

EXECUTIVE SUMMARY:

BUSINESS MODELS FOR DECENT WORK

This paper includes case studies from Afghanistan, Zambia, Kosovo and Nigeria which draw out practical lessons on how market systems programmes can support business models that pass the twin 'tests' of commercial viability and development impact.

> Read the full report at www.ilo.org/thelab

1. Introduction

Market Systems Development (MSD) is an approach to poverty reduction that aims to create long-lasting and large-scale change by stimulating more inclusive growth. To achieve a systemic change vision, market systems programmes often partner with the private sector to introduce new or improved business practices, products and services.

Understanding the mechanics of these business models is at the heart of programme success. After all, innovations will not be sustained unless they align with the core incentives of companies to continue to deliver value after programme support ends. But understanding partner motivations can be tricky. Programmes operate in data poor environments, have to navigate complex relationship building processes, and often lack the skills to interpret commercial performance from the private sector perspective.

The task of MSD programmes is not only to bring benefits to target groups - but to do this in a way that delivers value to all market players involved so the innovation becomes a *new normal* in the market system. Sustainable profits are not a by-product of change; they are often the engine for creating sustained outcomes over time.

MSD programmes have focused much more on discussing, measuring and managing towards the *ends* of impact, but much less on the *means* of delivering impact: the business models themselves¹. This has led to a lack of understanding about how business models are structured and delivered and the array of commercial decisions involved – from costs to cashflow implications to return on capital. These neglected aspects ultimately determine whether new ways of working are truly being internalised by companies, let alone can start to be ‘scaled’ across the market system.

“The challenge with market systems thinking [is this]: Implementers focus more on the target group and neglect value capture for the other market players. The focus should be on aggregate value creation and value capture by all actors in the innovation ecosystem”

Golden Mahove

This paper contributes to addressing the gap by examining business models being supported by market systems programmes. It sets out to better understand what business models look like in reality and the practical challenges facing project implementers and their partners. Above all, it asks the question: *what can MSD practitioners learn to support business models that bring both commercial viability and development impact?*

1. For example, see the findings of Blewett, J., Keddie, J., Van Hummelen, S. (2016) Pre-intervention investment toolkit: The challenge of achieving impact at scale in MSD (M4P) interventions.

What is a market system?

A market system is the inter-connected network of actors and factors that interact to shape the outcomes of an economic exchange². In the case of decent work, the core exchange is between companies as employers (demand for labour) and workers as employees (supply of labour). These exchanges are governed by a range of:

- *Supporting functions.* The context- and sector-specific functions that inform, support and shape the quality of exchange; such as information, skills, infrastructure, finance and access to markets.
- *Rules and Norms.* The legislative and regulatory environment, including policies, voluntary standards and social norms that guide day-to-day attitudes and conduct.

Supporting functions and rules are carried out by a wide range of market actors, from businesses to financial institutions, trade associations, regulators and government agencies.

When certain rules or functions do not operate well, a market system *constraint* is created that reduces the effectiveness of the system and limits outcomes for the people and market actors involved in the transaction.

Market systems development programmes aim to create positive systemic changes. A systemic change takes place when there is a lasting improvement in one or more market system constraints which leads to improved outcomes for target groups, be they workers suffering from poor safety and health conditions, or young people excluded from the labour force. Programmes discover why market actors have not addressed such constraints themselves, and then work on improving their incentive and capacity to perform new or improved roles. Market Systems Development for Decent Work aims to boost incomes, create jobs and improve working conditions.

What are business models?

A business model describes how an organisation creates, delivers, and captures value for itself as well as its customers³. There are many different ways of conceptualising business models. According to management theorist Peter Drucker, a business model should answer the questions of “who your customer is, what value you can create/add for the customer and how you can do that at reasonable costs”.

A business model therefore needs to cover:

- Everything related to designing and manufacturing the product.
- Everything related to selling the product, from finding the right customers to distributing the product.
- Everything related to how the customer will pay and how the company will make money.

