



Action Research Project

Report 1 – Identifying market based approaches for improving economic well-being

Executive Summary

Overview

Palmera is an international organisation working with grassroots local partners to enable small holder farmers and rural entrepreneurs who are excluded from profitable markets, to improve their economic well-being, so they are able to meet their daily needs and pursue goals.

Palmera's operations are focused in villages in rural and war-affected communities in North Sri Lanka, including the most disadvantaged, women and youth, where the ability to make a living has been stripped away. As a result of the protracted war, poverty headcount ratio in the Northern Province is up to four times the national average, and the Human Development Index is the lowest in the country (0.625 in the Northern Province compared to 0.75 for Sri Lanka) (UNDP, 2012, p.16). The main economic activities of agriculture, dairy and fishing suffered due to loss of assets. Cattle were lost or went stray, boats destroyed, land became dangerous due to landmines, infrastructure such as roads, and irrigation were undermined and markets and extension services were lost (UNDP, 2012, p.6).

During the period of conflict, a large part of the region lost not only the livelihood activities of the people, but also the prerequisites of growth and development such as human resources and skilled labour, investment and investor class, physical assets and institutions (ADB, 2011, p. 22).

Through the implementation of sustainable livelihood projects, Palmera aims to restore freedom to hard-working families who deserve to live in dignity and offer their children the best possible future. Palmera initiated a robust, systematic action research process to establish the most effective way of achieving the goal of lasting change in communities through improved economic well-being.

Motivated by a commitment to aid effectiveness and high quality programming, Palmera documented our approach: developing and testing a theory of change, and selecting a strategy to achieve this change. The results are detailed in this Phase 1 report to enable other organisations intending to use MSED approaches in their own operational contexts to adopt the process. Palmera aims to scale this impact through replication: sharing evidence-based models, experience and tools which enables other organisations to work more effectively. In particular, Palmera is working in partnership with Transform Aid, who have stated that the partnership with Palmera is showing tremendous promise in identifying scalable MSE approaches, which will enable their work in Asia and sub-Saharan Africa to have even greater impact. Palmera is also working with local NGOs in Sri Lanka, whose own livelihoods strategy development processes are informed by Palmera's work.

The goal of this report is to answer the question:

What is the most effective strategy to improve the economic well-being of small holder farmers and rural entrepreneurs who are excluded from profitable markets, including the most disadvantaged, women and youth?

To ensure that strategies and models are developed which are practical and directly relevant to the needs of people in the community, Palmera conducted an extensive needs analysis and landscape of programs and support in North Sri Lankan villages. Palmera was able to leverage its extensive local network to conduct an action research project which is not just theoretical, but directly relevant to the poor. The location was selected because it is the area of greatest need in the country, with people recovering from decades of civil war.

During the needs analysis, Palmera made an important discovery in the field which is also well-documented in the literature. While the poor earn their income through micro enterprises, they are not growth-oriented entrepreneurs. They are *necessity entrepreneurs* who are engaged in a diverse range of activities, doing everything they can to survive. Necessity entrepreneurs have their own business to earn income, but not out of choice or a desire to grow a business, but because this is one of the only options open to them to survive. Indeed, this is the reality for most of the MSEs of the poor. As renowned social entrepreneur David Bornstein describes:

‘The majority of the world’s poor are not employed in factories; they are self-employed – as peasant farmers, rural peddlers, urban hawkers, and small producers, usually involved in agriculture and small trade in the world’s vast “informal economy”’ (Bornstein, 2004, p. 156).

Based on the findings in the needs analysis and an extensive literature review, Palmera developed a theory of how to improve economic well-being. The ‘theory of change’ is a development tool which enables organisations to document the development hypothesis which explains the causal events for achieving the desired result (USAID, 2013a). Palmera’s theory of change on how economic well-being can be improved is that:

Theory of change: Improving the performance of the MSEs of necessity entrepreneurs, while reducing vulnerability, leads to a sustained increase in income and wealth, which improves economic well-being.¹

