of market systems, rather than undermining these systems. In this way, M4P is based on recent thinking about how to use market systems to meet the needs of the poor and how to support the private sector through market mechanisms that bring about sustainable change.

The approach outlined in this paper can be used as an analytical tool for governments that are preparing growth and poverty reduction strategies. It can help to inform private sector development strategies that aim to accelerate growth, assisting in making them more effective and contributing to pro-poor growth. But it is also a practical tool that can be used to change market outcomes in favour of the poor. It can be used to design and implement programmatic loans that address rural livelihoods, private sector competitiveness and private sector productivity. It can be used within programmes that address sectoral growth patterns that are not pro-poor, the problems of lagging regions and the development of international trade to be pro-poor. It may also be used on a stand-alone basis to bring about change in the markets that matter to the poor.

Part 2 Making Market Systems Work Better for the Poor (M4P)

2.1 Theoretical Context

It is widely recognised that efficient markets play an important role in generating economic growth. They provide a way to allocate resources that ensures the highest value of production and maximum consumer satisfaction. Elaborations of neo-classical economics demonstrate that perfectly competitive markets lead to an optimal allocation of resources, where it is impossible to improve anybody's welfare through changes in production or exchange without worsening someone else's welfare. However, there are two main caveats:

1) Perfectly competitive markets are hardly ever found in the real world – particularly in developing countries.
2) Well-functioning (efficient) markets can co-exist with widespread poverty, since distributional and equity issues are not directly dealt with by the market.

The starting point for M4P is the work of New Institutional Economics (NIE). The NIE approach questions the relevance of the assumption of a perfectly competitive market, noting that information is incomplete, asymmetrical, costly to acquire and costly to use. Poor information introduces risks in undertaking transactions. Transaction costs must then be incurred to acquire information and provide protection against these risks, and market

players must make decisions that allow for these risks and costs. Institutions – 'rules of the game' – exist and evolve to reduce transaction costs and risks. An NIE definition of a market is framed by this understanding: 'Markets are institutions that exist to facilitate exchange; that is, they exist in order to reduce the cost and risk of carrying out transactions' (cited in Porteous 2004).

In addition to NIE, other related work also focuses on how markets provide solutions to traditional development problems. The World Bank has supported work on housing provision that shows how it is possible to introduce incentives that will encourage the private sector to provide for the needs of the poor. The Consultative Group to Assist the Poor (CGAP) has shifted attention from direct support to microfinance institutions to an approach of mainstreaming microfinance into the financial market system as a whole. Michael Porter's work on value chains and subsequent work on global value chains attempts to understand the way market forces work to influence returns to the various participants in international commodity chains (Porter 1998).

Recent work on how private sector development contributes to pro-poor growth indicates that it is not the type or size of enterprise that is important for achieving pro-poor growth. Pro-poor market outcomes can be generated by both small and large enterprises. What is more important is the operation of the overall market system to produce pro-poor outcomes. Reflecting these findings, donor support for enterprise development is changing from direct support to individual enterprises to support for the development of markets for business services. These trends are reflected, for example, in the Small to Medium Enterprises (SME) Donor Committee 'Blue Book' and the International Labour Organisation (ILO) 'Primer' on Business Development Services.

2.1.1 The Original M4P framework

Much of this new thinking was brought together in the late 1990s in 'Making Markets Work Better for the Poor' (DFID/OPM 2000). The original M4P framework encourages better analysis and understanding of the role of markets in achieving pro-poor growth in order to identify ways of strengthening the pro-poor functioning of markets and to guide policy formulation. The framework considers markets for goods and services, and factors of production, and focuses particularly on *credit, land, labour* and *staple foods*, as these are the basic markets in which the poor are either directly involved – or could more directly benefit from participation in. The framework sets out how markets can work better for the poor through assisting broadly-based growth.

The original framework combines an analysis of poverty based on the Sustainable Livelihoods (SL) model with an analysis of the functioning of markets based on insights from NIE. The SL model highlights the importance of poor people's access to physical, natural, human, social and financial assets, and the returns they get from those assets. Markets provide opportunities to get better returns from assets and to obtain new assets through exchange. The NIE analysis of markets emphasises the role of institutions and the level of 'transactions costs' in influencing economic behaviour and pro-poor market development. In this perspective, markets themselves are an institution with sets of rules that govern exchanges for value between buyers and sellers.

For markets to work better for poor people, they must provide access to the opportunity to build and acquire assets, and help to reduce vulnerability. To do this, markets must become progressively more developed, more complete and more accessible to poor people. Market development can contribute to enhancing growth, empowerment, opportunity and security in a variety of ways and through a range of mechanisms (some of which are illustrated in Table 1).

The development of market institutions will increase growth rates by lowering transaction costs[3], enabling more types of goods and services to be bought and sold, and allowing prices to reflect scarcity and information. Improved access to markets and services can both empower the poor and expand their livelihood opportunities; for example, education and skills. Finally, security will often be strengthened by improved access to markets. For example, access to insurance and other markets give the poor more options in managing risk. Access to wider or non-local food markets may provide options to stabilise supplies and prices.

Table 1: Links between markets and strategies against poverty

Strategy against poverty	Potential positive roles of markets	Examples of market factors that may work against the poor
Growth	Promoting efficiency in allocation and use of resources.	• Market failures and distortions in factor markets (capital subsidies) that prevent efficient allocation of productive resources. • Disabling economic framework.
Empowerment	May provide incentives for local organisation.	• Poor lack livelihood assets (land, capital), and are disadvantaged by low education and poor health. • Structure and functioning exclude poor. • Poor not involved in setting market rules; lack of voice.
Equality of opportunity	Access to assets, services. Markets for assets of poor (notably labour).	• Adverse or weak institutions that discriminate on the basis of transaction size or impose unnecessarily high technical standards. • Social exclusion. • Higher transaction costs in poor areas due to infrastructure. • Weak demand for assets of poor people. • Market failures (e.g. credit markets and excessive market power).
Security	Risk management. Supplies of food and other basic requirements.	• High transactions costs. • Incompleteness of markets.

(Source: DFID/OPM 2000, 3)

The framework recognises that even successful market development may not assure a pro-poor outcome. Markets can exclude the poor, especially those who are destitute and have little to offer the market. Social or economic barriers to entry may mean that specific groups of the poor – notably, ethnic minorities, migrants, women or members of certain castes – are excluded from markets. Conventional policies for market restructuring and reform – such as liberalisation and privatisation – cannot simply be assumed to be poverty-reducing through an anticipated 'trickle-down' process. On the contrary, it is now widely accepted that explicit methods must be considered in order to encourage and promote participation by the poor.

Moreover, an analysis of the functioning and development of markets, and their potential role for reducing or exacerbating poverty, cannot be undertaken in purely economic terms. Markets also exist in social space and are deeply embedded in a set of non-market, social and political institutions. The way in which people, and the poor in particular, participate in markets is conditioned by economic, political, social and cultural factors which must be incorporated in the analysis. In the original framework, such an analysis was presented in terms of four domains (see Table 2 below).

[3] See Annex 3 for more on the analysis and lowering of transactions costs .

Table 2: An analysis of markets based on four domains

Market Domain	Key Issues
Enabling environment	What roles are played by institutional and environmental factors, such as international markets, macroeconomic policy, financial and legal infrastructures and forms of governance? Issues: • The importance of a stable macro-economic environment. • Low entry and exit barriers to business, and efficient and deepening factor markets, to maximise efficient allocation of resources and opportunities for the poor. • Regimes that produce greater equality of opportunity throughout the economy. • Secure and stable property rights, which guarantee an adequate control over the returns to assets, enhance market development and efficiency. • Social insurance mechanisms and investments in basic infrastructure, health and education, enhance the likelihood for the poor to benefit from market development.
Market failures: • public goods, externalities • market power and economies of scale • asymmetric information • costs of establishing and enforcing agreements	How do markets fail, and which alternative arrangements arise? • Barriers to entry are too high as a result of government or private sector institutions. • High transaction costs and the risk of transaction losses are often associated with lack/inadequacy of infrastructure and information. • Collective action may be a cause of collusion and barriers to entry, or a response to market failure (reducing transaction and information costs). • Government policy may impose high risk and transaction costs. Can the state address critical market failures? • What level of infrastructure and public intervention encourages market development and which elements of these are particularly important for poverty reduction?
Adverse power relations	What economic, social, cultural and political biases inhibit the poor from participating in, and benefiting from, markets? • Markets exclude or discriminate against the poor because of the lack of economic assets, lack of political/institutional rights and/or lack of social connections. • Regulations and social norms may be biased against the poor, and supportive of bigger and more powerful organisations.
Inter-market linkages	Is the performance of a market critically determined by the development of, and integration with, other markets? • Access to financial/insurance markets increases access, and the terms of access, to assets in other basic markets and vice versa.

Source: derived from DFID/OPM 2000

The M4P framework also recognises that markets are also not the only institutions that provide economic exchange, co-ordination and allocative functions. Gifts and hierarchies are also used either alone or in combination with markets. The NIE literature explains the internal organisation of firms and of governments using hierarchies as alternatives to markets (or as complementary to markets where governments and firms, as part of their own governance arrangements, combine hierarchies with internal markets). Circumstances where non-market solutions may be needed are where transactions costs are so high that markets fail or do not exist, or where large firms abuse their market power in situations where government capacity to regulate monopoly is limited.

2.1.2 The Evolving M4P Framework

Since the development of the original M4P framework document, a number of M4P 'branded' interventions have been developed and initiated. These developments have been 'organic' and country-led, as strong central guidance or direction on M4P issues was limited when these interventions were being designed. Consequently the interventions that emerged are perhaps more diverse than was originally planned. The M4P framework has been used as a practical tool for developing specific market-enabling interventions and approaches to private sector development. Examples include market-enabling interventions in the cases of FinMark and ComMark in Southern Africa and PrOpCom in Nigeria (see text boxes), an investment climate survey in Bolivia, support for collective action by clusters of SMEs in Jamaica, and business service development with KATALYST in Bangladesh.

Outside DFID, the Asian Development Bank (ADB) and ADB Institute (ADBI) have supported policy-oriented research in Cambodia, Laos and Viet Nam under a regional technical assistance project called 'Making markets work better for the poor' (ADB 2003). Sida has adopted *'Making Markets Work for the Poor'* as its approach to support for the private sector (Sida 2003). See Part 3 and Annex 1 for more details on the approaches of these various interventions.