2. The business model case studies

Four business models are included: three from the agricultural sector, where the majority of market systems programmes are engaged; and one from the service sector (ICT). Very brief extracts of the four cases are provided below. The full business models can be read in the paper *Business Models for Decent Work*.

2. The description of a market system is based on “Facilitating youth employment in the information technology (IT) sector in Bosnia & Herzegovina”, by Roel Hakemulder and Andrew Wilson on behalf of the MarketMarkers project

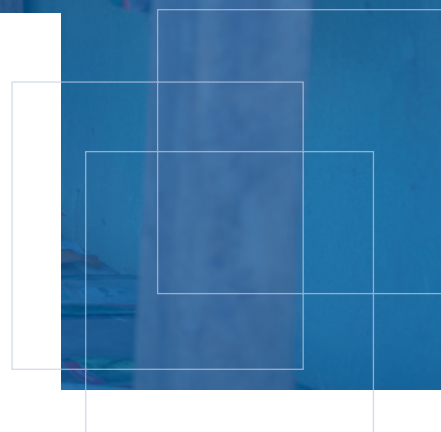
3. European Venture Philanthropy Association



Last mile input distribution

BUSINESS MODEL

1



KEY LESSONS LEARNED FOR MSD PRACTITIONERS

1. Base business models on the market player reality - which often cuts across multiple crops and commodities - rather than a narrow project sub-sector view.
2. Iterate towards a viable pilot business model by bouncing ideas off market players themselves.
3. In addition to having an impact, interventions need to solve a pain point for market players: If there is no business imperative to act, or if the model does not deliver a core business objective, it is less likely to be sustained.
4. Any business investment decision should be subjected to proper financial appraisal: Projects can play a role helping companies think through the risk-return spectrum and cost structures where partner capacity is weak.
5. Testing new and improved ways of doing business requires a certain level of risk appetite. But this needs to be informed risk-taking, not just about intuition and ambition.

Country: Zambia | **Sector:** Agriculture

Yapasa | Implemented as a UN Joint Programme by the ILO and FAO, with funding from the Government of Sweden

Systemic change vision: Market actors innovate commercially viable last mile distribution channels which can both generate youth-suitable jobs and meet the needs of smallholder farmer customers through improved availability, affordability and higher quality inputs⁴.

The Business Model: Yapasa is supporting independent agro-dealers to grow their input distribution network through Community Agro Dealers (CADs). The model is built on the physical distribution and promotion of inputs. CADs act as sales agents, running marketing activities (such as demonstration plots), holding stock and selling on behalf of the agro-dealers, and are given a commission in return. Several input suppliers are also supporting the model through product promotion and CAD training.

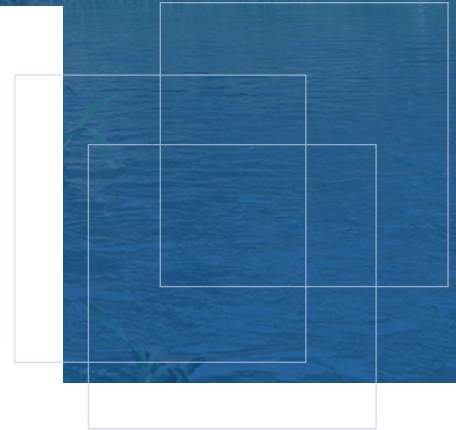
4. Last mile is a supply chain management term used to describe the final step in delivering a product to the end-consumer.



Private Extension Services

BUSINESS MODEL

2



KEY LESSONS LEARNED FOR MSD PRACTITIONERS

1. Projects often try and 'bolt on' a service offering to a company selling products (such as an agro-dealer). This bolt-on is usually based on the argument that embedded services can help drive sales and create repeat purchases. While this is sometimes the case, a product-plus-service offering is not always aligned with commercial strategies or incentives. Instead of trying to force services through existing actors, consider creating new types of market actor better suited to the role.
2. This 'market creation' to overcome a completely absent supporting function is fundamentally different from the kind of 'tweaks' and small changes to business models often supported by market systems programmes. Such transformational change requires more time, resources and patience. It also requires an approach to implementation that is flexible, learning-led and adaptive – rather than being neatly 'boxed into' the tight boundaries of logframes and results chains.