The next step was to identify a strategy or intervention with the highest likelihood of improving economic well-being, according to the theory of change. However, there does not appear to be a clear consensus in the sector on the most effective strategy to improve the economic well-being of the poor while reducing vulnerability. Therefore Palmera decided to develop a means of comparing and evaluating the available strategies against key selection criteria. Again, Palmera found a gap in the literature on criteria for selecting and adapting programming models. To address this gap, Palmera went through a systematic research process. As a result of the research process, criteria have been developed for selecting and adapting a programming strategy, driven by the theory of change. Palmera identified three sets of selection criteria:

- Organisational criteria: the selected strategy must fit the capacity, scale and technical expertise of Palmera and partners, while addressing key components of the theory of change.
- MSE local context: the selected strategy must be relevant and applicable in Palmera’s target areas, as identified in the needs analysis.
- Micro and small enterprise performance factors: the selected strategy must be effective in improving the performance of the MSEs of necessity entrepreneurs.

The criteria were developed from primary and secondary research in the needs analysis in Sri Lanka, consultation with peer organisations and subject matter experts, reflection among staff and local partners and an extensive literature review.

In developing these criteria, Palmera encountered another major gap in the literature. While there is some evidence-based information on the keys to MSE performance, there are no explicit criteria which relate to the needs of necessity entrepreneurs. Since the theory of change identifies that necessity entrepreneurs have specific goals and needs which are unmet by most programs, this was a major

¹ Vulnerability is “the probability or risk today of being in poverty—or falling deeper into poverty—at some point in the future” (Coudouel, Hentschel & Wodon, 2001, p. 29). Economic well-being is the material living conditions, including income and wealth (OECD, 2013).

gap. To overcome this problem, Palmera conducted primary research through a case study: vulnerable poor people in North Sri Lanka who are livelihood insecure small holder farmers. Palmera applied these results to the MSE performance factors and adapted them to the specific needs of necessity entrepreneurs. Through focus group discussions and key person interviews, the MSE performance factors were ranked by the severity of impact on MSEs. As a result, this report defines what the MSEs of necessity entrepreneurs need to improve performance while reducing vulnerability.

The primary research findings corroborated the analysis in the literature that necessity entrepreneurs tend to be trapped in a web of shared poverty. The reciprocal nature of relationships are essential to survival, but also make it difficult to invest increases in income, as fellow community members have pressing needs which consume any potential gains. However, through our work in grassroots community development, Palmera discovered that by doing concentrated work in villages, an intervention can affect an entire community and enable all of the people to move ahead economically together. This enables the entire village to move out of shared poverty. This and other criteria identified for selecting a strategy for improving economic well-being are as follows:

Criteria for selecting the strategy for improving economic well-being

| Organisational requirements | MSE local context criteria | MSEs of necessity entrepreneurs need: |
|--|--|--|
| <ul style="list-style-type: none"> • Intended Target Group - Fosters inclusion of vulnerable poor and livelihood insecure, in particular women • Inclusive of youth - as part of the strategy for reducing inter-generational poverty • Evidence-based - proven strategy for achieving desired change • Sustainable design, fostering ownership, not aid dependence . • Market-driven - uses market mechanisms • Scalable - projects can be scaled up so that the cost per beneficiary decreases as more MSEs are reached • Feasible implementation - feasible for local partners to implement • NGO is Facilitator of change - leveraging strength in participatory community development • Replicable - can be implemented in many different project locations | <ul style="list-style-type: none"> • Viable in rural villages and with low population density • Type of MSEs: Suitable for primary producers in the dominant sectors of agriculture and fisheries. • Accessible to vulnerable poor who are excluded: low barriers to entry • Works effectively with necessity entrepreneurs • Supports household MSE diversity | <ul style="list-style-type: none"> • Financial services (including savings and financial education) • Business support which is immediately relevant to their existing activity • Infrastructure such as transport, water and storage facilities and production technologies • Markets - concentrated support to improve local competitiveness • Legal and regulatory environment: proactive and continuous engagement to overcome barriers to doing business • Human capital: positive interventions to address factors hindering an entrepreneurial mindset. • Financial capital: linked to appropriate and affordable sources. • Social capital: engaged within social networks, enabling all necessity entrepreneurs in a village move ahead together. |

Identifying strategies to improve economic well-being

Having identified the selection criteria, Palmera sought to find the most effective strategy to improve economic well-being by increasing income and reducing vulnerability as driven by the theory of change. Given Palmera's criteria for strategies which are sustainable, scalable and driven by market demand, Palmera investigated strategies in private sector development, particularly in the informal sector. Developing the private sector as the engine of economic growth in developing countries can provide a pathway out of poverty (DFAT, 2015).