Lesotho - Wool and Mohair

Wool and Mohair is a major source of livelihood for poor, rural households in Lesotho, particularly those in the five mountain districts. Wool production has been declining as a result of the high mortality of lambs, high incidence of scabs that affects the quantity and quality of wool, and low quality and prices for wool outside the government-run wool sheds. The government-run woolsheds take three to five months to pay growers, providing an incentive for 40% of the wool to be sold through other channels that pay much lower prices.

ComMark is working with the private sector owners of woolsheds to improve the quality of shearing, sorting, grading and bailing to increase the value of the wool. It has trained self-employed entrepreneurs to inoculate sheep, replacing the now virtually defunct public sector livestock extension service. The result has been higher prices or prompter payment for growers, higher wool output per sheep and reduced mortality of lambs. The private sector cost of inoculation, through ComMark, is a quarter of the charge levied by the public sector.

Nigeria – Cashew nuts

PrOpCom aims to reduce discounts on the CIF price for Nigerian cashews and hence provide an incentive (premium) for producing cashews for snacks instead of for the culinary market. This requires institutional change:

- An agreed standard for well-dried cashews that can be sold to the snack market.
- Training purchasing agents of exporters to recognise/pay premiums for well dried cashews.
- Broadcasting information on standards/premia for well-dried cashews; how to dry cashews.
- Establishing markets for training purchasing agents – intervene pre-delivery by establishing training curricula, post delivery to accredit purchasing agents.
- Supporting nurseries that supply better genetic material.
- Supporting less developed exporters of raw and processed cashews to increase competition in the purchase of cashews.

There have been theoretical developments of relevance to M4P. For example, Sen's *Development as Freedom* argues that choices, and the capability to exercise those choices, are a good thing in their own right. The expansion of freedoms that are enjoyed by people is seen as both a means and an end for development. In this analysis, freedom of exchange and transaction is in itself part of the basic liberties that people have reason to value. Conversely, the rejection of the freedom to participate in, for example, the labour market is a means to keep people in bondage and captivity. From a different perspective, *The Fortune at the Bottom of the Pyramid* (Prahalad 2004) examines the prospects for 'large-scale entrepreneurship' in order to empower the poor and serve the poor in exercising choice as consumers.

There has been much new work and discussion on the importance of institutions as determinants of long-term growth (Rodrick 2002, Rodrick et al 2004, Chang 2002, Ohno

2004). Other work (Sachs 2003) questions an over-emphasis on institutions at the expense of other determinants such as geographical location. The 'Drivers of Change' approach to understanding policy processes (DFID 2002) indicates that a better understanding of political economy is key to understanding prospects for reform and market development, as well as specific options for donor engagement.

In agriculture, Dorward et al (2004) revisit the appropriate roles of the state, the private sector and civil society in situations where markets are perceived to be performing poorly – especially in poor rural areas. Drawing on quantitative analysis of active state interventions in 20th century 'green revolutions', they suggest that current policies which emphasise the benefits of liberalisation and state withdrawal fail to address critical institutional constraints to market and economic development in poor rural areas. They conclude that a fundamental reassessment of policies espousing state withdrawal from markets in poor agrarian economies is needed. Given widespread state failure in many poor agrarian economies today, particularly in Africa, new thinking is urgently needed to find alternative ways of 'kick starting' markets – ways which reduce rent-seeking opportunities, promote rather than crowd-out private sector investment, and allow the state to withdraw as economic growth proceeds.

Joffe and Jones (2004) present another perspective on this issue in their examination of means to stimulate market development for pro-poor agricultural growth. They conclude that the orthodox public-private division of roles in relation to market failure, and the provision of public goods, is insufficient and that more innovative mixed public-private partnership arrangements are required. In many contexts there is a case for time-limited public actions, provided that the actions are well designed and take into account the capacity of the parties to bear risk. Specific models examined include: (a) private enterprises taking over public functions; (b) building market linkages for smallholders; (c) building market institutions; and (d) private investors in supply chains.

Finally in the area of business services there has been a significant shift towards 'market development' approaches. The main differences between a traditional and a market development approach are summarised in Table 3 below.

Table 3: Comparison of conventional with market development approaches

Conventional development approach	Market development approach
1. Understanding of the 'system'	
• Businesses as beneficiaries of business support. • Provision by government organisations and NGOs. • Services typically defined as public goods and financed primarily by the state.	• Businesses as discerning consumers of services. • Provision by private sector in functioning markets. • Private services. • Through provider-consumer transactions. • Market-supporting functions by a variety of actors.
2. What are business services	
• Narrow view: formal/education oriented. • Non-financial services deemed by agencies or governments to be 'good' for business, mainly training and counselling.	• Broader view: enterprise/pragmatic oriented. • Any non-financial service to business, offered on a formal or informal basis.
3. How they should be provided	
• Organisations: Mainly government-owned or sponsored agencies and not-for-profit agencies. • Rigid, modular 'one size fits all' approach to delivery.	• Market system: mainly the for-profit private sector, including informal networks, business associations and business-to-business relationships. • 'Right-sized' delivery demanding a diversity of service offers and service providers.

4. How they should be promoted	
• General support for design and delivery of business services, with an implicit assumption of continued subsidy and often standardised services.	• Finite, focused support aimed at addressing business service market constraints through limited interventions; 'facilitation'.

Source: DFID (2004c)

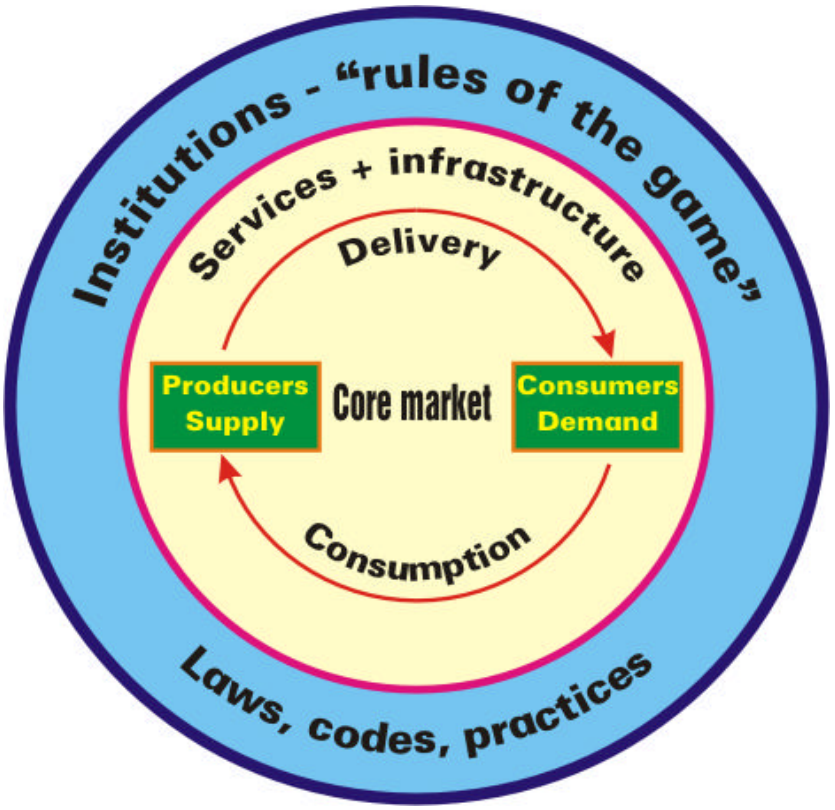
2.2 Extensions of the M4P framework

The need to operationalise M4P has led to some specific extensions of the M4P framework. **Before a market can work for the poor, it must first be able to work at all.** The following section looks at the main elements of a functioning market.

2.2.1 What does it mean for a market to 'work'?

The most documented attempts to interpret and apply the M4P framework have been under the ComMark and FinMark programmes in Southern Africa (Gibson et al 2004, Porteous 2004). A working market has four components, shown in the 'layers of the onion' of Figure 1 below (adapted from Gibson et al 2004, 12):

Figure 1: The components of a functioning market



In the centre is the 'core market'. The forces of demand and supply are the necessary (and sometimes sufficient) conditions for markets. Demand is driven by ***Consumers*** who wish to buy products and services and have the means to do so. Consumers are likely to have differing levels of income and hence willingness to pay. In a well functioning market, all those who are able to afford to pay the minimum cost of producing an acceptable product are served by producers. In thin or distorted markets, only the needs of the better-off are met.

The demands of consumers are met by ***Producers*** who supply products and services to the market. If the dynamics of supply and demand promise sufficient returns, firms will attempt to overcome the problems of weak institutions and infrastructure themselves. Examples include

extractive industries in many territories and some firms (e.g. South Africa Breweries) that have a core competence in working in difficult environments. The market structure in terms of number, size and type of participants (firms, households, etc) will vary greatly among market sectors based on their history, their stage of growth and the barriers to entry.

The core market is supported in the 'first layer' by ***infrastructure and services*** that provide the physical requirements of a market, as well as services to market players and regulators. Infrastructure and services – notably communications, transport, finance, bookkeeping, etc – may be provided by Government and/or private providers through fee-based or 'embedded' services. The provision of infrastructure and services are critical to a functioning market. For example, if the cost of transport is too high, markets will not develop; if there are no certification services, producers may not be able to export; or lack of bookkeeping and reliable auditing services may deter investors, etc.

Completing the overall context is the second layer, the ***institutional context***, which is comprised of the rules and organisations, including informal norms that coordinate human behaviour (see Section 2.2.4 for more analysis of institutions). The institutional environment is not fixed. To function well, the institutional environment must be inclusive, and capable of picking up feedback and signals from diverse market players. It must balance interests by negotiating change and facilitating agreement. And it must be able to implement solutions. Institutions can vary from trust and other forms of social capital at their most informal through to conventions and codes of private sector organisations through to the laws, rules, regulations, and regulatory enforcement capacity[4] at the formal end of the spectrum. Common problems with institutions relate to the power of concentrated interests (e.g. monopolists and monopsonists) who are able to shift the 'rules of the game' in their favour. This may result in barriers to market entry, low levels of competition, high levels of rent-seeking, and the exclusion of newcomers. Non-economic exclusion may be practiced based on exclusion by gender, race, religion, ethnicity or social status (e.g. caste).

