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The Private Sector and the Marginalized Poor

An Assessment of the Potential Role of Business in Reducing Poverty and Marginality in Rural Ethiopia

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Abstract

The present research analyzes the role that the private sector can play in reducing poverty and marginality in Ethiopia by providing improved agricultural inputs to marginalized poor farmers. Two important insights motivate the present research: one is the rise of various innovative business approaches in the last years that aim at reducing poverty or contributing to the solution to other societal problems. These innovative business approaches add social returns to a firm's bottom line and thus provide additional reasons for companies to invest in agricultural markets in poor countries like Ethiopia apart from pure profit seeking.

The other insight motivating this research is that the very poorest have long not benefitted from poverty reduction efforts. In that context, marginality has been identified as a root cause of poverty and its persistence. Marginality helps to explain why certain groups are left behind while other parts of a society prosper. Thus, the concept of marginality is presented and applied to the context of Ethiopia. Using Geographic Information System (GIS) software, a marginality map of Ethiopia is created by overlaying seven indicators capturing different aspects of marginality. Results show that marginality is a severe and widespread problem in Ethiopia with more than 40 million people being severely marginalized. Marginality hotspots are found in Amhara and SNNP. Interestingly, marginality hotspots are not correlated with agro-ecological zones and are ethnically more homogeneous than non-hotspot areas. Furthermore, areas posing specific business opportunities and challenges are identified based on information on population density, quality of road and mobile phone connection and farming systems. This area classification reveals that companies catering to the marginalized poor need to go the 'last mile' within areas exhibiting special business challenges and opportunities rather than investing in separated areas.

After having identified and located the marginalized poor in Ethiopia, survey data that is representative for the most marginalized in the country is analyzed concerning purchasing behavior and needs expressed by the marginalized poor. Using descriptive statistics it can be shown that the amount of cash the marginalized poor have at hand varies considerably across regions but not very much within regions. The marginalized poor have in common that they spend a high percentage of their expenditures on food (around 70%), followed by commodities such as kerosene and clothes. The three most bought products are salt, kerosene and soap. This translates into considerable market sizes of these products. The survey also shows that the marginalized poor have diversified needs. While

most of them name higher-order food products like dairy products or meat as most urgent unsatisfied needs, agricultural items, including livestock, as well as housing and commodities like clothing are also mentioned frequently.

That people mention agricultural inputs as one of their most urgent unsatisfied needs can be explained by the fact that productivity of smallholder farmers is very low in Ethiopia and improved agricultural inputs are in short supply. Thus, an institutional analysis of the seed, fertilizer and agro-chemical markets is carried out to understand the frictions on these markets and to assess possibilities for the private sector to contribute to the reduction of poverty and marginality through adequate investments. Analyzing more than 60 expert interviews carried out in Ethiopia, it turns out that the market for seeds of major crops is highly regulated by the government, with institutions favoring public companies. Based on a *de facto* monopoly on breeder seed, Ethiopian seed companies depend on the government for most of their operations, including price setting. One implication of this system is that all seed is distributed via one channel, which leads to a lack of traceability of the seed and, as a result, lacking accountability for seed producers. Moreover, it causes a lack of agro-dealers as seed distribution is exclusively carried out by cooperatives and cooperative unions on behalf of the government. Thus, cooperatives and Development Agents spend much of their time on demand assessments and seed distribution although they actually have other tasks. The only exceptions from the strict government control are international seed companies that produce their own varieties.

Institutions favoring public organizations have led to a situation, in which fertilizer importation and distribution is completely under government control, with no private companies being active on this market. The markets for fruit and vegetable seeds and agro-chemicals, however, are less regulated. A multitude of small private firms engages in import and distribution. Nevertheless, there is a shortage also for these products that is mainly caused by a lack of access to finance. Due to the absence of an agro-dealer network in the country, the availability of fruit and vegetable seeds and agro-chemicals is very limited outside urban centers as small traders do not have the capacity to invest in marketing infrastructure.

To motivate private companies to invest in agricultural markets and to cater to the marginalized poor, several institutional changes are necessary. For seed companies, access to breeder seed, the assignment of more land and the availability of plant breeders are crucial elements. Especially access to breeder seed implies the ability for companies to determine full-fledged firm strategies, including price determination and marketing strategies. For fertilizer companies, a fair tendering process and the abolishment of import quantity prescriptions are of major importance. Such well-designed market liberalization efforts are likely to result in the creation of an agro-dealer network as a positive externality that would also benefit traders of fruit and vegetable seeds and agro-chemicals. For all companies, access to finance at reasonable cost, especially with lower collateral requirements, is essential to expand operations.

While companies can be expected to push for changes, the current system and the self-conception of the Ethiopian government require the government to be in the lead in the efforts for changes. Successful role models, support by other stakeholders and successes with investment incentive schemes in other sectors in Ethiopia could encourage the government to gradually liberalize the market. If institutional changes are enacted to partly liberalize the market, it needs to be ensured that the marginalized poor, who currently benefit from the government's equity approach, are included in the value chains even if companies do not operate with innovative business approaches. However, as the poor constitute a very large share of the market, Ethiopia may even be a leading example for companies in how to apply business models catering to the poor as companies are forced to adjust to this target group if they want to develop the largest part of the market.