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Business Initiative in the fight against poverty
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Session 1: Economic freedom, Social entrepreneurship and Poverty Intervention

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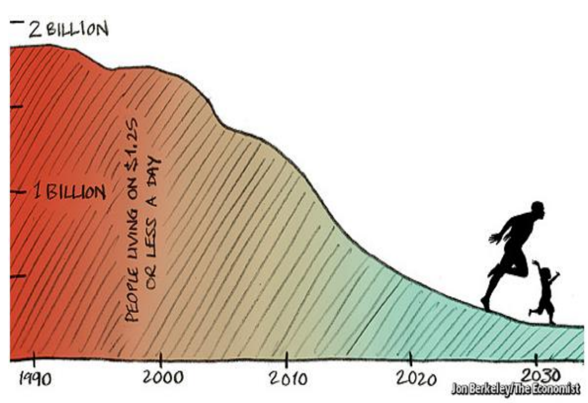
A few weeks ago, I was at a meeting with a representative of a U.S. international humanitarian relief agency. The topic of entrepreneurship arose, specifically of bringing business into poor neighborhoods in the U.S. The aid professional was indignant at the idea, decrying, “How dare they make a profit off of the poor”. Unfortunately, in the arena of poverty solution, profit is all too often considered evil. Bureaucratic organizations instead tax, redistribute, and socially engineer. While the persons at these organizations have good intentions, they often create scenarios in which their charity too often hurts.

Other aid organizations take a technocratic approach to poverty. They build up infrastructure privatize, enable rent seeking and natural resource exploitation.

These two approaches, which much of the aid industry is faced with today, Bureaucracy and Technocracy, are actually very similar in their basic assumptions – they’re both materialistic utilitarian approaches. While they can be effective in emergencies and in humanitarian disasters, they cannot really eradicate poverty because they both rely on poverty. The bureaucratic approach relies on poverty as the object of its charity and the technocratic approach relies on poverty as the business it manages. As such, they are both self serving.

The actual alternative is to become more humanistic – more person centered. The goal of the economy after all, is human flourishing and human excellence. To do that we need to build person centered companies - what I call CEntrepreneurship.

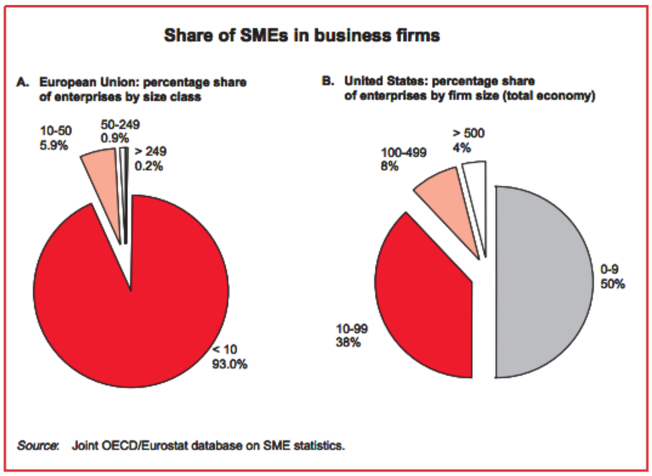
Although capitalism is popularly represented as bad, credit must be given to the market system – abject poverty has never been so low and eradicated at this speed. Most of that progress is due to the current economic system, faults and all.



So what's missing?
It seems to me that living on $1.25 a day can hardly be called "well-off". We fight abject poverty all right, but we are not creating a sustainable middle class.

The issue is what's called the "missing middle": a middle class is required for a society to develop and for persons to become financially independent, and small-medium enterprise (SME) entrepreneurs are the key building block to the building of such a middle class.