Markets are institutions which work by efficiently facilitating exchange. A well-functioning market reduces transactions costs and risks between buyers and sellers. In such a market, while each component will differ in form, there will be certainty and basic stability about how the components fit together. In newer markets, the roles of the different players are often still in the process of definition. An inherent characteristic of mature markets is their constant evolution in response to changing circumstances and the feedback effects from other markets.

2.2.2 What is a market that works for the poor?

A market which *works for the poor* is one which expands the choices available to poor people and produces market outcomes that benefit the poor. These outcomes include job opportunities with attractive wage rates, better returns on goods sold, and greater affordability of important products and services. Over time the participation of the poor in these key markets should increase. In terms of contributing to pro-poor growth, the key indicator will be the average rate of growth of the incomes of the poor. From the perspective of the poor, the important criteria are improvements in:

- access to important markets and overcoming any forms of market exclusion;
- affordability (for purchases);
- returns (for sales) including wages from the sale of labour;

[4] Well-recognised elements of a regulatory framework are: i) legal or social conventions which define and allocate property rights; ii) rules about transactions (which define the right to exchange property rights, and legitimate contracts, forms of co-operation/competition permissible or not); iii) monitoring and enforcement mechanisms; and iv) mechanisms by which these rules can be adapted to changing economic circumstances.

- choice; and
- risk reduction.

It is also helpful to distinguish between markets in which the poor participate directly and those where the links are indirect. In the cases of direct participation, conditions such as the differential access of different groups of the poor can be quite precisely measured. But in other cases (e.g. international commodity markets) the poor are not direct participants, although the outcomes of these markets are critical for the welfare of the poor. In M4P, both types of market need to be analysed, and the policy implications for each type of market will be rather different. Some approaches, e.g. value chain analysis, attempt to map the linkages between a distant global market (indirect link) and the markets in which the poor directly participate, e.g. labour markets or markets for unprocessed agricultural products. A number of M4P interventions attempt to improve the distribution of value to the poor through institutional innovations (producer groups) and systematic attempts to add value to the products of poor producers though pre-processing, quality improvements, vertical integration with large processors, etc.

2.2.3 Market growth, market deepening and the access frontier

A key feature of a market that works for the poor is the rate of market expansion, so that the products and services being supplied by the market are brought within the reach of the poor. Porteous (2004) describes a stylised market development over time (shown in Annex 3) to show how this process occurs. The significant aspects of this are the lowering of prices and the increased availability of the product or service, driven by the profit-seeking behaviour of incumbent and entrant firms. Growth may itself generate virtuous cycles through economies of scale that will enable further cost reduction and/or profitability to be achieved. In the presence of competitive forces that allow new entry, a healthy market will show increasing usage, but at a decreasing rate as it approaches a natural limit.

Another important concept for M4P is the **access frontier**, which is defined as 'the maximum proportion of usage possible under existing structural conditions of technology, infrastructure and regulation'. The position of the frontier, and the rate of movement towards it, reflect both a deepening of the market and the extent to which the market is working for the poor. A key policy choice relates to whether the state wishes to increase the use of the particular good or service beyond the access frontier into what is termed 'the supra market zone'. There are various redistributive techniques that can do this, ranging from subsidies through to market segmentation and price discrimination. The challenge – from the M4P perspective – is to design redistribution mechanisms that don't 'crowd out' the private sector altogether. If private sector players are driven away, the access frontier effectively becomes a ceiling and the market will not be able to work for the poor. However, if state sponsored redistribution can meet the needs of the very poor while maintaining the incentive for private firms to participate – e.g. through market segmentation – then the access frontier can continue to push out, increasingly including the poor.

Shifting the Access Frontier

The development in South Africa of technology that allows consumers to pay for mobile phone usage in small amounts as calls are made has transformed access to telephones throughout Africa, far outstripping donor initiatives and government programmes in providing access through land lines. In many countries, mobile phones exceed landline connections several fold. Although more expensive than line rental, it is the ability to pay in small amounts and to control expenditure that has made mobile technology accessible. The selling of mobile phone cards has become a major employer of young people in the informal sector.

In India, the use of simpler processing technology combined with excellent marketing by the small scale producer Nirma forced multinational Hindustan Lever to reduce the cost and price of its world wide brand of washing powder, Surf, to better meet the needs of the poor. The development of a non-soap detergent, that did not use capital intensive spray drying, enabled Nirma to be marketed as 'twice the power at half the price.' To compete, Surf had to be re-engineered to meet a lower price point.

2.2.4 Institutional and Political Economy Change Analysis

The institutional context – or the outer layer of the market 'onion' shown in Figure 1 – presents a key challenge for the M4P framework. Achieving institutional and systemic change in the operation of markets important to the poor is at the core of the M4P approach. The complex interaction between economic, political, institutional and social factors determines why certain contractual arrangements are in place, and how they affect market access and the livelihoods of the poor. The work of Harriss-White (1996) on power relations within agricultural markets in India provides an example of the application of political economy and anthropological perspectives to the analysis of markets. Institutional and political economy change analysis can also guide the selection, design and implementation of interventions which may be required to promote some competitive markets and prevent the failure of others. For example there may be cases where investment in roads or telecommunication may be necessary to reduce transaction costs in agricultural markets. Regulatory frameworks that create a market or enhance competition may also be needed, for instance for financial intermediaries and information services. Collective action may also be required to generate effective demand, or diversify delivery of goods and services for the poor.

The development of certain markets may produce negative outcomes for a country in general, and for the poor in particular. Where the institutional environment is weak and/or infrastructure is lacking, competitive markets may not develop at all, or may exclude the more vulnerable socio-economic groups. In addition, whilst market development may contribute to the build up of some assets, it may lead to the depletion of others. For example, markets prompt institutional change from informal to formal arrangements and this can potentially undermine traditional social norms and social capital. Market development may also deplete natural assets, as natural endowments become tradable commodities.

2.2.5 Drivers of Change

The objective of identifying and supporting systemic change that produce market outcomes that benefit the poor has profound implications for what action should be taken. Effective use of the framework implies a strategic and catalytic role amongst potential 'constituencies for change' who may be drawn from all three pillars of the state, private sector and civil society, supported, where appropriate, by donors.

Drivers of Change is a way of understanding the political economy of growth and poverty reduction (DFID 2002). Drivers of Change focuses on the longer-term underlying factors that affect the incentives and capacity for pro-poor change, as well as the prospects for reform. The approach starts from the local situation and examines the relative roles of change agents, institutions and structural issues. This type of approach is very relevant for M4P which aspires to achieve systemic change and recognises that it involves:

Constituencies for Change

In Bolivia, DFID's support for an umbrella organization that brings together interests of small businesses and the informal sector has helped the organization engage more effectively with the public sector and representatives of big business in the country's productivity and competitiveness council. The results include bringing about change in public procurement policies to improve access for small and informal businesses and a pro-poor focus in the development of value chains.

In Nicaragua, the World Bank has been assisting the Ministry of Industry and Trade to develop a system for promoting competition through regulating monopolies and unfair trade practices. A competition law has been drafted and buy-in has been obtained for the organizational framework to implement the law. The law however is opposed by big business and has failed to obtain support amongst the legislature. At the same time, the association of small business organizations has prepared a law for promoting SMEs that has support of the legislature. The SME law is however considered less of a priority by the Ministry. The impasse may be broken by building a wider constituency in support of both laws bringing together SME organizations, the Ministry, parts of the legislature that support SME development and NGOs involved in poverty alleviation. The constituency can be empowered to develop support amongst the government and legislature through evidence based dialogue that demonstrates the potential benefits of both laws for pro-poor growth.

- **Formal and informal institutional change.** For example, reconfiguring the roles of the public sector, private sector and civil society in providing public goods and services; the promotion of accountability and transparency of government services and programmes; and supporting non-market institutions effective in providing services to the poor that reduce transaction costs and risks.
- **Policy change.** For example, improvements in regulatory rules that may facilitate the development of one or more markets and/or enhance the access of the poor to certain markets.
- **Developing markets, market linkages and market infrastructure.** For example, information, finance, business services, accreditation systems, credit bureaus, etc; promote or provide infrastructural investment, especially in rural areas, for roads and transport, irrigation and electricity, water and sanitation, and telecommunication.
- **Addressing 'pressure points' or functions in the value chains** that constrain pro-poor outcomes. For example, support for local empowerment and organisations for poor and marginalised groups, strengthening their participation in decision-making processes.
- **Supporting market activity** in the early stages of development where the constraints and risks facing private agents are too great – though such activity must be very carefully designed and implemented to limit negative distortions, and to promote its phasing out in the transition to greater reliance on a stronger private sector.

Different interventions and a changing institutional mix may be needed at different stages of development. The table below sets out some changing Government and market roles.

Table 4: Stages of Development

Stage	Market status	Government roles in market development
Establishing the Basics	• Thin or failing and stagnant markets.	• Stability and security. • Reduced risk of expropriation. • Basic infrastructure. • Support to technology development / adaptation. • Basic education and health.
Key reforms 'unleashing' growth	Unorthodox Hybrid Arrangements with Government roles in economic co-ordination and risk mitigation.	
	• Growing and more reliable markets for seasonal finance, inputs and outputs. • Increasing private investment.	• Market oriented incentives in place, e.g. decentralization of production decision making to households, time limited and performance-related investment grants/ protection.
Sustaining growth and competitive advantage	• Global integration. • Deepening private markets in operation. • Increasing private investment. • Increasing participation by bigger and more diverse enterprise types, e.g. services. • Wider multipliers and growth linkages.	• Credible institutions and enforceable 'rules of the game'. • Checks and balances to maintain transparency and predictability. • Promotion of 'competitive coordination' (competition for efficiency and equity incentives but deliberative mechanism for industry coordination where necessary).

Part 3 Putting M4P into Practice – a tool to promote pro-poor growth

We now turn to the practical application of M4P, or how M4P can be used as a framework for action. The M4P approach can be applied in two ways, as (a) ***an analytical tool*** to bring new insights to policy development and programme designs that will bring about systemic institutional and market system change in support of pro-poor growth; and as (b) ***a tool for intervention.***

3.1 M4P as an analytical tool

The M4P approach can be applied at a number of different levels. At the macroeconomic level the approach can provide constructive inputs to national strategic planning, including the Five Year Plan system, and nationally-driven Growth and Poverty Reduction Strategies, as well as sector plans. The holistic and integrative nature of the approach means that it can be useful in co-coordinating or specifying the linkages between different sectoral ministries and departments (e.g. Finance, Trade, Agriculture and Infrastructure). For donors, the approach can help to formulate assistance plans and strategies as well as specific instruments such as the PRSC and other programmatic and policy-based instruments. In a decentralised environment the approach could also be applied to provincial Growth and Poverty Reduction Strategies. At the meso- and micro-level, the approach can be used to identify specific 'pressure points' for change within value chains.