Palmera identified eight specific strategies which are likely to have an impact on improving the performance of MSEs, and which to varying extents integrate the very poor, women and youth into their programs. These strategies are value chain development, business development services, business incubators, financial services, micro-franchises, cooperatives, local economic development and BRAC's graduation model. Although they are not exclusively micro and small enterprise development (MSED) strategies, for ease of presentation, this report will refer to them as 'MSED strategies'.

Assessing and selecting the MSED strategy

The question facing Palmera was then which of the eight strategies could best improve the performance of the MSEs of necessity entrepreneurs, while reducing vulnerability. The literature on necessity entrepreneurs critiques even these pro-poor approaches, arguing that their frame of reference is growth with potential for transformation. (Berner, Gomez & Knorrington, 2012; Brewer & Gibson, 2014). They argue that these strategies do not effectively engage the poor where the driving force is survival and necessity

Having developed the criteria based on the theory of change, Palmera was able to assess the efficacy of these strategies in improving economic well-being by applying the criteria to the MSED strategies. Each of the MSE strategies were reviewed and evaluated against the three selection criteria. A scoring system was used: through discussion and testing of the results against the theory of change and primary research findings, the importance of the criteria to strategy selection and likelihood of meeting the criteria were quantified. This informed Palmera's identification of MSE strategies had the highest likelihood of improving the performance of the MSE of necessity entrepreneurs while reducing vulnerability.

Palmera found that that there was no single strategy able to meet all of the selection criteria. Of the eight MSED strategies reviewed, value chain development (VCD) is the strategy with the highest likelihood of meeting the selection criteria, with some promise for savings and loans groups. However, some adaptations will need to be made, as described in the next section.

Value chain development

VCD scored highly in being an evidence-based approach, with proven results in increasing incomes through transforming market relationships. Palmera is committed to market driven programming in which MSEs improve performance by meeting market demand.

The research also found strong synergies between VCD and Palmera's emphasis on sustainability, scalability and NGOs' role as facilitators of pro-poor change in the local value chain:

- VCD supports producers to identify and connect to profitable markets for their products: livelihood insecure producers are able to leverage their existing economic activity and increase their incomes, which is a low risk scenario for the necessity entrepreneur

- VCD projects work with MSEs on all of the barriers they face to meeting market demand and improving their bargaining power in the value chain
- VCD aligns with Palmera's work in North Sri Lanka, where necessity entrepreneurs are working in agriculture as primary producers
- VCD interventions address access to other factors which are important for improving MSE performance by linking producers to commercially viable, sustainable business and financial services, and technical support

There were however a number of areas where value chain development does not fully meet the selection criteria, and in these areas Palmera will need to adapt the strategy.

Savings and loans groups

Another key strategy which Palmera reviewed was financial services (including microcredit, microsavings services, mobile banking, financial education and savings and loans groups). Of these, the savings and loans group model was identified as being the most applicable to Palmera, given the breadth of other services.

Savings and loans groups also scored highly against the criteria because they are a local level strategy which works with vulnerable poor and livelihood insecure people in the community, in particular women. Savings and loans groups are also an effective mechanism in enabling MSEs to manage cashflow and build a small amount of capital by saving small amounts regularly. In this way, they reduce vulnerability, sustain income gains and support the accumulation of wealth (or at least enable households to avoid depletive strategies such as selling key assets during crises).

The need for adaptation and re-modelling

Adaptations to the value chain development (VCD) strategy

VCD models are typically implemented at a national or regional level, working to make one entire value chain pro poor. However, social capital and social networks are a crucial factor in reducing vulnerability. Therefore Palmera's strategy for achieving sustainable increases in income is a *whole-of-village* intervention which enables necessity entrepreneurs to retain survival strategies through relationships of reciprocity and to improve other market relationships which enables everyone in the village to rise together.

A related criteria is that the strategy must support the efforts of necessity entrepreneurs to minimise risk by diversifying their livelihood. In order to impact all families in a village, Palmera needs to be prepared to work with more than one value chain. To this end, Palmera will identify a range of potential value chains which have strong and growing demand and potential for high impact, and link MSEs to these winning value chains.