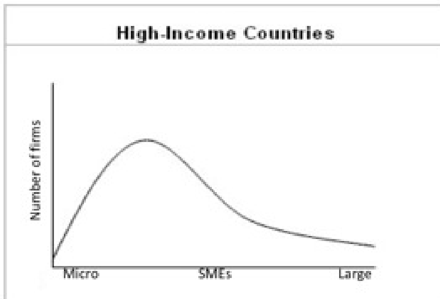
Yet we have a lack of SMEs in emerging markets, even in an increasing number of developed markets, though we know that SMEs are the engines of prosperity. SMEs create significant jobs and income.



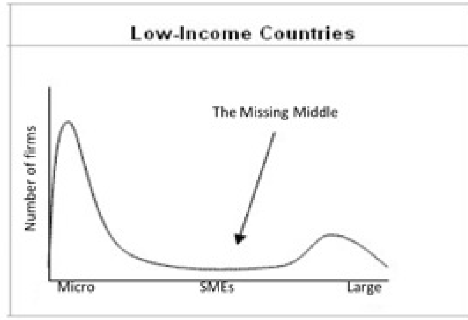
- In the EU, it is estimated that more than 20 million SMEs (with up to 250 employees) accounted for over 86 million jobs (66.5% of all jobs) and representing around 99 % of all enterprises
- In the USA (where small firms are defined as those having fewer than 500 employees), 99.7% of all firms fall into the "small business" category, accounting for half the nation's jobs, 54% of all sales, and contributing to more than 50% of nonfarm GDP (66% of all net new jobs since the 1970s).

The detailed information may vary slightly, but we can see that the SME sector is most certainly the engine of prosperity in developed economies.

In developing countries, this SME sector is almost entirely missing, comprising only 16% of GDP and 18% of employment, which is a major contributor to the cycle of poverty.



Source: Center for International Development at Harvard University.



Why this lack? I perceive two reasons:

1. Poor people are poor not because of a certain number of "dollars per day" that they have or lack, but rather because they are excluded from networks of productivity and exchange. Such networks can be of any number of things: cell phones, internet, schools, roads, financial products, bank loans, free trade agreements, participatory government, rule of law, trading groups, etc.

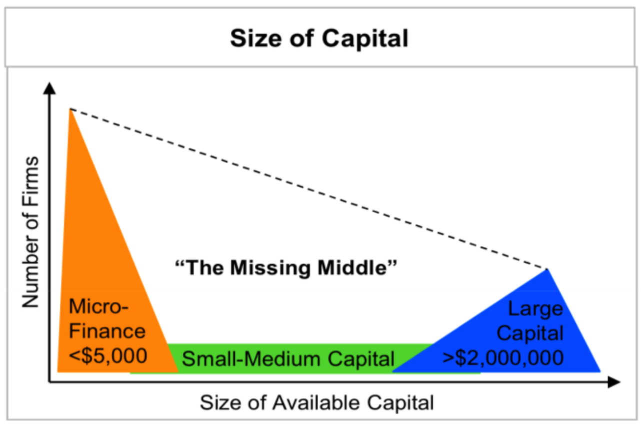
2. We see the poor as a problem to be solved rather than as people with unfulfilled potential, that is, people who want to flourish. This results in our current approach to poverty. Because of this underlying mental model, we only seem to be interested in "managing" poverty rather than actually ending it. Perceiving the poor as a problem to be solved leads to anti-human solutions such as population control, social engineering and separate markets. When we see the poor as human beings on the other hand, we perceive their unfulfilled potential. Unleashing their potential will lead to sustainable solutions to poverty, will lead to prosperity.