The analytical work has three main dimensions:

a) Poverty and livelihood strategy analysis. This includes a better understanding of the market systems within which the poor are embedded and an understanding of livelihood strategies.

b) Market analysis. An analysis of the extent to which outcomes in markets that affect the livelihoods of the poor are pro-poor.

c) Institutional and political economy change analysis.

3.1.1 Poverty and livelihood strategy analysis

The starting point is a better understanding of poverty and of the market systems that affect the lives of the poor. This includes current interactions between markets and the livelihoods of the poor, as well as analysis of future market opportunities and constraints. The poor interact directly with markets in three ways:

1. Producers and sellers of goods or services.
2. Consumers or buyers of food and other essential commodities.
3. Employees of businesses or other organisations where they are paid a wage in return for their labour inputs.

Depending on which markets the poor are interacting with, well-functioning markets that are accessible, affordable and offer choices, adequate returns and simple low cost means of settling exchanges can improve the welfare of the poor by providing higher income and returns from their assets (e.g. labour – or the products they have sold). Similarly, lower prices for the goods they buy may also increase their real net incomes. But the intensified competition resulting from greater market integration may be a two-edged sword, bringing simultaneous positive and negative effects. For example, markets may bring greater production efficiency and lower consumer prices, but also a livelihood loss for existing producers.

Market interactions are dynamic. Structural changes in an economy present new opportunities. Poor people will try to improve their welfare by changing their livelihood strategies. There are different roles for markets in different livelihood strategies as well as requirements for new and different markets that must work in combination. Three such strategies can be identified (Dorward et al 2005).

- **Maintenance or 'hanging in'** - concerned with preserving current levels of welfare with the current portfolio of activities.
- '**Stepping up'** – increasing productivity and incomes in the sectors in which the poor currently earn their livelihoods.
- **'Stepping out'** - transition to new forms of livelihoods that provide higher incomes, notably self-employment or wage employment in manufacturing and services. This is the major pathway out of poverty for most poor rural people. Well-functioning labour markets will be critical for 'stepping-out', as will means to transmit money, access to education and a stable source of low priced food. When people 'step out' they will need to be able to sell or rent out assets that will be left behind such as land and property.

The combination of stepping-up and stepping out recognises that inter-linkages between sectors make for a pro-poor pattern of growth and the transformational nature of such growth. Growth of agricultural productivity is associated with pro-poor growth because it increases incomes for the poor, provides cheaper raw materials for manufacturing and lowers the cost of food. For labour to move away from direct involvement in agriculture, the productivity and wages paid by non-farm activities must be higher than agriculture. This can set up a virtuous circle in which agricultural productivity rises as underemployed labour departs, resulting in higher returns to labour for those remaining in agriculture. Stepping-out is recognition that as an economy develops, there will be a falling share of agriculture in employment and GDP, and a shift of resources to more productive sectors. Without stepping-up, shifting resources to other sectors can result in large numbers of the poor failing to benefit from growth. Without stepping-out, growth is likely to stall.

3.1.2 Market analysis

The core of the M4P approach will be a solid and comprehensive analysis of the market in order to identify areas of potential systemic change. The following questions are relevant:

- How are markets changing and how are they likely to change as a result of wider, external processes of change? What opportunities are there for support to wider processes of growth?
- How well do these markets currently serve the poor, in terms of ease of access, security of access and conditions of access?
- How do these markets fit into supply and value chains? How do these chains operate: where are the constraints, where are the high returns being made?
- What stakeholders are involved in these markets and what are their roles, their interests, and their strengths,

The ComMark approach

a) **Understanding the market** – looking beyond prima facie evidence of market failure and constraints to business development to identify the systemic constraints to pro-poor market outcomes.

b) **Developing a vision of market growth and sustainability** – interventions to be informed by a clear vision of how markets will continue to deepen and bring about pro-poor outcomes beyond the life of the intervention.

c) **Designing and implementing strategic interventions** – to be strategic the intervention must alter the incentives provided by the market in terms of risk, transaction costs, and greater competition in backward and forward linkages in value chains to alter market power in favour of the poor.

weaknesses, opportunities and threats?

- What are the barriers to entry and the transaction costs and risks for different stakeholders?

3.1.3 Institutional and political economy change analysis

The M4P approach is based on changes in the *market system* in order to achieve pro-poor outcomes. This means changing the incentive structure (the risk to reward ratio) sufficiently so that *private sector* players will become increasingly involved in the delivery of pro-poor market outcomes. Incentive structures also have to be considered to motivate politicians, bureaucrats and other powerful stakeholders to support pro-poor change. Systemic change may be brought about by addressing:

- inappropriate institutions and policies, particularly those that act to exclude the poor;
- market structure and infrastructure,
- market failures, particularly those related to coordination failure;
- providing new or enhanced services; and
- stimulating pro-poor business linkages.

The table below matches the main market functions with potential roles to be played by the three pillars of the state, the private sector and civil society.

Table 5: Roles played by the state, the private sector and civil society in relation to main market functions

Player	Core Market or Coordination function	Provision of Infrastructure and Services	Institutions and Rules
The State	• Public action to reduce transaction risks and stimulate markets. • Direct intervention will sometimes be needed to (temporarily) address severe market failures.	• Regulator. • Service provider but limited by Govt budget and donor resources.	• Legislation. • Enforcement through the legal system. • Information Provision: standards, public health, etc.
Private Sector	• Buying and selling. • Hierarchies and embedded markets.	• Service provider, market-driven, fee-based or embedded service.	• Advocacy though Business Associations. • Self-enforcement, e.g. through codes of conduct.
Civil Society	• Collective action to reduce transaction risks.	• Advocacy. • NGO service provider limited by NGO resources. • Service provider based on fees, e.g. producer associations,	• Advocacy through Consumer and Producer Associations, • Information provision via the media, • Enforcement through social capital,

All three 'pillars' will have a role to play, and the following will need to be determined:

- What are the main drivers of change in the priority market areas? What change model and change processes will be supported to enable pro-poor change?
- What is the institutional environment like and what are its effects on key markets – is it enabling or disabling? How could these be developed or modified to improve market access for the poor?

- What systemic change will M4P aim to achieve? What are the changing incentives? What will be done differently as a result of the intervention? Who are the members of the constituency for change? Who are the winners and losers and how will losers be compensated?

3.2 M4P as a tool for intervention

M4P can also be used as a practical tool for intervention. Constructing a case for a market development intervention depends on identifying exactly why the goods and services in question are being sub-optimally supplied. It is not always the case that a market failure is occurring, or that market failure can easily and economically be remedied.

Joffe and Jones (2004) discuss three areas of constraint in which private investment may be deterred by the lack of profitable opportunities due to the following:

a) **Weak 'fundamentals'** such as low demand, low prices, high production costs and distance from markets. The scope for market development is severely constrained and is likely to remain so without substantial public investment in infrastructure and technological change. The private sector may still be partners in this process through various forms of Public Private Partnership (PPP). However a substantial subsidy element will be required.

b) **Extensive market and/or government failures.** Mechanisms to reduce and manage risk come to the fore, such as insurance, guarantees and other financial instruments, but also via institutional strengthening, novel partnerships and contractual arrangements. The sustainability of any intervention may be compromised without parallel longer term reforms, structural change and public investments to improve the investment climate.

c) **Poor access to finance**, either debt or equity. Measures to strengthen the rural financial sector may be the priority, including institutional strengthening and new product design.

Degrees of Intervention in Markets. Another perspective is to consider interventions in terms of increasing likely degrees of market distortion:

a) The most neutral interventions are those aimed broadly at the removal of existing distortions, and improvements to the investment climate.

b) Next are non-transactional interventions that aim to improve or enhance supply of and demand for goods and services within a given market via education and training, improved information availability, and various institutional measures to reduce transaction costs.

c) The least neutral are interventions that directly affect the prices of goods and services via some form of subsidy. Such measures if maintained indefinitely will distort consumption and investment decisions.

Uganda: Market information for rural producers

Conventional approach: Views market information as a public good. Project buys commercial airtime and prepares and disseminates standard, one-size-fits-all general information product.

Market development approach: FIT-SEMA Uganda recognised opportunities from a recently liberalised media environment. Commercial radio attracts sponsors by demonstrating audience share. Competitive advantage comes through distinctive programming to retain listeners. Project assists radio stations to develop differentiated information products focusing on business and agriculture according to audience base, the bulk of which is rural. Market information is regularly updated and provided entirely commercially.

3.2.1 The strategic 'lens' for M4P

Even where there is a case for market intervention, the M4P intervention must be further filtered through

a ‘poverty reduction lens’. This is likely to be comprised of the following three criteria:

a) ***Bang for buck*** Are there sufficient numbers of the poor in the market to make the intervention worthwhile?

b) ***Accelerating pro-poor growth?*** Will the intervention make a significant contribution to Pro-poor Growth (PPG)? The choice of sectors should be informed by the concept of *stepping-up* or increasing productivity and incomes in the sectors from which the poor currently earn their livelihoods; and *stepping-out* or helping the poor access new sectors that have the potential to provide better livelihoods. The simple phrase ‘stepping-up and stepping-out’ captures much of what makes for a pro-poor pattern of growth.

c) ***Systemic change***. Within these sectors/areas, are there suitable sub-sectors/areas for bringing about systemic change?

3.2.2 Changes in incentives in markets

At the meso- and micro-level there is a need to identify which incentives can be changed to gain pro-poor outcomes. Such changes will involve winners and losers. These groups need to be identified and their interests need to be addressed if the change is to be feasible and sustainable. In order to measure impact and success, criteria must be developed to show: the rate and direction of market deepening, the increasing participation of the poor, and the growing significance of private sector providers. The text boxes (Lesotho Textiles & Apparel and Uganda: Market Information) show examples of how M4P activities result in changes in market incentives.

