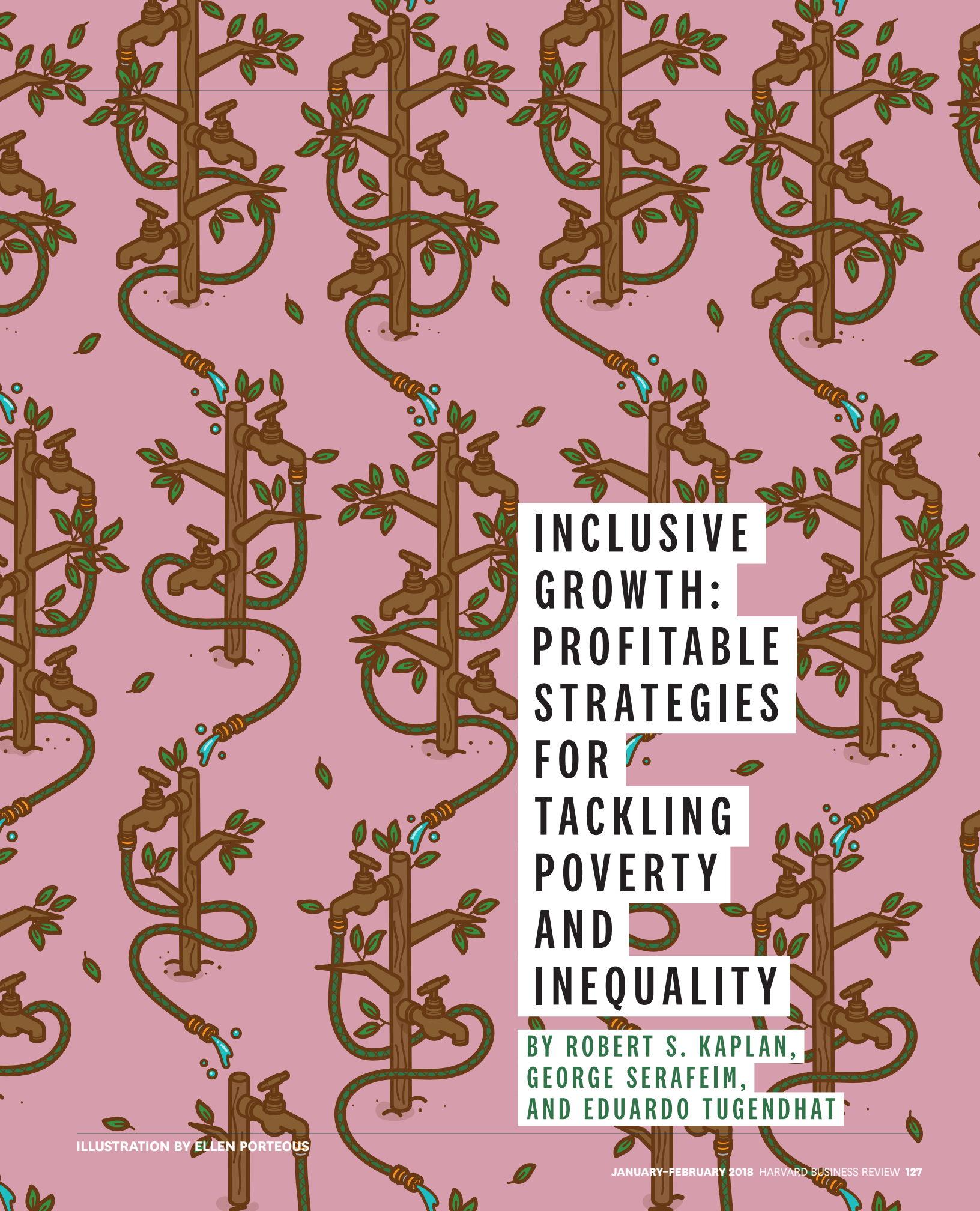


FEATURE INCLUSIVE GROWTH





# INCLUSIVE GROWTH: PROFITABLE STRATEGIES FOR TACKLING POVERTY AND INEQUALITY

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# GLOBAL CORPORATIONS AND MARKET-DRIVEN CAPITALISM HAVE GENERATED TREMENDOUS GROWTH SINCE WORLD WAR II, CONSIDERABLY REDUCING OVERALL RATES OF POVERTY.