Country: Nigeria | **Sector:** Agriculture

Economic Development Program | Implemented by the Foundation for Partnerships in the Niger Delta (PIND), with funding from the Chevron Corporation

Systemic change vision: To create a new class of service provider in the market who promotes better quality inputs and improved cultivation techniques to farmers.

The Business Model: PIND is supporting selected entrepreneurs to provide training, advice and information to fish farmers. The model is built on a mix of demonstrations at fixed ponds and direct-to-farmers mobile delivery. Entrepreneurs organise demo ponds and provide short training courses on fish farming as well as business management. Fish farmers pay to attend demonstration and classroom training as well as to receive technical advice. These entrepreneurs engage in a profit share with the feed manufacture: 50% of the demonstration pond profits are returned to feed companies as a way of covering the costs of providing fish feed.

"Successful market creation requires a very different approach to product positioning and go-to-market strategies more broadly. The primary objectives are to help kick-start an initial consumer "sensemaking" process - a trial-and-error based form of experimentation - that invites consumers to figure out on their own terms how a product fits into their lives and the value it holds, and to then catalyse a bandwagon effect that, in sociological terms, normalizes the offering and makes it seem a necessary and vital part of any person's life."

Erik Simanis, Bringing Bottom of the Pyramid into business focus



Supply chain management

BUSINESS MODEL

3

Country: Afghanistan | **Sector:** Agriculture

Road to Jobs | Implemented by the International Labour Organization (ILO) with funding from Sida

Systemic change vision: Improved market infrastructure allows dairy producers to expand beyond local consumption and access higher value markets which can boost incomes and create jobs

The Business Model: On the supply-side, Pakiza trains farmers in the good practice of dairy production methods to ensure a high-quality supply of milk. Milk Collection Centres give farmers the opportunity to sell their milk to factories who then process the milk into dairy products. Three centres (each with a catchment area of 5-10 villages) collect farmer's fresh milk on a daily basis, which is then bought by the Pakiza Livestock and Dairy Production Company.

KEY LESSONS LEARNED FOR MSD PRACTITIONERS

1. Find partners who already have a strong business incentive to try new models. Possessing the 'will' to change is much more important than the 'skill', as capacities can always be built – but it is much harder to shift motivations.
2. Allow form to follow function, rather than the other way around. So instead of fixating on what the solution looks like (a physical milk collection center), work out what the market needs (cost-effective milk aggregation) and probe different solutions (which may be a cooperative, fixed or mobile collection point).
3. In donor-crowded, aid-saturated contexts, it may be impossible to find companies that have not received significant 'free' support. Working on a partnership basis to 'co-invest' with these companies, rather than as a grant giver-recipient basis, may require a mindset change on the part of companies (and sometimes project staff!) which will not happen overnight.



Vocational education and job placements

BUSINESS MODEL

4

Country: Kosovo | **Sector:** ICT

KEY LESSONS LEARNED FOR MSD PRACTITIONERS

1. **Be patient.** Deep trust between programs and market actors develops slowly over time – and failed initial experiments can be a crucial source of learning.
2. **Humility is welcome.** Transformative business model concepts emerge from understanding systemic problems as well as the business realities of market actors. It can be helpful for projects to see themselves as collaborators in this analysis and ideation process, rather than the source of ideas for new models.
3. **The customer (partner) is not always right.** At times, programs may need to challenge the assumptions of market players they partner with. In this case, the price point for tuition needed to be significantly reduced to make it viable for students. This may seem to run counter to the notion of local ownership, but can be crucial to overcoming blind spots.
4. **Do the math.** Detailed financial modelling, jointly developed by program and partner, helps both sides understand and discuss risk sharing based on explicit assumptions and projections of the break-even point.