3.2.3 Policy and Institutional Change

One of the key areas of intervention for the M4P approach is likely to be support for **policy-oriented research**. The formulation of the research will have an aspiration for systemic change and a good understanding of the ‘uptake mechanisms’ from research to policy making. It may also be necessary to adopt more innovative ways to communicate policy messages amongst a wider and more diverse set of potential change agents. In many cases, Government ministries may not be the only ‘target’, other targets will be private sector and civil society groupings.

External communication is a core element of both ComMark (South Africa) and of M4P in Viet Nam. The success of most interventions will depend on their ability to convince various stakeholders of the need to bring about institutional and policy change, and to develop new or underdeveloped markets. But the key intent of the two programmes is to prove the concept and spread the word about M4P. This requires the development of a voice which has content, credibility and focus. In the case of Viet Nam, a specific communications strategy has been developed. This strategy divides communications activities between awareness raising, capacity building, lobbying and campaigning, and also considers how they interact in areas such as advocacy and influencing policy (Davies 2005).

MMW4P
Lesotho Textiles & Apparel

Textiles and Apparel is the largest employer in Lesotho, providing 54,000 jobs, mainly for poor, illiterate women, addressing poverty and inequality. The industry has grown as a result of preferential access provided by the Africa Growth and Opportunities Act (AGOA) of the US. The survival and growth of the sector post AGOA depends upon addressing the currently low levels of productivity brought about by the unfamiliarity of the Taiwanese owners to motivating and managing the Basotho workforce.

Having identified the systemic constraint, ComMark has initiated the development of a market for training service providers (TSPs) to improve productivity. It is familiarising the Taiwanese owners with the concept, registering competent TSPs, providing matching grants to provide an incentive for the use of TSPs and monitoring outcomes.

3.2.4 Implications for donors

This type of catalytic role, implied by the M4P approach, presents a number of challenges to the way donors are set up to do business. The traditional emphasis on transferring resources is not strongly relevant to this approach, where the main mechanism for delivery is changes in the market system itself. However, there are implications for the type of donor personnel that are engaged in analytical processes, as well as for flexibility in the type of funding that may be required. There may be significant investment needs for some activities, especially in the early stages of growth where (a) the need for such investment is greatest; and (b) government capacity (both administrative and financial) is weakest. By definition, many of the actual interventions cannot be identified up front as they will emerge from a variety of dialogue and analytical processes. In addition, the systemic institutional and policy changes that the M4P approach requires for success will present challenges for monitoring and evaluation. Donors may also play a catalytic role through promoting cross country lesson learning, and in providing additional external perspectives in support of pro-poor institutional and policy change.

3.2.5 Data needs:

The M4P approach will draw upon the following types of data:

- Poverty reports including household surveys and PPA surveys.
- Specific market and transactions studies using participatory and other techniques to complement existing poverty data.
- 'Doing Business' and Investment Climate Surveys.
- Trade, production and price data.
- Market outcomes and data from the operation of value chains.
- The rate and direction of the evolution of key markets for the poor, especially the:
    - process of market deepening and the expansion of the access frontier;
    - crossing of key thresholds for participation, outreach, choice, economies of scale and sustainability; and
    - effects of cross market linkages.

3.2.6 Tools for measurement

The measurement of the progress of M4P interventions will require the application of a number of existing tools. See Gibson et al 2004, and Joffe and Jones 2004 for examples such as the tools developed by CGAP to cover the Microfinance industry or tools developed for Business Services. In addition there are specific market indices such as the Lerner Index (market power) or the Herfindhal index (market concentration).

3.3 Summary and next steps

This paper introduces the M4P concept. The paper charts the evolution of the M4P framework and shows how M4P can be used as a:

- development objective;
- framework for analysis and understanding; and
- practical tool to promote pro-poor growth.

The paper describes some of the issues arising from early attempts to operationalise the M4P framework using combinations of poverty analysis, market analysis, and political economy and change analysis. But clearly this remains a work-in-progress. Many gaps remain, and we expect to see further evolution and refinement of the approach, especially in

terms of its practical application. Some of the areas of work that may be needed to further improve the usefulness of the concept are set out below:

- **Mainstreaming M4P**. Whilst early inroads have been made in terms of influencing the portfolio of donor programmes, their remains the challenge of integrating the M4P framework more fully and seeing the framework being used in a much wider group including: developing country governments, the private sector, NGOs and other civil society organisations. A potentially useful contribution of the M4P framework is to support a more sophisticated understanding and appreciation of the links between markets and poverty reduction and to move beyond the simplistic pro- or anti-market positions that can be found in discussions of, for example, globalisation issues.
- **Further refinement of the M4P framework**. As noted above, the M4P framework remains a work in progress. There is scope for further work to improve our understanding of a number of areas including: (a) the processes that catalyse the 'thickening' of markets; (b) the case for public or private provision of different types of market infrastructure at different times in market evolution; (c) tools and approaches for market enablement and market creation; and (d) measures to identify and manage the risks of implementing a M4P approach.
- **Further integration of 'Drivers of Change'** and other political economy approaches into the core of the M4P approach. This may involve a more systematic attempt to bring together relevant currents from both NIE and political economy.
- **Institutional development**. Identifying the relevant institutions needed for effective markets, including the identification of 'missing' institutions, e.g. competition authorities, and the means to ensure that market power is not abused.
- **Markets, hierarchies, value-chains and vertical integration.** On-going work, particularly in the context of thin agricultural markets, which presents a case for more work on the role of hierarchies in promoting pro-poor growth.
- **Gaining real involvement of the private sector.** Much of the success of the application of the M4P approach is predicated on the uptake of market functions by the private sector on a larger scale that donors and government simply cannot achieve. To facilitate this process, M4P needs a more sophisticated toolkit to work with the private sector covering more diverse public-private arrangements and new aid instruments.
- **Better knowledge management, communications and advocacy capacity**. Whilst this recent process to develop an M4P summary paper and present it to a 'learning event' is very valuable, it is clear more can be done on a more professionalised and systematic basis. A collective 'knowledge base' should be easily available to those who want to use it. M4P advocates should be able to add lessons from their own experiences to contribute to the evolution of the M4P framework.

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Annex 1: M4P Country Initiatives list

<u>Bangladesh</u> – key words: Business Development Services, Agriculture, Rural, Finance, IT, Media,

The goal of the KATALYST project is to improve the competitiveness of business in Bangladesh especially within sectors where the most opportunities for development exist. KATALYST's purpose is to develop more effective markets for business services. KATALYST follows a comprehensive approach to business services markets that reflect their complexity, choosing a total of 18 "markets" to work in 3 subsectors (regional sub-sectors, such as Pond Fishery, Onions, Vegetables and Potato), 5 clusters (Plastics clustered in Lalbagh/Islambagh, Knitwear clustered in Narayanganj and Agro-tools and spares clustered in Bogra and Dholaikhal), 3 rural markets (Greater Faridpur, Greater Rangpur and Greater Rajshahi), 6 cross-sector services (These service markets relate to Accounting, Finance and Taxation (AFT), Quality Management (QMS), Marketing, IT-related and Legal Advisory) and 1 media business service. At the same time KATALYST tackles regulatory issues related to those markets selected. KATALYST is organized into three operational divisions:

- The Services Division aims to develop cross-sector business services markets including accounting, finance and taxation, quality management services, marketing, IT-related services, and legal services.
- The Industry and Rural Services Division focuses on specific sub sectors, including plastics, knitwear, and agro-tools as well as specific rural areas.
- The Centres of Expertise and Regulations/ Media Services contribute to the project purpose by directing and supporting KATALYST's activities in the enabling environment, media, and three cross-cutting issues: gender and socially and environmentally responsible business.

<u>South Africa</u> – key words: Commodity, Financial markets.

The ComMark Trust: The ComMark Trust supports and promotes policies and institutional and operational initiatives to help develop and improve the way the commodity and service markets (so far the focus has been on textiles and wool, there has also been work on metals, plastics and machinery) work in Southern Africa (Namibia, Botswana, Lesotho, South Africa) to benefit the poor. ComMark is focusing on the key sub-sectors that clearly have the potential to make the biggest impact on pro-poor growth and poverty reduction. Within these sectors, ComMark's operation will be based on the identification of clear areas of distortion or 'market failure', which inhibit the growth of sub-sector markets and economic activity, and which restrict the ability of the poor to benefit from them.

Celebrating its first birthday in May 2004, ComMark has to date committed R23 million (US$3.5million) to research and implementation initiatives including research on:

- Regulatory barriers that inhibit international tourist air traffic
- Investment incentives to overcome barriers to the formation of community public private partnerships in tourist lodge developments in rural conservancies
- Policy and regulatory constraints affecting South Africa's nascent off shoring sectors (call centres and business process outsourcing)

- The growth and pro-poor characteristics of the red meat and natural products sectors.

The FinMark Trust: Financial Markets, Transactions, Savings, Credit, Insurance

The FinMark Trust was established in March 2002 with initial funding of £5 million from DFID. It is an independent trust whose business is controlled by five trustees from countries in Southern Africa. The trust's mission is summarised as "Making financial markets work for the poor". In pursuit of this objective, the FinMark Trust aims to promote and support policy and institutional development towards the objective of increasing access to financial services by the un- and under-banked of southern Africa (South Africa, Botswana, Lesotho, Swaziland and Namibia.) We follow two main, complementary, strategies of engagement towards this:

- **Supporting the removal of obstacles,** or 'haak-plekke', to ensure improved functioning financial markets. This typically involves working with policy makers and regulators to address legislative obstacles;
- **Promoting pro-poor innovation** in the financial sector: this typically involves supporting organizations that seek to develop new products or processes; including the production of credible information highlighting market opportunities.

<u>Nigeria</u> – key words: Commodity, Agriculture, Finance

This project is still in the inception phase.

1 (a). The Nigerian MMW4P programme **PrOpComm (Promoting Pro-poor Opportunities from Commodity and Service Markets)** was approved in June 2004. The PrOpCom approach is based on the understanding that markets are the structures through which the assets of the poor are transformed into livelihoods. The main outputs of the programme will be to provide an enabling environment for greater private investment in the agricultural sector, support business development and functioning input and commodity markets that combine poverty reduction with social cohesion and sustainable natural resource management.

(b). A complimentary programme to this is The Promoting Pro poor financial services programme that is currently in design. This programme will aim to facilitate critical private sector access to financial services to enhance their ability to effectively take advantage of market opportunities; and enhance poor peoples' access to financial services to facilitate effective participation in the formal financial sector.

<u>Viet Nam</u>: key words: Land Markets, Labour Markets, Agriculture Value Chains, Institutions for Market Development.