## IN BRIEF

### THE PROBLEM

Although growth has raised the standard of living in the developing world, more than a billion people remain in extreme poverty and outside the formal economy. Traditional corporate social responsibility programs have done little to alleviate the situation and rarely produce transformational change.

### WHY IT HAPPENS

Companies' projects are not ambitious enough. Instead of trying to fix local problems, corporations and other actors need to reimagine the regional ecosystems in which they participate.

### HOW TO FIX IT

Ecosystem reinvention requires searching for systemic, multisector opportunities and mobilizing complementary partners. Corporate financing can be supplemented with start-up capital from private and public organizations with a mission to alleviate poverty.

That growth, however, has not benefited everyone. In developed economies, a small fraction of the population has captured the most recent gains, while many people in working-class rural and especially urban communities have experienced socioeconomic decline.

The situation is far worse in the developing world. Although growth has raised the standard of living in Africa, Asia, and Latin America, more than a billion people remain in extreme poverty and outside the formal economy. This is especially true in countries with large rural populations, where smallholders are shut out of the supply chains of nearby food companies because they lack knowledge of modern agricultural practices and the means to access and finance needed technology inputs. Developing nations also suffer from massive talent gaps. Large numbers of young adults are unemployed, while corporations find planned expansions stymied by a shortage of skilled local workers.

To be fair, companies have tried to upgrade their traditional corporate social responsibility (CSR) programs to sustainability and shared value strategies designed to deliver positive economic returns while improving the quality of life in low-income, distressed communities. But those programs have had a limited impact and rarely produce transformational change. For example, the widely publicized CocoaAction alliance in Côte d'Ivoire and Ghana aimed to improve the livelihoods of about 20% of the families involved in cocoa farming. But evidence has yet to emerge that it has actually moved many households out of poverty. Similarly, the agricultural technology supplier Syngenta's Good Growth Plan has doubled the productivity of small-scale farmers in Indonesia and Nicaragua—but only a tiny percentage of the destitute farmers in each country have benefited, and the impact on total company

sales is hard to detect. (See the sidebar "Syngenta: Ambitious Goals Need Ambitious Projects.")

This raises a fundamental question: Given the strong demand for companies to deliver economic and social value and the ample opportunities for improving the quality of life in distressed communities, why do businesses find it so difficult to implement scalable and profitable strategies for inclusive growth—growth that benefits all society's stakeholders?

The answer, our research suggests, is that companies' projects are generally not ambitious enough. Instead of trying to fix local problems, corporations and other actors need to reimagine the regional ecosystems in which they participate if they are to bring poor farmers and unemployed urban youths into the mainstream economy. In the following pages we draw on our experience with several successful inclusive-growth projects to offer a road map for creating such new ecosystems.

## FROM LOCAL SOLUTIONS TO ECOSYSTEM CHANGE

To understand why CSR and sustainability initiatives often fail to scale up successfully, we interviewed 30 chief sustainability officers (CSOs). Most saw the problems as relating to implementation; they cited poor integration with the company's core businesses, the difficulty of engaging with the multiple actors in local communities, and the lack of relevant measurements to motivate and evaluate benefits for the company and the target populations.

But as we looked more deeply, we came to believe that the main problem was not in the execution of shared value projects; it was in the limited scale of projects' ambitions. CSOs were not thinking big enough.

Poorly functioning supply chains and systemic talent gaps cannot be solved by any single company through targeted local solutions, such as building a new warehouse, establishing a regional headquarters, selecting a local distributor, or building a school or training center. A sustainable, scalable solution requires that the company help create a new ecosystem that replaces economically and socially inefficient supply chains with ones that are both more profitable and capable of bringing more people into the formal economy. To learn how this can be achieved, we examined the experiences of several companies, now part of the global consultancy Palladium, that have helped implement some three dozen projects in 25 countries over the past 15 years. (Full disclosure: All three authors are employed by or advisers to Palladium.) We identified three principles for designing strategies that can create inclusive, sustainable, and profit-generating ecosystems: Companies should search for systemic, multisector opportunities; mobilize complementary partners; and obtain seed and scale-up financing.

In what follows we'll explain these principles in detail and show how a new actor, which we call the catalyst, can help develop the new ecosystem and drive pilot projects and scale-up before passing the baton to the sustaining market players. We'll conclude by discussing a potential fourth principle: Implement a new measurement and governance system to build commitment, monitor progress, and sustain alignment among the key players involved in creating the new ecosystem.