My own experience in emerging market business strategy consulting and enterprise solutions to poverty philanthropy has convinced me that there is an outright bias against the entrepreneurship of small business owners. This is of grave concern. Consider these examples:

- A vegetable producer in Kenya – could not get a 2m loan from bank (because of a lack of collateral) or from AID agencies because "the founders might become wealthy and that would not be fair to others."
- A Salvadorian entrepreneur could get a loan for a house, but not for his business. Yet a business grows and creates jobs and a house does not.
- A Haitian insurance company entrepreneur could not get a commercial loan to keep the company alive after the earthquake. Aid was available for the general public, but no loans to their businesses. The aid agencies inadvertently let local markets fail, hence making the economy overall more dependent on aid.
- Micro credit is a most popular tool of aid agencies because it mitigates poverty but it doesn't create wealth. I have come across no evidence that micro enterprises actually mature into SMEs, a fact that I am convinced the aid industry is well aware of and comfortable with.

In my 20 years of working in developing countries, I have seen an aid industry whose business is poverty, and thus more poverty means more business. Again, it's not that the persons involved in the aid industry are ill-intentioned; in fact, many are virtuous and work with the best intentions. The problem is that the system itself has no incentive to eradicate poverty. Moreover, providing humanitarian help in emergencies and promoting sustainable economic development are two distinct and very different objectives. The same people who do humanitarian help are not at all well suited to promote economic development.

Then there are the financial market players who do not have the incentives nor the know-how to offer effective products to emerging market SMEs. They can offer loans at competitive rates to local governments with very low risk. But in the absence of good credit rating devices and bankruptcy laws, the risk adjusted loans to SMEs average 30% interest rates. The loan officers are not ill-willed, but ill positioned.



Consider that the continent of Africa makes up 12% of humanity, receiving about 30% of all charity spending and yet only 4% of foreign direct investment. Africa does not need more charity; Africa needs more business.

My philanthropic company The SEVEN Fund ran a competition called Pioneers of Prosperity where we set out to find the best entrepreneurs in emerging markets – not based on business plans, but functioning businesses that were in the midst of scaling-up.

After doing this four or five times, we noticed a pattern: The successful emerging market entrepreneurs we found were mostly from strong faith communities. But it was not the faith per-se that was their competitive advantage – though that helped (delayed gratification, personal accountability, pursuit of virtue, long-term thinking, person-centered thinking, etc.).
What we found was their competitive advantage was that their faith communities served as a kind of incubation market where they could rely on a "parallel legal framework" and a kind of peer pressure on all to be forthright and fair in their dealings with each other since they did not want to be ostracized from that community. This relatively safe

environment protected them to grow their companies to critical mass before entering the larger market where these same guarantees do not exist for SMEs.

We found such companies in industries as varied coffee, wood, cleaning materials, tea, graphic design, commercial real estate, education, transportation, health and more.

So what is needed?… I don't have all the answers, but I have a few ideas and suggestions to take into consideration as we think of poverty eradication:

Let's make sure we think of the poor as people with unfulfilled potential, people who can flourish and not as a problem. A part of that is not to patronize them, but treat them as equal partners. To do that we need to build person centered companies - what I call CEntrepreneurship.

Let's provide competitive loans to SMEs as one of the key ways we encourage growth in emerging markets. Banks are too comfortable to provide loans to governments in these markets and so can afford to make loans for SMEs almost unattainable with average interest rates well above 30%. Michael Novak once said that lending is the mothers-milk of prosperity. At 30%, this "formula" is priced out of the market.

Let's find ways to provide business training as a key tool in fighting poverty: What I find over and over again is that there are quite a few entrepreneurs but almost no qualified mid-level managers. A great project would be to train people in basic management.

Let's find proactive ways to integrate the poor into our very own networks of productivity and exchange. Buying fair trade coffee and giving some money to charity while investing your retirement exclusively in the S&P 500 is not solidarity and does nothing to alleviate systemic poverty.

Let's work in our own countries to stop the exclusions of emerging market products from our local markets. The tariffs, import restrictions and taxes on the one hand and the subsidies and export-dumping on the other side do more damage to emerging markets than our aid does to help them.

Let's not forget the growing urban poverty in our own countries. Think of cities like Detroit where almost 50% of citizens live in poverty. Instead of traveling half way around the world to help, we can start by alleviating poverty at home.