<u>Lao PDR</u>: key words: Contract Farming, Infrastructure services

<u>Cambodia</u>: key words: Contract Farming

Viet Nam, Lao PDR and Cambodia: Making Markets Work Better for the Poor

Brief project description: *Making Markets Work Better for the Poor (MMWBP*) is a three-year regional technical assistance (RETA) project covering Vietnam Lao PDR and Cambodia. The US$2.4 million project is co-financed by ADB and the

Government of the United Kingdom (Viet Nam) and the Asian Development Bank Institute (for parallel activities in Lao PDR and Cambodia)

The purposes of the project are to (a) conduct analytical work on the functioning of markets and the extent to which the poor are able to benefit from them, and (b) to build capacity to support pro-poor market development through research activities, networking and the promotion of policy dialogue in the three project countries.

(1) Research Activities The following research topics are currently underway:

Lao PDR

- Infrastructure services and poverty reduction
- Contract Framing

Cambodia

- Contract Farming

Viet Nam

- The Participation of the Poor in Agricultural Value Chains with case studies drawn from supermarkets (fruit and vegetables) and agricultural export commodities (rice, cassava/starch and tea).
- Rural Land Market Processes
- Segmentation in Labour Markets
- The Formalisation of Household enterprises
- Participatory Market Assessment in Danang City
- Institutions and Market Development

(2) Capacity Building.. The project promotes capacity development through the use of local research institutes to conduct the research. In addition, for each research topic, there will be a formal linkage with an international "mentor".

(3) Policy Dialogue. The project will promote policy dialogue relating to market development and poverty reduction. Dialogue will be promoted via diverse means ranging from conventional reports, workshops and meetings to media articles to an actively managed project website (www.markets4poor.org).

Annex 2: Jargon buster

Jargon	Meaning
Collective Action	Actions taken by two or more people, comprising a group or organization, in pursuit of the same collective good—a good such that, if any member of the group consumes it, it cannot feasibly be withheld from the others in the group. *Mancur Olson (1965), The Logic of Collective Action: Public Goods and the Theory of Groups, Cambridge, MA: Harvard University Press, p. 1, p. 14.*
Commons	A scarce resource used in common, from which it is not feasible to exclude potential beneficiaries from using or consuming it, and for which each actor's use or consumption of it subtracts from its availability to others. *Elinor Ostrom (1990), Governing the Commons, Cambridge: Cambridge University Press, p. 2, p. 6.*
Contract	A legally enforceable agreement. It is a formal, legal commitment to which each party gives express (though not necessarily written) approval and to which a particular body of law applies. *Scott E. Masten (2000), Contractual Choice, in Encyclopaedia of Law and Economics, Volume III. The Regulation of Contracts, Boudewijn Bouckaert and Gerrit De Geest, eds., Cheltenham: Edward Elgar, p. 25.*
Corruption	Behavior which deviates from the formal duties of a public role because of private-regarding (close family, personal, private clique) pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence. *Joseph S. Nye (1967), Corruption and Political Development: A Cost-Benefit Analysis, American Political Science Review, 61 (2): 417-427.*
Governance structure	An institutional framework in which the integrity of a transaction, or related set of transactions, is decided. Governance is the means by which order is accomplished in a relation in which potential conflict threatens to undo or upset opportunities to realize mutual gains. *Oliver E. Williamson (1996), The Mechanisms of Governance, Oxford: Oxford University Press, pp. 11-12.*
Informal Economy	Economic actions and activities conducted outside the legal framework of society. The activities or products may in themselves be legal, but they are conducted in a way which disobeys specific legal provisions, such as registration with the government, payment of taxes, and so on. *Hernando de Soto (1989), The Other Path, New York, Harper & Row, p. 12.*
Market	A set of arrangements by which buyers and sellers are in contact to exchange goods or services; they are thus a means by which the decisions of producers and consumers are reconciled through the adjustment of prices. Fourie's definition of market exchange as an "economically qualified purposeful interchange of commodities on the basis of quid pro quo obligations at a mutually agreed upon exchange rate …… in a cluster of exchange and rivalry relations" highlights important market characteristics of mutuality (of agreement if not always benefit) within a framework of competition. Despite their centrality, there exists considerable debate (and disagreement) over the nature of markets, especially over the extent to which theoretical constructs illuminate reality. *Source: DFID/OPM 2000 Technical Annex; Springfield Centre Foundation Paper for ComMark.*
Institutions	The rules of the game: the humanly devised constraints that structure human interaction. They are made up of formal constraints (such as rules, laws, constitutions), informal constraints (such as norms of behavior, conventions, self-imposed codes of conduct), and their enforcement characteristics. *Douglass C. North (1994), Economic Performance Through Time, The American Economic Review, 84 (3): 359-368, p. 360.*

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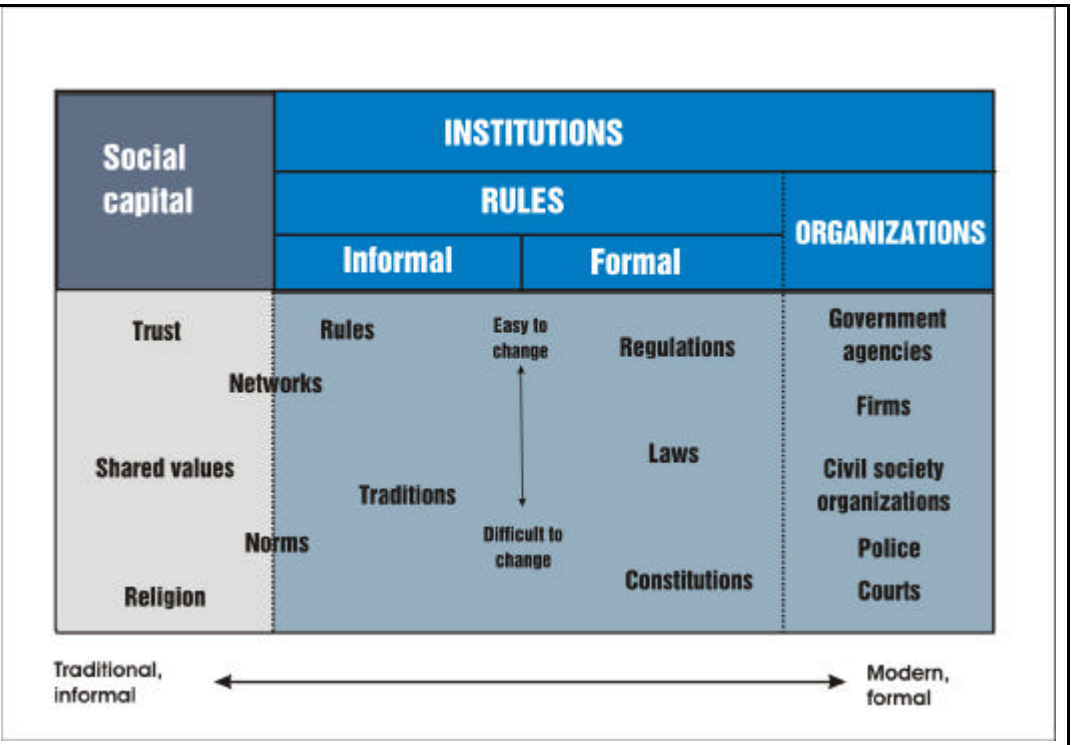

Source WDR 2003

In the context of markets, transactions between demand and supply side players are dependent on a third party to exchanges, namely government, which specifies property rights and enforces contracts and second on the existence of norms of behaviour to constrain parties in interaction”; i.e. dependent on institutions to create a conducive market environment.
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<td>New Institutional Economics</td>
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Incorporates a theory of institutions into economics. It builds on, modifies, and extends neoclassical theory. It retains and builds on the fundamental assumption of scarcity and hence competition - the basis of the choice theoretic approach that underlies microeconomics. It has developed as a movement within the social sciences, especially economics and political science that unites theoretical and empirical research examining the role of institutions in furthering or preventing economic growth. It includes work in transaction costs, political economy, property rights, hierarchy and organization, and public choice. Most scholars view the work of Ronald Coase as a central inspiration for the field.

Douglass C. North (1992), The New Institutional Economics and Development, Washington University
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<td>Market Failure</td>
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The failure of the market to provide a good or service. Common Market failures include:
♦ Public goods, which the private sector will not supply (or will under-supply) because it cannot appropriate the benefits
♦ Externalities, which exist when the production or consumption of a good or service has spill-over effects which are not reflected in the market price
♦ Market power and economies of scale, where barriers to entry create market power, enabling monopoly rents to be earned and depressing production
♦ Asymmetric information, where parties to a transaction have different information about the nature of the exchange. In credit and insurance markets and in input supply systems, information failures are especially widespread
♦ Cost of establishing and enforcing agreements may be so high as to increase risks to the point at which markets do not exist.
Correcting for market failures provides one widely accepted justification for market intervention --- whether by the state or by private sector or co-operative agencies, the
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	latter often involving self-regulation or other collective action. State intervention actions to correct for market failures are often warranted --- provided that state failure or the costs of intervention do not outweigh the original market shortcoming. *Source DFID/OPM (2000)*
Economic Co-ordination	Process in which players within a supply chain are encouraged to take common or complementary actions necessary to achieve individual goals *Source: Adapted from Poulton et al (2004)*
Economic Coordination Failure	Failure to make an investment due to a possible absence of complementary investments by other players at different stages in the supply chain" *(Dorward & Kydd*) Where individuals' failure to coordinate complementary changes in their actions leads to a state of affairs for everyone that is worse than some alternative state of affairs that is also an equilibrium" *(a broader, more systemic view with political economy connotations)* (*Hoff)*
Opportunity cost	The evaluation placed on the most highly valued of the rejected alternatives or opportunities when a choice is made. It is the value that is given up in order to secure the higher value that selection of the chosen object embodies. *James M. Buchanan (1987), Opportunity Cost, in The New Palgrave: A Dictionary of Economics, John Eatwell, Murray Milgate, and Peter Newman, eds, London: Macmillan Press, volume 3, pp. 718-721.*
Organization	A group of individuals bound by some common purpose to achieve objectives. Organizations include political bodies (political parties, regulatory agencies), economic bodies (firms, trade unions), social bodies (churches, clubs), and educational bodies (schools, universities). Note that the term "institution" refers to the rules of the game, whereas "organization" refers to players of the game. *Douglass North (1990), Institutions, Institutional Change and Economic Performance, Cambridge: Cambridge University Press, p. 5.*
Path dependence	A condition that exists when the outcome of a sequence of economic changes can be significantly influenced by temporally remote events, including happenings dominated by chance elements rather than systematic forces. *Paul A. David (1985), Clio and the Economics of QWERTY, American Economic Review 75 (2): 332-337, p. 332.*
Porter's five forces	A framework for diagnosing industry structure, built around five competitive forces that erode long-term industry average profitability. The industry structure framework can be applied at the level of the industry, the strategic group (or group of firms with similar strategies) or even the individual firm. Its ultimate function is to explain the sustainability of profits against bargaining and against direct and indirect competition. Porter's five forces, or factors that shape business strategy are: • Threat of entry to the market from other organisations • Supplier power • Buyer power • Availability of substitute products • Existing competitors
Property Rights	There are two distinct meanings: economic property rights and legal property rights. The economic property rights of an individual over a commodity or an asset are the individual's ability, in expected terms, to consume the good or the services of the asset directly or to consume it indirectly through exchange. These can include (1) the right to use an asset, (2) the right to earn income from an asset and contract over the terms with other individuals, and (3) the right to transfer ownership rights permanently to another party. The legal property rights are the property rights that are recognized and enforced by the government.