We have chosen to focus here on experiences in developing nations. But we envision that a similar pathway for more-inclusive ecosystems can be implemented in low-income urban and rural areas in the United States and Europe.

## SEARCH FOR SYSTEMIC, MULTISECTOR OPPORTUNITIES

The traditional corporate approach to engaging with socioeconomic problems is to make relatively specific investments in infrastructure, waste reduction, environmental protection, and local training and health programs. Investments and programs like those remain largely under the corporation's direct control; much of the motivation behind them is to provide tangible evidence of the company's commitment to improving local environmental and social performance.

But such programs typically benefit a relatively small number of people and don't fundamentally change the community's socioeconomic conditions. What's more, they are generally funded from a sustainability budget, not embedded in the company's local business strategy. That means they are often the first programs to be cut during lean times. The traditional corporate sustainability approach ultimately has a limited impact because it is positioned as a social or an environmental program, not a profit-generating one.

Our first principle, therefore, is that corporations should search for projects that generate economic benefits for themselves while creating socioeconomic gains for all other actors in the new ecosystem. Such projects require diverse investments from many stakeholders and have the potential to scale up to other communities and regions. The aim is not to incrementally upgrade an existing system but, rather, to unleash market-based forces to create a new ecosystem that is economically self-sustaining and organically growing.

This is a complex undertaking. It requires developing trust so that relationships can be established, particularly among actors from multiple sectors who may have little knowledge of or empathy for what motivates people from sectors other than their own. It also involves identifying the resources and skills that are lacking in the community, the intermediaries who can potentially close those gaps, and the incremental support that will persuade each player to participate.

Uganda provides a classic example of this dynamic. More than 70% of the country's population ekes out a precarious living by growing crops, mainly low-quality maize, on tiny plots. Farmers dry their maize on bare ground shared with domestic animals and thus lose 30% to 40% of the crop, with much of the rest failing to meet minimum commercial standards. In 2010 household incomes in the country averaged \$307 a year, or just 87 cents a day. Eleven million people, or 30% of the population, were severely undernourished (the paradox of the starving farmer), and 40% of children were stunted from eating contaminated food. These conditions persisted despite the presence of Nile Breweries, a large regional company owned by SABMiller—which bought almost all its grain products from overseas suppliers.

That year Carana, a global economic-development consultancy (since acquired by Palladium), initiated a project aimed at creating a supply chain that could bring small maize farmers into the mainstream regional economy. This required deep engagement with multiple players, including Nile Breweries, grain traders, and the farmers themselves. It involved multiple investments in new assets and capabilities for the traders and farmers, including the creation of maize demonstration plots to showcase good agricultural practices and proper postharvest handling techniques. An offtake agreement with Nile Breweries facilitated farmers' access to credit and attracted input suppliers that could help farmers finance the purchase of improved seeds, equipment, and fertilizers along with access to irrigation and pest- and fungus-control solutions.

## Uganda

After five years median crop yields had risen by

65%

and annual household incomes had more than doubled.

## Uganda

Annual sales of maize grits to Nile Breweries increased to

12,000

metric tons, up from 480 metric tons.



Fast-forward five years. By 2015 the enhanced supply chain encompassed 27,000 farmers, more than half of them female. Median crop yields had risen by 65%, and the median price per metric ton had increased from \$139 to \$179. Annual household incomes had more than doubled, to \$688, and participating farmers' gross margins had increased by 50%. Farmers' families had a more diversified and nutritious diet that included vegetables, nuts, fruits, and occasionally meat, fish, and eggs. Farmers were buying drought-resistant seeds and could access crop insurance and interim financing through mobile-phone payment systems.

Downstream in the new supply chain, annual sales of maize grits from the lead grain trader, AgroWays, to Nile Breweries had increased from 480 to 12,000 metric tons, and the improved quality and processing meant higher prices. This enabled AgroWays to recoup the investment in its new storage and processing facilities. Another company, Maganjo Grain Millers, built a regional facility to turn maize germ from AgroWays into high-nutrition porridge and other products. Other companies were entering the region, creating the sustainable mass for an agribusiness cluster.

Beyond these tangible financial results was the impact on quality of life. One farmer said, "Things are different now. All my children own pairs of shoes. We are a happy family that can afford to eat meat and chicken, which were unheard of in my home before. My children enjoy school because they no longer feel left out."