Enhancing Youth Employment | Implemented by Helvetas and Management Development Associates (MDA), with funding from Swiss Development Cooperation (SDC)

Systemic change vision: Increased trust and cooperation in the IT market drives industry-supported innovation in curriculum and pedagogy for IT courses, enabling more youth to upskill and gain employment in IT firms. In turn, an increased supply of skilled labour enables local IT companies to more reliably bid on larger projects, retain skilled staff, and grow their position in the IT export services market. Ultimately, the vision is for more dynamic IT and vocational education sectors that offer opportunities for youth to invest in their education and enter the labour market with meaningful jobs.

The Business Model: EYE is supporting an innovative ICT training provider to pilot a new partnership with employers and students, underpinned by a conditional contract. Employers agree to cover half of the cost of the training and guarantee jobs to the students who successfully complete the training course. To get companies to agree, they are heavily involved in the selection process for students to be admitted into the course. The training provider agrees to forego up-front tuition, and instead agrees to be paid through deductions from the graduate salaries once they have completed and are employed.

3. Summary lessons for programme implementers

Lesson 1

Making money is not same as making a profit

As the maxim goes: Sales for vanity, profit for sanity. Simply put, it may seem like a ‘good thing’ to sell extra seed packets to farmers, but to be deemed successful the revenues have to cover both the cost of sales (e.g. stock or raw material) and contribute to the fixed (e.g. rent, wages) and variable costs (distribution and product promotion costs) of the new business model – as well as generating returns at a degree higher than the other alternative uses of company resources.

Small business owners may not be able to make profitability calculations, but this is where programme implementers can play a value-added role in helping partners think through the financial aspects of the business model. As the Yapasa case shows, dedicating time and effort to do this upfront would have greatly helped further down the line. Soft measures of ‘will’ and stated preferences remain useful – but the motivating factor, ultimately, is profitability which can only be captured quantitatively.

Lesson 2

Explore the pathway to profitability; not profitability from Day One

MSD programmes focus a lot of discussion and energy on detailed impact projections, but much less so on business performance projections. This may be in part because financial forecasting is thought to be a more established practice, and a task for businesses themselves. But at a minimum, programmes need to conduct due diligence to ensure the innovations they are helping introduce are viable. A range of profitability measures exist for this purpose⁵. Both PIND (Case 2) and EYE (Case 4) developed net cash flow margin projections to ensure that innovations would not put partner businesses under too much financial pressure, while the calculations could also help partners decide on appropriate stock levels and the size of credit lines for customers.

These projections are essential to set realistic expectations about the pathway towards profitability – and the timeframe for ‘success’. For some innovations it may take 6 months to make a positive contribution to operating profits, for others it will take years: The key is to make decisions based on how the data coming back matches expectations, and using this data to inform any expansion or scale up strategies. Aggressively promoting an innovation that is recording a gross profit but not yet an operating profit has the potential to do more harm than good. Finally, it is critical to revisit and update the forecasts as innovations are iterated upon and as market conditions change. This is especially the case for organisations such as PIND that engage in market creation to introduce an entirely new product or service offering.

5. <https://corporatefinanceinstitute.com/resources/knowledge/finance/profitability-ratios/>

Lesson 3

Focus on the metrics that matter

Different partner companies may have very different measures of business success. The job of a market systems programme is not to morph into a management consultancy, but to help businesses focus on the metrics that matter to track, monitor and assess innovation performance from a commercial viability perspective. To do this, market systems facilitators do not have to be accountants, economists or business analysts, but they do have to be armed with a certain business language and toolkit of common metrics that they can use to have data-driven conversations with company leaders. The BEAM Exchange's MSD Competency Framework outlines some of the basic knowledge, skills and attributes required to perform business and financial analysis with an organisation⁶.

Here, investment appraisal is critical as the question is not whether the innovation is profitable, rather – whether it is more profitable than alternative options. Businesses are constrained by the level of finance available to them, so choices need to be made between competing investments – based on their respective risk-return profiles⁷.

Financial metrics guide business decision making in the smallest of enterprises – even if these decisions are often made implicitly. An aggregator providing seed on credit may not perform complicated cashflow projections, but will know that they remain cash poor until they can recoup their initial investment costs – so would expect to see a return in excess of what they could have got by, for example, putting the cash they spent on seed in the bank (or a local savings and credit group or cooperative). Programmes may not have full sight of company accounts, so 'back of an envelope' calculations may have to suffice for sense-checking.