	Yoram Barzel (1997), Economic Analysis of Property Rights, Cambridge: Cambridge University Press, second edition, pp. 1-2. Thrainn Eggertsson (1990), Economic Behavior and Institutions, Cambridge: Cambridge University Press.
Pro-poor growth	There are two main approaches to defining pro-poor growth. Both require that 'the poor' be identified by specifying a poverty line, such as the international $1 a day line or a national poverty line. The people whose incomes lie below this line are the poor. The ***absolute*** definition of pro-poor growth considers only the incomes of poor people. How 'pro-poor' growth is should be judged by how fast on average the incomes of the poor are rising. The ***relative*** definition of pro-poor growth compares changes in the incomes of the poor with changes in the incomes of people who are not poor. Growth is 'pro-poor' if the incomes of poor people grow faster than those of the population as a whole. In other words, for growth to be pro-poor on this definition, income inequality must fall. *Source: DFID Pro-poor growth Briefing No.1*
Pro-poor market development	Market interventions that comprise one or more of the following: • Identifying and addressing constraints that are notably severe for the poor. For example, the poor's exclusion from: tight-knit market networks and the norms and information around these, resource distribution through administrative allocative mechanisms (e.g. for land), the benefits of insider protection in the labour market; and the service markets in which providers have historically not focused on them and are therefore unaware of how to reach them. • Focusing on markets where the poor are present in significant numbers. As producers, this might include agricultural markets, as consumers, financial services and as labour market participants (producers) labour intensive sectors. • Focusing on markets that allow improved risk management, for example improving land transferability should allow better access to collateral-based finance. Improving business networks should allow better information flows to anticipate and plan for market change *Source: Springfield Technical Annex prepared for ComMark*
Rent	A factor's earning in excess of its opportunity cost (Pareto) i.e. incomes higher than in the next best opportunity. Costs or losses as a result of powerful government, political, criminal or other agents expropriating or threatening to expropriate income or assets (see annex 3)
Rent-seeking	The outlay of resources by individuals and organizations in the pursuit of rents created by government. *Anne O. Krueger (1974), The Political Economy of the Rent-Seeking Society, The American Economic Review, 64 (3): 291-303, p. 291. Gordon Tullock (1998), The Fundamentals of Rent-Seeking, The Locke Luminary Vol. I, No. 2 (Winter 1998) Part 2.*
Risk	The chance of an event occurring in accordance with a known probability. Three types are of particular relevance for markets: • Natural risks (e.g. weather, "acts of god") • Market (price) risk • Transaction risks: (coordination failure, opportunism (cheating), rent seeking)
Regulatory framework	The set of rules and actions that guide market participants. There are four main requirements of a regulatory framework for a market system to function: • A set of "ordered relations" between economic agents established by legal and social conventions that define and allocate property rights, entitlements, and delineate the scope of economic behaviour. • Rules about transactions between economic individuals that define processes for exchange of property rights, what constitutes legitimate contracts, permissible and non-permissible forms of co-operation and competition, and rules on liability.

	• A system of legitimate authority to enforce rules, including penalties for delinquency • Mechanisms by which rules can be adapted to changing economic and social circumstances while providing a predictable framework for market participants. While the state may play a role in developing a regulatory framework, other organisations (such as representative business associations) and formal and informal mechanisms can also be important. Indeed, it has been argued that the most successful market systems are built on generalised social norms with minimal resort to legal enforcement . In general, as economies become more complex, regulatory frameworks become more formalised and, with increasing trade, international. *Source: Bromley, D.W. (1993); Reconstituting economic systems: institutions in national economic development; Development Policy Review, 11, 131-151* *Shaffer, J. (1980); Food system organisation and performance: towards a conceptual framework; American Journal of Agricultural Economics, Vol 61(2), 723-31*
Social Capital	1. Features of social organizations, such as trust, norms, and networks that can improve the efficiency of society by facilitating coordinated actions. 2. Features inherent to the structure of relations between and among actors. Each variety of social capital consists of some aspect of social structure, and each facilitates certain actions of actors—persons or corporate actors—within the structure. *Robert D. Putnam (1993), Making Democracy Work, Princeton: Princeton University Press, p. 167. James S. Coleman (1988), Social Capital in the Creation of Human Capital, The American Journal of Sociology, Vol. 94, Supplement, pp. S95-S120, p. S98.*
Social Cost	An actor (business firm, individual, etc.) initiating an action does not necessarily bear all the costs or reap all the benefits of that action. Those that the actor does bear are the private costs; those that the actor does not bear are the external costs. The sum of these two is the social cost. *Ronald Coase (1960), The Problem of Social Cost, Journal of Law and Economics 3:1-44.*
Transaction Costs	The costs of resources utilized for the creation, maintenance, use, and change of institutions and organizations. They include the costs of defining and measuring resources or claims, the costs of utilizing and enforcing the rights specified, and the costs of information, negotiation, and enforcement. *Eirik G. Furubotn and Rudolf Richter (1997), Institutions and Economic Theory: The Contribution of the New Institutional Economics, Ann Arbor: The University of Michigan Press, p. 40.*
Value Chain	The value chain describes the full range of activities that are required to bring a product from its conception to its end use and beyond. This includes activities such as design, production, marketing, distribution and support to the final consumer. The activities that comprise a value chain can be contained within a single firm or divided among different firms. Value chain activities can be contained within a single geographical location or spread over wider areas. *Source: IDS Value Chain Website; Goletti (2004).*
Washington Consensus	Shorthand for a standard IMF-World Bank ("Washington") devised policy package to support "structural adjustment" comprising a combination of macroeconomic stabilisation (especially restricting the money supply to reduce inflation), exchange rate liberalization, deregulation and the privatisation of state-owned enterprises

Annex 3 – additional technical material

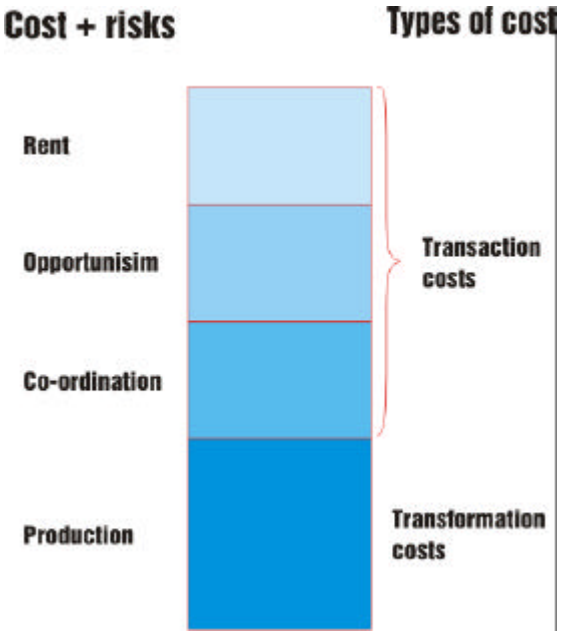
This annex contains further expositions of three areas of relevance to the content of the main report:

- Additional work on the role of markets in reducing Transactions Costs;
- Market Creation, Expansion and Deepening
- The access frontier

A) Reducing Transactions Costs or the "costs of doing business"

An area where supplementary work has extended the M4P framework is in the analysis of costs and their relationship with market failure. As we have seen a key market function is to allow coordinated exchange with low transactions costs and risks. The costs of a good or service can be divided between the "transformation" or production costs of the good or service and the "transaction" costs incurred in buying and selling.

If transactions costs plus transformation (production) costs exceed returns, there will be no transaction leading to missing markets or market failure. The Figure (derived from Dorward and Kydd, 2004) shows different elements of costs.



Rent refers to costs or losses as a result of powerful government, political, criminal or other agents expropriating or threatening to expropriate income or assets.

Opportunism costs are associated with the risk of cheating. Sellers may not deliver to specification. Buyers may not pay. In addition there are the costs of dispute settlement and resolution.

Coordination costs are the costs related to matching suitable buyers and sellers. These may be "search" costs as well as "reference" costs. Technical change – such as the Internet - may dramatically reduce search costs for potential buyers and sellers. However, after sale opportunism costs remain.

These transaction costs (coordination, opportunism and rent seeking) are particularly important where

- there are only a small number of players and
- markets are thin at critical stages in supply chains,
- risks and vulnerability are high (due to price and production uncertainty and large investments relative to income), and
- quality standards are important.

These conditions are common in the development of new activities that are important for pro-poor growth. Innovation is driven by the search for higher returns and is essential for productivity gains through a process that Schumpeter termed 'creative destruction'. In this process the innovators drive out the less efficient. Where markets function well, the rents, premia for opportunism and co-ordination costs are reduced over time increasing the efficiency of production and the benefits to the consumer. Where high transaction costs persist however there may be a need for intervention on the part of governments and those concerned to achieve pro-poor growth to address the cause of the failure of markets to grow and deepen. High transactions costs incentivise informality, which constrains productivity growth. High transactions costs in adverse environments also cause firms to internalise these transaction costs. There are economies of scale in doing this consequently adverse environments hurt SMEs disproportionately. This is one of the reasons behind the "missing middle" in enterprise structures in Africa.