## **MOBILIZE COMPLEMENTARY PARTNERS**

The second principle recognizes that a company almost certainly cannot create a transformational ecosystem on its own. It needs to partner with a catalyst organization to engage actors from multiple sectors in collaborative relationships and strategies for economic and social value creation.

The catalyst can be an NGO or a project management or consulting company committed to the economic and social benefits that a new ecosystem can generate. Ideally it has deep country knowledge as well as expertise in helping create new ecosystems on the ground, such as enhanced supply chains for products or talent. Most important, it has a strong reputation as an independent player that understands and respects the perspectives of all participants in the new ecosystem.

Often the catalyst is the first to identify a transformational opportunity. Carana saw that investing in the capabilities and capacities of small local trading companies in Uganda could enable those companies to link large end-use processors of agricultural products with smallholders.

Carana also saw an opportunity in El Salvador. In 2010 fewer than 40% of the country's children

completed high school, and most aspiring entrants to the labor market lacked necessary skills. Unemployed youths, or "ninis" (not in school and not in jobs), joined gangs, contributing to the country's world-leading crime rates. Carana believed that partnerships between regional corporations and local training providers could give young adults the skills needed to access entry-level positions in the country's rapidly growing retail, hospitality, and services companies.

Catalysts are usually better placed than corporations to spot such opportunities. Company executives, located at corporate headquarters, are infrequently able to recognize chances to create regional private-public partnerships. And they are constrained by financial management systems that guide them toward short-term incremental change and quick paybacks rather than value chain transformations.

A CSO or a country manager who wants to create transformative change is unlikely to get much traction, let alone a budget sufficient to provide proof of concept. Nor does he or she have the authority to add sustainability objectives to line managers' operational responsibilities and performance assessments. And local managers, under pressure to deliver short-term financial results, lack the authority, legitimacy, trust, capabilities, and resources to support more than incremental feel-good projects.

Whoever recognizes an opportunity, one thing is certain: Without the involvement of a profit-seeking corporation, no program is likely to go far. For an industrial ecosystem to be sustainable, it must be credible to businesses searching for competitive advantage and able to scale up. Governments are attracted to public-private partnerships for improving local socioeconomic conditions because they can harness the resources and innovation capabilities of profit-seeking companies.

## **OBTAIN SEED AND SCALE-UP FINANCING**

The corporate partner would seem to be a natural supplier of seed financing for an ecosystem transformation. After all, a corporation has resources to invest in positive net present value projects and will be a prime beneficiary when projects succeed.

But few companies are prepared to finance this type of risky investment, especially with their limited sustainability and CSR budgets. Corporate investment funds favor safe projects with short payback periods, not projects that require disrupting an existing equilibrium and creating new relationships across multiple sectors far from headquarters. All the organizational, incentive, and cultural hurdles that make disruptive innovation so hard become amplified when implementing projects designed to create new, socially inclusive business models and ecosystems.

Advocates for systemic change can look for seed capital from organizations that already have a mission



to create inclusive growth ecosystems and are under less pressure to generate short-term financial returns.

In Uganda, for example, Carana successfully approached USAID for a grant to test the hypothesis that modest funding could stimulate investment by intermediary companies in a new agricultural supply chain. In El Salvador, it used a USAID grant to establish the Youth with Commitment (YwC) job-training program. With Carana bringing external seed capital to the table, local corporations were willing to cofinance and advise on program content.

After a pilot launched with seed funding has demonstrated proof of concept, the catalyst may need additional funds to rapidly scale up the project. It can now seek support from the anchor corporation, since funding to scale up an existing ecosystem is perceived as less risky than initial financing. But a better source may be impact investment funds, which currently manage about \$80 billion in assets worldwide. Foundations and the private offices of wealthy families also have hundreds of billions of dollars available to fund projects in distressed communities. These

external investors usually have hurdle rates for their impact investments of 6% to 8%—much lower than companies' typical cost of capital: 12% to 14%.

The pool for impact investment is growing rapidly. The Ford Foundation and others now make investments for which they seek close-to-market-rate returns on capital deployed in mission-related causes. The W.K. Kellogg Foundation supports projects that generate attractive financial returns while contributing to more-healthy environments for families and children. One of its investments, Revolution Foods, has delivered 250 million nutritious meals to schoolchildren over the past 10 years.