The model will work intensively with producers in a village on a range of strategies to address all of the local constraints faced by producers in those value chains. In doing so, Palmera will need to develop a 'village-based value chain development' operational guide, with tools and steps which can be directly applied by Palmera and local partners.

Savings

The need for savings was identified in the theory of change as being important in enabling households to hold onto gains in income and build wealth through the accumulation of cash savings and other

assets. This reduces the likelihood of falling back into poverty. While VCD strategies enable households to increase income, it is essential that these improvements in income are sustained if well-being is to be improved. Therefore Palmera will integrate savings and loans groups to the village-based value chain model to support households through savings strategies to protect their gains, invest income and build a buffer to cope with shocks and crises. A subsequent report will evaluate which savings mechanisms are the most relevant, whether that be savings and loans groups or another model.

Empowering the next generation

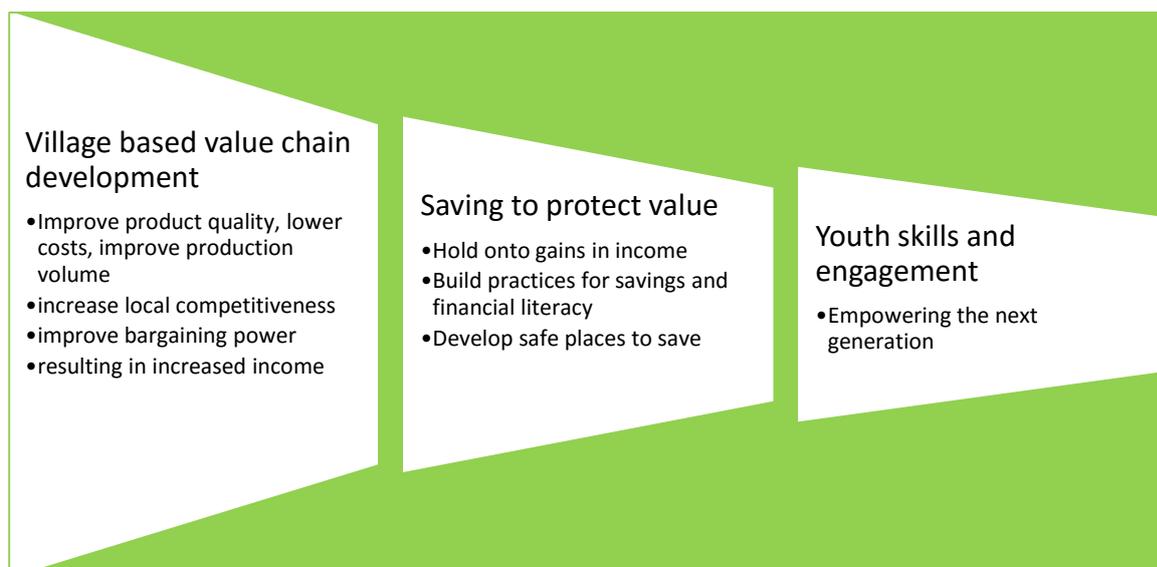
The theory of change identified that by increasing the number of income earners and decreasing the number of dependents, vulnerability is reduced. Households with reduced vulnerability are more able to sustain income and increase wealth. The 2007 World Development Report (World Bank, 2007b) argues that ‘young people are critical to further progress with poverty reduction and growth’. However, value chain projects are not always able to engage youth who may not have the skills or assets to join dominant value chains.

Palmera identified the need for strategies to prepare youth for employment and connect them to winning value chains as part of an integrated strategy with village-based value chain development.² This will support necessity entrepreneurs’ efforts to break the cycle of poverty for future generations, by moving youth from dependents to income earners—a key determinant of reduced vulnerability.