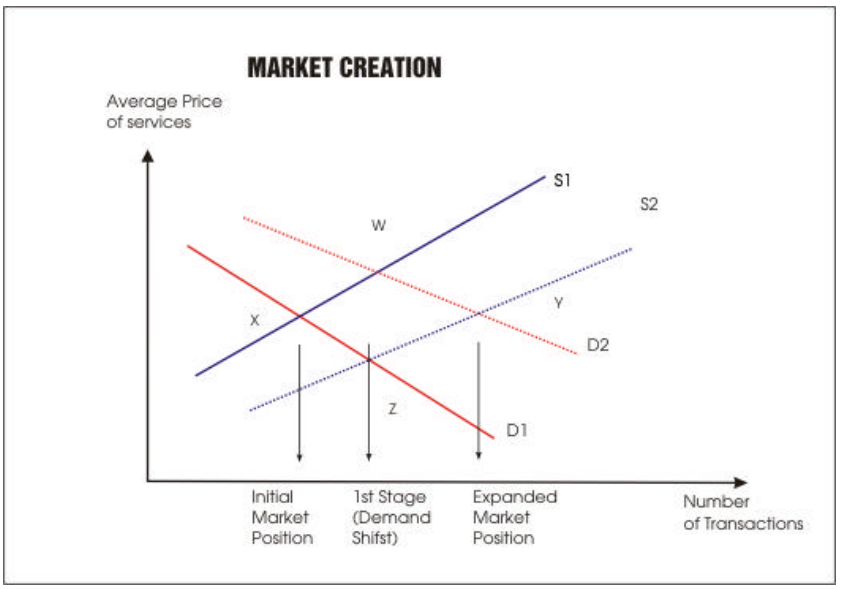
A key research challenge for M4P is to identify innovative, time-limited public actions that overcome the transaction cost problems described above in such a way that potential private sector providers are increasingly drawn into the market rather than displaced from it. Each of problems cited above (coordination failures, opportunism risks and rent seeking) provide potential entry points.

Reducing production or transformation costs will also be important in driving the expansion of a market. Michael Porter outlines five forces that explain the structure of an industry or market. Some of the insights from this perspective relate to the high "switching costs" that make it hard for the poor to move to new areas of economic activity.

B) Market Creation, Expansion and Deepening

Concepts and General Principles of Market Creation[1]

The general problem to be addressed is a situation where one or more goods or services are perceived to be sub-optimally supplied and consumed under existing market conditions. The 'sub-optimality' may be in terms of the level of consumption, the quality of goods and services, or other characteristics of the markets.



Source Joffe and Jones (2004)

[1] From Joffe and Jones (2004)

The Figure above depicts a process of market expansion, with the objective of achieving a sustainable shift from point X to point Y.

Initially, at X the market is small and insensitive to the cost of services. An intervention increases effective demand from D1 to D2. Such an intervention may be in the form of a community-based grant scheme, or other transactional subsidy, but equally might be achieved via an improved information or institutional environment or for example the building of a new feeder road. Service supply responds initially by expanding to point W. Further progress to point Y, depends upon a shift in the supply conditions being achieved such that supply shifts outwards to S2. This may also result from direct enterprise support, or equally from improved management skills, or reduced perceived risk as a result of parallel regulatory change. Importantly for the change to be 'permanent' the increase in demand must be sustained after the intervention has ceased. Otherwise the market will contract back towards Z and then to X as suppliers exit.

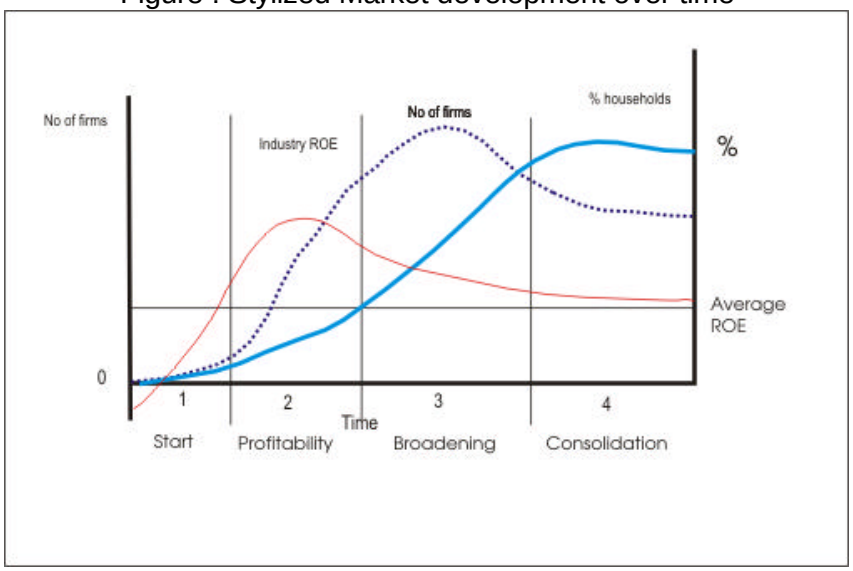
This model helps to illustrate the importance of

(i) the need for 'joined-up' attention to both demand and supply sides of a market,
(ii) understanding the dynamics of specific markets with specific metrics,
(iii) designing means to lock in changes in the long term.

Market Development[2]

Although individual markets may differ substantially, certain stylized facts of general market development can be presented. The figure below summarizes the conventional 'stages of market growth' model, tracking the number of firms in a given market segment (market structure), the average firm profitability and the percentage of eligible consumers using the product or service (market size).

Figure : Stylized Market development over time



Source: Porteous (2004, 12)

[2] This and the following section are from Porteous (2004)

The figure above tells the following story of market development. In the *first phase*, a few pioneers introduce a new product to the market. They often make losses due to R&D investment which they hope to recoup at a later stage (hence the average return on equity (ROE) line is below zero); and they serve a small number of early adopter customers.

The experimentation results in a product which works. We see increasing numbers of clients in *Phase 2*; and the consequent move to profitability by the initial firms. This success prompts other firms to enter the market. Competition may initially be on the basis of service quality or by product differentiation.

In Phase 3, supply continues to increase, prices start to fall as increasing numbers of firms compete. This creates a virtuous cycle of boosting further demand, hence usage grows rapidly in this phase as the market broadens. Competition is usually on price terms as the product features start to be commoditized. As It is quite likely that the supply will overshoot—a number of suppliers will not be able to survive, and will withdraw from the market.

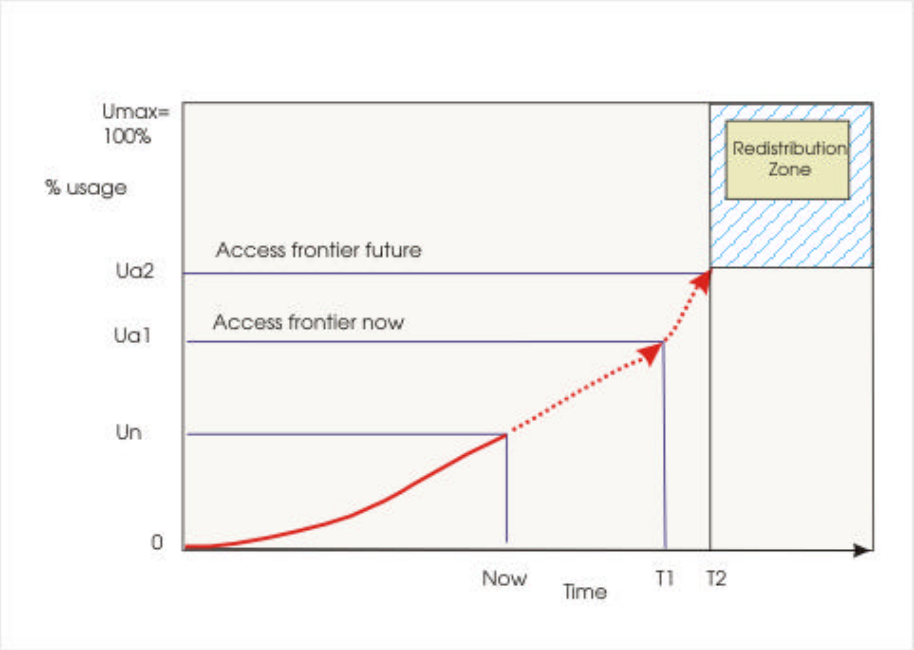
In *Phase 4*. the market consolidates. Remaining firms benefit from greater economies of scale as market acceptance and usage grows further, but prices fall further, pushing the average profitability of this market sector back towards the overall risk adjusted average. The overall level of usage of the product reaches saturation at some natural limit, at which all who wish to use the product and service are able to. Hence, non-usage is then a function of genuine, not income-constrained, choice. After reaching the natural limit, turnover in the market consists mainly of replacement sales and any growth in volume is generated by exogenous factors such as demographics.

Markets have high growth potential the early phases of development. If demand is price elastic, the pursuit of further profit by incumbent and entrant firms will drive price reduction over time, which in turn grows the potential market size. Growth in itself may generate virtuous cycles--for example, through economies of scale, which enable further cost reduction and/or profitability to be achieved. In the presence of competitive forces which allow new entry, it is reasonable to expect that a healthy market will show increasing usage, but at a decreasing rate as it approaches a natural limit.

C) The access frontier

An important concept for M4P is the access frontier which is defined as “the maximum proportion of usage possible under existing structural conditions (of technology, infrastructure and regulation)”. The position of the frontier and the rate of movement towards it reflect market deepening and the extent to which the market is working for the poor. Current levels of usage may be below the access frontier, as shown in the Figure below, where Un is below Ua1, usage at the current access frontier. The position of the frontier will change over time. In a healthy market, it will be pushed outwards over time; bringing a further group of consumers into the market--Ua1 to Ua2 in the Figure below. However, establishing where this boundary is enables the first clear diagnosis of whether the market is above or at its access frontier. Once this is clear, the next order policy question is how to ensure that the frontier continues to shift outwards over time: this means that the reach of those served by market provided solutions is growing.

Figure : Market development and the access frontier



The figure (adapted from Porteous 2004, 15) shows the shaded 'supra-market zone' which is comprised of consumers who are beyond the reach of the market in the foreseeable future due to lack of income (i.e. those between Umax and Ua2 who will not be within the expected frontier at T2). These represent in most cases the very poor with very low or no cash income.