Private equity groups such as Bain Capital and TPG Capital have recognized the emerging opportunities in this space and accumulated funds for impact investing in new physical and information infrastructures in impoverished communities. The private equity fund Summa Equity raised \$500 million in the first six months of 2017 for investment in companies working toward one or more of the UN's 17 sustainable development goals. (One of the authors, George Serafeim, is an adviser to the fund.) Those companies include Lin Education, a Swedish education-technology firm that helps adults acquire the skills to remain competitive in the 21st century, and eGain, whose technology helps households reduce their electric bills and carbon footprints.

Even NGOs are entering the space, introducing financial products that align incentives for the creation of social value. The nonprofit organization Social Finance has developed innovative pay-for-success programs to incentivize the delivery of social impact. Recent projects include bonds that pay interest according to education and employment outcomes for underprivileged populations in the United States.

To sustain and scale up the new ecosystem, the catalyst can introduce a special purpose vehicle (SPV) to receive financing, collect payments, and distribute interest on bonds and dividends on equity shares. For a training program like those in El Salvador, an SPV could issue a \$500,000 bond paying 5% interest over 10 years. The interest could fund programs whose graduates would be hired by local companies paying the SPV a fixed amount—say, \$200—for each hire. Designing the SPV's parameters and payment structure would require plausible estimates of the potential pool of candidates and the productivity improvements yielded by the training.

Although we don't believe a corporation needs to be the primary source of funds, it must be an engaged partner, because a significant corporate presence is critical to funders' decisions to invest.

## El Salvador

Over a two-year time frame Walmart hired

380

young adults from the training program and reduced its hiring period for open positions by 15 days.

## El Salvador

Turnover among those employees was

30%

lower than among previous hires, and training costs were reduced by 15%.

The participation of a lead corporation lowers risk and guarantees that a minimum quantity of products or services will flow through the new ecosystem. The developer of a shopping center starts by signing up an anchor store; similarly, external funders will most likely want a lead corporation to anchor the ecosystem.

### BUILDING OUT THE ECOSYSTEM RELATIONSHIPS

In the projects we studied, leadership shifted over time. Initially the catalyst played the key role, but as the project became commercially viable, corporations took the baton. Once the new ecosystem in the Ugandan maize project was established, Carana could disengage as AgroWays, Nile Breweries, and other agribusiness companies made their own new investments to reach a broader population of maize farmers.

In El Salvador's YwC program, Carana started by identifying the skill and competency needs for entry-level employees of service sector businesses whose growth was constrained by a shortage of qualified workers. It then selected local NGOs and other organizations that could train unemployed young adults in the necessary skills and secured agreements from businesses. For example, Walmart agreed to hire graduates of an 80-hour YwC program as cashiers, food handlers, and entry-level managers. Carana also

partnered with government ministries to reach unemployed youths, launching a social media campaign to publicize the training programs and local job openings. The training lasted one to three weeks, included travel and meal stipends, and culminated with guaranteed job interviews. Companies made the hiring decisions and provided any additional technical training specific to their needs.

Over a two-year time frame Walmart hired 380 young adults from the program and reduced its hiring period for open positions by 15 days. Turnover among those employees was 30% lower than among previous hires; training costs were 15% lower; and a much higher percentage of candidates became eligible for promotions. The program was so successful that Walmart brought it in-house and hired the YwC director to head HR for Central America.

Over a four-year period 16,000 young people received career-specific training for nine industry sectors, with 15,000 obtaining new or better jobs. (To put those numbers in perspective, consider that the entire Salvadoran economy produced only 15,500 formal jobs in 2009, the year YwC was formed.) Businesses across the economy now willingly pay training and hiring fees to third-party providers, enabling the trainers to sustain and grow the programs. The training programs and company associations compete to get youths off the streets and prepared for employment.

## SYNGENTA: AMBITIOUS GOALS NEED AMBITIOUS PROJECTS

Syngenta, a \$13 billion Swiss seed and crop protection company, embarked on its Good Growth Plan in 2000. The plan articulated several commitments to be met by 2020, including:

- a 20% increase in the productivity of the world's major crops, to be achieved without using more water, land, or other inputs
- a 50% increase in the productivity of 20 million smallholders
- the completion of labor safety training by 20 million farmworkers, mostly in developing countries
- fair labor conditions throughout the supply chain

An early initiative was the FrijolNica (Nicaraguan Bean) program, focused on 16,000 small coffee-bean growers organized in cooperatives. After 10 years their productivity had doubled, more children were attending school regularly instead

of working in the fields, and all communities were more optimistic.