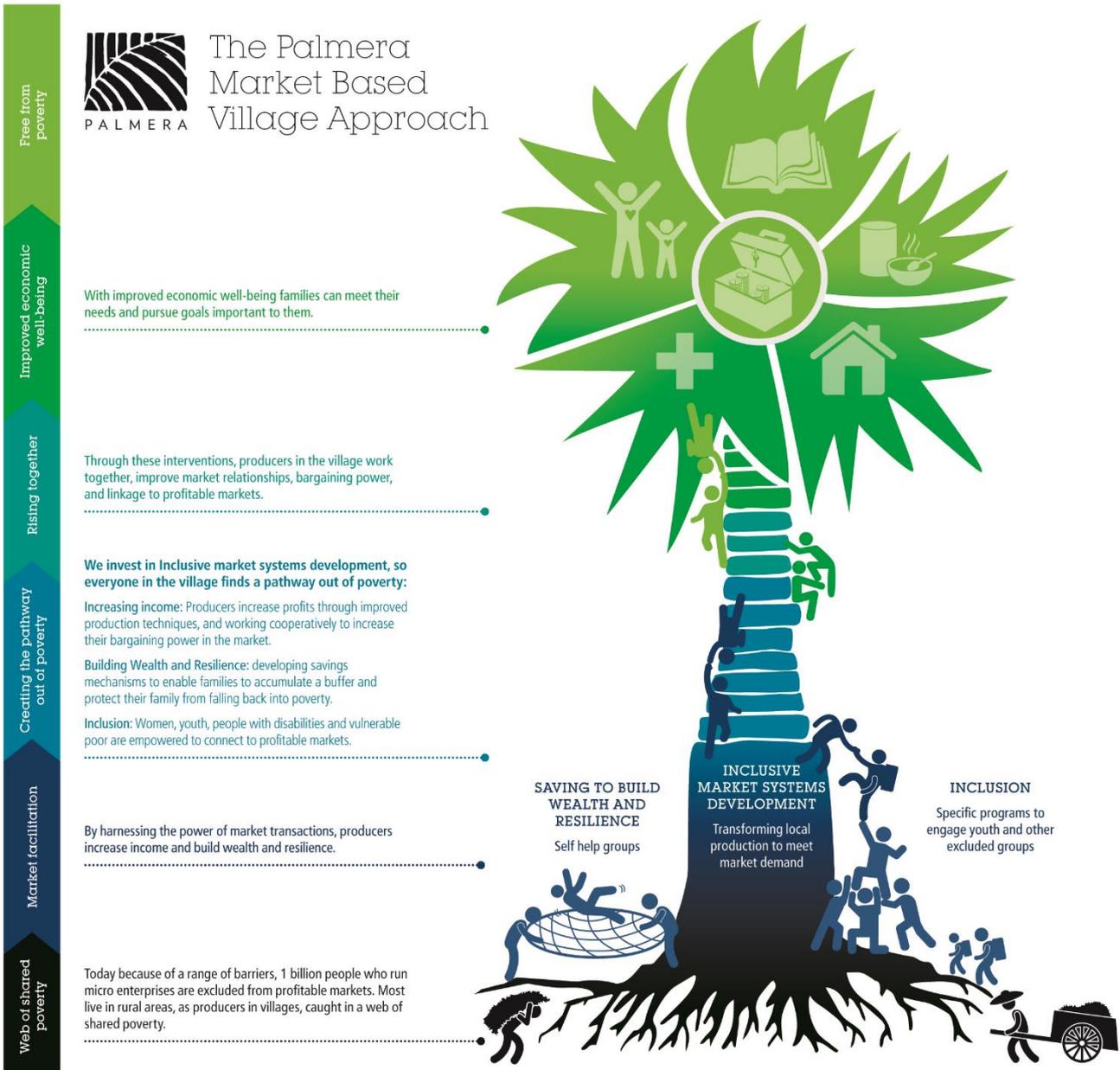
According to the 2007 World Development Report:

*“Building human capacity early is important not just for the future opportunities open to young people but also to mitigate the intergenerational transmission of poverty”
(World Bank, 2007b, pp. 27-28).*

These three pillars (a village-based value chain development, savings strategies and youth engagement) form the core of Palmera’s approach to a village-level interventions to improve economic well-being. Given the centrality of the village to the facilitation of change, the model will be called the ‘Village Model’.



² Palmera has commissioned a second report (‘Assessment of Youth Skills and Engagement’) on the best way to engage youth early and build core skills for successful transition to employment.



The next step is to develop the operational guide for village-based Value Chain Development, and the supporting approaches which protect the value created (savings and youth engagement). Piloting in the field is required to determine if the goal of improved economic well-being is achieved by implementation of these models.