6. See <https://beamexchange.org/msd-competency/>

7. The three main investment appraisal techniques are payback period (time it takes to payback the initial investment), net present value (the monetary value of today of future cash flows), and rates of return (target return thresholds)

Lesson 4

Growth is not always good

In some situations, unplanned and rapid business growth may be as detrimental as no growth at all. Companies can come under intense pressure when customer demand outstrips supply, creating problems for inventory management and cashflow. Human resource management systems struggle to catch up – leading to overworked employees and new hires that are not properly trained, jeopardising quality service delivery.

Research has shown that the growth of any company-based innovation needs to be aligned to the growth of the ecosystem that supports it⁸. A company providing cold chain storage solutions, for example, relies on a steady supply of equipment provided by refrigerator manufacturers. To properly consider commercial viability we need to look beyond the direct partner into their upstream and downstream supply chain. As demonstrated in the EYE case with the links between private training providers and ICT employers, many business models rely on brokering B2B partnerships. The business case then has to make sense for the partner(s) and their wider value chain. Too-rapid growth can either place extreme downwards pressure on these chains to meet rising demand, or lead to excessive dependence on a limited number of suppliers. When market conditions change because of external shocks and stresses, this can leave market systems less resilient – increasing the risk that entire supply chain nodes collapse and stop the flow of goods and services to target groups.

For many programmes, the scale of impact is directly correlated to company growth. The more seed packets a company sells, the more farmers a programme can claim it has benefitted. Yet programmes need to be careful not to push companies into a growth phase too quickly without a corresponding support ecosystem from other supply chain players. What the optimum growth strategy is for a particular company will depend on their specific context. MSD programmes need to anchor company-specific plans within the programme's vision for market systems change, which is based on ideas about the pace and pattern of what 'healthy' growth looks like for the sector.

8. See *Right Tech, Wrong Time* in the November 2016 issue of the Harvard Business Review

Lesson 5

Look towards long-term value creation

Much of the so-called current ‘crisis of capitalism’ can be attributed to a culture of *short-termism* in the modern corporate world. The pressure to meet quarterly earnings figures creates incentives for company leaders to boost short-term results at the expense of long-term gains. In theory, MSD programmes should be immune against such short-termism, and focus on building robust, resilient business models that can continue to deliver benefits to business leaders and their customers long after programme support ends.

Yet the political economy of international aid means that many programmes face the same short-term pressures: Having to hit targets and demonstrate impact, especially where payment structures are tied to results. This can undermine the case for sustainability; creating temptations to ‘buy impact’ at the expense of building towards long term sustainable business models’ viability. Luckily, cases like PIND show what is possible to achieve by iterating business models freed from the need to generate ‘quick wins’.

Even where programmes do not face this pressure themselves, they likely operate in an environment which does – meaning partner businesses are not immune. In both the case of Yapasa, where some companies appear to rely on development grants to finance their revenue and asset growth, and in Afghanistan, where market players have become consummate at navigating the donor proposal system rather than building a business model based on sound commercial considerations, many companies are building their business models around grant funding mechanisms.

MSD programmes are often extremely conscious about the level of support they provide to companies, introducing strict cost-sharing rules and tapering off financial support year-on-year. But to create long term value, programmes need to base decisions not just on the *level* of support they provide, but also on the *nature* of support – and how intrinsic this is to business model creation. Is technical advice being provided for a one-off activity, or does the continued operation of the model rely on the programme, say, acting as a broker between distributors and sales agents? Who will fulfil this function when the programme ends? When recurrent activities are supported, it is often the case – as we saw in Cases 1 and 3 – that as soon as one programme ‘steps out’, another one ‘steps in’ to plug the gap. Different projects come and go, but partners remain the same year after year creating ‘band aid’ business models that cannot stand up on their own two feet without external support.



The Lab: Market systems for decent work

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