The project was certainly a success. But the 16,000 growers represented only 5% of the nation's bean farmers, and the incremental financial benefits to them totaled only \$7.5 million. Juan Gonzalez-Valero, Syngenta's head of public policy and sustainability, realized that the project—and others like it—needed to be much larger to achieve the ambitious 2020 targets while supporting sales growth for the company's products.

Mapping the entire bean ecosystem, Gonzalez-Valero discovered that many of the remaining 95% of bean farmers also worked as laborers on large coffee and cattle farms. The farms' owners, who included Syngenta's best customers in Nicaragua, traditionally provided or rented small plots for their laborers to grow food. But many farmers, trapped in poverty, were beginning to leave for work elsewhere, creating serious labor shortages during harvest season. Gonzalez-Valero also learned that major food companies such

as Goya were seeking more-reliable sources of quality beans. He recognized that bean farmers employed on large coffee farms represented an opportunity to expand the FrijolNica program.

So Syngenta will be implementing a new system strategy in Nicaragua, one that requires getting progressive large-scale coffee farmers to invest in bean aggregation facilities in collaboration with a major food company that needs a stable source of beans. Working with Syngenta, the aggregator will provide smallholders with training and access to inputs, a guarantee to purchase a minimum amount of crops, and support in expanding their farms. This will give them a more diversified and sustainable business model. Increasing small farmers' household incomes will help retain critical labor for the harvest while expanding sales of Syngenta's crop-protection products and increasing the reliable supply of beans for local food companies. Inclusive growth will be achieved, with all local partners realizing benefits from the enhanced supply chain.

## ALIGN AND GOVERN THE ECOSYSTEM PARTICIPANTS

Building an ecosystem is not for the fainthearted. By some estimates, more than 50% of joint ventures and strategic alliances fail to achieve their desired synergies, and inclusive growth strategies are orders of magnitude more complex than traditional private-sector strategic partnerships. As discussed, a new ecosystem requires collaboration among unrelated actors from multiple sectors—corporate, NGO, and public—each typically with a deep mistrust of the attitudes and motives of those outside its sector.

All this suggests that ecosystem creation should include an additional design principle: Align multiple stakeholders around the new strategy. This can be achieved through proven tools from the corporate sector, such as a strategy map—a widely used component of the balanced scorecard tool kit for creating organizational alignment around strategy. As documented in the 2010 HBR article “Managing Alliances with the Balanced Scorecard,” a co-created strategy map helps partners align around common goals and how to achieve them. We have consistently seen that it breaks down barriers. One corporate CEO observed, “The scorecard gave us a common language for our strategic direction and intent. We could develop and communicate strategy so that it was quite clear to everyone. The widespread participation in developing the scorecard gave it great acceptance.”

It is reasonable to assume that potential partners in a new ecosystem could similarly collaborate, possibly under the catalyst’s leadership, on a strategy map for inclusive growth. The process would help generate trust and a shared understanding about implementing the strategy they participated in creating. The strategy map would be followed by a balanced scorecard specifying financial and nonfinancial performance metrics for all participants. This would quantify the tangible benefits of participation: financial returns for corporations and seed and impact investors, and economic and social benefits for local citizens. The existence of a shared scorecard should inhibit the short-term incentives of large corporations to use their power to capture most of the gains from a more productive ecosystem. And having measurable objectives and results for the entire ecosystem would help it raise capital for growth.

Shared metrics also provide accountability and the foundation for governing the ecosystem. Monitoring and governance occur during periodic meetings at which all participants review performance, identify the root causes of any shortfalls, and develop action plans to correct deficiencies and adapt to changing circumstances.

**THE FOUR INCLUSIVE-GROWTH** design principles constitute a road map for corporations to pursue profitable multisector strategies to transform impoverished



communities into vibrant, sustainable economies. Past corporate efforts in social responsibility and sustainability have yielded only modest returns. To address persistent poverty and inequality, corporations must reach beyond their own capabilities and partner with other private-sector entities and with governments, communities, and nonprofits to create new ecosystems that will deliver value to all. That will require clear strategies, access to seed and growth capital, and new means of measurement and governance that can maintain alignment, focus, and balance among all participants. ☺

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